

**Date:** March 30, 2015  
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**Subject:** **Cincinnati Retirement System Audit**

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Attached is the Cincinnati Retirement System (CRS) audit report. The objectives of this performance audit were to determine if CRS had a strong internal control structure in place for managing retirement accounts, benefit calculations were accurate, and outstanding loan balances were properly managed.

We would like to thank the CRS staff for their assistance and cooperation during this audit.

If you need any further information please contact me.

Attachment

# Cincinnati Retirement System Audit

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March, 2015



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Internal Audit Manager

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## **Executive Summary**

Internal Audit (IA) performed an audit of the Cincinnati Retirement System (CRS). The primary objectives of this audit were to determine if: CRS had a strong internal control structure in place for managing retirement accounts, benefit calculations were accurate, and outstanding loan balances were properly managed.

Comprehensive policies and procedures are necessary to have a strong internal control environment. Documented policies and procedures assist management with providing guidance and direction to staff, and permits reviewers to easily follow the process. IA found CRS policies and procedures were not up to date, and the processes, data interpretations, and methodology used to calculate retirement benefit calculations were not documented in a systematic manner.

Approximately 368 employees retired between 2012 and 2014. IA tested 37 (10%) benefit calculations to determine accuracy and found 1 (3%) error. Documenting the complexity of retirement benefit calculations step by step would increase transparency, and prove useful when reviewing discrepancies and identifying errors.

Reconciling financial data on a monthly basis is a control activity used to detect irregularities and variances in a timely manner. IA found the department procedure is to reconcile the outstanding loan balances reported on the general ledger to the outstanding loan balance in PensionGold on an annual basis; however, the beginning and ending outstanding loan balances in PensionGold were not reconciled, and a variance was identified. Implementing a process to reconcile beginning and ending outstanding loan balances in PensionGold will allow staff to detect variances, identify the root cause, and perform corrective action. Without having this control in place irregularities may not be found in a timely manner.

Overall, CRS has strong management controls in place. The recommendations listed in the audit report are intended to improve upon current processes and strengthen internal controls.

## **I. Introduction**

### **Background**

The Cincinnati Retirement System was established in 1931 as a defined benefit pension plan, in accordance with Chapter 203 of the Cincinnati Municipal code. The plan is funded by both the employees and employer. In 2014 employees contributed 9.0% of pensionable earnings to CRS.

CRS provides several benefits to members and their beneficiaries, some of which include: retirement, disability, healthcare, burial benefits, and survivor benefits. The burial benefit is only payable to members who retired on or before July 1, 2011. As of January 1, 2015 there were 4,340 pension benefits payments made to pensioners. Some members receive multiple benefits, in most cases when both spouses earned a benefit from CRS and named the other spouse as a joint annuitant. Additionally, there were 3,325 contributing CRS members as of the first pay period in 2015.

In prior years, CRS members with at least three years of service were permitted to apply for signature loans and mortgage loans. Signature loans were to be repaid within five years. Mortgage loans were to be paid in full within fifteen years. The repayment process is structured to automatically deduct loan payments from member's paychecks; however, other methods of repayment are also allowed. CRS stopped accepting loan applications on September 29, 2010. As of December 31, 2014 there were approximately 127 active loans managed by CRS. The majority of the outstanding loans are projected to reach maturity by December 31, 2015. If the loans are not paid within the appropriate time period, CRS will collect the outstanding loan balance from the member's CRS account balance, reduce their service credit (to actuarially adjust future pension benefits for the amount of the collection), and issue a 1099 for the unpaid loan balance.

CRS utilizes the PensionGold pension administration system to record, track and calculate pension benefits. The PensionGold system is programmed to automatically retrieve employee data from the Cincinnati Human Resource Information System (CHRIS). CRS also utilizes the OnBase system to scan and record documents.

### **Audit Selection**

IA conducted this audit as part of the current audit agenda.

### **Audit Objectives**

The audit objectives were to determine if: CRS had a strong internal control structure in place for managing retirement accounts, benefit calculations were accurate, and outstanding loan balances were properly managed.

### **Audit Scope and Methodology**

This audit encompassed pertinent city staff, records, and CRS database systems. Events occurring between January 1, 2012 and June 30, 2014 were reviewed.

To accomplish the objectives of this audit, IA used the following methodologies: interviewed city staff, reviewed policies and procedures, recalculated retirement benefits, analyzed data, and reviewed system reports.

**Statement of Auditing Standards**

As required by Article II, Section 15 of the City of Cincinnati Administrative Code, this audit was conducted in accordance with the Generally Accepted Government Auditing Standards (GAGAS), except for standard 3.96 pertaining to external peer review requirements. This exception did not have a material effect on the audit. Audit fieldwork was performed between November 2014 and February 2015.

**Commendations**

Internal Audit commends the CRS staff on their cooperation throughout the audit.

## II. Audit Findings and Recommendations

*A benefit calculation error was found.*

IA tested the accuracy of retirement benefit calculations by reviewing benefit calculation data in PensionGold and methodologies used by staff. Approximately 368 employees retired between 2012 and 2014. IA tested 37 (10%) benefit calculations to determine accuracy and found 1 (3%) error. When brought to staff attention the error was immediately corrected. IA also found the complexity of retirement benefit calculations and methodologies used to compute retirees benefits were not documented in a systematic manner, which would facilitate easier reviews, increase transparency, and provide an audit trail. For example, some calculations included multiple data interpretations for holiday saving plan buybacks, service credit reductions, and overtime. Without implementing a system to improve benefit calculation transparency, the review process may become unnecessarily complicated.

**Recommendation 1:** CRS should document the step by step retirement benefit calculation process, including data interpretations, data sources, exceptions, and all methodologies used to calculate retirees' benefit payments. Going forward, additional supervisory reviews of the retirement benefit calculation process should be performed to detect errors and ensure proper account notation.

**Department Response:** Agree. CRS received the disputed benefit calculations identified by Internal Audit. Of those, only one was determined to be in error. That error was due to an oversight by CRS staff to include the Member's longevity payment into his Final Average Salary (FAS) calculation. At the beginning of the Audit Review, there were about 120 active members of CRS subject to the 2.22% Plan which was the only plan that recognized longevity pay for pension purposes. Of those 120, about 25 (less than 1% of the CRS active members) were eligible for longevity pay. Longevity pay was the only component of a member's lump-sum payout that was not automatically included in a member's FAS calculation by the PensionGold system because it is not recorded on an accrual basis (unlike an employee's vacation, sick time, and compensatory time balances). CRS processes included an additional manual step to identify and calculate the longevity pay component. In this particular instance, the failure to include the longevity payment in the FAS calculation was not observed by the CRS staff or supervisor. That member's monthly pension benefit was corrected and increased by \$3.70 for the 4/1/15 pension payroll and retroactive pay was included for the 4/1/15 payroll to make the member whole since his date of retirement. (Important note: Longevity payments were stopped by the City effective January 1, 2015. This change eliminates the longevity pay manual exception process and the risk of future errors in the future.)

CRS administers multiple levels of plan benefits. Understanding the variables and the different rules for each plan requires intensive training over a period of months. Four members of staff are currently fully trained for these processes. The documentation of these processes was developed based on a working knowledge of the PensionGold System and CMC 203. In addition, CRS staff regularly uses the PensionGold User Manual and consults with LRS, the company that supports the PensionGold system.

CRS will review the documentation of all policies and procedures, particularly those concerning benefit calculations, to ensure that all salient aspects are fully discussed and specified and that outdated language is removed.

*Comprehensive policies and procedures were not up to date.*

Comprehensive policies and procedures assist management with providing direction and guidance to staff, and are a key component of internal controls. Approved changes in operating procedures and processes should be updated. IA found the department policies and procedures have not been revised to reflect current practices. The CRS pension plan enrollment procedure document indicates a monthly board meeting report is generated and emailed to the board secretary. According to CRS management, this procedure has not occurred in several years. Additionally, procedures for obtaining a deceased retiree death certificate were vague. The notification of death procedure document indicates a death certificate is needed for paying a burial benefit, but does not specifically address whether or not the department is required to obtain a death certificate in cases where the burial benefit is not applicable.

The current policies and procedures exclude details that address the period in which service credit reductions and benefit reductions should occur on the unpaid loan accounts. Additionally, the policy does not include the criteria that must be met to write off small loan balances, although this is a commonly practice by the department. Also, 1099 record retention requirements were not listed on the retention schedule. Unacceptable deviations of standard operating procedures could occur when policies and procedures have not been thoroughly updated and communicated to staff.

**Recommendation 2:** CRS policies and procedures should be updated to reflect current practices. At a minimum, policies and procedures should include the methodology used to prepare benefit calculation, guidelines for recording service credit reductions and benefits, write-off criteria, obtaining death certificates, and 1099 record retention requirements. Additionally, updated policies and procedures should be communicated to CRS staff.

**Department Response:** Agree. Before the CRS Board was restructured by City Council in 2010, CRS provided lists of new members who were enrolled in the CRS pension plan each month to the Board. This practice stopped when the Board was restructured. This outdated language will be removed from the Enrollment Procedures.

CRS requires and has consistently collected proof of death documentation in all situations that involve the termination of a pension benefit, the continuation and or termination of a pension benefit to an optionee, or the payment of a burial death benefit and/or distribution of an account balance to a named beneficiary. CRS will update its procedures to clearly state the situations that require the collection of proof of death documentation.

The method of collecting defaulted loan amounts through service credit reductions (used as a last resort if the member fails to use other payment options) was developed with the assistance of the CRS actuaries and legal counsel in recent years. The amount of the service credit reduction is actuarially equivalent to the value of the defaulted loan amount. CRS has updated its procedures to specify that a service credit reduction is to be recorded in the same transaction record that depicts the reduction of the member's account balance and satisfaction of the outstanding loan balance. CRS will update loan procedures to include the service credit reduction methodology. As of March 27, 2015 there are 97 outstanding loans.

In addition, CRS will develop criteria for the write-off of the negligible loan balances (less than \$10) that occur as a result of resetting the loan repayment amounts due to disruption of the member's original loan amortization schedule.



The PensionGold System maintains an archived record of all 1099s issued by CRS from 2001 going forward. In addition, 1099 records prior to 2001 are retained by CRS on microfiche. Paper copies of 1099's issued will not be retained by CRS. CRS will review and update its record retention policy to provide more accurate descriptions of the various document and record types being retained.

*A data variance was found.*

Reconciling financial data on a monthly basis is a control activity used to detect irregularities and variances in a timely manner. Performing monthly reconciliations can also provide insight regarding the factors causing the variance. The PensionGold system captures loan payment transactions and other loan related activity. IA found the outstanding loan balance in PensionGold was not reconciled, and a variance was identified. This issue was brought to CRS management attention and is currently under review. Implementing a process to reconcile outstanding loan balances in PensionGold will allow staff to detect variances, identify the root cause, and perform corrective action.

**Recommendation 3:** CRS should reconcile PensionGold beginning and ending outstanding loan balances on a monthly basis, and rectify any variances.

**Department Response:** Agree. The variance in beginning and ending loan balances at year end were due to reporting limitations that did not clearly identify the principal and interest components of the loan amounts that were paid off early during the year by the member or were paid off through the loan default procedures that included service credit reductions equivalent to the actuarial value of the defaulted loan amount.

Although the correct cash amount was collected, the reporting limitations did not allow for the proper accounting for the principal and interest. CRS will develop a method of reporting the principal and interest for all outstanding and paid off loans, and will change procedures to require the monthly reconciliation of loans.

*Controls over recovering pension payments submitted in error need strengthening.*

CRS control procedures for detecting deceased pensioners consist of utilizing professional services, web research, and obtaining notifications from the deceased family member or associates. After receiving the notification of death, CRS staff updates the PensionGold system and terminates the deceased member's future pension payments. Pension payments are issued one month in arrears. For example, if a retiree dies May 19<sup>th</sup>, he/she is entitled to receive their June 1<sup>st</sup> payment, which covers May benefits, and any future payments should be terminated.

IA reviewed payment history for 320 retirees who died between 2012 and 2014 to determine if adequate controls were in place to detect deceased retirees and stop payment. IA found 312 (98%) deceased retirees pension payments were terminated or voided within the appropriate time frame.

**Recommendation 4:** CRS should perform additional analysis of the deceased data file and the payment history file to identify pension payments issued in error. Once identified, the recovery process should be properly noted in PensionGold.

**Department Response:** Agree. Internal Audit identified eight benefit payments that appeared to be overpaid due to the death of the member. Of the overpayments identified by Internal Audit, all except one were resolved within 30 days, and most were recovered from the continuing pension benefit payable to the optionee. One remains unresolved. In that instance, the pensioner had elected a Single Life Option, and no continuing benefit was available to be paid. CRS continues to make collection efforts for this overpayment and has communicated several times to the executor regarding collection of the overpayment amount.

CRS was recently advised by its professional search vendor, LexisNexis (the operator of the Accurint System), that new Federal regulations instituted in 2014 require users of the Accurint System, such as CRS, to provide an additional certification to be able to access death records through the Master Death Data File generated by the Social Security Administration. CRS was not notified by LexisNexis of these new requirements in a prompt manner. This oversight by LexisNexis unknowingly delayed access to and notification of death notice reports to CRS. CRS provided that certification to LexisNexis in February 2015.

CRS will use the death check process through Accurint on a monthly basis, rather than on a bi-monthly basis. In addition, any overpayments that occur that cannot be resolved in a timely manner will be submitted for collection through the City's Treasury Division and City's Solicitor's Office, per the City's Standard Procedures.

### **III. Conclusion**

CRS provides an important service to the City; they assist many individuals with the retirement application process, benefit determinations, and other areas. The audit revealed CRS internal controls were functioning; however there are opportunities for improvement. For example, CRS policies and procedures were not thorough and up to date, methodologies used to determine benefit calculations were not transparent, data discrepancies were found, and in some instances actions taken to recover pension payments issued in error were not apparent.

## V. Cincinnati Retirement System Response

**Recommendation 1:** CRS should document the step by step retirement benefit calculation process, including data interpretations, data sources, exceptions, and all methodologies used to calculate retirees' benefit payments. Going forward, additional supervisory reviews of the retirement benefit calculation process should be performed to detect errors and ensure proper account notation.

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