COUNCIL AGENDA: 06-07-11
ITEM: 3.4

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Dennis Hawkins, CMC
City Clerk

SUBJECT: **SEE BELOW**

DATE: 05-19-11

SUBJECT: AUDIT OF KEY DRIVERS OF EMPLOYEE COMPENSATION

RECOMMENDATION

As referred by the Public Safety, Finance and Strategic Support Committee on May 19, 2011 and outlined in the attached memo previously submitted to the Public Safety, Finance and Strategic Support Committee, accept the Audit of Key Drivers of Employee Compensation.

PSFSS Committee: 5/19/11
Item: (d)5

Office of the City Auditor

Report to the City Council
City of San José

KEY DRIVERS OF EMPLOYEE COMPENSATION: BASE PAY, OVERTIME, PAID LEAVES AND PREMIUM PAYS

Report 11-04
May 2011

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Office of the City Auditor
Sharon W. Erickson, City Auditor

May 11, 2011

Honorable Mayor and Members
Of the City Council
200 East Santa Clara Street
San José, CA 95113

Key Drivers of Employee Compensation: Base Pay, Overtime, Paid Leaves and Premium Pays

Employee compensation is the City's largest General Fund expense. Our analysis of actual payroll data (that is, the actual compensation paid to or on behalf of City employees) showed employee costs for all funds totaled over $840 million in FY 2009-10. Over the last 10 years, employee costs as tracked in the City's payroll system increased 54 percent even as the number of employees dropped. On an hourly basis, payroll data shows costs increased from $35.54 to $56.38 per hour from fiscal year 2000-01 to 2009-10. A large portion of this increase is retirement and fringe costs that we have addressed in previous audits of pension and employee health benefits. Since 2000-01 employees are bearing an ever increasing portion of these costs. In addition, many employee units have agreed to an on-going 10 percent total compensation reduction for 2011-12. This audit focused on the City's cost of employee cash compensation from 2000-01 to 2009-10. It compares components of employee pay, but does not compare overall compensation packages either to other jurisdictions or to private employers.

Most Increases in Base Pay Are Not Tied to Performance. Base pay makes up the bulk of employees' earnings. In 2009-10, base pay totaled about $465 million, or 73 percent of total employee cash compensation. Some increases to base pay are automatic and occur as a result of longevity in a position. Commonly known as *step increases* these increases stop once an employee reaches the top step. Employees in step classifications receive automatic 5 percent increases upon reaching the required time milestones. It takes an average civilian employee about 3-1/2 years to reach top step – a 22 percent pay increase. A typical sworn employee would reach top step in 5-1/2 years – a 34 percent pay increase. Most step increases are not tied to performance. In a small sample of employees we found that 42 percent of step increases were issued without performance appraisals, and in one case an employee received a step increase in spite of receiving an overall negative rating.

Other base pay increases are typically negotiated between the City and various employee units and are applicable to all employees in the affected unit. Commonly known as *general wage increases*, these increases have totaled from 20 to 53 percent over the last 10 years. CPI over the same time period totaled 27 percent.

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All the government employers we surveyed followed a similar wage increase model. However, in contrast, all the private entities we surveyed reported that all raises and bonuses are tied to performance appraisals. We recommend the City Administration take steps to move towards a merit based system by: (1) requiring a current positive performance appraisal before implementing any pay increase (including step and general wage increases), (2) considering elimination of the automatic step increase process and/or establishing minimum performance thresholds for receiving step increases, and (3) automating the current performance appraisal system.

The City's Overtime Provisions Add to Overtime Costs. Overtime is generally paid to eligible employees who work in excess of 40 hours per week; generally at the rate of 1-1/2 times their hourly rate. In 2009-10, overtime pay totaled about $26 million, or 4 percent of total employee cash compensation. The Fair Labor Standards Act (FLSA) establishes minimum criteria for when overtime pay is required. We found that the City provides more generous provisions than required. Specifically, the City pays overtime to most bargaining units based on *hours paid,* not *hours worked*. In one case, an employee worked 18 hours during the time period, was out of the office on paid leaves the remainder of the period, but still received 3 hours of overtime pay. We also found the City pays overtime to some employees who also receive executive leave, in spite of the fact that executive leave is generally granted to salaried employees who are not eligible for overtime. Finally, we found that the City pays overtime to some presumably exempt employees such as Battalion Chiefs. To reduce the cost of overtime, we recommend the City (1) conduct a Citywide FLSA overtime review or at a minimum review job specifications for specific positions; (2) pursue reductions in overtime to align with FLSA requirements (including but not limited to calculating overtime on hours worked, not paying overtime to exempt employees, and not paying overtime to employees receiving executive leave); and (3) prepare full cost estimates of contract provisions that exceed FLSA provisions.

Paid Leaves are a Significant Cost to the City. The City offers a generous leave package. For full-time employees, this generally includes 14 paid holidays, 10-25 days of paid vacation leave, and 12 days of paid sick leave. In addition, some employees receive up to 5 days of paid personal leave for a total of 38-56 days. Comparing an average employee across jurisdictions, it appears that San Jose is generally comparable to other jurisdictions, but is more generous than the private sector employers we interviewed who offer from 22-35 days of annual paid time off including holidays. In 2009-10, paid leave totaled almost $85 million or about 13 percent of employee cash compensation. We recommend the City include all eligible paid time off in calculation of total compensation, and consider aligning paid leave, particularly holidays, with comparable employers.

Sick Leave Payouts Have Quadrupled. The City's sick leave payout program is far more generous than other comparable employers. Our review of payroll data showed that sick leave payouts nearly quadrupled from $3 million in 2000-01 to more than $12 million in 2009-10. We estimate the City's sick leave liability for employees within one year of retirement is more than $20 million. To reduce sick leave payout costs, the City Council should consider eliminating or capping the sick leave payout program.

Premium Pays Impair Transparency and Have Triggered Additional Costs. The City offers premium pays to some employees who take on special assignments or possess useful skills or certifications beyond the requirements of their positions. In 2009-10, premium pays totaled about $28 million, or over 4 percent of employee cash compensation. However, we found that some premium pays compensate employees for compulsory job aspects.

Also over the last few years, the City has changed how it classifies certain premium pays. Rather than classify these pays as "premium" the City is now rolling these pays into base pay. Although, rolling these types of pay into base pay is appropriate, this practice can have long-term cost implications that should be disclosed. For example, we estimate that rolling Police anti-terrorist training pay into base pay cost the City about $1.2 million because of the impact on other premium pays and leave payouts. Similarly,

we estimate rolling Police holiday in-lieu pay into base pay cost the City nearly $1.1 million in additional premium pays and leave payouts, in addition to higher pension and overtime costs. We recommend the City Administration continue to seek to roll obsolete premium pays into base pay, but that the Administration disclose the indirect costs associated with the action and consider discounting the value of the premium pays to maintain cost neutrality when rolling in premium pays.

The City Can Improve Transparency in Defining Total Compensation. It is difficult to compare compensation packages because of the numerous differences in how compensation is defined across different job classifications and employers. These complexities make it difficult to determine whether the City's employees are paid on par with similar employees in other jurisdictions because every jurisdiction defines total compensation differently. In the interest of transparency, and to fully recognize all employee compensation, we recommend the City standardize the definition of total compensation to include all eligible pays, including the average value of leave payouts and make such information publicly available for all employees and members of the public.

I will present this report at the May 19, 2011 meeting of the Public Safety, Finance, and Strategic Support Committee. We would particularly like to thank the Finance Department Payroll Division, Human Resources Department, and Office of Employee Relations for their time and cooperation during the audit process. The Administration has reviewed the information in this report and their response is shown on the attached yellow pages.

Respectfully submitted,

Sharon W. Erickson
City Auditor

finaltr
SE:lg

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Introduction

In accordance with the City Auditor's fiscal year (FY) 2010-11 Audit Work Plan, we have completed an audit of employee compensation. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We limited our work to those areas specified in the "Audit Objective, Scope, and Methodology" section of this report.

The City Auditor's Office thanks the management and staff of the City Manager's Budget Office; Human Resources Department; Finance Department; Office of Employee Relations; San José Fire Department; Parks, Recreation and Neighborhood Services Department; Department of Transportation; San José Police Department and City Attorney's Office for their time, information, insight, and cooperation during the audit process.

Background

Employee Compensation Is the City's Largest General Fund Expense

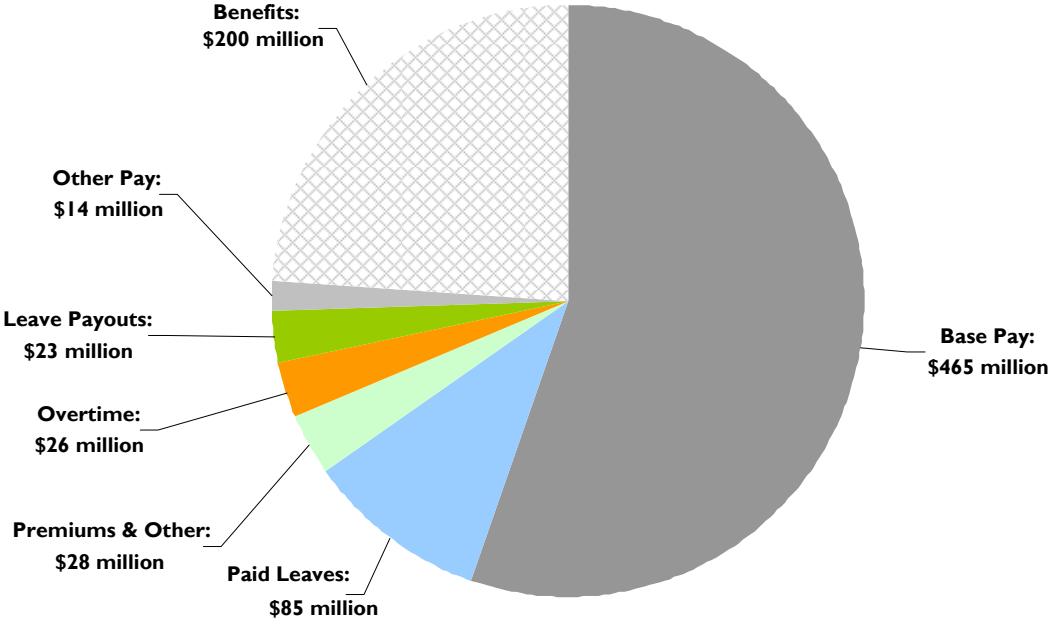
The City's FY 2010-11 Adopted General Fund Operating Budget totals $954 million. Of that, $612 million, or 64 percent, is allocated for personal services. The total personal services budget for all funds (not just the General Fund) for 2010-11 is $822 million.[1] The budget authorized a total of 5,840 full-time equivalent employees (FTE) in all funds.

In answer to the question "what are the key components of employee pay?", we compiled 10 years of employee compensation data reflecting actual transactions through the City's PeopleSoft payroll system.

Our analysis of actual payroll data (that is, the actual compensation paid to or on behalf of City employees) showed that total employee costs for all funds totaled over $840 million in FY 2009-10. Exhibit 1 shows a breakdown of total employee compensation by type for 2009-10.

[1] The $822 million budget included most employee concessions that had been agreed to for the General Fund, but did not include POA concessions agreed to later. It included base pay, City contributions for retirement and fringe benefits. Neither the budget nor our payroll analysis includes the full cost of workers' compensation benefits, or payroll and personnel administration.

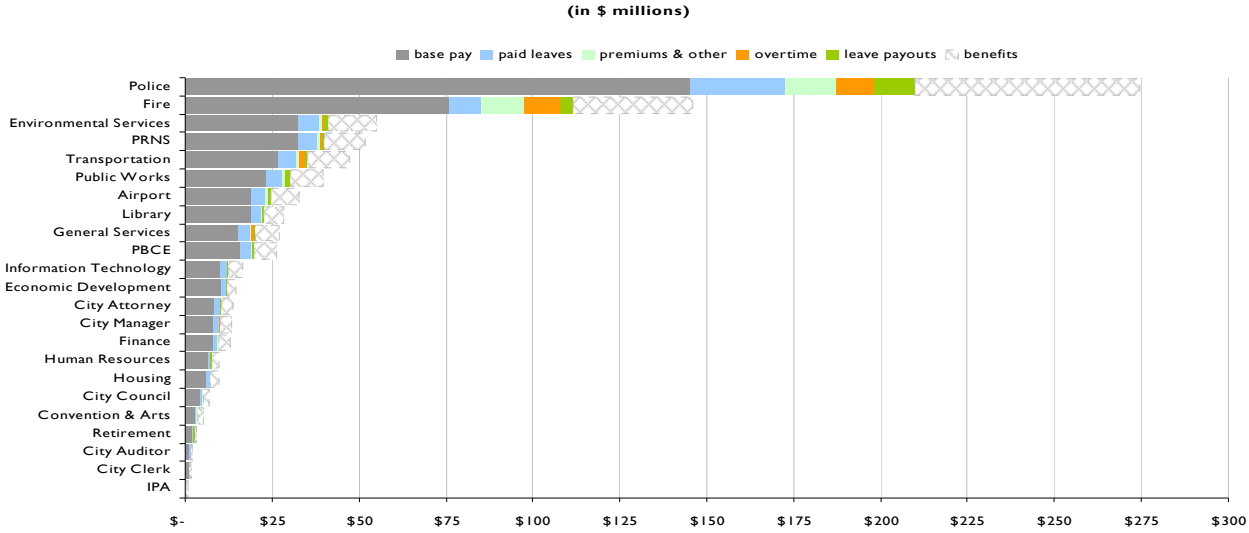
Exhibit 1: Total Actual Employee Compensation by Type FY 2009-10 (all funds)



Source: PeopleSoft (above figures reflect all cash compensation, including payouts provided to employees, but do not include any workers compensation costs, costs the City incurs on behalf of the employees such as commuter checks, Eco-Pass or Med-Line Benefits).

Exhibit 2 below shows the $840 million in employee compensation broken down by department for FY 2009-10, including those that are largely funded outside of the General Fund.

Exhibit 2: Total Actual Employee Compensation by Department FY 2009-10 (all funds)



Source: PeopleSoft (above figures reflect all cash compensation, including payouts provided to employees, but do not include any workers compensation costs, costs the City incurs on behalf of the employees such as commuter checks, Eco-Pass or Med-Line Benefits)

Various Rules and Regulations Govern Cash Compensation and Pay Schedules

Various federal and local rules regulate personnel practices. These include the Federal Fair Labor Standards Act, San José's City Charter, the San José Municipal Code, various Council resolutions, and Memoranda of Agreement (MOA) between the City and the various employee units.

Federal Fair Labor Standards Act: The Fair Labor Standards Act (FLSA) establishes minimum wage, overtime pay, recordkeeping and child labor laws affecting fulltime and part-time employees. While FLSA sets basic minimum wage and overtime pay standards and regulates the employment of minors, it does not regulate some employment practices including the following:

- vacation, holiday, severance, or sick pay;
- meal or rest periods, holidays off, or vacations;
- premium pay for weekend or holiday work; or
- pay raises or fringe benefits.

Per FLSA, the above matters are for agreement between employers and employees or their authorized representatives.

City of San José Civil Service Rules: The San José *City Charter section 1101* establishes the Civil Service system and generally defines those employees who are classified and unclassified, with the former being subject to San José Civil Service Rules. The Municipal Code outlines guidelines for the City's approach to personnel issues including performance appraisals. Initially, for new positions, employee salaries and salary ranges are set by Human Resources (HR) through salary surveys, guidance provided by the City Charter and Municipal Code, and agreements negotiated between the City and the various employee units.

The Civil Service Commission: The City Charter establishes the Civil Service Commission which is a 5-member advisory body. The Commission reviews and recommends changes to the Civil Service Rules and appoints members to the City Council Salary Setting Commission.

Council Resolutions: Generally, the City Council has the ability to make rules related to employee cost matters by a 6 member vote.

Agreements with various bargaining units: Most City employees are represented by bargaining units. These groups negotiate different aspects of employment including salaries, benefits and working conditions with the City. Generally, the terms within the MOAs between the City and these bargaining units supersede the Municipal Code (Code) provisions and any changes to the Code that affect employee earnings, benefits or working conditions may require labor negotiations.

Exhibit 3 outlines the City's employee units along with the current status of the agreements.

Exhibit 3: City of San José's Employee Units with Status of Agreement (as of May 11, 2011)

Unit	Status of Agreement	Number of Full-time Equivalents
Association of Building, Mechanical and Electrical Inspectors (ABMEI)	Council Implemented terms effective June 27, 2010	50
Association of Engineers and Architects Local 21, Units 041 and 042, 043 (AEA)	2011-13 (approved 4/19/11)	200
Confidential Employees Organization (CEO)	Three year agreement expires 9/17/2011	191
International Association of Firefighters, Local 230 (IAFF)	2009-2013 (approved 3/22/11)	647
International Brotherhood of Electrical Workers, Local No. 332 (IBEW)	One year agreement expires 6/30/11	74
Municipal Employees' Federation, AFSCME, Local 101 (MEF)	Three year agreement expires 6/30/11	1,844
International Union of Operating Engineers, Local No. 3 (OE3)	One year agreement expires 6/30/11	759
San José Police Officers' Association (POA)	One year agreement expires 6/30/11	1,220
Association of Legal Professionals of San José (ALP)	One year agreement expires 6/30/11	38
Association of Maintenance Supervisory Personnel (AMSP)	2011-13 (approved 4/19/11)	79
City Association of Management Personnel, IFPTE, Local 21 (CAMP)	2011-13 (approved 4/19/11)	344
Unit 82 (Unrepresented)	One year compensation terms approved 4/19/11	5.35[2]
Unit 99 (Unrepresented)	One year compensation terms approved 4/19/11	228

Source: Office of Employee Relations (Number of employees based on 2011-12 Base Budget; Unit 81 has no employees at the current time)

Employee Compensation Is a Multi-Office/Department Function

The City Manager's Office of Employee Relations (OER), Human Resources (HR), the City Manager's Budget Office (Budget Office), and Finance Department's Payroll Division (Payroll) are key to facilitating employee compensation.

Office of Employee Relations: OER is responsible for overseeing most employee-related issues on behalf of the City. OER duties related to employee compensation include:

- Conducting negotiations with each of the City's employee units,

[2] Unit 82 also has part-time employees. The number reported is only full-time employees.

- Facilitating and coordinating new and existing agreements,
- Ensuring fair, accurate and consistent interpretation of contract language citywide,
- Presenting cost savings and cost estimates to various employee units and the City Council during negotiations, and
- Conducting salary surveys for position classifications during negotiations as needed.

Human Resources: HR is responsible for managing personnel needs. Its key activities include:

- Identifying the City's employment needs,
- Ensuring that positions are within approved classifications,
- Negotiating benefit terms and rates with benefit providers,
- Working with OER and the City Manager's Budget Office to ensure that benefit rates are accurate in budget estimates, and
- Conducting salary surveys for new position classifications.

Finance Payroll: Payroll is responsible for ensuring that employees are paid the accurate amounts. Key responsibilities include:

- Ensuring that employees are paid in a timely manner,
- Configuring PeopleSoft[3] to ensure that pay codes are accurate,
- Providing actual salary information to Budget Office and OER as needed, and
- Following up on/correcting inappropriate payouts and delinquent accounts.

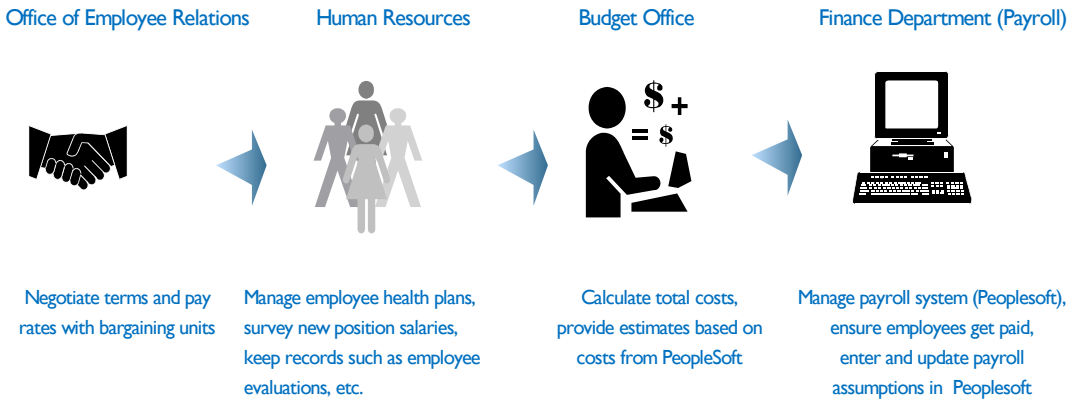
City Manager's Budget Office: The Budget Office is responsible for the annual operating budget. Some of its activities include:

- Pulling information from PeopleSoft and Automated Budgeting System (ABS) and presenting estimates for future budgets (including estimating the various costs of contract terms and negotiated payouts),
- Providing OER with data for negotiation purposes,
- Working with HR to ensure that benefit rates are accurate in its budget estimates, and
- Ensuring City positions are appropriately accounted for.

Exhibit 4 documents the responsibilities.

[3] PeopleSoft is a human resources management system that the City uses to administer employee payroll and benefits.

Exhibit 4: Cross-Departmental Responsibilities



Source: Auditor summary based on interviews with key departments.

In addition, the Department of Information Technology (IT) plays a significant role in providing technical support to Payroll in its configuration of PeopleSoft to ensure payroll is accurate. Finally, the City Attorney's Office (CAO) plays a key role in legal interpretations of contracts and various local, State and Federal laws.

Audit Objective, Scope, and Methodology

The objective of the audit was to: 1) define and quantify the various components of employee compensation, and 2) review major cost drivers of employee cash compensation. To achieve our objectives, we:

- Compiled, quantified and analyzed 10 years of personnel costs data (2000-01 to 2009-10) reflecting actual transactions through the City's PeopleSoft payroll system. Specifically, we:
  - Accessed the City's PeopleSoft system which houses cost data on past and present employees' cash compensation and benefits.
  - Reviewed the City's pay codes and worked with Finance Payroll staff to identify those codes that represented cost to the City and those that did not.
  - Allocated each pay code that represented cost to the following categories: "base pay," "paid leaves," "leave payouts", "overtime", "premium & other" pays.
  - Reviewed earnings against the terms of labor contracts, and terms outlined by City policy.
  - We only included those costs that were paid out through the City's payroll system. We did not include reimbursements, and worker's compensation costs that were not paid through the payroll system, or costs the City incurs for

commuter checks, Eco-Pass, or other programs such as the Med-Expert pilot program provided to City employees.

- Interviewed staff from HR, Payroll, OER, Fire Department (SJFD), Parks Recreation & Neighborhood Services (PRNS) and San José Police Department (SJPD) regarding some PeopleSoft transactions.
- Reviewed the City's Municipal Code, Civil Service Rules, Charter provisions, and various memoranda related to employee costs, current contracts and compensation between the City and employee units.
- Reviewed pertinent local, State and Federal regulations and laws.
- Surveyed and analyzed compensation terms at nine similar government employers: City of San Diego, City of Santa Clara, City of Fremont, City of Fresno, City of Sacramento, County of Santa Clara, City of Long Beach, City of Los Angeles and City and County of San Francisco. We also reviewed labor contracts in place at these nine government employers.
- Compared benefit levels, paid leave offerings, and performance appraisal processes of four private employers. These included three large local technology companies and one large private university.
- With the assistance of HR, we reviewed a sample of 25 employees who received automatic step increases to learn if they received corresponding performance appraisals and whether any of those evaluations were negative.

The audit focused on overall drivers of compensation costs, and did not include tests of compliance of various pays such as overtime, a workload assessment, or a reconciliation of employee costs and payroll transactions. We should note that the City Auditor's Office staff has the same benefit package as other similarly situated personnel in the City.

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Chapter 1 Key Drivers of Employee Compensation

Chapter Summary

The majority of the City's costs are attributable to the cost of employees who provide services – over $840 million in FY 2009-10. Over the last 10 years, employee compensation as tracked in the City's payroll system increased 54 percent. Further, the average cost per employee has risen significantly. We identified three major cost drivers of employee compensation:

- **Cash compensation** including all cash payments provided to City employees including base pay, overtime, payouts for unused leaves, premium pays, stipends, etc. Different employee groups are compensated in different ways. Some employee groups are eligible for various premium pays, step increases and overtime whereas other groups are not.
- **Retirement contributions** include City contributions made on behalf of employees' post-employment pension and retiree medical benefits.
- **Fringe benefits** include City contributions made on behalf of employees' medical and dental benefits, and other fringe benefits like City-provided insurances and mandated insurances such as unemployment insurance.

Over the last decade, the City's retirement and fringe costs have grown more than cash compensation. Previous audit reports addressed the increasing cost of employee health and pension benefits. This audit focuses on the increases and the major cost drivers of cash compensation. As we will discuss in the following chapters, eligible employees received automatic step increases and general wage increases which are not tied to satisfactory performance; and even though the biggest component of employee cash compensation is base pay, oftentimes a major component of cash compensation is "other" pays which include overtime, paid leaves, leave payouts and premium pays. These cash compensation components add significantly to the City's costs.

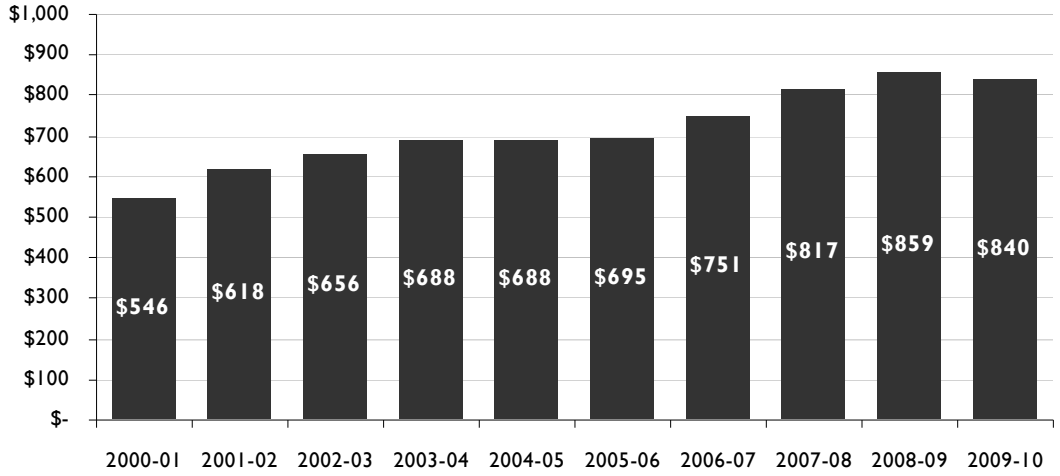
Total Employee Compensation Costs Increased 54 Percent Between 2000-01 and 2009-10

Our analysis of the City's payroll data shows that between 2000-01 and 2009-10, total employee compensation in all funds rose from $546 million to over $840 million (54 percent). This includes all compensation paid through the payroll system including cash compensation, retirement contributions, and fringe benefit costs.[4] Exhibit 5 shows the increase.

[4] These figures include the City's contributions for retirement and retiree healthcare as recorded in the City's PeopleSoft system based on applicable pay codes.

Exhibit 5: Total Actual Compensation Increased 54 Percent Over the Last Decade

(in millions)



Source: PeopleSoft (above figures reflect all cash compensation provided to employees, but does not include any workers compensation costs, costs the City incurs on behalf of the employees such as commuter checks, Eco-Pass or Med-Line Benefits)

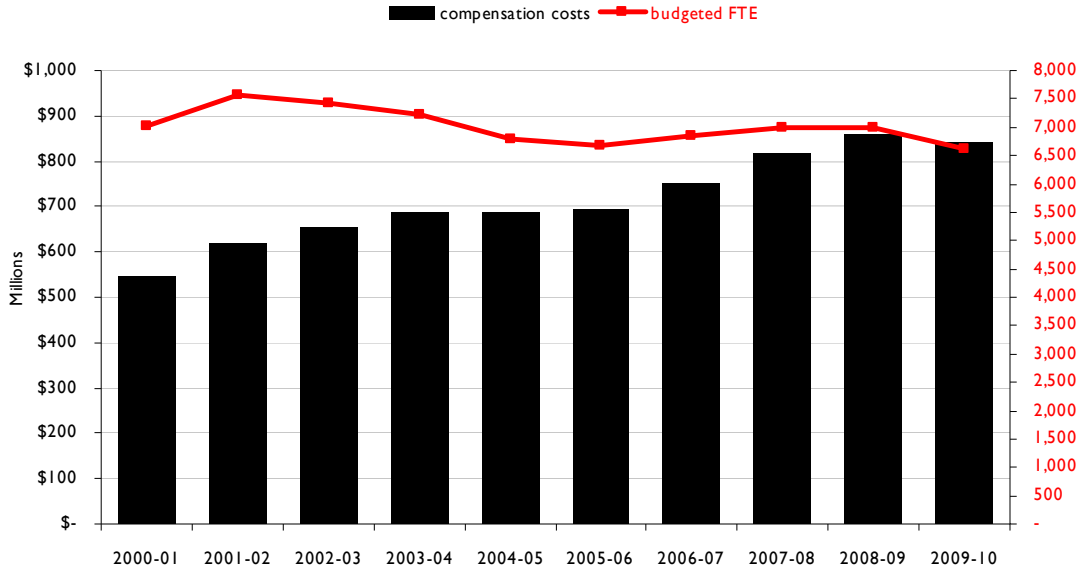
We should note that while employees' total compensation has increased since 2000-01, actual "take-home" earnings have not proportionately increased. Employees are contributing increasingly larger portions toward their benefits. In 2000-01 sworn and civilian employees contributed 9.79 and 4.76 percent respectively of their base pay toward retirement benefits. In 2010-11 contribution rates have grown to 15.57 percent of base pay for Police employees, 13.7 percent for Fire employees and 10.3 percent for civilian employees. Similarly, employees have seen their contributions to medical benefits increase from $300 per year in 2000-01 to over $2,200 (family coverage) – an increase of over 640 percent.

The Number of Employees Has Dropped

The growth in total employee compensation occurred even as the number of employees declined. The number of full-time equivalent employees (FTE) has dropped from about 7,025 positions in 2000-01 to about 6,623 in 2009-10[5]. Per the 2010-11 adopted budget, the total number of FTE further dropped to 5,840. Our analysis of actual payroll data shows that the total number of full-time staff members (individuals, not FTE) also declined.

[5] Adopted Budget 2000-01 and 2009-10.

Exhibit 6: Actual Compensation and Budgeted Full-Time Equivalents (all funds)

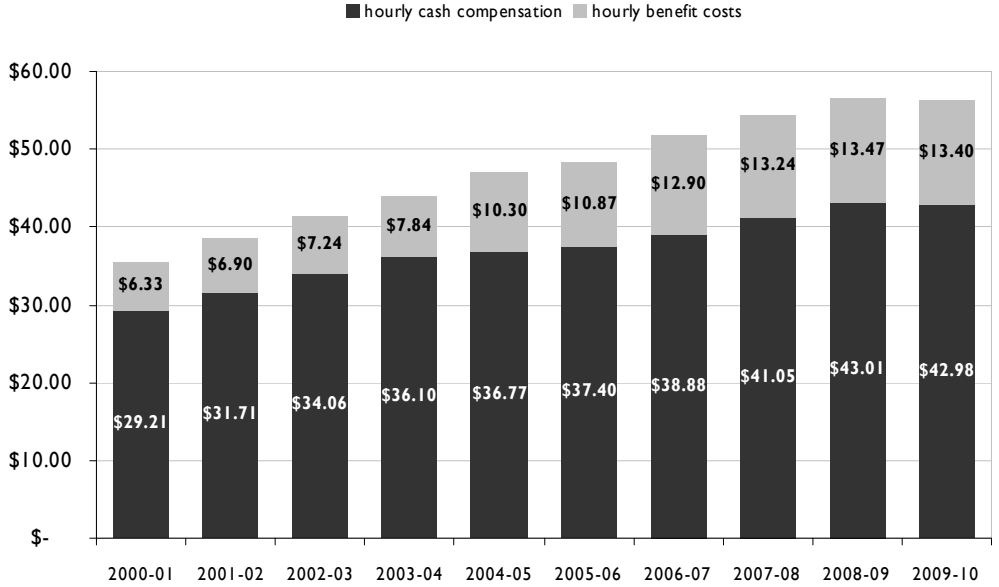


Source: PeopleSoft (above figures reflect all cash compensation provided to employees, but does not include any workers compensation costs, costs the City incurs on behalf of the employees such as commuter checks, Eco-Pass or Med-Line Benefits). Auditors summarized the total number of full-time employees from the adopted budget (2000-01 to 2009-10)

Average Hourly Compensation Increased 47 Percent

As Exhibit 7 shows, average hourly compensation increased year over year. Average hourly pay increased from $29.21 per hour in 2000-01 to $42.98 per hour in 2009-10. Average hourly benefit costs doubled over the same time – from $6.33 to $13.40 per hour.

Exhibit 7: Average Hourly Compensation Including Benefits



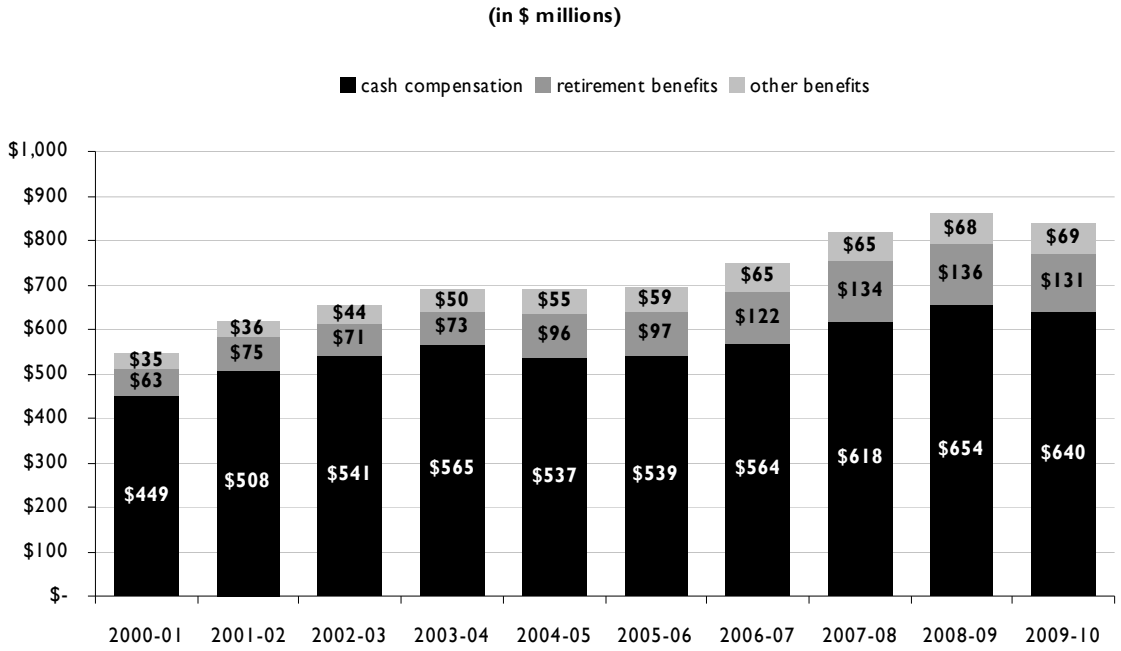
Source: PeopleSoft (above figures reflect all cash compensation provided to employees, but does not include any workers compensation costs, costs the City incurs on behalf of the employees such as commuter checks, Eco-Pass or Med-Line Benefits)

The City's Retirement and Fringe Costs Have Grown More than Cash Compensation

Over the last decade, the fastest growing aspect of employee compensation was employee benefits, which more than doubled between 2000-01 and 2009-10. Specifically, the City's retirement contributions grew by 108 percent while the medical contributions grew by 100 percent. Employees' cash compensation also rose, but at a lower rate – 43 percent.

In 2000-01, cash compensation accounted for 82 percent of total personnel costs; by 2009-10, cash compensation accounted for 76 percent of total employee compensation. Exhibit 8 below shows this trend

Exhibit 8: Retirement and Fringe Growth as Compared to Cash Compensation (all funds)



Source: PeopleSoft (above figures reflect all cash compensation provided to employees, but does not include any workers compensation costs, costs the City incurs on behalf of the employees such as commuter checks, Eco-Pass or Med-Line Benefits)

Previous Audit Reports on Costs of Medical and Pension Benefits

The City Auditor's Office has issued two audit reports outlining the need to contain the costs of medical and pension benefits – *Audit Of The Employee Medical Benefits* (issued June 2009) and *Pension Sustainability: Rising Pension Costs Threaten The City's Ability To Maintain Service Levels - Alternatives For A Sustainable Future* (issued September 2010).[6] This audit focuses primarily on cash compensation – base pay, overtime, paid leaves, leave payouts and premium pays.

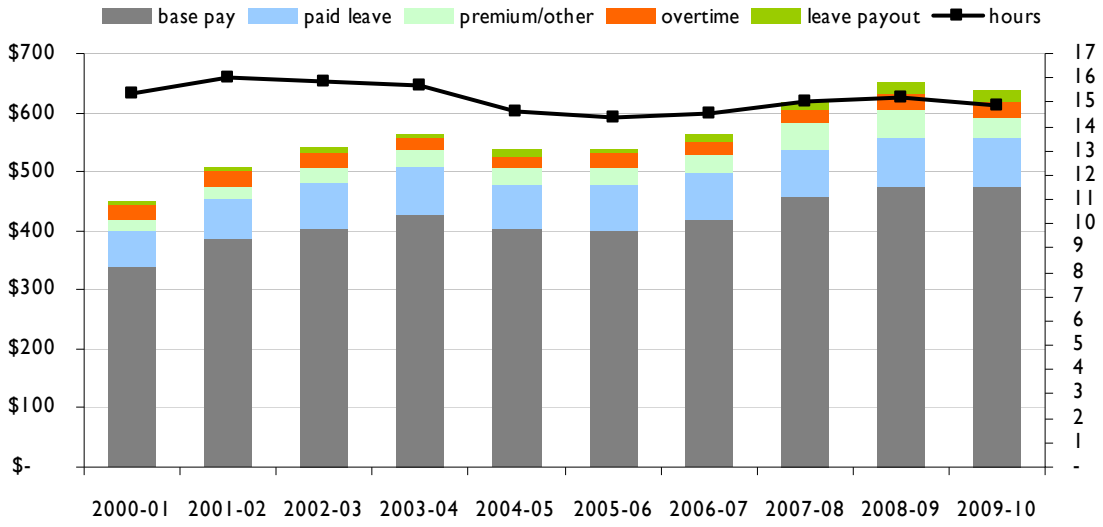
[6] http://www.sanjoseca.gov/auditor/AuditReportsMemos.asp

In Total, Employee Cash Compensation Increased 43 Percent from 2000-01 to 2009-10

Between 2000-01 to 2009-10, employee cash compensation grew from $449 million to $640 million, or 43 percent. This includes all forms of cash compensation received by employees through the PeopleSoft payroll system: base pay, overtime payments, paid leaves such as sick leave, vacation leave and holidays, leave payouts and premium pays. Exhibit 9 shows Citywide cash compensation across all City funds from 2000-01 to 2009-10.

Exhibit 9: Employee Cash Compensation Grew 43 Percent (all funds)

(millions)

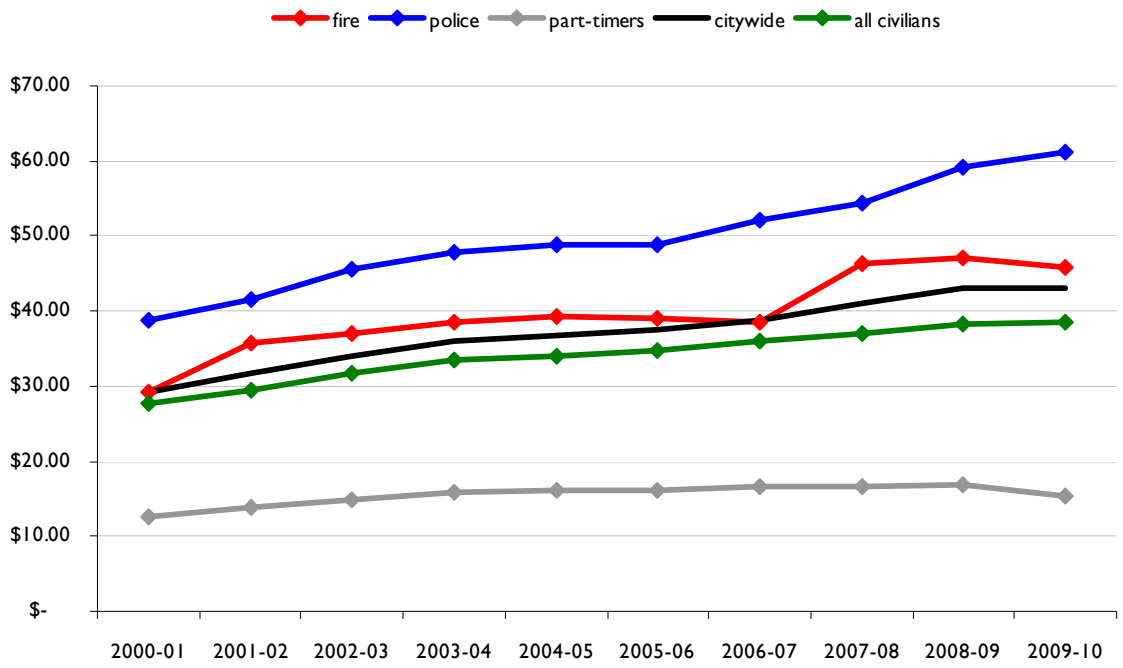


Source: PeopleSoft (above figures reflect all cash compensation provided to employees, but does not include any workers compensation costs, costs the City incurs on behalf of the employees such as commuter checks, Eco-Pass or Med-Line Benefits)

Hourly Cash Compensation Also Grew Over the Same Period

As mentioned before, on an hourly basis, cash compensation grew from $29.21 to $42.98 per hour from 2000-01 to 2009-10, or 47 percent citywide. Exhibit 10 below shows actual hourly cash compensation among different employee types over the last decade.

Exhibit 10: Hourly Employee Cash Compensation



Source: PeopleSoft (above figures reflect all cash compensation provided to employees, but does not include any workers compensation costs or benefit costs)

Some Employee Groups Had a Bigger Increase in Cash Compensation Rates than Others, but All Employee Groups Cash Compensation Rates Increased

The Citywide growth in costs varies among different types of City employees as shown in the City's PeopleSoft payroll system:

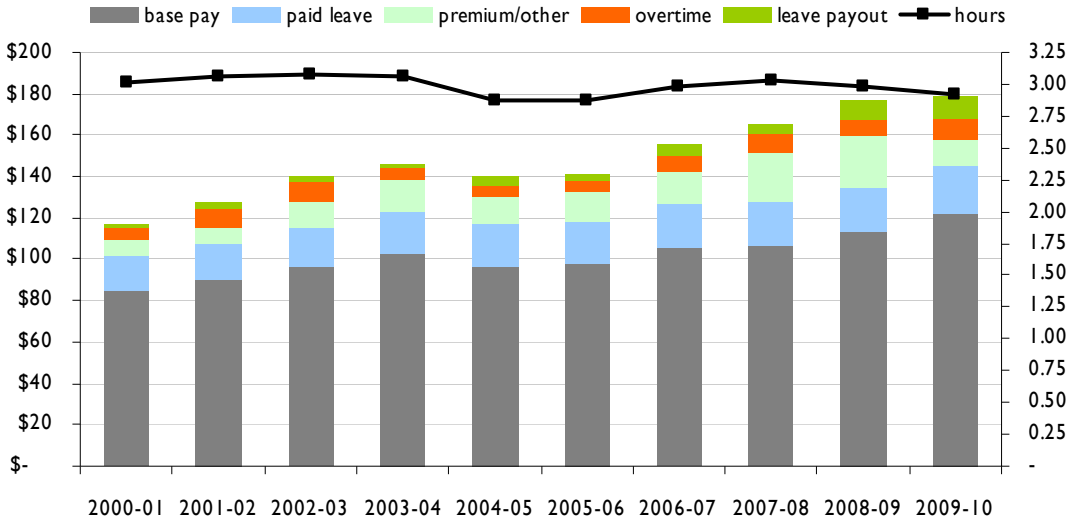
- **Police Employees**;
- **Fire Employees**;
- **Civilian Employees** are fulltime non-sworn employees including management/professional employees and the chiefs, assistant chiefs and deputy chiefs of the Police and Fire departments;
- **Part-time Employees** include those City employees who work fewer hours than required to be considered "full-time".

Exhibits 11, 12, 13, and 14 below show the growth in cash compensation for various types of employees.

Police Employees

Cash compensation to Police employees grew from $116.6 million to $179.2 million -- this represents roughly a 54 percent increase. The largest rate of increase occurred in leave payouts which grew nearly six-fold -- from $1.9 million in 2000-01 to $11.3 million in 2009-10; the smallest rate of change occurred in base pay which grew by 41 percent -- $83 million to $117 million.

Exhibit 11: Cash Compensation to Police Employees Grew 54 Percent
(millions)

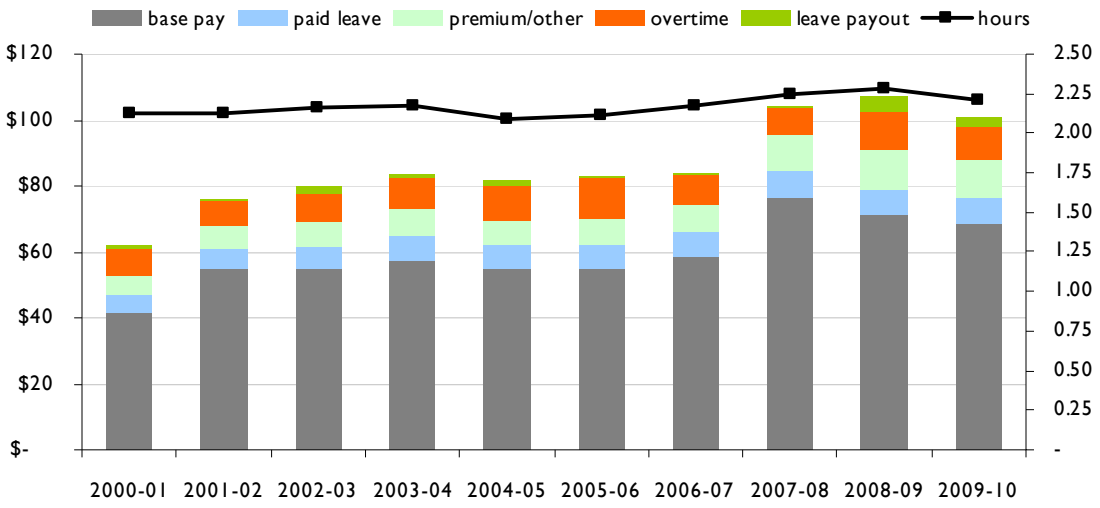


Source: PeopleSoft (above figures reflect all cash compensation provided to employees, but does not include any workers compensation costs or benefit costs)

Fire Employees

In the ten-year period between 2000-01 and 2009-10, Fire employees' cash compensation grew from $62 million to $101 million -- this represents roughly a 62 percent increase. The largest rate of increase occurred in leave payouts which grew 161 percent -- from $1.1 million in 2000-01 to $2.9 million in 2009-10; the smallest rate of change occurred in overtime which grew by 23 percent -- $8.4 million to $10.2 million.

Exhibit 12: Cash Compensation to Fire Employees Grew 62 Percent
(millions)

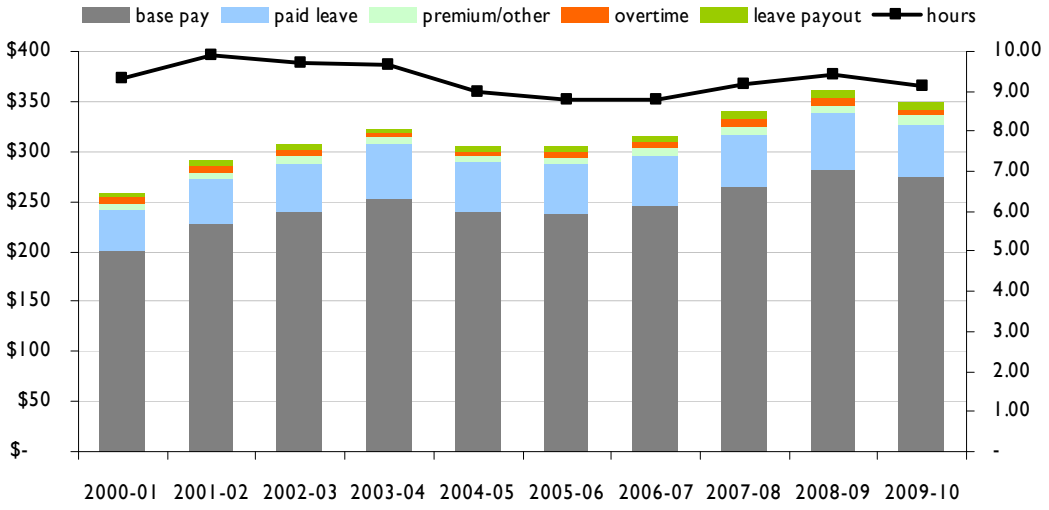


Source: PeopleSoft (above figures reflect all cash compensation provided to employees, but does not include any workers compensation costs or benefit costs)

Civilian Employees

In the ten-year period between 2000-01 and 2009-10, civilian employees' cash compensation grew from $259 million to $350 million -- this represents roughly a 35 percent increase. The largest 10-year increase was in leave payouts which grew 150 percent – from $3.5 million to $8.7 million. The largest decrease over the 10-year period between 2000-01 and 2009-10 was overtime which decreased by 34 percent from $8.1 million to $5.4 million.

Exhibit 13: Cash Compensation to Civilian Employees Grew 35 Percent
(millions)

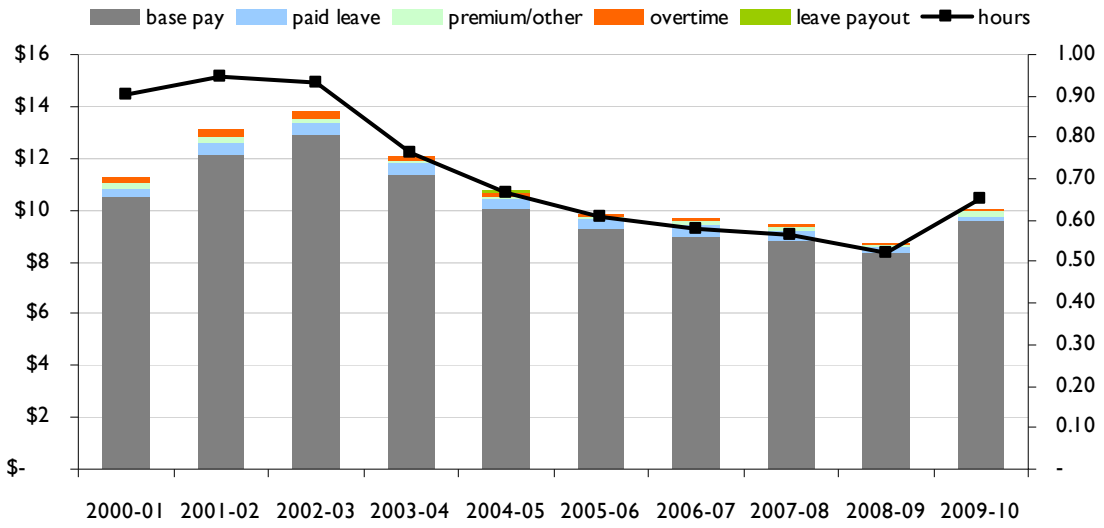


Source: PeopleSoft (above figures reflect all cash compensation provided to employees, but does not include any workers compensation costs or benefit costs)

Part-Time Employees

Cash compensation to part-time employees declined over $1.2 million between 2000-01 and 2009-10 – from $11.3 to $10 million.

Exhibit 14: Cash Compensation to Part-Time Employees Decreased 11 Percent (millions)



Source: PeopleSoft (above figures reflect all cash compensation provided to employees, but does not include any workers compensation costs or benefit costs)

For an Individual Employee, Cash Compensation May Include Much More than Base Pay

An employee's cash compensation can consist of different forms of compensation besides base pay earned for performing standard duties during regularly scheduled shifts. Examples include health in-lieu payments for employees who waive City-provided medical benefits, bilingual pay, and vacation balance payouts when employees separate from the City.

Exhibit 15 below shows how "other" earnings besides base pay were major components of an actual employee's cash compensation. In this example, other earnings, including premium pays, overtime, and paid time off made up nearly 55 percent of the employee's total cash compensation.

Exhibit 15: Snapshot of an Actual Employee's Biweekly Paystub Showing the Effect of Paid Time Off, Other Pays and Overtime

Hours And Earnings						
Code	***Description***	***Hours***	***Pay Rate***		***Amount***	***Rate Used***
Earnings						
REG	Regular	55.50	43.7500	$	2,428.13	Hourly Rate
OVT	Overtime	14.50	70.5469	$	1,022.93	Hourly Rate
Paid time off						
SIC	Sick Leave	10.00	43.7500	$	437.50	Hourly Rate
VAC	Vacation Leave	10.00	43.7500	$	437.50	Hourly Rate
COM	Comp-Time Taken	4.50	43.7500	$	196.88	Hourly Rate
Premium Pays						
ATT	Anti-Terrorist			$	175.00	5% of Base
PPA	POST Pay Advanced			$	262.50	7.5% of Base
TRN	Police Field Training Pay			$	175.00	5% of Base
HIL	Holiday In-Lieu			$	211.57	5.623% of REG+PPA
BIL	Oral Bilingual Pay			$	29.00	29.00 Flat
		Gross Pay		**$**	**5,376.00**	

Source: Auditor presentation of an actual City employee's actual compensation summary from the PeopleSoft payroll system.

Generally, sworn employees are eligible for more types of special and premium pays than civilian employees. Based on our analysis of 2009-10 payroll records, we estimate 35 percent of Fire employees' pay comprised "other" earnings, compared to 34 percent of Police employees' pay, and 22 percent of full-time civilian employees' pay. This issue is discussed further in later chapters of this report.

Continuing Budget Deficits Have Triggered Compensation Reductions

Over the years, the total cost of employee compensation has grown faster than revenues. In 2009-10, the City closed a budget shortfall of more than $80 million by a myriad of means including eliminating positions and reducing services. Despite reductions in the number of employees, compensation costs in total continue to rise.

Fiscal year 2010-11 was the City's ninth consecutive year of budget reductions. Similar to the previous fiscal year, the City once again closed this shortfall by eliminating positions, service reductions, and through reductions in total compensation (including cuts in wages and benefits, and higher employee contribution rates to pension and health benefits). For 2010-11, negotiations between the City and the various employee units resulted in some employee units taking compensation cuts. Two employee units received 2 percent pay increases that same year because of previously agreed upon terms of their contracts.

For 2011-12, the City Council has approved a goal of 10 percent on-going total compensation reductions. As of the writing of this report, contract negotiations are underway for FY 2011-12. Four bargaining units and the City agreed to new contract terms in March and April 2011, which included 10 percent on-going compensation reductions.

Some Components of Cash Compensation Continue to Be a Significant Expense

This audit focuses on some aspects of cash compensation that are driving employee compensation. As we will discuss in the following chapters, a large part of employee cash compensation is made up of base pay, and paid leaves such as City holidays, vacation, personal, and sick leave. Finally, overtime and premium pays continue to be a significant cost to the City and a large part of some employees' compensation. We will discuss these individually in Chapters 2 through 7:

- Increases in base pay (Chapter 2)
- Eligibility for overtime (Chapter 3)
- Paid time off (Chapter 4)
- Sick leave payouts (Chapter 5)
- Premium pays (Chapter 6)
- Total compensation (Chapter 7)

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Chapter 2 Most Increases in Base Pay Are Not Tied to Performance

Chapter Summary

Base pay makes up the bulk of employees' cash compensation. In 2009-10, base pay totaled about $465 million, or 73 percent of total employee cash compensation. Some increases to base pay, such as step increases, are automatic and occur as a result of longevity in a position and stop once an employee reaches top step. On the other hand, general wage increases are typically negotiated between the City and the various employee units and are applicable to all employees in the affected employee units. Eligible employees oftentimes receive step increases and general wage increases in the same year:

- **Step Increases:** As of February 2011, the City had over 600 job classifications — 64 percent of which contained salary steps. Most of the City's step classifications have between 5 and 7 steps. Most step-eligible employees move to top step between 3-1/2 to 5-1/2 years.
- **General Wage Increases:** In addition, since 2000, employee units have received annual general wage increases ranging from 0 to almost 8.4 percent. Despite recent concessions, we found these wage increases have resulted in employee units achieving an average 37 percent pay increase between fiscal year 2000-01 and 2009-10.

Most of the above mentioned types of wage increases are not contingent on performance appraisals. In fact, from our review of personnel records of 25 employees who received automatic step increases, we found that 42 percent of the automatic step increases did not coincide with performance appraisals. In our opinion, the City Administration should take steps to move towards a merit based system by: (1) requiring a current positive performance appraisal before implementing any pay increases (including step and general wage increases), (2) considering elimination of the automatic step increase process and/or establishing minimum performance thresholds for receiving step increases, and (3) automating the current performance appraisal system.

Most Step Increases Are Not Tied to Performance

In 1979, Council Resolution 51870 established "step increases" for many of the City's job classifications. Eligible employees in step classifications receive automatic 5-percent increases upon reaching the required time milestones. Generally these time milestones are completion of 2,080 hours. Any changes to step increases may require labor negotiations.

Most of the City's step classifications have 5 steps; although police officers and firefighters have 7 steps. Each step represents about 5 percent increase to base pay. As of January 14, 2011, about 4,500 City employees occupied "step classifications". These employees represent 7 of the City's employee units. Of these estimated filled step positions, about 3,373 (or **74 percent**) were at top step.

Purpose of Step Increases

Step increases, which are more common in the public sector than in the private sector, were implemented to ensure fairness.

> *[…] civil services compensation systems were designed with the assumption that the relationship of one job to another could be determined, and its value assessed, apart from the job incumbent. Seniority and equity were valued as products of a stable working environment. Today the basic assumption of stability has been replaced by dynamism and change.* [7]

Employees in Step Classifications Receive Automatic 5-Percent Increases upon Reaching the Required Time Milestones

It takes an average civilian employee about 3-1/2 years to reach top step. In other words, in 3-1/2 years some employees may receive a **minimum** 22 percent pay increase without needing a corresponding performance evaluation to justify it. Currently, a typical police officer or firefighter starting at step 1 would reach step 2 after 6 months, and would advance a step each year thereafter with a five percent salary increase between each step. Such an employee would reach top step in 5-1/2 years at which time s/he would have earned a minimum base pay about 34 percent greater than her/his starting pay[8]. Once an employee reaches "top step" no further automatic pay increases (other than general wage increases) occur. Employees represented by MEF, CEO, IBEW, OE3, POA and IAFF are eligible to receive automatic step increases.[9]

Step Increases Have a Significant Dollar Impact to the City

For 2011-12, the City's Budget Office estimates that step increases will cost about $2.6 million. This includes about $1.2 million for Police, $600,000 for Fire and about $790,000 for all other employees. The $2.6 million does not include

[7] *Public Personnel Management-Contexts and Strategies* by Donald E. Klinger and John Nalbandian

[8] These time milestones are based on a full-time/2,080-hour-per-year work schedule. The 22 and 34 percent increases assume no general wage increases, merit pays, premium pays, or any other pay increases. In its 2011-12 negotiation proposals, the City has proposed reducing the size of some classifications' automatic steps from 5 percent to 2.5 percent.

[9] Employees represented by ABMEI are required to have a performance appraisal prior to receiving a step increase.

the impact these step-increases have on future leave balances that are calculated from base pay.

Step Increases Are Not Tied to Satisfactory Performance and Employees Get Step Increases Without Documented Performance Appraisals

To determine whether automatic step increases were tied to job performance, we reviewed the step increases of 25 step-eligible employees. These employees received a total of 125 step increases. 52 of the 125 **(42%)** step increases were issued without performance appraisals.[10] In two cases, employees had not received appraisals in 10 years. In one case, even though an employee received her/his evaluation, s/he received an **overall negative rating** and still received an automatic step increase. In essence, this employee was monetarily rewarded even though, according to the appraisal, s/he had not performed satisfactorily.

General Wage Increases Have Been Granted Regularly

In addition to step increases, the City also grants general wage increases (commonly referred to as cost of living adjustments "COLA"). Typically these are a result of negotiations between the City and the various employee units. Between 2000-01 and 2009-10, employee units have achieved an average general wage increase of 37 percent, in addition to automatic step increases.

As outlined in Exhibit 16, general wage increases are not necessarily tied to the Consumer Price Index (CPI) and in many instances, the increases exceeded the CPI. In addition, like the automatic step increases, these wage increases are granted to every employee based on their employee unit and are not tied to performance. General wage increases contribute not only to increasing employee base pay but also significantly increases other costs that are calculated from base pay: overtime, leave payouts, premium pays and pension contributions. Exhibit 16 below shows the year over year change in the CPI and general wage increases granted since 2000-01.

[10] For three employees, performance appraisals for multi-year periods were issued after the step increases had been implemented.

Exhibit 16: General Wage Increases Since 2000-01 by Employee Unit

Year	CPI	OE#3	IAFF	ABMEI	IBEW	AMSP	AEA	CAMP	POA	MEF	CEO	Unit 99
2000-01	6.6%	5%	8.40%	3.50%	5%	3.25%	3.25%	3.25%	6%	3.25%	3.25%	3.25%
2001-02	1.2%	6%	8%	6%	3.25%	6%	6%	6%	6%	6%	6%	6%
2002-03	1.6%	5%	7%	6%	6%	5.35%	5%	6%	6%	5%	5.50%	5%
2003-04	1.4%	6%	4%	6%	6%	6%	3%	6%	4%	6%	6%	3%
2004-05	1.1%	0%	0%	0%	6%	0%	0%	0%	0%	0%	0%	0%
2005-06	3.9%	1.50%	1.50%	1.50%	0%	1.90%	1.50%	1.80%	1.50%	1.50%	1.75%	1.80%
2006-07	3.4%	4%	5.70%	3.75%	1.50%	3.75%	3.75%	3.75%	5.70%	3.75%	3.75%	3.75%
2007-08	4.2%	3%	5.70%	3%	3.75%	3%	3.60%	3%	5.70%	3%	3%	3%
2008-09	0.2%	3.75%	3.75%	3.75%	3%	3.75%	3.75%	3.75%	3.75%	3.75%	3.75%	3.75%
2009-10	1.1%	0%	0%	0%	3.75%	0%	0%	0%	1.50%	0%	0%	0%
2010-11	N/A	-3.35%	0%	-4.65%	-2.95%	-3.05%	-2.80%	-2.80%	0%	2%	2%	-10.15%
Compound Total	**27.42%**	**35.06%**	**53.28%**	**32.27%**	**41.02%**	**33.87%**	**30.22%**	**34.91%**	**47.92%**	**39.82%**	**40.83%**	**20.03%**

Source: OER and Bureau of Labor Statistics Consumer Price Index All Urban Consumers- San Francisco-Oakland-San José, CA – June to June. (Note that IAFF was without a contract since FY 2008-09. On March 3, 2011 the City Council approved terms of a IAFF contract with the contract term being 2009 to 2013. Note that prior to 2004-05, AEA members were part of the unrepresented Unit 99 group. Further, prior to FY 2010-11, members of ALP were also part of the unrepresented Unit 99 group and that in FY 2010-11 ALP agreed to a 6.65% salary reduction with unpaid furlough days. It should also be noted that in FY 2010-11, AEA, AMSP, CAMP, IBEW and POA reduced take-home pay by increasing their retirement contributions which is not reflected in this exhibit.)

The City Has Merit-Based Models

The City Charter emphasizes the need for a merit-based system. Section 1100 states:

> *"All appointments and promotions to positions in the Classified Service shall be made on the basis of merit and fitness, demonstrated by examination and other evidence of competence, in accordance with Civil Service Rules adopted in the manner provided in this Charter."*

Various MOAs also lay out provisions on how performance appraisals should be done. The City's Management Performance Program is even more definitive and ties the salary increases to the employee's performance appraisal. City Policy requires an annual evaluation for all employees. Some MOAs lay down a framework for the appeals process if there is disagreement on the assessment. In our opinion, performance appraisals are an essential tool for managing employee performance and pay increases, and should be performed regularly.[11]

[11] It should be noted that in June 2008, the City Council approved the City Auditor's recommendation to exempt unclassified employees in the City Auditor's Office from the automatic general salary increase that had been recommended for management employees, instead awarding salary increases based on performance evaluations.

Private Sector Employers Follow a Merit Based Model

All the government employers we surveyed followed a similar model to the City of San José. However, all the private entities we surveyed reported that all raises and bonuses are tied to performance appraisals. Further, employees of those private entities do not get pay increases without completed performance appraisals and any resulting pay increases are tied to those appraisals.

In its 2011-12 negotiation proposals, the City has proposed reducing the size of some classifications' automatic steps from 5 percent to 2.5 percent. Though this would slow compensation growth, it does not address the issue of tying salary growth to performance. As currently structured, automatic step and general wage increases do not reflect employees' contributions to the City and job performance.

Automating the Performance Appraisals Would Improve the Process

The City has at least two different performance appraisal forms in use. These include a management performance appraisal form and a non-management form. Exhibit 17 below shows the non-management form.

Exhibit 17: Non-Management Performance Appraisal Form

City of San José Performance Appraisal Form

(Please type this form. For Instructions Refer to Section 3.3.3 of the City Policy Manual)

Last Name, First Name, Initial:	Employee ID #:	Action: (Check any applicable)
Department:	Type of Appraisal: (Check one)	☐ Retention/Permanent Status ☐ Rejection During Probation
Class Title/Number:	☐ Second Probationary ☐ Final Probationary	☐ Extension of Probation ☐ Step Increase
Beginning/Ending Period: to	☐ Annual ☐ Special	☐ Merit Increase ☐ Withhold Step Increase

KEY ELEMENTS OF JOB PERFORMANCE *(Please complete this section last)*	Exceptional	Above Standard	Meets Standard	Needs Improvement	Unsatisfactory
Job Expertise					
Customer Service					
Communication Skills					
Teamwork/Interpersonal Skills					
Judgment/ Problem Solving					
Reliability					
Supervisory & Leadership Skills (If applicable)					
OVERALL RATING					

Source: City of San José Human Resources Department

The City's PeopleSoft system also has a module for employee appraisals. The module provides the opportunity to automate the current evaluation process. Supervisors could provide more detailed comments if desired. One of the private employers we interviewed uses the performance appraisal module in its PeopleSoft system to document performance appraisals. Automating the process

would also help with tracking whether performance appraisals have been completed and remind supervisors of previous evaluations, including previously set goals.

The City Policy Manual does provide guidance to supervisors on performing appraisals. However, before tying compensation to performance, the City must commit to requiring regular performance appraisals and develop timelines and schedules. These efforts may require an assessment of the current appraisal tools and training for supervisors.

Recommendation #1: We recommend the City Administration take steps to move towards a merit-based system by: (1) requiring a current positive performance appraisal before implementing any pay increase (including step and general wage increases), (2) considering elimination of the automatic step increase process and/or establishing minimum performance thresholds for receiving step increases, and (3) automating the current performance appraisal system.

Chapter 3 The City's Overtime Provisions Add to Overtime Costs

Chapter Summary

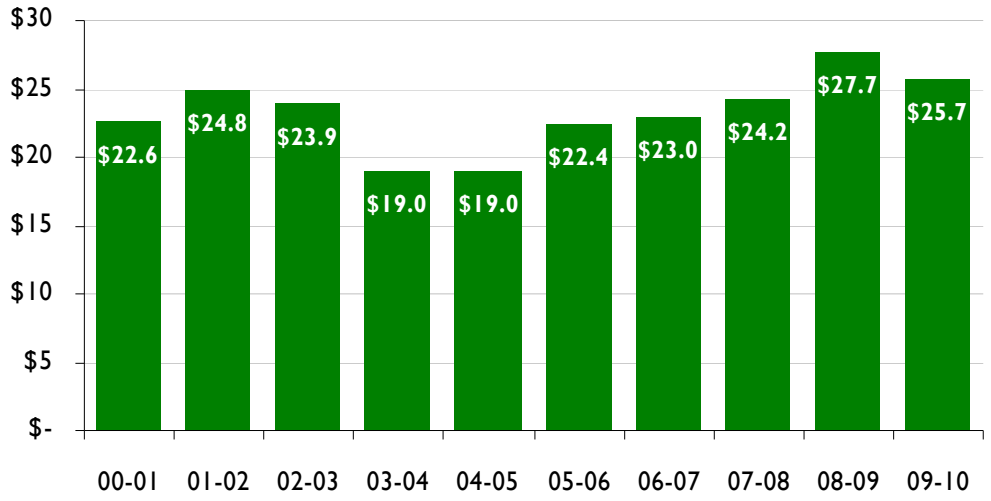
Overtime is generally paid to eligible employees who work in excess of their regularly scheduled shifts. In FY 2009-10, the City paid almost $26 million in overtime, or about 4 percent of employee cash compensation. Generally, for working overtime, employees are compensated at the rate of 1-1/2 times their hourly rate. In certain circumstances, overtime-eligible employees may choose compensatory time in lieu of cash overtime. Compensatory time (comp time) is additional paid time off that can be taken at a later time. These terms originate with standards prescribed by the federal Fair Labor Standards Act (FLSA) which establishes the minimum criteria for when extra overtime compensation is required and to whom it is required. However, employers can offer more than what is required by FLSA. Several current agreements between the City and the various employee units exceed FLSA overtime requirements, which adds costs to the City. Further, employees in one employee unit not only receive overtime but also receive executive leave, which the City generally provides to salaried employees in lieu of overtime. Finally, the City should consider limiting overtime eligibility for some salaried positions, and review its job classifications to determine whether updates are needed to more closely reflect FLSA guidelines.

The City Has Significant Overtime Expenses

Between 2000-01 and 2009-10, overtime was a significant expense for the City. Exhibit 18 below shows that in FY 2009-10, the City paid almost $26 million in overtime, or about 4 percent of cash compensation.[12] About 80 percent of that overtime (over $20 million) was paid to Police and Fire employees. We should note that one of the reasons for overtime in the SJFD is its minimum staffing requirements.

[12] These overtime costs exclude compensatory time that City employees received in lieu of overtime in FY 2009-10.

Exhibit 18: Actual Overtime Paid Between 2000-01 to 2009-10
(in millions)



Source: Actual PeopleSoft overtime expenditures

An employer who requires or permits non-exempt employees to work overtime is generally required to pay a premium for such overtime work. Non-exempt employees covered by the Fair Labor Standards Act (FLSA) receive overtime pay for **hours worked** in excess of their weekly shifts. According to FLSA, overtime must be paid at a rate of at least one and one-half times the employee's regular rate of pay for each hour worked in a workweek in excess of the maximum allowable in a given type of employment.

Under the current bargaining unit agreements, about 70 percent of the City's positions are overtime eligible. These include job classifications represented by POA, IAFF, AMSP, ABMEI, MEF, CEO, IBEW and OE3. As of July 2010, 421 City job classifications were overtime eligible.

The City Pays Overtime to Most Bargaining Units Based on Hours Paid, Not Hours Worked

FLSA requires overtime *for hours worked*, however, some agreements between the City and the various bargaining units require the City to pay employees overtime **on hours paid**. This means that an employee scheduled to a standard 40-hour work week who exceeds 40 paid hours in a week, receives overtime even if this employee spent a majority of a pay period away from work on paid leave. The exhibit below shows an actual employee's cash compensation for a standard biweekly pay period. The employee in the example below worked only 18 hours. The remaining 62 hours were paid in sick leave, vacation leave, holiday leave and comp time[13]. However, in the same pay period, this employee earned an additional 3 hours of overtime pay at a rate of time-and-a-half for those 3 hours.

[13] A department director may authorize payment for overtime hours worked in compensatory time (comp time).

This occurred even though a majority of this employee's time had been spent away from work.

Exhibit 19: Snapshot of an Actual Employee's Biweekly Paystub Showing Overtime Eligibility

Hours And Earnings						
Code	***Description***	***Hours***	***Pay Rate***		***Amount***	***Rate Used***
Earnings						
REG	Regular	18.00	45.4800	$	818.64	Hourly Rate
OVT	Overtime	3.00	68.2200	$	204.66	Hourly Rate
Paid time off						
SIC	Sick Leave	26.00	45.4800	$	1,182.48	Hourly Rate
VAC	Vacation Leave	9.00	45.4800	$	409.32	Hourly Rate
COM	Comp-Time Taken	18.00	45.4800	$	818.64	Hourly Rate
HOL	City Holiday	9.00	45.4800	$	409.32	Hourly Rate

Source: Auditor presentation of an actual City employee's actual compensation summary from the PeopleSoft payroll system. Based on a 40 hour work-week.

The City Pays Overtime to AMSP Employees Who Also Receive Executive Leave

Certain salaried[14] employees receive between 1 and 10 days of executive leave. Executive leave is provided to salaried employees or granted as part of the Management Performance Program as recognition of outstanding performance. Per City policy 4.2.4, executive leave is paid leave available to **employees who are not eligible for overtime**. Executive leave is a benefit provided in recognition of the many hours in excess of forty (40) hours per week, which may be required but are not directly compensated on an hourly basis. However, per the agreement between AMSP and the City, employees represented by AMSP can receive up to 40 hours of executive leave, **in addition** to getting overtime and comp time. For 2009-10, AMSP employees were compensated an additional $245,000 in combined overtime and comp time. During the same period, some AMSP employees were also compensated over $20,000 in executive leave. In our opinion, paying overtime to potentially exempt employees also receiving executive leave is contrary to the purpose of executive leave and should be discontinued.

[14] This assumes that salaried employees are exempt under FLSA. FLSA does not preclude an employer from paying overtime to salaried employees.

The City Pays Overtime to Some Presumably Exempt Employees

Some City supervisory positions, like Battalion Chiefs, employees represented by AMSP, and Police Captains receive overtime but may be exempt per the FLSA. Our cursory review of the job specifications of some City positions found that at a minimum, the City could save more than $1 million in one year[15] if it were to successfully eliminate overtime and comp time eligibility for positions that are likely exempt from FLSA.

Exhibit 20: Potential Overtime Cost Savings

Job Position	Job Duties	Overtime/Comp time Compensation in 2009-10
Battalion Chiefs	Supervising personnel and equipment in routine and emergency conditions; maintaining discipline and morale; commanding the respect of superiors and subordinates.	$713,000
Members of Association of Maintenance Supervisory Personnel (AMSP)	Assigns and directs the completion of custodial maintenance projects […] and assigns staff; requisitions materials, supplies and repair parts. **OR** Plans, organizes and directs carpentry, painting, plumbing and custodial sections in the construction, maintenance and repair of Convention and Cultural Facilities, Airport, and other City facilities.	$245,000
Police Captains	Managing major criminal investigations and major field incidents and criminal investigations which involve sensitive issues such as officer involved; managing major projects and programs; preparing the bureau's management reports and annual budget plans; managing personnel and staffing of a bureau/division (inter-bureau and intra-bureau) and providing in-service leadership and management training for subordinate command officers.	$203,000

Source: Auditor summary based on the City's job specifications.

We found that even though many of the government employers we surveyed operated in a similar manner as the City of San José, some were more restrictive. For example, while Battalion Chiefs in some jurisdictions earn overtime like their counterparts in San José, Battalion Chiefs for the City of Santa Clara do not earn overtime. Nonetheless, a comparison of the job specifications of the Battalion Chief position at the City of Santa Clara with those of the City of San José reveals similarities. For instance, key abilities for the Santa Clara position requires the ability to "*direct, schedule, evaluate, and train subordinates.*" Similarly, San José Battalion Chiefs are expected to be able to "*supervise personnel and equipment in routine and emergency conditions.*" Both job specifications list the key ability to maintain discipline and morale. However, the San José's Battalion Chiefs are eligible for overtime whereas the City of Santa Clara's are not.

[15] The amounts only reflect active employees and does not include potential future liability from comp time accruals. The savings in overtime may be reduced by providing these employees with executive leave.

With respect to police positions, SJPD Captains are eligible to receive overtime while their counterparts in the City of Santa Clara, the City of Fresno, the County of Santa Clara, and the City of Fremont did not earn any overtime.[16]

Potential Inconsistent Overtime Eligibility Terms Within the City

Within the City, we found similar classifications that had different overtime eligibility terms. For instance, based on their job duties and the fact that they are represented by AMSP, which is a supervisorial employee unit, we believe that AMSP employees should be treated the same as other management/professional positions within the City that are not eligible for overtime. Another example of inconsistency is the job specifications for Analyst I/II which are similar to those of Executive Analyst I/II, but the former is overtime-eligible and the latter is not. In some cases, incumbents even work together in the same work groups. These potential inconsistencies present potential inequities in compensation.

One of the purposes of an FLSA overtime review is to determine whether, based on the job duties, a specific classification is overtime exempt or not. According to HR, the City performs FLSA reviews only when new classifications are introduced. We did not find evidence that an FLSA review for existing positions has ever been done. The first step in determining whether a position is subject to FLSA or is exempt from FLSA overtime requirements is reviewing job specifications. After considering the job specifications, employers should also review what employees actually do – job specifications do not necessarily align with what people do on a day-to-day basis. The final step would be to conduct an audit of job positions to ensure that the specifications actual duties are being appropriately classified as FLSA exempt/non-exempt.

Overtime Provisions That Exceed FLSA Requirements Add to the City's Costs

As discussed above, the City of San José exceeds FLSA requirements, and consequently added $245,000 in combined overtime and comp time for salaried employees who also received executive leave, and over $900,000 for Battalion Chiefs and Police Captains.

The agreed upon overtime provisions that exceed FLSA requirements are part of the City's compensation and benefits package. Any changes to contract provisions may require labor negotiations.

In our opinion, if the City continues to exceed FLSA requirements, it should publicly identify and disclose the excess costs. Transparency regarding the cost of these practices is essential when comparing compensation packages to those of other government employers, and for decision-making by both the City and its employees.

[16] Based on auditor review of publicly available overtime data for 2009 and Auditor's compensation survey.

Recommendation #2: To reduce the cost of overtime, the City should (1) conduct a Citywide FLSA overtime review or at a minimum review job specifications for specific positions and whether they would qualify for an FLSA overtime exemption; (2) pursue reductions in overtime to align with FLSA requirements (including but not limited to calculating overtime on hours worked, not paying overtime to exempt employees, and not paying overtime to employees receiving executive leave); and (3) prepare full cost estimates of contract provisions that exceed FLSA provisions.

Chapter 4 Paid Leaves Are A Significant Cost to the City

Chapter Summary

Our discussion of the City's compensation costs would be incomplete without consideration of the significant costs associated with paid leaves. Like other large employers, the City of San José offers its employees a variety of paid leaves including City holidays, sick leave, vacation leave, personal leave, and executive leave. In addition, when needed, the City allows employees to take emergency paid leaves like bereavement leave, and funeral leave.

In total, paid leaves account for a significant portion of the City's compensation package. Between 2000-01 and 2009-10, City employees' paid leaves have consistently accounted for between 13 and 15 percent of total cash compensation. In 2009-10, paid leaves totaled almost $85 million – 13.2 percent of Citywide pay. Besides cash compensation, another cost associated with paid leave is lost productivity when employees are not at work. We estimate that each day of leave that is granted to the entire full-time workforce will cost the City about $1.9 million in 2011-12. Given these costs, the City may need to reconsider certain aspects of its paid leave benefit, and should include paid leaves in any discussion of total compensation.

The City Offers a Variety of Paid Leaves

The City offers different types of annual paid leaves. For full-time employees, this includes 14 paid holidays, between 10-25 days of paid vacation leave[17] (depending on employee unit and number of years with the City), and 12 days[18] of sick leave. In addition, some employees receive up to 5 days of personal/executive leave[19] on an annual "use-it or lose-it" basis.

Exhibit 21 shows the number of days available to each bargaining unit.

[17] 5 – 12 shifts (120-288 hours) for IAFF (24-hour shift) employees.

[18] 5.6 shifts for IAFF (24-hour shift) employees.

[19] Some management/professional employees may receive up to 5 additional days of executive leave that can be granted in recognition of exceptional performance. Also, some overtime eligible employees can accrue up to 480 hours of compensatory (comp time).

Exhibit 21: Paid Leave Terms Vary by Employee Unit and Seniority (in days)

Leave Types	Service Years	ABMEI, MEF, IBEW, OE3, CEO, Unit 82	AEA, ALP, AMSP, CAMP, Unit 99	POA*	IAFF (40 hours)	IAFF (24-Hour Shift)*	Total Range (Excluding IAFF 24-Hour Employees)	
							Min	Max
Vacation	0 - 5	10	15	10	10	5	10	15
	6 - 10	15	20	15	15	7	15	20
	11 - 12	17	20	17.5	17	8	17	20
	13 - 14	19	20	20	19	9	19	20
	15 +	21	25	22.5	25	12	21	25
Holidays	all	14	14	-	-	-	14	14
Personal/Executive Leave	all	3[20]	5[21]	0	0	0	0	5
Sick	all	12	12	12	12	5.6	12	12

Source: Compiled by Auditor from reviews of labor contracts and compensation summaries.

*POA and IAFF employees receive additional cash compensation in exchange for the likelihood that they may be scheduled to work on City holidays.

As Exhibit 21 above shows, paid leaves including sick leave for a City employee can range from 36 to 51 days, with additional personal and executive leave which can range from 2 to 10 days for eligible employees.

As a result of these standard paid leave offerings, a Unit 99 employee with 15 years experience could be away from work on paid leave more than 23 percent of the time (61 days).

A MEF employee with 6 years of City service would receive 18 days of combined vacation and personal leave, 12 days of sick leave and an additional 14 paid holidays (a total of 44 days).[22] We found that this is higher, but not out of line with other comparable jurisdictions which provide a similarly situated employee between 33 to 43 days of paid time off.

[20] OE3 employees are eligible for 16 hours of personal leave.

[21] AMSP employees are eligible for 16 hours of personal leave and up to 40 hours of executive leave. AEA, ALP, CAMP, and Unit 99 employees may receive an additional 40 hours also.

[22] A MEF employee with 15 years of service would receive 50 days.

Exhibit 22: Comparison of Paid Time Off in Comparable Jurisdictions

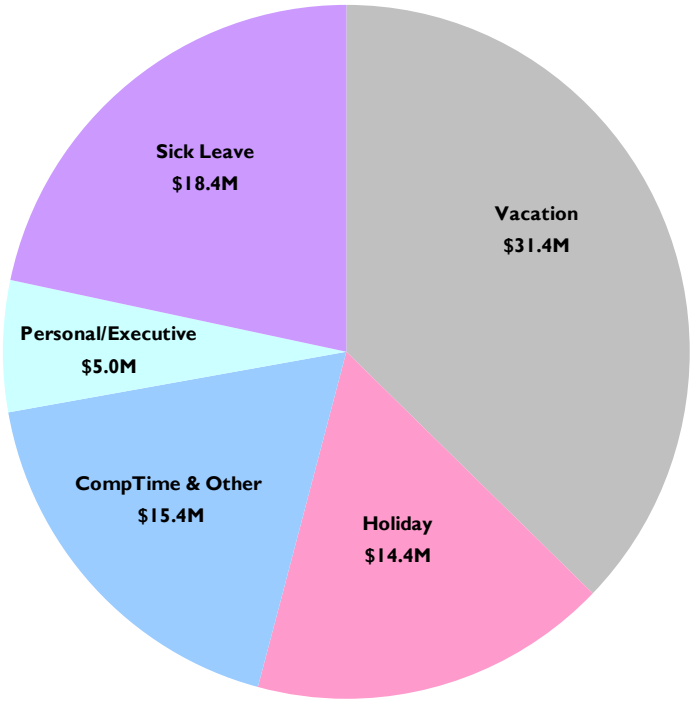
Public Sector Employer	Hours Offered to Typical Civilian Employees with 6 Years of Service				
	Holidays	Sick	Vacation	Discretionary	Total
City of San Diego	10	0	0	23	33
City of Fremont	11	0	0	28	39
City of Fresno	10	12	15	3	40
City of Long Beach	9	12	15	4	40
City of Sacramento	12	12	15	2	41
City of Santa Clara	14	12	15	1	42
City of Los Angeles	12	12	17	2	43
City & County of San Francisco	11	13	15	4	43
CITY OF SAN JOSÉ	**14**	**12**	**15**	**3**	**44**

Source: Auditor summary of surveys and labor agreements of comparable jurisdictions. Discretionary leaves include personal time, floating days off, and compensatory time off.

Paid Leaves Cost Almost $85 Million in FY 2009-10

In total, paid leaves account for a significant portion of the City's compensation costs. Between 2000-01 and 2009-10, City employees' paid leaves have accounted for between 13 and 15 percent of total pay. In 2009-10, paid leaves totaled almost $85 million, or 13.2 percent of Citywide cash compensation. We estimate that a single paid leave day costs the City about $1.9 million. As shown in Exhibit 23, various types of leaves accounted for the City's leave costs.

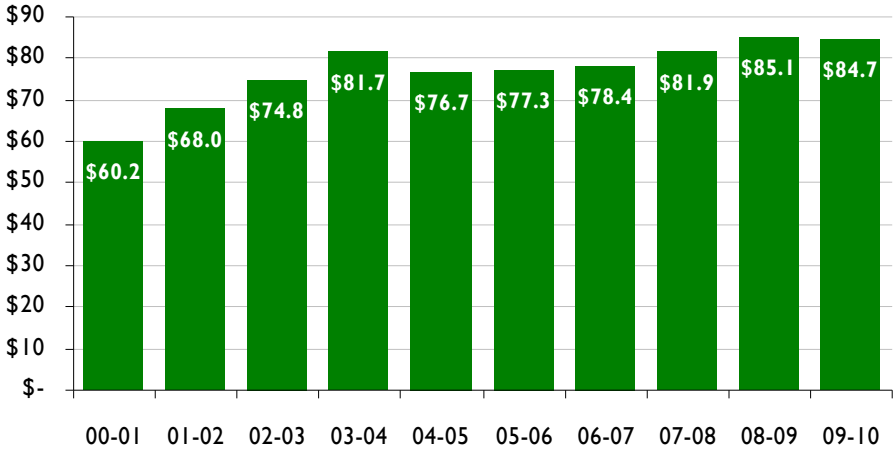
Exhibit 23: FY 2009-10 Paid Leave Compensation by Type



Source: Compiled by Auditor using actual PeopleSoft payroll data.

Exhibit 24 shows actual compensation for paid leave increased from $60.2 million to $84.7 million, or 40 percent, from 2000-01 and 2009-10. Possible reasons for the increase include the addition of one new holiday (Cesar Chavez Day was added as a paid holiday in 2002). Otherwise, it appears that the increase in costs is associated with salary increases and, potentially, average tenure of employees (employees with more years of service earn more vacation leave).

Exhibit 24: Citywide Paid Leave Costs
(in millions)



Source: PeopleSoft payroll data

The City's Vacation Leave Allotment Varies by Employee Unit and Years of Service

The City provides employees with annual allotments of paid vacation leave. This leave varies by employee unit, employment status and years of service. In general, as employee longevity increases, so does the annual allotment of vacation. Vacation time has accounted for over $31 million in cash compensation in 2009-10 alone.

Vacation leave accrues and carries over year-to-year, but employees cannot accrue more than double their annual allotment. Once employees reach their limits, vacation hours stop accruing. For example, under the existing agreement between the City and MEF, a new fulltime MEF employee accrues 10 days of paid vacation leave during the first year, but receives accelerated accrual formulas after 5-, 10-, 12- and 14- year anniversaries. By the time an MEF employee reaches 15 years, s/he accrues 15 days of paid vacation in one year, and is eligible to accumulate up to 30 days.

The City Is Changing Its Vacation Sell-Back Program

The City provides a vacation sell-back option to ALP, AEA, AMSP, CAMP and Unit 99 employees. Depending on their employee unit, these employees can sell back between 96 and 120 hours per year. As of January 2011, barely halfway into FY 2010-11, the City has already issued over $2.5 million in vacation sell backs. Employees sold back nearly $2.7 million worth of vacation in 2009-10. Recognizing this potential cost, the City is currently pursuing a phase-out and elimination of the vacation sell back program. For 2012, the City proposed, and most affected employee units have agreed to reducing the number of hours that employees are eligible to sell back and completely eliminating the program by 2013.

Per California law, the City must also pay out unused vacation leave when employees terminate employment. For example, in 2009-10, the City paid nearly $4 million in vacation leave payouts to employees who separated from the City.

The City Provides More Paid Holidays than Many Other Employers

When compared to other employers, we found the City's 14 paid holidays is the most generous aspect of the paid leave offerings. According to the Bureau of Labor Statistics' March 2010 National Compensation Survey, in 2010, the median and mean number of paid holidays provided by West Coast public-sector employers was 12. The number of paid holidays provided by the four private sector employers we interviewed ranged between 10 and 12 per year.

Each paid City holiday presents additional costs through higher holiday in-lieu premiums. Furthermore, holidays can indirectly drive up the City's vacation liability. For example, if the City chose to designate only Thanksgiving Day as a holiday and eliminate as a City holiday the day after Thanksgiving, we believe that many employees would elect to use vacation leave, personal leave or comp time rather than work on that day, hence lowering the City's future vacation payouts.

When considering its total compensation package, the City may want to consider adjusting its vacation and/or personal leave offerings in acknowledgement of the extra leave City employees receive as a result of having more holidays than are granted elsewhere.

Private Employers Offer Fewer Paid Days Off than the City

We found that in general, government employers' paid leave offerings are far more generous than those provided by private sector employers. Specifically, we found that the four private entities we surveyed offer between 22 and 35 days of annual paid leave compared to 33 to 44 days of paid leave for public employers for a typical six-year employee. These include a combination of vacation, holiday, personal/executive, and sick leave.

The City's Paid Leave Increases Cash Compensation[23]

As shown above, paid leaves cost the City nearly $85 million or 13 percent of the total cash compensation. We estimate that each day of paid leave represents almost $1.9 million, when granted to all City employees, and that each leave day is a potential opportunity to redirect employee resources to perform valuable services on behalf of the City. We also found that the City may be underestimating vacation leave while calculating total compensation. In our opinion, including total eligible paid time off in the calculation of total compensation would provide employees and the City with better information about the true cost and structure of employee compensation.

Recommendation #3: We recommend that the City include eligible paid time off in calculations of total compensation, and consider aligning paid leaves, particularly holidays, with other comparable employers.

[23] Because the City's sick leave program is under review we did not analyze the cost of changing to a Paid Time Off program like many private employers offer.

Chapter 5 Sick Leave Payout Costs Have Quadrupled

Chapter Summary

The City provides cash payouts for some types of unused accumulated leave including sick leave, vacation leave and comp time. Since 2000-01 the costs of these payouts have grown dramatically. In particular, between 2000-01 and 2009-10 sick leave payouts have nearly quadrupled. We estimate the City's sick leave liability is more than $20 million.[24] Sick leave payouts are a benefit offered to employees upon retirement from City service with a minimum number of years and after vesting in the City's retirement. For civilian employees this period is 15 years. For sworn employees it is 20 years. In light of increased cost and the fact that San José's sick leave payouts are considerably more generous than comparable employers, we believe the City Council should take steps to reduce its costs. Cost-containment reforms to the City's sick leave payouts may include capping the amount of sick leave that Police and Fire employees can cash out upon retirement from the City, or eliminating sick leave payouts altogether.

Sick Leave Payouts Have Increased Significantly

Between 2000-01 and 2009-10, the City has made sick leave payouts to over 1,000 eligible City retirees. Police and Fire payouts are significantly larger than the payouts for civilian retirees. In 2009-10, Police and Fire employees' average sick leave payouts were about $80,000 and $60,000 respectively as compared to an average of $48,000 for managers/professional employees and $10,000 for civilian/non-management employees.

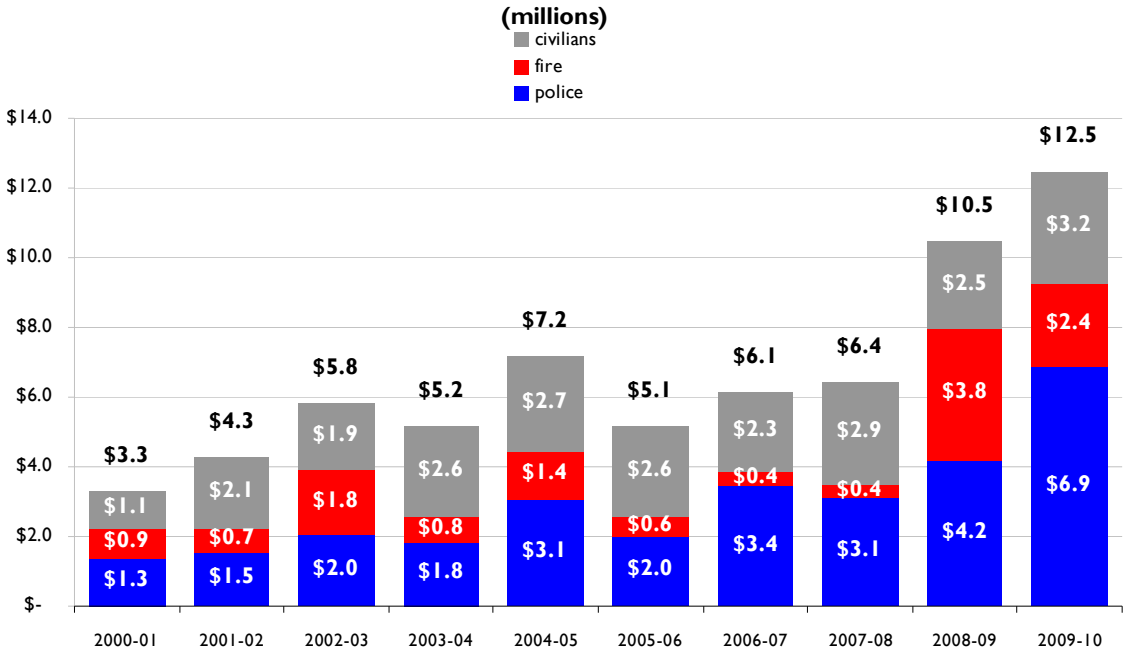
The differences in the sworn and civilian payouts is driven in part by the different pay rates for these two groups; sworn employees tend to have higher hourly rates than their civilian counterparts. In addition, Police and Fire employees on average, carry higher sick leave balances. As of January 2011, the average sick leave balance among Fire employees was 632 hours, the average sick leave balance among Police employees was 679 hours[25], and the average sick leave balance for all other City employees was about half that –344 hours.

The differences in the payouts is illustrated in Exhibit 25 which shows the distribution of sick leave payouts from 2000-01 to 2009-10 by employee type.

[24] Calculated from the accumulated sick leave hours of retirement eligible employees.

[25] Higher sick leave balances for sworn employees may be due to their alternative work schedules and access to compensatory time.

Exhibit 25: Growth in Sick Leave Payouts



Source: PeopleSoft payroll data.

Enhanced Payout Provisions

Some of the cost of sick leave payouts was rooted in past enhancements that triggered long lasting costs – particularly for sworn retirees. In 1992, the City enhanced sick leave payouts for Police and Fire retirees who could become eligible to receive the total of 100 percent of unused accrued sick leave at their outgoing hourly pay rates from the original limit of 80 percent (civilians are limited to payouts equal to 75 percent of their unused hours at outgoing pay rates).

The City also enhanced sick leave payout terms for management/professional employees represented by AMSP, and CAMP providing additional payouts for hours earned in the last two years of employment extending the maximum cap to 1,392 hours. This enhancement to the sick leave payout was later extended to employees in Unit 99 (which included ALP members) and AEA members. This benefit enhancement was not accompanied with publicly-disclosed, long term cost projections. The effect of the enhancements, especially for sworn employees, is apparent as shown in Exhibit 25.

Purpose of Sick Leave

According to Section 4.2.6 of the City Policy Manual, sick leave is for use when an employee is required to be absent from work on account of non-job related, illness or injury; routine medical or dental appointments; illness in the immediate family as defined herein, or absence of an eligible female employee due to illness,

injury or disability related to pregnancy or childbirth, for job-related illness or injury if the employee is medically required to be absent from work. In essence, sick leave is intended to serve two purposes: 1) it provides a measure of financial security during periods of illness or injury, and 2) it protects the health and safety of employees and co-workers.

We assume that the purpose of the sick leave payout was to minimize sick leave abuse, but the City already has rules in place to guard against abuse. And in our opinion, the cost of the payouts far exceed the potential benefit in reining in potential abuse.

As shown earlier, the cost of the program has been growing. The millions the City spends annually on sick leave payouts threaten the City's ability to fund other personnel-related costs – like current employee salaries which are tied to City services.

San José's Sick Leave Payouts Are More Generous than Those of Other Government Employers

Through the sick leave payout program, the City pays eligible employees upon retirement, up to the full value of their accumulated unused sick leave at the outgoing hourly rate. Sick leave provisions vary by employee unit with most employees eligible to be paid out up to 1,200 hours of accumulated sick leave at their final payrate. In contrast, sworn employees can be paid out for all their sick leave with no limit on the number of hours. The City calculates sick leave payouts on total accruals and wage rate at service separation even if leave has been accrued at lower wages. Exhibit 26 below shows the differing sick leave payout provisions for sworn and civilian employees.

Exhibit 26: Various Sick Leave Payout Provisions Across the City

Employee Type	Hours	Payout	Maximum allowable	Eligibility[26]
AMBEI, CEO, IBEW, MEF, OE3	Less than 400 hours 400-799 hours 800-1200 hours	Hours accumulated X 50% of final hourly rate Hours accumulated X 60% of final hourly rate Hours accumulated X 75% of final hourly rate	1200 hours	15 years
AEA, ALP, AMSP, CAMP, and Unit 82 and 99	Less than 400 hours 400-799 hours 800-1200 hours	Hours accumulated X 50% of final hourly rate Hours accumulated X 60% of final hourly rate Hours accumulated X 75% of final hourly rate	1200 hours + 75% of the value of sick leave in excess of 1,200 hours that is earned but unused during the two (2) years prior to retirement	15 years
Police	Less than 400 hours 400-799 hours 800-1200 hours More than 1200 hours	Hours accumulated X 50% of final hourly rate Hours accumulated X 60% of final hourly rate Hours accumulated X 80% of final hourly rate Hours accumulated X 100% of final hourly rate	No Maximum	20 years
Fire (Regular 40 hour)	Less than 400 hours 400-799 hours 800-1200 hours More than 1200 hours	Hours accumulated X 50% of final hourly rate Hours accumulated X 60% of final hourly rate Hours accumulated X 80% of final hourly rate Hours accumulated X 100% of final hourly rate	No Maximum	20 years
Fire (24-hour shift)	Less than 560 hours 561-1120 hours 1121-1680 hours More than 1680 hours	Hours accumulated X 50% of final hourly rate Hours accumulated X 60% of final hourly rate Hours accumulated X 80% of final hourly rate Hours accumulated X 100% of final hourly rate	No Maximum	20 years

Source: Auditor summary of various MOAs and employment contracts. (Note that sick leave payouts for sworn employees who retire on a service-connected disability are reduced by 25 percent for Police and 20 percent for Fire).

Other Comparable Employers Do Not Provide Sick Leave Payouts Like San José's

Some employers, including the City of Fresno, City of Sacramento and the City of Long Beach do not offer any payouts for unused sick leave, and none of the private-sector employers we surveyed offered them. Further, those employers

[26] In general a terminated employee (according to most MOAs) also has to qualify for retirement to qualify for the sick leave payout. The Police and Fire payout is slightly different. A member of the Police and Fire plan has to retire under the provisions of the retirement plan and be credited with at least twenty years of service in the retirement plan or with any service prior to a service connected disability. In addition, if an employee is terminated, the employee has to have terminated the service with the City in good standing, retained vesting rights in a retirement system according to the provisions of the San José Municipal Code and qualifies for retirement.

that offer sick leave payouts do not provide the level of payout that City of San José provides. Exhibit 27 below summarizes the various sick leave payout provisions at comparable public sector employers.

Exhibit 27: Comparison of Sick Leave Payout Benefits

City	Minimum Tenure	Formula	Maximum Payout and Other Details
City of Los Angeles	None	Final hourly rate X sick leave balance X 50%	No maximum payout, but sick leave accrual is limited to 800 hours for sworn and for others
City of Fresno	5 years (must be retirement eligible)	Percentage of accumulated sick leave put in a health reimbursement arrangement account for use in paying medical insurance premiums.	None. 40% of accumulated sick leave in excess of 240 hours
City of Santa Clara	15 years for regular employees	25 years-75% of accumulated sick leave X final hourly rate 20 years- 50% of accumulated sick leave X final hourly rate 15 years- 25% of accumulated sick leave X final hourly rate**	1,500 hours and 3000 hours for 24 hour employees
City of Sacramento	20 years	33.33% of total sick leave hours accrued towards PERS service credit.	Only for employees hired before June 30, 2005. No payout for those hired after.
County of Santa Clara[27]	10 years	1)Years of service X 2% 2) First 480 hours paid at 25% value, beyond 480 hours at 12%	1)Max 50% value
City & County of San Francisco	None	2.5% X sick leave balance X years of service.	Only for sworn. 1,040 hours or 1,272 hours for 24-hour shift employees. Ended this practice for others on 6/30/10.
City of Fremont	Provides combined sick and vacation leave.	Employees are eligible to take up to 1040 hours sabbatical.	N/A
City of San Diego	None	Final hourly rate X sick leave balance	350 hours

Source: Auditor summary of compensation survey results

As shown above, the City & County of San Francisco eliminated sick leave payouts for civilian employees in 2009-10. According to San Francisco's HR, the program was eliminated in recognition that sick leave payouts were a significant liability. Even though the City saw a spike in retirements due to the change in the provisions, it felt that the long-term benefit of making this change far outweighed the short-term costs. The payout benefit offered by San Francisco for its sworn staff was more generous than those offered by some local governments we surveyed. Still, its payout was far less generous than that the City of San José offers its sworn staff. San Francisco determines sick leave

[27] Formula depends on the employee group that the employee belongs to.

payouts by multiplying 2.5 by the years of service by the number of unused accrued sick leave hours, hence an employee with 30 years of service would be eligible for a payout equal to 75 percent of the value of her/his unused sick leave.

Reducing or Phasing Out the Sick Leave Payout Program Presents a Significant Cost-Saving Opportunity for the City

As described above, the City has generous sick leave payouts. As of March 2011, we estimate the Citywide sick leave liability for employees eligible to retire within one year exceeds $20 million. Eliminating the sick leave payout would completely eliminate this liability; however, even extending to sworn employees the sick leave payout terms currently available to civilian employees, could save more than $3 million in one year (depending on actual retirements).

Any changes to the sick leave payout program may be subject to labor negotiations. The City has proposed changes to the formula for some employee units; however no further changes have been agreed to as of the writing of this report.

Recommendation #4: To reduce costs, the City Council should consider eliminating or reducing the sick leave payout. If the City decides to leave a payout option for employees and caps the total payout, disclose the expected costs of the remaining benefit over the long-term.

Chapter 6 Premium Pays Impair Transparency and Have Triggered Additional Costs

Chapter Summary

On top of base pay which compensates for regular job duties, the City of San José offers premium pays to some employees who take on special assignments, or possess useful skills or professional certifications beyond the requirements of their positions. Examples of premium pays include "canine pay" for police officers who accept the added responsibilities required of a canine officer, or "bilingual pay" for employees who can be called upon to utilize their language competencies to serve community members. Between 2000-01 and 2009-10, premium pays have consistently constituted a significant share of total cash compensation. In 2009-10 alone, City employees collected about $28 million in miscellaneous pays, the bulk of which were premium pays. We found that:

- Some premium pays may overly compensate for required job skills;
- Premium pays obscure actual compensation;
- "Rolling in" premium pays into base pay increases overall compensation costs; and
- Peace Officer Standards and Training (POST) premium pay implementation is costly.

While premium pay warrants close scrutiny, in our opinion, changes to premium pays should be considered in the overall context of total compensation. In our opinion, rolling premiums into base pay is essential to simplifying the City's compensation structure, however roll-ins are rarely cost-neutral and the cost of roll-ins should be publicly disclosed. Changes to premium pays may require labor negotiations.

Some Premium Pays May Overly Compensate for Required Job Aspects

The City provides premium pays for various skills that enhance employees' performance. However, many premium pays compensate employees for job-required skills. Examples of the latter include EMT pay for sworn Fire employees, and anti-terrorist pay for sworn employees. In some instances the City provides premium pays as an incentive to achieve a recently changed job requirement.

Premium pay for Fire employees who obtain their Emergency Medical Technician (EMT) certification was originally instituted as an incentive to obtain EMT certification. However, the current job specification for a firefighter **requires** this certification. Specifically, the City's Human Resources job specification for a firefighter position states: *"Incumbents are **required** to obtain Emergency Medical*

Technician (EMT) certification prior to completing probation and must maintain current EMT certification thereafter." The 2009-10 cost of providing this premium pay to Fire employees for this job requirement is $2 million. We also found that all sworn Fire employees are receiving anti-terrorist pay which in FY 2009-10 totaled nearly $1.5 million.

We found some civilian employees receive $40 per pay period in premium pay for maintaining a class A/B drivers license. In total, the City paid over $220,000 in Class A/B license premium pays in FY 2009-10. Among the classifications eligible for this premium pay are heavy equipment operators who according to their job specifications, *typically operate a 15-ton truck crane, 20-ton tractor and tilt trailer on grade-all, operating a motor grader to set crowns for roads and streets, to finish grade bottoms, dry lagoons and to repair roads and dikes and operating a chip spreader for sealing streets*. According to HR's job specifications, a **minimum** qualification for heavy equipment operator is *possession of a valid State of California Class A driver's license with applicable endorsements*.

Private sector companies we interviewed generally do not provide premium pays. Base pay reflects the employer's acknowledgement of the job required skills. In addition, we found that some of the widely used premium pays available to City employees were not provided by other government employers. For instance, we found that the City of Santa Clara, does not offer its Police employees premium pay for POST certifications. It is rolled into the base salary. In our opinion, the City should review and update its current policy of paying employees for minimum job-required skills.

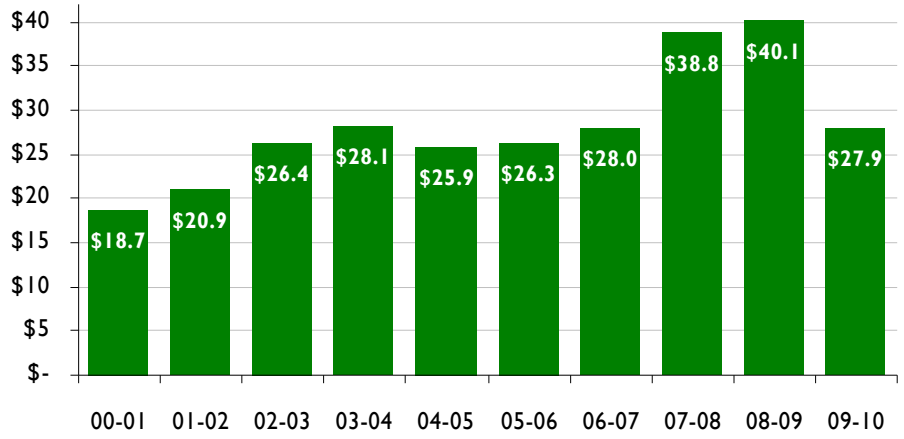
Premium Pays Obscure Total Compensation

Base pay is supposed to be a transparent measure of compensation for specific job classifications. However, because of the increasing use of premium pays, comparing base pay with other comparable jurisdictions is increasingly difficult. Premium pays constituted about 4 percent of City employees' earnings in 2009-10. However, premium pays accounted for a higher portion of Police and Fire employees' earnings—7 percent and 12 percent respectively.

During our review, we attempted to compare the City's base salaries with those of other jurisdictions, but could not accurately do so because of the extent to which some premium pays make up some employees' cash compensation. The exhibit below illustrates the additional costs of premium pays since 2000-01. We should note that the 2009-10 decrease in premium pay was largely due to rolling in the anti-terrorist and holiday-in-lieu premium pays for Police employees.

Exhibit 28: Citywide Premium Pays from 2000-01 to 2009-10

(in millions)



Source: Compiled by Auditor using PeopleSoft data

"Rolling In" Premium Pays Into Base Pay Has Increased Overall Compensation Costs

As discussed above, eliminating the "premium" aspect of some compulsory job aspects is generally a good idea on the grounds of transparency. The City Administration has recognized this need and has "rolled-in" some pays that are generally provided to all employees in a particular employee unit. These include the anti-terrorist pay and holiday-in-lieu pay for Police employees. However, we found that rolling in certain pays into base pay causes compounding effects and reduces the overall cost effectiveness of this practice. In our opinion, even though rolling in premium pays to ensure transparency is generally a good practice, the City Administration should explicitly disclose the cost impacts of such "roll-ins" and factor the compounding effects into overall compensation.

Anti-Terrorist Training Pay

Between 2002 and March 2009, Police employees received 5-percent premium pay for completing required anti-terrorist training. In 2009, the City and POA agreed to stop classifying anti-terrorist training as a premium pay and rolled it into base pay.[28] This essentially increased every Police employee's base pay by 5 percent, which increased all other compensation calculated from base pay. We estimate that due to the compounding effects of rolling in anti-terrorist training pay, the City paid $660,000 in additional premium pays and over $575,000 in additional leave payouts through fiscal year 2009-10 alone, for a total of about $1.2 million.

[28] Per the contract between the City and POA, effective March 22, 2009, the 5% Anti-Terrorist Training pay will be rolled into base pay in recognition of the additional training that all employees represented by the POA receive related to Police Anti-Terrorist Tactics.

Exhibit 29: Estimated Impact of "Rolling-in" Police Anti-Terrorist Training Pay through FY 2009-10

Compensation Type	Actuals Incurred through 2009-10 After Anti-Terror Roll-in	Estimated Costs If Roll-in Had Not Occured	Estimated Roll-in Costs
Bomb Duty (5% of base pay)	$83,060	$79,105	$3,955
Canine Duty (5% of base pay)	$124,269	$118,351	$5,918
Holiday In Lieu* (5.623% of base and POST)*	$2,175,111	$2,071,534	$103,577
MERGE Duty (5% of base pay)	$150,145	$142,995	$7,150
Motorcycle Duty (5% of base pay)	$258,979	$246,647	$12,332
Advanced POST* (7.5% of base pay)*	$9,667,503	$9,207,146	$460,357
Intermediate POST* (5% of base pay)*	$937,091	$892,468	$44,623
Training Duty (5% of base pay)	$454,683	$433,031	$21,652
Leave Payouts	$12,078,977	$11,503,788	$575,189
TOTAL ROLL-IN EFFECT ON CASH COMPENSATION			**$1,234,753**
TOTAL ROLL-IN EFFECT ON RETIREMENT CONTRIBUTIONS			**$157,008**

Source: Auditor analysis of actual FY 2009-10 PeopleSoft payroll data and contract terms between POA and the City.
*Denotes pensionable compensation

Furthermore, although the anti-terrorist pay itself was already pensionable, by rolling in anti-terrorist premium pay, the City has and will continue to incur higher retirement contributions because some **affected premium pays** were pensionable. We estimate this roll-in cost $157,000 in additional retirement contributions in 2009-10. In addition, the City has and will continue to incur higher overtime, not only because overtime rises proportionately with base pay, but also because it is also calculated from some affected premium pays.

Holiday In-Lieu Pay

Similar to the above described anti-terrorist premium roll-in, in 2009 the City rolled into base pay a 5.623-percent Holiday In-Lieu premium for POA members. As a result of this roll-in, the City incurred the additional costs associated with increasing base pay as discussed above. We estimate that for FY 2009-10 alone, the costs of rolling holiday in-lieu into base pay include over $486,000 in additional premium pays and $582,000 in additional leave payouts through fiscal year 2009-10 alone, for a total of nearly $1.1 million, with significantly higher pension ($119,000 per year) and overtime costs.

Exhibit 30: Estimated Impact of Rolling in Police Holiday In-Lieu Pay through FY 2009-10

Compensation Type	Actuals Incurred through 2009-10 after Holiday In-Lieu Roll-in	Estimated Costs if Roll-in Had Not Occured	Estimated Roll-in Costs
Bomb Duty (5% of base pay)	$62,632	$59,298	$3,334
Canine Duty (5% of base pay)	$97,738	$92,534	$5,203
MERGE Duty (5% of base pay)	$118,151	$111,861	$6,290
Motorcycle Duty (5% of base pay)	$206,209	$195,231	$10,978
Advanced POST* (7.5% of base pay)*	$7,591,455	$7,187,312	$404,143
Intermediate POST* (5% of base pay)*	$732,266	$693,282	$38,983
Training Duty (5% of base pay)	$332,488	$314,788	$17,701
Leave Payouts	$10,936,155	$10,353,952	$582,203
TOTAL ROLL-IN EFFECT ON CASH COMPENSATION			**$1,068,834**
TOTAL ROLL-IN EFFECT ON RETIREMENT CONTRIBUTIONS			**$119,157**

Source: Auditor analysis of actual FY 2009-10 PeopleSoft payroll data and contract terms between POA and the City.
*Denotes pensionable compensation

Impact on Pay

In order to more clearly illustrate the compounding effects of rolling in pays into base pay, Exhibit 31 below outlines key compensation components of a hypothetical police officer before and after the anti-terrorist and holiday-in-lieu premium pays were rolled in. In this example, the employee's earnings increased by more than $3,700 or 2 percent after the roll-in.

Exhibit 31: Hypothetical Police Officer's Annual Compensation With and Without "Roll-ins" of Anti-Terrorist and Holiday In-Lieu Premium Pays

Compensation Type	Compensation Totals	
	Without Roll-ins	With Roll-ins
Base Pay and Paid Leaves*	$104,000	$115,340
Anti-Terrorist Pay (5% of base pay)*	$5,200	$0
Holiday In-Lieu Pay (5.623% of base and POST)*	$6,287	$0
MERGE Duty (5% of base pay)	$5,200	$5,767
Advanced POST (7.5% of base pay)*	$7,800	$8,651
TOTAL CASH COMPENSATION	$128,487	$129,758
RETIREMENT CONTRIBUTIONS	$31,808	$31,990
LEAVE BALANCE	$20,800	$23,068
TOTAL COST	**$181,094**	**$184,816**
TOTAL ROLL-IN EFFECT		**$3,721**

Source: Auditor-generated scenario based on labor contract between the City and POA, and terms of the Police & Fire Retirement Plan. Hypothetical employee is a step 5 police officer with an hourly rate of $50 and 416 hours of accrued paid leave. Retirement contribution rates were 25.89 percent of pensionable earnings.

*Denotes pensionable compensation

Potential Costs of Rolling in Other Premium Pays

Rolling in pays is rarely if ever cost neutral because of the effect on other pays, leave payouts, and retirement contributions. As shown above, we estimate rolling two premium pays into Police employees' base pay increased City costs by $2.3 million. Given the desirability of simplifying the City's complex pay structure, we believe negotiations to roll in premium pays should continue, but with the costs explicitly calculated and disclosed.

For example, Fire employees also receive a significant number of the City's premium pays including anti-terrorism pay and holiday in-lieu premiums which cost the City $1.5 million and $4.3 million respectively in 2009-10 alone. We estimate the single-year cost of rolling in these premium pays for Fire employees would exceed $200,000 and $420,000 respectively. Additional costs would result from higher overtime rates from increased base pay and premium pays that factor into overtime.

Exhibit 32: Potential 1-Year Effect of Holiday In-Lieu and Anti-Terrorist Pay Roll-in for Fire Employees

Compensation Type	2009-10 Actual Costs	Holiday In-Lieu Roll-in		Anti-Terrorist Roll-in	
		Total	Extra Cost	Total	Extra Cost
Fire Anti-Terrorist Training (2% of base pay)*	$1,520,373	$1,605,864	$85,491	$0	$0
Holiday In-Lieu (5.623% of base pay)*	$4,257,402	$0	$0	$4,342,550	$85,148
Emergency Medical Technician (3% of top FF base pay)*	$2,103,209	$2,221,473	$118,263	$2,145,273	$42,064
Hazardous Incident Team (5% of base pay)	$46,027	$48,615	$2,588	$46,947	$921
Paramedic Support	$362,604	$382,993	$20,389	$369,856	$7,252
Urban Search & Rescue (5% of base pay)	$83,899	$88,617	$4,718	$85,577	$1,678
Leave Payouts	$3,436,156	$3,629,371	$193,215	$3,504,879	$68,723
POTENTIAL ROLL-IN EFFECT ON CASH COMPENSATION			**$424,664**		**$205,786**
POTENTIAL ROLL-IN EFFECT ON RETIREMENT CONTRIBUTIONS			**$101,253**		**$36,014**

Source: Auditor analysis of actual FY 2009-10 PeopleSoft payroll data and contract terms between IAFF and the City.
*Denotes pensionable compensation

Moreover, because some of the affected premium pays that would be affected by such roll-ins are pensionable (EMT pay for example), the City's retirement costs would also be higher. Lastly, we conservatively estimate that should such hypothetical roll-ins occur, the immediate effect to leave balances would present well over $1 million in additional costs in the future.

In our opinion, if the City were to decide to roll-in certain pays for Fire employees, the City should consider the compounding impact to other pays, and reduce compensation or discount other premium pays accordingly.

Publicly Disclosing Long-term Cost Estimates

Before agreeing to changes to premium pays (including roll-ins), OER enlists the CMO Budget Office to estimate the budgetary impact of proposed changes. In our opinion, providing the long term impacts not only of added benefits but also of any future roll-ins is essential to ensuring that cost-neutrality is maintained, or that resulting pay increases are acknowledged, when making these changes.

Our review of the February 2009 information memorandum provided to Council when the City rolled in the holiday-in-lieu and anti-terrorist training pay for Police employees found that the Administration did not provide a breakdown of the estimated costs of these roll-ins. As shown above, we estimate that rolling in just these two pays essentially increased Police employees' total compensation by over $2 million through FY 2009-10. In our opinion, the Administration should provide a breakdown of these roll-in costs or discount the value of the premium pays in order to maintain true cost-neutrality. Any changes may be subject to labor negotiations.

Recommendation #5: We recommend the City Administration (1) seek to eliminate obsolete premium pays, (2) disclose the direct and indirect costs associated with rolling in premium pays, and (3) consider discounting the value of premium pays to maintain cost neutrality when rolling in premium pays OR identify and disclose the full cost associated with rolling in these premium pays into base pay.

POST Premium Pay Implementation Is Costly

Eligible Police employees receive a 5 or 7.5 percent premium pay for attaining certifications in Peace Officer Standards and Training (POST). We estimate about 82 percent of sworn Police personnel receive POST premium pay. The MOA does not specifically require the inclusion of POST in calculation of other pays, however for many years the City has included POST pay with "base pay" when calculating payouts for vacation leave, sick leave, comp time, and the former holiday in-lieu premium. No other premium pay is treated in this manner. From 2000-01 and 2009-10, we conservatively estimate the additional cost of including POST for calculating payouts and holiday in-lieu exceeds $4 million. Furthermore, we estimate the City incurred over $700,000 in additional retirement contributions over the last decade because POST pay increased the holiday in-lieu premium, which was pensionable. During the 2011-12 negotiations, the City Administration has proposed excluding POST from calculation of separation payouts. Any changes may be subject to labor negotiations.

Recommendation #6: The City should discontinue including POST in its calculation of overtime and leave payouts, or should roll POST pay into base pay on a discounted, cost neutral basis.

Chapter 7 The City Can Improve Transparency In Defining Total Compensation

Chapter Summary

The City compares its compensation packages to those of comparable employers to determine whether it is providing fair and competitive compensation. Such comparisons are an important aspect of the City's labor negotiations. However, there are numerous differences in how compensation is defined across different government employers. These complexities make it difficult to determine whether the City's employees are paid on par with other similar employees in other jurisdictions because every jurisdiction defines total compensation differently.

While the City does include most of the essential components of an employee's earnings in its definition of total compensation, we found that this definition does not include some other important elements of employee cash compensation. These include overtime, budgeted leave accruals, and leave payouts. In our opinion, standardizing and formalizing total compensation and including these other costs would better inform the City and its employees about their total cash compensation and allow the City to make more informed compensation decisions, and would help employees understand and balance the various components of their compensation.

Comparing Compensation with Other Employers

The City compares its compensation packages to those of comparable employers in order to determine whether it is providing fair and competitive compensation. However, oftentimes these comparisons only consider base pay. As we have shown throughout the report, employees are compensated in many different ways beyond base pay. Some of these include overtime, paid leave, payouts for unused leaves, and premium pays.

Different Cities Define Total Compensation Differently

Our survey of 9 jurisdictions found that each of the jurisdictions defined total compensation differently. Because of this, we also found that it is difficult to fully compare an employee's salary from other jurisdictions to the City and accurately determine whether the City's compensation packages are comparable with those of other employers. Exhibit 33 below outlines select examples of how different cities define total compensation.

Exhibit 33: Comparison of Definitions of Total Compensation

Jurisdiction	Definition of Total Compensation
City of San José	➢ Base salary ➢ City's retirement contribution ➢ Fringe benefits ➢ Vacation, holidays, personal/executive leave and sick leave, to the extent that paid leave is taken during the fiscal year.
City of Fremont	➢ Base salary plus 401(a) City paid contribution ➢ To compare to outside agencies consider their base pay, plus 401(a) contributions plus any agency paid portion of the employees required CalPERS contribution.
City of Fresno	➢ No single defintion. Done on a case by case basis.
City of Long Beach	➢ Base salary (top step of salary range for non-management positions), ➢ Special pays that all incumbents are eligible to receive, ➢ Employer pickup of the employee retirement contribution ➢ Deferred compensation - maximum employer contribution ➢ Retiree health savings plan - employer contribution before the employee retires.
City of Los Angeles	➢ Base salary, regularly assigned bonuses and health
City of Sacramento	➢ Base salary, benefits, and retirement.
County of Santa Clara	➢ No set definition
City of San Diego	➢ Pay and benefits
City and County of San Francisco	➢ Wages and Benefits - salary, health insurance, retirement/social security contributions; any payments made to or for an employee
City of Santa Clara	➢ Discussed in detail later

Source: Summary based on Auditor compensation survey

The City of Santa Clara More Clearly Defines Total Compensation

We found that the City of Santa Clara provides particularly transparent breakdowns of total compensation. For each of its job classifications, the City of Santa Clara clearly defines "total compensation" and makes it publicly accessible. Exhibits 34 and 35 below show the City of Santa Clara's website along with an example of the total compensation for a job classification.

Exhibit 34: Screenshot of City of Santa Clara Website Showing Employee Total Compensation by Classification

JOB TITLE	SALARY RANGE	BENEFIT SUMMARY	TOTAL COMP	BARGAINING UNIT
Account Clerk I	A-19	Benefits Unit 8	8	MOU Unit 8
Account Clerk II	A-23	Benefits Unit 8	8	MOU Unit 8
Account Clerk III	A-25	Benefits Unit 8	8	MOU Unit 8
Accountant	A-31	Benefits Unit 8	8	MOU Unit 8
Accounting Division Manager	UNCL	Benefits Unit 9	9	MOU Unit 9
Accounting Technician I	A-18	Benefits Unit 8	8	MOU Unit 8
Accounting Technician II	A-20	Benefits Unit 8	8	MOU Unit 8
Administrative Analyst	UNCL	Benefits Unit 9	9	MOU Unit 9
Assistant City Attorney	UNCL	Benefits Unit 9	9	MOU Unit 9
Assistant City Clerk	UNCL	Benefits Unit 9	9	MOU Unit 9

Source: City of Santa Clara website (http://santaclaraca.gov/index.aspx?page=976)

Exhibit 35: Example of City of Santa Clara's Publicly Available Total Compensation Package

2010 Total Compensation Adjustment
Unit 5, 7 & 8 - Combination Inspector
0.32% Total Compensation Increase
0.00% Salary Change
Effective 12/26/2010

Total Compensation Element		12/27/2009 Comb. Inspector*	Changes @	12/26/2010 Comb. Inspector*
Salary - Range A37 Step 5*		$ 9,096	$ -	$ 9,096
Mandatory Allocations				
Social Security 2010 @ 6.20% of $106,800 2009 @ 6.20% of $106,800	6.20%	551.80	-	551.80
Medicare @1.45% of Salary	1.45%	131.89	-	131.89
Holiday Pay 13 Days per Year		453.24	-	453.24
Vacation Pay 15 Days per Year		522.97	-	522.97
Awarded Comp Time 2 Days per Year		69.73	-	69.73
Medical Insurance (PERS Min.)		105.00	3.00	108.00
Medical Insurance (City Min.)		429.85	33.25	463.10
PERS. Medical Insurance Fund		2.00	-	2.00
Discretionary Allocations				
Life Insurance ($15,000 Coverage)		5.85	-	5.85
Medical & Dental Insurance Medical Insurance # Dental Insurance **		55.74	-	55.74
Long Term Disability (Capped at $43.41)	0.0102	43.41	-	43.41
Total Compensation (For Salary Adj. Purposes)		**$ 11,467.20**	**$ 36.25**	**$ 11,503.45**
City Paid PERS = 100% of Employer Rate; ER Rate = 17.774%		1,547.64	69.04	1,616.67
VEBA - City Funded		50.00	-	50.00
Retiree Medical		218.06	(11.10)	206.96
Total Compensation (For Benchmark Adjustment Purposes)		**$ 13,282.90**	**$ 94.19**	**$ 13,377.08**

Medical Insurance includes Administrative Fee of 0.37% and excludes $571.10 non-discretionary allocation.

Source: City of Santa Clara website (online at http://santaclaraca.gov/index.aspx?page=976)

As the exhibit above shows, the City of Santa Clara not only included retirement contributions and various City insurance contributions but also includes the number and value of vacation days, comp time and holidays. According to a staff person in the City of Santa Clara, the total compensation instrument allows employees and the City to see more clearly how increases in the City's contributions or decreases in the employee's base compensation impacts total compensation. In our opinion, formalizing this definition would not only assist in providing the City Administration but also provide employee units clarity on the value of each component of the compensation provided by the City. Therefore, we recommend that:

Recommendation #7: In the interest of transparency, and to fully recognize all employee compensation, the City should standardize its definition of total compensation to include all eligible pays, including the average value of sick leave payouts and consider making such information publicly available for all employees and members of the public.

Conclusion

Over the last ten years employee compensations as tracked in the City's payroll system increased 54 percent even as the number of employees dropped. Base pay makes up the bulk of the employee's earnings but overtime provisions, paid leaves, sick leave payouts and premium pays add to the City's costs. Transparency in total compensation is essential.

RECOMMENDATIONS

Recommendation #1: We recommend the City Administration take steps to move towards a merit-based system by: (1) requiring a current positive performance appraisal before implementing any pay increase (including step and general wage increases), (2) considering elimination of the automatic step increase process and/or establishing minimum performance thresholds for receiving step increases, and (3) automating the current performance appraisal system.

Recommendation # 2: To reduce the cost of overtime, the City should (1) conduct a Citywide FLSA overtime review or at a minimum review job specifications for specific positions and whether they would qualify for an FLSA overtime exemption; (2) pursue reductions in overtime to align with FLSA requirements (including but not limited to calculating overtime on hours worked, not paying overtime to exempt employees, and not paying overtime to employees receiving executive leave); and (3) prepare full cost estimates of contract provisions that exceed FLSA provisions.

Recommendation #3: We recommend that the City include eligible paid time off in calculations of total compensation, and consider aligning paid leaves, particularly holidays, with other comparable employers.

Recommendation #4: To reduce costs, the City Council should consider eliminating or reducing the sick leave payout. If the City decides to leave a payout option for employees and caps the total payout, disclose the expected costs of the remaining benefit over the long-term.

Recommendation # 5: We recommend the City Administration (1) seek to eliminate obsolete premium pays, (2) disclose the direct and indirect costs associated with rolling in premium pays, and (3) consider discounting the value of premium pays to maintain cost neutrality when rolling in premium pays OR identify and disclose the full cost associated with rolling in these premium pays into base pay.

Recommendation #6: The City should discontinue including POST in its calculation of overtime and leave payouts, or should roll POST pay into base pay on a discounted, cost neutral basis.

Recommendation # 7: In the interest of transparency, and to fully recognize all employee compensation, the City should standardize its definition of total compensation to include all eligible pays, including the average value of sick leave payouts and consider making such information publicly available for all employees and members of the public.

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APPENDIX A
Earnings That Auditor Included In Compensation

Auditor Category	Pay Code Description	Pay Code
base pay	Administrative Assignment	ADA
base pay	Dispatchers Training Pay	TRD
base pay	Education & Training Pay	EDT
base pay	Merit Pay - Pensionable	MER
base pay	Mngmt Perform Pay-Fixed Rate	MFR
base pay	Other hours - Back pay	OHR
base pay	Pol Data Speclist Training Pay	DST
base pay	Regular	REG
base pay	Regular Time GT 40 Hrs Per Wk	RG2
base pay	Retroactive Pay/Pensionable	RTR
base pay	Witness Leave	WIT
Involuntary paid leave	Administrative Leave	ADM
Involuntary paid leave	Disability Leave @ 100%	DIS
Involuntary paid leave	Disability Leave @ 85 %	DSE
Involuntary paid leave	Fire Line Disability Earnings	DSF
Involuntary paid leave	Non-Taxable Disability Leave	DS2
Involuntary paid leave	Non-Txbl Fire Disability Earns	DF2
leave payout	Aged Comp-Time Paid	CTP
leave payout	Comp-Time Payoff	PCT
leave payout	Comp-Time Payoff - Police	CPO
leave payout	Excess Comp time Payout	XCP
leave payout	Sick Leave Balance Payoff	SLP
leave payout	Vacation Balance Payoff	LBP
leave payout	Vacation Sellback	VSB
overtime	Call Back for Pay @ 1.0	CP1
overtime	Call Back for Pay @ 1.5	CPJ
overtime	FLSA - Fire Pensionable	FLR
overtime	FLSA Increase 50% 1099 MISC	F98
overtime	FLSA OT Adjustment - Fire	FFL
overtime	FLSA Overtime Adjustment	FLS
overtime	FLSA Settlement	F97
overtime	FLSA Settlement Pensionable	F96
overtime	Overtime Conversion Fire @ 1.5	OVC
overtime	Overtime for Pay @ 1.0	OV1
overtime	Overtime for Pay @ 1.5	OVT
overtime	Overtime for Pay @ 2.0	OV2
overtime	Retro Pay/Overtime	RTO
paid leave	Cancer Screening Release Time	CSR
paid leave	Comp-Time Taken	COM
paid leave	Conversion-Other Paid Leaves	OPL
paid leave	Executive Leave	EXE
paid leave	FMLA Comp-Time Taken	FCO
paid leave	FMLA Executive Leave	FEX
paid leave	FMLA Holiday Leave	FHO
paid leave	FMLA Personal Leave	FPE
paid leave	FMLA Sick Leave	FSI
paid leave	FMLA Vacation Leave	FVA
paid leave	Funeral Leave	FNL
paid leave	Holiday Leave	HOL
paid leave	Jury Duty	JUR
paid leave	Military Leave	MLT

Auditor Category	Pay Code Description	Pay Code
paid leave	Military Leave Non Taxable	MLN
paid leave	Military Pay Adjustments	MPA
paid leave	Military Prior Adj Taxable	MPJ
paid leave	Military Supplemental Pay	MSP
paid leave	Military Supplemental Pay Txbl	MST
paid leave	Paid Time Off	PTO
paid leave	Personal Leave	PER
paid leave	Sick Leave	SIC
paid leave	Vacation Leave	VAC
premium/other	$200 Automobile Allowance	CR2
premium/other	$350.00 Automobile Allowance	CAR
premium/other	$450 Automobile Allowance	CR4
premium/other	$600 Automobile Allowance	CR6
premium/other	Advance	ADV
premium/other	AEA Prof Achievement Incentive	PA2
premium/other	Alternate Employment Pay	AEP
premium/other	Anti Terrorist Training Pay	ATT
premium/other	ATT Management Pay	AT3
premium/other	Automobile Allowance	CR1
premium/other	Bilingual Pay Full-Time	BL1
premium/other	Bilingual Pay Part-Time	BL2
premium/other	Bi-weekly Notary Pay	N01
premium/other	Bomb Pay	BMB
premium/other	Bonus Pay	BNS
premium/other	Brake, Lamp and Smog Certifica	MEC
premium/other	Canine Unit Premium	DOG
premium/other	CAR Allowance Prorated	CR0
premium/other	City Paid 401(a) Plan	MSV
premium/other	City Paid Deferred Comp	MDC
premium/other	City Paid Deferred Comp - 9%	MD9
premium/other	Class A/B License Pay	LIC
premium/other	Conversion-Bilingual Pay	BIL
premium/other	Conversion-Other Earnings	OTH
premium/other	Conversion-Spec Unit Premium	SUP
premium/other	Crane Operation	CRN
premium/other	Dental In Lieu-Standard	DIL
premium/other	Emergency Medical Technician	EMT
premium/other	Employee Recognition Award	RCG
premium/other	Employee Suggestion Award	SAW
premium/other	Enhanced Dental In Lieu	EIL
premium/other	FF Anti-Terrorism Training Pay	AT1
premium/other	Fire Education Incentive	FEI
premium/other	Fitness Programs	FIT
premium/other	Graveyard Shift Premium - $1.6	SHR
premium/other	Hazard Incidents Team (Relief)	HTP
premium/other	Hazardous Incidents Team (Reg)	HTR
premium/other	Health In Lieu-Family	HLF
premium/other	Health In Lieu-Single	HLS
premium/other	Higher Class Pay	HCL
premium/other	Holiday In-Lieu Pay	HIL
premium/other	IBEW Graveyrd Shift Prem $1.75	SH4

Auditor Category	Pay Code Description	Pay Code
premium/other	IBEW Shift Premium - $1.55	SH3
premium/other	Interim Housing Allowance	RNT
premium/other	Management Allowance + HIL	MAL
premium/other	Management Allowance 10%	MAC
premium/other	Management Allowance 10.15%	MAO
premium/other	Management Allowance 12.5%	MAD
premium/other	Management Allowance 15%	MAE
premium/other	Management Allowance 17.5%	MAF
premium/other	Management Allowance 2.5%	MAM
premium/other	Management Allowance 5%	MAA
premium/other	Management Allowance 5.2%	MAG
premium/other	Management Allowance 6.0%	MAH
premium/other	Management Allowance 7%	MAI
premium/other	Management Allowance 7.5%	MAB
premium/other	Management Allowance 8%	MAN
premium/other	Management Allowance 8.71%	MAJ
premium/other	Management Allowance Special	MAK
premium/other	Meal Allowance	MLA
premium/other	MEF Bilingual Pay PT Unbenefit	BL3
premium/other	MEF CEO Svce Perfor Pilot Prog	ESP
premium/other	MEF Prof Achievement Incentive	PA1
premium/other	MERGE Unit Pay	MGE
premium/other	Mngmt Performance Pay - 1.0 %	M10
premium/other	Mngmt Performance Pay - 1.5 %	M15
premium/other	Mngmt Performance Pay - 1/2 %	M05
premium/other	Mngmt Performance Pay - 2.0 %	M20
premium/other	Mngmt Performance Pay - 2.1%	M21
premium/other	Mngmt Performance Pay - 2.5 %	M25
premium/other	Mngmt Performance Pay - 3.0 %	M30
premium/other	Mngmt Performance Pay - 3.5 %	M35
premium/other	Mngmt Performance Pay - 4.0 %	M40
premium/other	Mngmt Performance Pay - 4.5 %	M45
premium/other	Mngmt Performance Pay - 5.0 %	M50
premium/other	Motorcycle Duty Pay	MTR
premium/other	Notary Fee	NOT
premium/other	Operator Incentive Pay	OIP
premium/other	Oral Bilingual Pay - Full Time	BLF
premium/other	Oral Bilingual Pay Part Time	BLP
premium/other	Oral/Written Bilingual F/T	OWF
premium/other	Oral/Written Bilingual P/T	OWP
premium/other	Paramedic - Support (5%)	PRN
premium/other	Paramedic Intern Preceptor	PIP
premium/other	Paramedic Pay (Regular)	PAR
premium/other	Paramedic Pay (Support)	PRS
premium/other	PDP Unit 99 Non Taxable	PN9
premium/other	Police Field Training Pay	TRN
premium/other	POST Pay Advanced	PPA
premium/other	POST Pay Intermediate	PPI
premium/other	Professional Development	PDP
premium/other	Protective Gear Allowance	PGA
premium/other	Referral Incentive Payment	RIP

Auditor Category	Pay Code Description	Pay Code
premium/other	Retirement Cell Phone Taxable	RCT
premium/other	Retro Pay/Non-Pensionable	RTN
premium/other	Retroactive Pay/PTC	R01
premium/other	Severance Pay	SEV
premium/other	Shift Differential Graveyard	SHG
premium/other	Shift Premium - $1.40	SHW
premium/other	Shift Premium 1	SHF
premium/other	Shift Premium 2	SH2
premium/other	Shorthand Pay	SHN
premium/other	Shorthand Premium $25.00	SHP
premium/other	Standby for Pay @ 1.0	SP1
premium/other	Standby for Pay @ 1.5	SPJ
premium/other	Stipend	ST1
premium/other	Supplemental Life Adjustment	SLF
premium/other	Taxable Gross Adjustment	TGA
premium/other	Time & Labor Earnings Code	ZZZ
premium/other	TPAC Stipend	TPC
premium/other	Tuition Reimbursement - Nontax	TUI
premium/other	Uniform Allowance - biweekly	UAB
premium/other	Uniform Allowance Advance	UAD
premium/other	Uniform Allowance Payment	UAP
premium/other	Urban Search & Rescue (Reg)	USR
premium/other	Urban Search & Rescue (Relief)	USP

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: Sharon Erickson
City Auditor

FROM: Alex Gurza

SUBJECT: **RESPONSE TO THE AUDIT OF "KEY DRIVERS OF EMPLOYEE COMPENSATION"**

DATE: May 10, 2011

Approved

Date 5/10/11

The Administration has reviewed the Audit of the "Key Drivers of Employee Compensation: Base Pay, Overtime, Paid Leaves and Premium Pays" and is in general agreement with the recommendations identified in the report. Many of the recommendations are items already under consideration and require direction from the City Council and meeting and conferring with the City's bargaining units. The following are the Administration's response to each recommendation.

BACKGROUND

The Audit identifies specific cost drivers of employee compensation; specifically wage increases, the calculation of overtime, the costs associated with paid time off, sick leave payouts, and premium pays. The Audit also addresses the issue of total compensation, including its definition and what aspects of pay should be included in the City's calculation. Given that personnel costs are the City's largest expenditure, it is important to identify and address those issues which drive employee compensation costs. As noted above, a majority of those issues identified in the Audit are currently being addressed by the City, and some have been proposed in the current and ongoing negotiations with different bargaining units.

RECOMMENDATIONS AND RESPONSE

Recommendation #1: We recommend the City Administration take steps to move towards a merit-based system by: (1) requiring a current positive performance appraisal before implementing any pay increase (including step and general wage increases), (2) considering elimination of the automatic step increase process and/or establishing minimum performance thresholds for receiving step increases, and (3) automating the current performance appraisal system.

Administration Response: The Administration is in general agreement that any increase in an employee's pay should have a connection with their performance. Currently, non-management employees who are not at top step receive a five percent (5%) automatic step increase regardless of performance, except for the Association of Building, Mechanical and Electrical Inspectors (ABMEI). This is a long standing practice in typical Civil Service compensation systems. Changing this is subject to the meet and confer process and the City is committed to pursuing this as noted in the City Manager's Fiscal Reform Plan that was released on May 2, 2011, which can be found at http://www.sanjoseca.gov/budget/FY1112/05MBA/MBA01-FiscalReformPlan.PDF.

Outside of general wage increases, management employees can only receive salary increases based on their performance. It should be noted that employees represented by ABMEI do not receive *automatic* salary step increases. ABMEI represented employees are expected to have positive performance reviews prior to receiving any salary step increase. Accordingly, the model of connecting performance with pay already exists within the City. The Administration will continue its pursuit of the long term goal of establishing a merit-based system and the eventual elimination of automatic step increases, an expansion of a concept already in place for some employees.

The Administration will review methods to make the performance appraisal system as efficient as possible, including analyzing the feasibility and effectiveness of automating the current performance appraisal system along with the costs associated with possible automation. At a minimum, the Administration will be working to make more effective the performance appraisal tracking system within our HR/payroll system.

Recommendation #2: To reduce the cost of overtime, the City should (1) conduct a Citywide FLSA overtime review or at a minimum review job specifications for specific positions and whether they would qualify for an FLSA overtime exemption; (2) pursue reductions in overtime to align with FLSA requirements (including but not limited to calculating overtime on hours worked, not paying overtime to exempt employees, and not paying overtime to employees receiving executive leave); and (3) prepare full cost estimates of contract provisions that exceed FLSA provisions.

Administration Response: The Administration is in general agreement with the Audit recommendations regarding the cost of overtime. A comprehensive review of what classifications would qualify for an FLSA overtime exemption, or whether any current classifications are in fact exempt from overtime under the FLSA but are eligible for overtime, may help reduce the cost of overtime paid by the City. This would require further analysis. It should also be noted that changing classifications to be ineligible for overtime, or eliminating overtime for any classifications that are exempt from overtime under the FLSA, may fall under the meet and confer process, and the Administration may have to negotiate any such changes with the affected bargaining units.

As noted in the May 2, 2011, Fiscal Reform Plan, the City paid approximately $26 million in overtime in Fiscal Year 2009-2010 alone, with over $20 million paid to Police and Fire employees. As part of current City Council direction, the City is pursuing changes to overtime so that paid leave is not counted towards the calculation of overtime. Currently, the agreements with most of the City's bargaining units eligible for overtime allow for any paid leave hours in a workweek to count towards an employee's forty (40) hour workweek. This is above and beyond what is required under the federal laws regulating overtime, the Fair Labor Standards Act (FLSA). Under the FLSA, employees are eligible to receive overtime only when they *work* additional hours over the normal forty (40) hour workweek. Additional information can be found at http://www.sanjoseca.gov/budget/FY1112/05MBA/MBA01-FiscalReformPlan.PDF.

The Administration will continue to examine whether employees who receive executive leave should be eligible for overtime. It should be noted that the City proposed eliminating overtime for employees who receive executive leave during this year's negotiations. For additional information, please see http://www.sanjoseca.gov/employeeRelations/labor.asp.

Determining what hours should be considered in the calculation of hours worked is a subject of ongoing negotiations with the City's bargaining units. The City has proposed to different bargaining units making only hours worked count towards the calculation of overtime, and the City is committed to continue to pursue this as noted in the Fiscal Reform Plan. Additional information can be found at http://www.sanjoseca.gov/employeeRelations/labor.asp.

Recommendation #3: We recommend that the City include eligible paid time off in calculations of total compensation, and consider aligning paid leaves, particularly holidays, with other comparable employers.

Administration Response: The Administration is in general agreement that it would be helpful for employees and the public to include eligible time off, including holidays and any paid leaves, in its calculation of total compensation. The Administration has made great strides making information available to the public about employee compensation and benefits. Additional information regarding total compensation can be found online at http://www.sanjoseca.gov/employeeRelations/labor.asp.

The City's definition of total compensation is the total cash cost to the City of an employee's pay and benefits. While it may be possible to determine the cash value of paid time off, this would not necessarily result in an increase in an employee's cash compensation. For example, if an employee is paid $100,000 annually, and it was determined that the value of paid time off is $10,000, an employee's compensation is still $100,000, and not $110,000. However, there are productivity costs associated with providing employees paid time off since the more time an employee can take off, the less productive work time from that employee the City receives. The City will continue to explore including paid time off in the calculations of total compensation and consider aligning paid leaves, particularly holidays, with other comparable employers. We will add the value of the paid time off benefit to the information we produce on total compensation.

Recommendation #4: To reduce costs, the City Council should consider eliminating or reducing the sick leave payout. If the City decides to leave a payout option for employees and caps the total payout, disclose the expected costs of the remaining benefit over the long-term.

Administration Response: The Administration is in general agreement that a reduction or elimination of the sick leave payout to employees should be pursued. This is currently a subject being negotiated with various bargaining units. We are expecting a cost of $9.5 million in Fiscal Year 2011-2012 for sick leave payouts. The Administration will continue to take steps in addressing the sick leave payout, and the City Manager's Fiscal Reform Plan recommends eliminating the sick leave payout by Fiscal Year 2012-2013. The City has proposed to eliminate sick leave payout in the current negotiations with the bargaining units and the agreements reached so far have agreements to continue these negotiations. Additional information can be found at http://www.sanjoseca.gov/employeeRelations/labor.asp, and in the May 2, 2011, Fiscal Reform Plan which can be found at http://www.sanjoseca.gov/budget/FY1112/05MBA/MBA01-FiscalReformPlan.PDF.

Recommendation # 5: We recommend the City Administration (1) seek to eliminate obsolete premium pays, (2) disclose the direct and indirect costs associated with rolling in premium pays, and (3) consider discounting the value of premium pays to maintain cost neutrality when rolling in premium pays OR identify and disclose the full cost associated with rolling in these premium pays into base pay.

Administration Response: The Administration is in general agreement with the recommendation that obsolete premium pays should be addressed. As noted in the Audit, certain premium pays have previously been rolled into base pay to more accurately reflect the cash compensation received by affected employees. Though this may have led to the increase in other aspects of compensation tied to base pay, it should be noted that the Administration considered any potential increases prior to eliminating the relevant premium pays and determined that it was appropriate and worthwhile to roll premium pays into base pay. These types of issues are typically discussed with City Council prior to the City making a proposal to the bargaining units to weigh the pros and cons and to consider any associated costs. It should also be noted that certain premium pays that were rolled into base pay were already deemed pensionable.

The Administration is in general agreement that, to the extent possible, the direct and indirect costs associated with rolling premium pays into base pay should be disclosed in a Council Memo approving such terms, so that employees and the public are aware of the implications of eliminating premium pays.

Recommendation #6: The City should discontinue including POST in its calculation of overtime and leave payouts, or should roll POST pay into base pay on a discounted, cost neutral basis.

Administration Response: The City is in general agreement that premium pays in general should not be included in the calculation of overtime or any leave payouts received by an eligible employee. However, unlike certain premium pays received by all represented employees, Peace Officer Safety Training (POST) premium pays differ based on the level of certification attained by individual employees. The Administration will review whether incorporating POST premium pay into an employee's base pay is practicable and review whether it is possible to do so on a discounted cost neutral basis. It should be noted that, as with any premium pays, addressing POST pay may have to be addressed through the meet and confer process, and the Administration may have to negotiate any such changes with the affected bargaining units. It should be noted that during the current negotiations with the San Jose Police Officers' Association (POA) the City has proposed to exclude POST pay from the calculation of any separation payouts. Those negotiations are currently underway.

Recommendation # 7: In the interest of transparency, and to fully recognize all employee compensation, the City should standardize its definition of total compensation to include all eligible pays, including the average value of sick leave payouts and consider making such information publicly available for all employees and members of the public.

Administration Response: The Administration is in general agreement that the definition of total compensation provided by the City to its employees is of great interest to the public. The Administration will review, to the extent possible, including all pays an employee is eligible for, but it should be noted that different employees, even within the same bargaining unit, may be

eligible for and receive different pays. Sick leave payout in particular can be complicated since not all employees are eligible for such payouts, and the amounts may vary depending on the sick leave balances, if any, maintained by individual employees. However, the City will review whether including the average value of sick leave payouts can be included in the calculation of total compensation. As noted above, the Administration has taken significant steps in educating both employees and the public about total compensation, and the Administration will continue its efforts to develop and communicate a uniform definition of total compensation, including base and other eligible pays as well as benefits.

CONCLUSION

This Audit makes valid recommendations for addressing the increasing costs to the City of compensating employees. City employees do a remarkable job in providing much needed services to the community, and an unfortunate result of the increases in employee compensation is that the City can no longer afford to keep valuable employees and to maintain services to the public. The City has and will continue to address the recommendations presented in the Audit and is hopeful that steps can be taken to make changes that would reduce costs and assist the City in providing services to the community in a cost effective manner.

We also want to confirm our commitment to completing annual performance appraisals for all of our employees. We are currently working on this issue with Departments and are committed to making improvements in this area. This remains a top priority for the Administration.

The City Manager's Office thanks the City Auditor's Office for its comprehensive and informative review of the cost of drivers of employee compensation.

COORDINATION

This memorandum has been coordinated with the City Attorney's Office, the Human Resources Department, the Finance Department and the City Manager's Budget Office.

Alex Gurza
Director of Employee Relations

For additional information on this report, contact Alex Gurza, Director of Employee Relations, at 535-8150.