

**Performance Audit
Impact of Early Retirement
Incentive Program**

February 2008

City Auditor's Office

City of Kansas City, Missouri

February 6, 2008

Honorable Mayor and Members of the City Council:

Resolution 070290 directed us to review the effectiveness of the 2003 early retirement incentive program. In 2002, city management proposed an early retirement incentive program to encourage long-term, highly paid employees to retire. The incentive was proposed to help the city deal with a difficult financial period. The City Council approved Ordinance 021393 in January 2003 and potential retirees had between February 1, 2003 and April 30, 2003 to take advantage of the early retirement incentive. Three hundred and eighty-eight employees covered by the Employees' Pension System opted for early retirement.

Early retirement salary savings have exceeded original projections. We estimate that salary savings for the first four fiscal years was almost \$100 million compared to the Budget Office's projected savings of \$63 million. The negative impact of the early retirements on city operations has lessened over the last five years. Department managers responding to a survey we conducted identified loss of knowledge or expertise as the greatest negative impact. However, some respondents stated that the early retirement program gave them an opportunity to reorganize or restructure their operations. The current staffing level has increased over 9 percent compared to 2003, when the early retirees left city employment. The number of currently filled positions is almost the same as before the early retirement incentive.

We shared a draft of this report with the city manager and the budget officer. Because we did not make any recommendations, we did not request a response from them. We would like to thank everyone who responded to our survey and staff from Human Resources, the Budget Office, and City Communications for their courtesy and cooperation. The audit team for this project was Vivien Zhi and Douglas Jones.

Gary L. White
City Auditor

Impact of Early Retirement Incentive Program

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Introduction

Objectives

We conducted this audit of the early retirement incentive program under the authority of Article II, Section 216 of the Charter of Kansas City, Missouri, which establishes the Office of the City Auditor and outlines the city auditor's primary duties. Resolution 070290 directed the city auditor to review the effectiveness of the 2003 early retirement incentive program.

A performance audit systematically examines evidence to independently assess the performance and management of a program against objective criteria. Performance audits provide information to improve program operations and facilitate decision-making.¹

This report is designed to answer the following questions:

- What is the amount of savings obtained through the 2003 early retirement incentive program?
- What is the impact on city functions caused by the program?
- What is the impact on hiring practices and staff expansion or reduction since the implementation of the program?

Scope and Methodology

Our audit work included:

- Interviewing the city manager, budget officer, director of human resources, retirement system executive officer, and Councilwoman Deb Hermann who sponsored the resolution.

¹ Comptroller General of the United States, *Government Auditing Standards* (Washington, DC: U.S. Government Printing Office 2003), p. 21.

- Reviewing the ordinance establishing the early retirement incentive program.
- Surveying department directors and division managers about the impact the early retirement program had on their functions.
- Analyzing Position Control Register data for April 30, 2002, April 30, 2003, April 30, 2004, April 30, 2005, April 30, 2006, and October 29, 2007.

We conducted this audit in accordance with generally accepted government auditing standards. No information was omitted from this report because it was deemed privileged or confidential.

Background

Early Retirement Incentive Program

In 2002, city management proposed an early retirement incentive program to encourage long-term, highly paid employees to retire. The incentive was proposed to help the city deal with a difficult financial period. The City Council approved Ordinance 021393 in January 2003 and potential retirees had between February 1, 2003 and April 30, 2003 to take advantage of the early retirement incentive.

To establish eligibility, the retirement incentive added three years' age and three years creditable service to members under age 65 with at least 10 years' creditable service to meet the requirements of normal or optional retirement. To determine the benefit, retirees would receive three additional years of service. However, the monthly benefit could not exceed 80 percent of the members' final average compensation. In addition, retirees would receive a \$300 monthly benefit until age 65 to cover medical insurance. Three hundred and eighty-eight employees covered by the Employees' Pension System opted for early retirement. (See Exhibit 1.) Employees taking advantage of the early retirement incentive were prohibited from reentering city employment for five years.

Exhibit 1. Retirees by Job Class

Job Class	Retirees	% of Total
Labor	156	40.2%
Management Exempt	135	34.8%
Management Non-Exempt	85	21.9%
Unclassified	12	3.1%
Total	388	100.0%

Source: Budget Office.

In fiscal year 2003, the Budget Office projected that the retirement incentive could save \$163 million over the next ten years. To fund the retirement incentives, the city committed to make additional contributions of about \$41 million to the employee retirement system for up to ten years. Estimates were based on salary expenditures and assumptions regarding future salary costs with or without a reduction in total payroll costs resulting from eligible employees taking early retirement less the additional retirement contributions.

The City Council was concerned about the lack of information related to the effect the early retirement program had on the budget and city programs. In March 2007, the City Council passed Resolution 070290 directing the city auditor to audit the program.

Impact of Early Retirement Incentive Program

Findings

Summary

Early retirement salary savings have exceeded original projections. We estimated that salary savings for the first four fiscal years was almost \$100 million compared to the Budget Office's projected savings of \$63 million. The negative impact of the early retirements on city operations has lessened over the last five years. Department managers responding to a survey we conducted identified loss of knowledge or expertise as the greatest negative impact. However, some respondents stated that the early retirement program gave them an opportunity to reorganize or restructure their operations. The current staffing level has increased over 9 percent since employees took advantage of the early retirement incentive. The number of currently filled positions is almost the same as before the early retirement incentive.

Salary Savings Have Exceeded Original Projections

Early retirement salary savings have exceeded original projections. Calculated salary savings for the first four fiscal years was almost \$100 million compared to projected savings of \$63 million over the same period. Fewer eligible employees took the early retirement than projected. More early retirees were allowed to extend their retirement date than the ordinance allowed.

Estimated Savings Was Almost \$100 Million Since Fiscal Year 2004

Estimated salary savings for the first four fiscal years following the early retirement incentive was almost \$100 million compared to the Budget Office's projected savings of \$63 million over the same period. The Budget Office's original projections assumed an annual covered payroll increase of 5 percent (before and after the retirement incentive).² The net savings from the early retirement for the past four fiscal years was projected to be about \$63 million. (See Exhibit 2.)

² Covered payroll is an annualized number including only base salary. Overtime/special/premium pay are not included.

Impact of Early Retirement Incentive Program

Exhibit 2. Early Retirement Savings Projection (In Millions)

	2003	2004	2005	2006	2007	Total
Projected Payroll before Incentive	\$154.2	\$161.9	\$170.0	\$178.5	\$187.4	\$697.7
Projected Payroll after Incentive		144.0	151.2	158.7	166.7	620.6
Required Pension Increase ³		3.2	3.4	3.6	3.7	13.9
Projected Net Potential Payroll Savings		\$14.7	\$15.4	\$16.2	\$17.0	\$63.2

Source: Budget Office.

However, when we compared actual covered payroll data to the projected annual covered payroll, assuming a 5 percent annual increase, the potential savings for the past four fiscal years approached \$100 million. (See Exhibit 3.)

Exhibit 3. Estimated Early Retirement Savings (In Millions)

	2003	2004	2005	2006	2007	Total
Projected Payroll before Incentive	\$154.2	\$161.9	\$170.0	\$178.5	\$187.4	\$697.7
Actual Payroll after Incentive		137.2	141.6	146.4	158.8	583.0
Required Pension Increase ³		3.2	3.4	3.6	3.7	13.9
Estimated Net Payroll Savings		\$21.4	\$25.0	\$28.5	\$24.9	\$99.8

Source: Budget Office, CAO Calculations, Employees' Retirement System Annual Report 2006.

Fewer Eligible Employees Took Early Retirement than Projected

At the time of the incentive proposal, 553 employees were eligible for the early retirement program. Seventy percent (388) of them chose to retire under the program. (See Exhibit 4.) The number of employees opting for early retirement was five percent less than the Budget Office originally estimated.

³ To fund the retirement incentives, the city committed to make additional contributions to the employee retirement system for up to 10 years. The additional contributions will total about \$41 million.

Exhibit 4. Retirees by Department

Department	Potential Retirees	Actual Retirees	% of Potential Retirees	% of Total Retirees
Aviation	55	42	76.4%	10.8%
City Auditor	0	0	0.0%	0.0%
City Clerk	1	1	100.0%	0.3%
City Development	12	5	41.7%	1.3%
City Manager	7	7	100.0%	1.8%
Codes	9	5	55.6%	1.3%
Convention & Entertainment Centers	20	15	75.0%	3.9%
Environmental Management	12	9	75.0%	2.3%
Finance	19	12	63.2%	3.1%
Fire	12	4	33.3%	1.0%
Health	23	19	82.6%	4.9%
Housing	7	3	42.9%	0.8%
Human Relations	3	2	66.7%	0.5%
Human Resources	0	0	0.0%	0.0%
Information Technology	12	8	66.7%	2.1%
Law	9	7	77.8%	1.8%
Mayor and City Council	2	2	100.0%	0.5%
Municipal Court	10	5	50.0%	1.3%
Neighborhood & Community Services	33	25	75.8%	6.4%
Parks	63	47	74.6%	12.1%
Public Works	97	68	70.1%	17.5%
Water	147	102	69.4%	26.3%
Total	553	388	70.2%	100.0%

Source: Budget Office.

More Early Retirees Allowed to Extend Retirement Date than Ordinance Allowed

The early retirement ordinance permitted up to 10 percent of the total early retirees to extend their early retirement date to July 1, 2003, for the operational needs of the city. The extension was granted to more retirees than the ordinance allowed. Almost 12 percent (45) of the 388 early retirees were granted extensions.

Early Retirement Had Some Negative Impact on City Functions, but Also Provided Opportunities

The negative impact of early retirements has lessened over the last five years. Over 60 percent of department directors and division managers who responded to our survey reported their department or division experienced negative impacts during the first year of the early retirement. Less than 25

percent reported negative impacts for the current fiscal year. Respondents identified that the greatest negative impact was on knowledge or expertise. However, some respondents stated that the early retirements gave them an opportunity to reorganize or restructure their operation.

Negative Impact of Early Retirements Lessened over the Last Five Years

The negative impact of early retirements on departments has lessened since the first year. We surveyed department directors and division managers from departments that had employees who took the early retirement incentive. We asked the directors and managers to rate how the early retirements impacted their departments from fiscal year 2004 to the current fiscal year. We sent out 121 surveys and received 58 responses. Over 60 percent of the respondents reported their department or division experienced negative impacts during the first year of the early retirement. Less than 25 percent reported negative impacts for the current fiscal year, while about two thirds of the respondents reported no impact. (See Exhibit 5.)

Exhibit 5. Overall Impact of Early Retirements on Departments by Fiscal Year

Impact	2004	2005	2006	2007	2008
High Negative Impact	20.7%	10.3%	8.8%	3.4%	3.4%
Medium Negative Impact	13.8%	15.5%	10.5%	8.6%	8.6%
Low Negative Impact	25.9%	15.5%	10.5%	15.5%	12.1%
No impact	32.8%	48.3%	64.9%	65.5%	67.2%
Low Positive Impact	1.7%	3.4%	1.8%	1.7%	3.4%
Medium Positive Impact	5.2%	6.9%	3.5%	5.2%	5.2%
High Positive Impact	0%	0%	0%	0%	0%

Sources: City Auditor’s Office Survey of Departments, November 2007.

The greatest negative impact was on knowledge or expertise. We asked survey respondents to rate how the early retirements impacted knowledge or expertise, staffing, and hiring practices. Almost 69 percent of the survey respondents reported a negative impact on knowledge or expertise. About 54 percent and 32 percent of the survey respondents reported a negative impact on staffing and hiring practices, respectively. (See Exhibit 6.) Several respondents stated that when the retirees left, institutional history, knowledge or expertise were also initially lost, which put pressure on existing staff and resources. It took time for the replacements to regain the knowledge lost.

Exhibit 6. Impact of Early Retirement on Knowledge or Expertise, Staffing, and Hiring Practices

Impact	Knowledge or Expertise	Staffing	Hiring Practices
High Negative Impact	10.3%	17.5%	14.3%
Medium Negative Impact	22.4%	14.0%	7.1%
Low Negative Impact	36.2%	22.8%	10.7%
No impact	27.6%	36.8%	58.9%
Low Positive Impact	3.4%	8.8%	5.4%
Medium Positive Impact	0%	0%	1.8%
High Positive Impact	0%	0%	1.8%

Sources: City Auditor's Office Survey of Departments, November 2007.

Several respondents identified the loss of institutional knowledge and trying to attract and hire good candidates as the biggest challenges. Other negative impacts included covering the workload and providing the same level of services with reduced staffing, overtime to cover the staffing shortage, and longer response times to provide services. Hiring was restricted for some time. To cope with these challenges and negative impacts, some departments reported that they cross-trained employees to perform additional duties and other departments reorganized and restructured their operations.

Early Retirement Gave Some Departments Opportunities

Some respondents stated that the early retirement program gave their departments an opportunity to reorganize or restructure operations, such as using electronic tools in daily functions, and encouraging new approaches/solutions to problem solving. The early retirement also allowed greater promotional opportunities for younger staff and brought new ideas into the organization.

Current Staffing Nearly Equals Staffing before Early Retirement Incentive

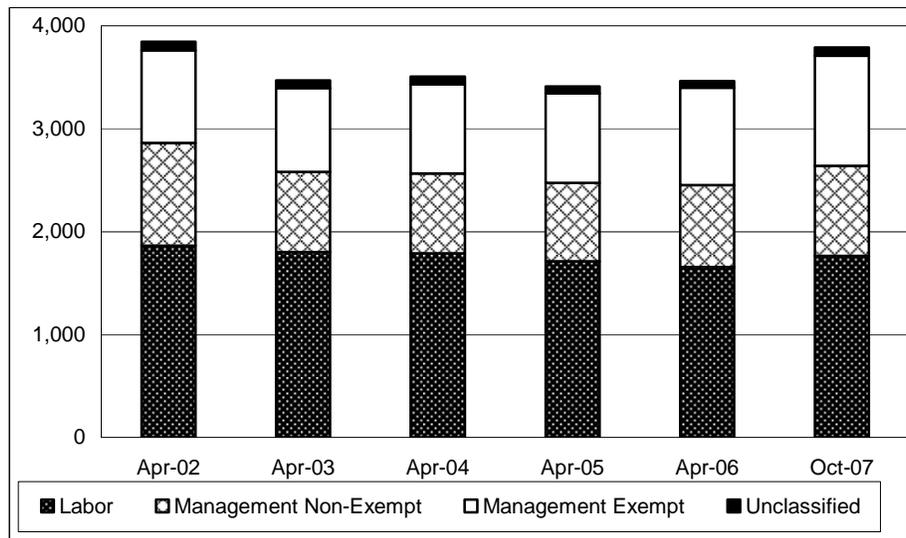
The current staffing level almost equals the staffing level prior to the early retirement incentive. Since the early retirements in 2003, filled positions increased about 9 percent with most of this increase occurring since April 2006. Most of the department director/deputy director positions hired after the early retirements are paid less than their predecessors.

Filled Positions Increased Between April 2003 and October 2007

Between fiscal years 2003 and 2006, the number of filled positions remained relatively steady. However, the number of filled positions has

increased over 9 percent from April 2006 to October 2007. As of October 2007, the city had 3,791 filled positions; almost the same number as in 2002 before the early retirement incentive. (See Exhibit 7.) Only one retiree reentered city employment during the 5-year no-hire period and this was permitted by Ordinance 070429.

Exhibit 7. Filled Positions by Job Class⁴



Sources: Position Control Registers on 4/30/02, 4/30/03, 4/30/04, 4/30/05, 4/30/06 and 10/29/07.

City Filled More Positions than Original Goal

City management set goals of filling only 10 percent of the vacated positions in the general fund departments and 50 percent of the vacated positions in the enterprise fund departments when proposing the early retirement incentive. In 2003, 244 employees retired from general fund departments and 144 employees retired from enterprise departments. Based on the number of retirees and management’s original goals, no more than 25 vacated positions in the general fund departments and 72 vacated positions in the enterprise departments would be filled. Using the number of filled positions at the end of fiscal year 2003 as the baseline, the city has filled 285 positions in general fund departments, which is almost 12 times the original goal for general fund departments, and 81 positions in enterprise fund departments, nine positions more than proposed.

⁴ Limited term contractors (LTC) are individuals providing services to the city for specific short terms and they are not part of the city's regular classification service system. The LTC classification and corresponding positions did not exist in the position control register until the implementation of the PeopleSoft system. We did not include LTC positions in Exhibit 7. The number of LTC positions was 140 on April 30, 2005, 84 on April 30, 2006, and 61 on October 29, 2007.

Most Director/Deputy Director Positions Paid at Lower Salaries

The Finance and Audit Committee asked us to look at whether the city is paying more to the current department directors/deputy directors than their predecessors who took early retirement. Among the department director positions retired during the early retirement program, only the director of convention and entertainment's salary is higher than his predecessor, assuming an annual salary increase of 4 percent in the past four years. The director of parks and recreation's salary is at the maximum as his predecessor's would have been. (See Exhibit 8.)

Exhibit 8. Comparison of the Current Position Holders' Salaries to Predecessors'

Title	Comparison of Salaries of Current Position Holders to Their Predecessors'
City Clerk	Lower
Assistant City Manager	Lower
Director of Convention and Entertainment	Higher
Deputy Director of Health	Lower
Director of Human Relations ⁵	Lower
Deputy Director of Information Technology	Lower
Director of Parks and Recreation	Same
Director of Public Works	Lower
Director of Water Services	Lower

Source: Position Control Registers 4/30/02 and 10/29/07.

⁵ This position was downgraded from director of human relations to assistant to the director-business & support.

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Appendix A

Early Retirement Impact Survey Questions

Impact of Early Retirement Incentive Program

Survey Questions

1. How would you rate the impact the early retirement program had on your department during the following fiscal years?

First year (fiscal year 2004)

- High - negative impact
- Medium - negative impact
- Low - negative impact
- No impact
- Low - positive impact
- Medium - positive impact
- High - positive impact

Second year (fiscal year 2005)

- High - negative impact
- Medium - negative impact
- Low - negative impact
- No impact
- Low - positive impact
- Medium - positive impact
- High - positive impact

Third year (fiscal year 2006)

- High - negative impact
- Medium - negative impact
- Low - negative impact
- No impact
- Low - positive impact
- Medium - positive impact
- High - positive impact

1. How would you rate the impact the early retirement program had on your department during the following fiscal years? (continued)

Fourth year (fiscal year 2007)

- High - negative impact
- Medium - negative impact
- Low - negative impact
- No impact
- Low - positive impact
- Medium - positive impact
- High - positive impact

Fifth year (fiscal year 2008)

- High - negative impact
- Medium - negative impact
- Low - negative impact
- No impact
- Low - positive impact
- Medium - positive impact
- High - positive impact

2. To what extent was staffing in your department impacted?

- High - negative impact
- Medium - negative impact
- Low - negative impact
- No impact
- Low - positive impact
- Medium - positive impact
- High - positive impact

What areas, programs or functions were impacted? What happened?

3. To what extent was knowledge or expertise in your department impacted?

- High - negative impact
- Medium - negative impact
- Low - negative impact
- No impact
- Low - positive impact
- Medium - positive impact
- High - positive impact

What areas, programs or functions were impacted? What happened?

4. Were services or programs dropped, scaled back, consolidated, etc.?

- Yes
- No

If yes, what services or programs? What happened?

5. What was your department's biggest challenge related to early retirements? Biggest opportunity?

6. How did your department deal with the challenges or opportunities? What did you do?

7. What was the impact of your department's hiring practices?

- High - negative impact
- Medium - negative impact
- Low - negative impact
- No impact
- Low - positive impact
- Medium - positive impact
- High - positive impact

How were your hiring practices impacted? What happened?

8. Did your department hire consultants to fill a gap in knowledge or expertise because of the early retirement program?

- Yes
- No

If yes, what were the consultants hired to do, for how long and at what cost?

9. Department?

10. Division?

11. Are you a

Department director

Division manager

12. If you wish to be contacted concerning your survey responses, please give us your name and phone number.