



Continuous Audit of Final Average Salary Calculations (Q4 2021)

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Internal Audit Department

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OCERS Internal Audit
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Audit Objective and Scope

The objective of this audit was to provide an independent review of Final Average Salary (FAS) calculations used in new benefit payments setup by OCERS' Member Services, on a continuous basis.

In response to Internal Audit's 2020 Audits of FAS Calculations, Member Services reorganized the Retirement Program Specialist Team and modified the FAS calculation process including an updated retirement transaction excel spreadsheet as part of the Management Action Plan. The action plan was implemented in Q2 2021. A total of 154 new service and disability retirement benefits were processed in Q4 2021. Internal Audit reviewed the FAS calculations for 134 of these benefits.

The audit was conducted in conformance with the International Standards for the Professional Practice of Internal Auditing issued by the International Internal Audit Standards Board.

Conclusion / Executive Summary

Opinion: *Opportunities for Improvement*

During our review, Internal Audit noted opportunities exist to improve Member Services' quality control review over FAS calculations.

We noted a 1.5% error rate (two errors) out of the 134 FAS calculations sampled from Q4 2021. The errors resulted in changes of less than \$2 in the monthly benefit payment. Additionally, Internal Audit identified a pay item that was incorrectly configured in V3 to be prorated when calculating the FAS. Separately, we also found nine instances in which the members' FAS supporting documentation required updates in the pension administration system, there was no financial impact.

Management has agreed to our findings. See below for additional detail and Management's responses.

Background

To finalize each retiree's FAS, Member Services uses a retirement transaction Excel spreadsheet. In the spreadsheet, Member Services inputs a preliminary FAS number calculated by the pension administration system after reviewing it, and also inputs other manually calculated pensionable pay amounts not captured or calculated by the pension administration system. To calculate these amounts, the Retirement Program Specialist (RPS) must reference a variety of external data sources provided by employers, such as

hourly rate history, timesheet data, and relevant Employer Memorandum of Understanding (MOU). A Member Services Quality Assurance team member then reviews the final FAS calculated by the RPS.

Internal Audit independently tested 134 of the 154 FAS benefit calculations from the October through December 2021 benefit payroll months, and performed the following:

- Recalculated and traced the preliminary FAS used in the spreadsheet back to the preliminary FAS number calculated by the pension administration system.
- Reviewed Member Service’s manual calculations of other pensionable pay item amounts (typically pensionable paid time off, or PTO) manually added to the preliminary FAS and the documentation used by Member Services to support their calculations.

Below is a summary of IA’s error rate noted in the current audit, plus error rates noted in prior 2020 and 2021 audits:

Quarter	Benefit Applications	Tested by Internal Audit (IA)	IA Error Count	IA Error Rate
Q1/2020	149	82	6	5.8%
Q2/2020	514	56	2	
Q3/2020	108	10	1	8.0%
Q4/2020	466	65	5	
Q2/2021	182	60	4	6.7%
Applications Processed Under the Revised FAS Calculation Procedure				
Q3/2021	75	75	6	8.0%*
Q4/2021	154	134	2	1.5%*

*Each of the quarters contained a month with 100% accuracy

Monthly Breakdown of Q4 2021 Quarter Testing				
Month	Benefit Applications	Tested by Internal Audit (IA)	IA Error Count	IA Error Rate
October	37	37	0	0%
November	55	55	1	1.8%
December	62	42	1	2.4%

Important Observations

1. **Internal Audit noted a 1.5% error rate (two errors) with the 134 FAS calculation sampled from the 4th quarter of 2021.** An oversight when reviewing FAS calculations can lead to errors in the monthly benefit paid to OCERS members. The errors resulted in changes of less than \$2 in the monthly benefit payment. The errors occurred in the

manual portion of the FAS calculation process, comparable to the type of errors Internal Audit had identified in prior FAS Calculation audits. In response to the observation, Member Services addressed the benefit calculation errors with the payroll team by providing additional training and guidance. Member Services will address the issue with the individual team member and determine an action plan, if necessary, to ensure that it will not happen again.

2. **A pensionable pay item was incorrectly configured in the Pension Administration System (PAS) to be prorated when calculating FAS.** The configuration error in the Pension Administration System (PAS) was identified in one of the two samples noted in the observation above. However, the Quality Assurance review manually applied the correct proration logic when calculating the FAS for this member. In response to the observation, Member Services Management team corrected the configuration in the PAS and no manual intervention will be required going forward.
3. **The FAS supporting documentation for nine members needed to be updated in the pension administration system (no FAS impact).** Member Services' quality control steps did not detect this oversight. FAS benefit calculations in the pension administration system would not have a proper audit trail if documentation is not complete. In response to the observation, Member Services Management team is working with the Quality Assurance team to enhance the audit process. Documentation errors will be addressed as a separate category, with the team Supervisor monitoring the team members' activities.

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Observation Details	Management Action Plan (MAP) /MAP Responsible Party / Completion Date
Important Observations	
<p>1. Internal Audit noted a 1.5% error rate (two errors) with the 134 FAS calculation sampled from the 4th quarter of 2021.</p> <p>Each of the errors resulted in changes of less than \$2 in the monthly benefit payment. The errors occurred in the manual portion of the FAS benefit calculation. The nature of the errors were comparable to the errors noted in the prior FAS Calculation audits. The details of the errors are noted in the FAS Calculation Summary table below.</p> <p>Further details in the FAS Error Summary table below.</p> <p>Risk: An oversight when reviewing FAS calculations can lead to errors in the monthly benefit paid to OCERS members.</p>	<p>Management Action Plan:</p> <p>Management will continue to address benefit calculation errors with the payroll team by providing additional training and guidance. Management will address the issue with the individual team member and they will work together to determine an action plan to ensure that it will not happen again. Each team members' performance is being monitored by the team Supervisor so that additional training can be provided as needed. When necessary and appropriate a corrective performance action plan will be put in place.</p> <p>Management Action Plan Responsible Party: Jeff Lamberson, Director of Member Services</p> <p>Completion Date: Completed</p>
<p>2. A pensionable pay item was incorrectly configured in the Pension Administration System (PAS) to be prorated when calculating FAS.</p> <p>The configuration error in the PAS was identified in one of the two samples noted in the observation above. However, the Quality Assurance review manually applied the correct proration logic when calculating the FAS for this member.</p> <p>The Backflow Certification pay item was configured in the PAS to prorate the amount of pay applied in the</p>	<p>Management Action Plan:</p> <p>This was a system configuration error that had no effect on the member's benefit. The payroll team had correctly computed the amount that was included in FAS. Management took action to ensure the configuration in our PAS system was corrected and no manual intervention will be required going forward.</p> <p>Management Action Plan Responsible Party: Jeff Lamberson, Director of Member Services</p> <p>Completion Date: Completed</p>

Observation Details	Management Action Plan (MAP) /MAP Responsible Party / Completion Date
<p>FAS when it is included in a partial pay period for the FAS measuring period. However, the pay item should not be prorated, but instead the full amount should be included in the FAS calculation as per the Memorandum of Understanding. A partial pay period is normally limited to the first pay period in a FAS measuring period. The Backflow Certification pay is applicable to Craft and Plant Engineers at the County of Orange at a rate of \$46.15 per pay period.</p> <p>Risk: A configuration error in the pension administration system can lead to errors in the monthly benefit paid to OCERS members.</p>	
<p>3. The FAS supporting documentation for nine members needed to be updated in the pension administration system (no FAS impact).</p> <p>Member Services later uploaded the finalized documentation identified by Internal Audit for the nine members to the pension administration system in response to the audit. The final FAS supporting documentation included the following type of documentation errors:</p> <ul style="list-style-type: none"> • Incorrect references to holidays • Information noted in the FAS worksheet summary tab did not reflect the correct details • Missing reviewer name 	<p>Management Action Plan:</p> <p>Management is working closely with the QA Team to enhance the audit process. In the future any documentation errors will be addressed as a separate category instead of being combined with the calculation error category. However, documentation errors will be addressed in the same manner as the calculation errors. The team members' activity is being monitored by the team Supervisor and if sustained improvement is not seen a corrective performance action plan will be put in place.</p> <p>Management Action Plan Responsible Party: Jeff Lamberson, Director of Member Services</p> <p>Completion Date: Completed</p>

Observation Details	Management Action Plan (MAP) /MAP Responsible Party / Completion Date
<p>The documentation errors did not result in an error in the FAS calculation.</p> <p>Risk: FAS benefit calculations in the pension administration system would not have a proper audit trail if supporting documentation is not accurately updated or finalized.</p>	

Internal Audit - FAS Error Summary (Q4 2021)

Sample	Nature of FAS Error	Monthly FAS Error	Monthly Benefit Payment Error	Months With Error
1	<u>Holiday Pay Rate - Manual</u> Member Services did not apply the correct hourly rate to pensionable holiday pay when manually calculating the FAS.	Original monthly FAS of \$6,899.26 overstated by \$1.05.	Original monthly benefit of \$3,205.97 overpaid by \$0.52.	1 month
2	<u>Holiday Hours - Manual</u> Member Services did not apply the correct number of hours to pensionable holiday pay when manually calculating the FAS.	Original monthly FAS of \$5,585.18 understated by \$2.27.	Original monthly benefit of \$3,928.71 underpaid by \$1.60.	1 month

Categories of Observations (Control Exceptions):

Priority Observations:

These are observation(s) that represent critical exceptions to the audit objective(s) and/or business goals. Such conditions may involve either actual or potential large dollar errors or be of such a nature as to compromise OCERS' reputation or integrity. Management is expected to address Priority Observations brought to its attention immediately.

Important Observations:

These items are important to the process owner and they do impact the control environment and/or could be observations for improving the efficiency and/or effectiveness of OCERS' operations. Management is expected to address within six to twelve months.

Management's Responsibility for Internal Control

Management has primary responsibility for establishing and maintaining the internal control system. All levels of management must be involved in assessing and strengthening internal controls. Control systems shall be continuously evaluated by Management and weaknesses, when detected, must be promptly corrected. The criteria for evaluating an entity's internal control structure are the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control – Integrated Framework. Our Internal Control Audit enhances and complements, but does not substitute for department management's continuing emphasis on control activities and self-assessment of control risks.

Internal Control Limitations

Because of inherent limitations in any system of internal control, errors or irregularities may nevertheless occur and not be detected. Specific examples of limitations include, but are not limited to, resource constraints, unintentional errors, management override, circumvention by collusion, and poor judgment. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or the degree of compliance with the procedures may deteriorate. Accordingly, our audit would not necessarily disclose all weaknesses in the department's operating procedures, accounting practices, and compliance with OCERS' policies.

Audit Report Opinions:

Satisfactory:

No issues or a limited number of “Important Observations” (typically no more than two Important Observations).

Opportunities for Improvement:

Multiple issues classified as “Important Observations” (typically two or more Important Observations) with no more than one “Priority Observations”.

Inadequate:

Usually rendered when multiple issues are classified as “Priority” ” (typically one or more Priority Observations), together with one or more other issues classified as “Important Observations”. The Priority Observations identified have a major effect on processes, plan sponsors/members, financials, and/or regulatory requirements.