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Secretary of State

State of Oregon

**PUBLIC EMPLOYES RETIREMENT SYSTEM**

July 1, 1995 to June 30, 1996



Audits Division

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July 1, 1995 to June 30, 1996



Audits Division





Secretary of State

Audits Division

*Auditing for a Better Oregon*

The Honorable John Kitzhaber  
Governor of Oregon  
State Capitol Building  
Salem, Oregon 97310

The Board of Trustees  
Oregon Public Employees Retirement System  
200 SW Market, Suite 700  
Portland, Oregon 97207

This audit was conducted for the purpose of reporting on the Public Employees Retirement System's (PERS) financial statements as of and for the year ended June 30, 1996, and on internal control and compliance with applicable laws and regulations.

We conducted our audit in accordance with generally accepted auditing standards and *Governmental Auditing Standards*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. Evaluation of the related internal control and significant compliance issues is also required by these standards.

PERS' financial statements, and our opinion thereon, are printed in a separate report published by the Public Employees Retirement System. Our Independent Auditor's Report gave an unqualified opinion, which is a conclusion that the financial statements are presented in accordance with generally accepted accounting principals.

Our reports on internal control and compliance with applicable laws and regulations are included herein. We noted certain matters involving the internal control and its operations that we considered to be reportable conditions. Furthermore, our tests of compliance with laws and regulations disclosed instances of noncompliance which are also included in this report.

OREGON AUDITS DIVISION

Sam Cochran  
Acting State Auditor

Fieldwork Completion Date:  
December 11, 1996

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## SUMMARY

The Oregon Public Employees Retirement System (PERS) is a statewide defined benefit retirement plan for units of state government, political subdivisions, community colleges, and school districts. At June 30, 1996 there were 822 employers that were members of PERS, including 116 state agencies, 450 political subdivisions, 17 Community Colleges and 239 School districts. There are more than 66,000 retirees and beneficiaries currently receiving PERS benefits and more than 179,000 current and terminated employees who are members but are not yet receiving benefits.

PERS is funded through member and employer contributions and investment earnings. For the fiscal year ended June 30, 1996, revenues of \$4.4 billion were reported. Expenses for the fiscal year ended June 30, 1996 totaled \$1.2 billion.

The audit was conducted for the purpose of reporting on the Oregon Public Employees Retirement System's financial statements for the year ended June 30, 1996. These financial statements, and our opinion thereon, are printed in a separate report published by the Public Employees Retirement System. Our Independent Auditor's Report gave an unqualified opinion, which is a conclusion that the financial statements are presented in accordance with generally accepted accounting principles.

This audit was also conducted for the purpose of reporting on the internal control structure and compliance with applicable laws and regulations, in accordance with *Governmental Auditing Standards* issued by the Comptroller General of the United States. Our reports on internal control and compliance with applicable laws and regulations are included herein.

The results of our audit identified the following areas where improvements can be made:

- PERS allows retiring members to use purchased wait time months in the calculation to determine the number of refunded months a retiree may purchase and use toward their retirement benefit. This allows certain members to retire with increased benefits. We suggest PERS request direction from the Attorney General to assure the application of purchased wait time is in accordance with statute.
- A limited review of the Retirement Information Management System's (RIMS) security access found some PERS employees have access to two or more screens that may allow them to perform functions that may be incompatible with their duties and they should not be allowed to perform. This degree of access increases the risk of unauthorized payments being made. Therefore, PERS should have controls in place to ensure account modification access is limited. PERS management indicated that a new computer system which is now in place should address this concern.

- There were over 80 outstanding work requests in PERS' Information Systems Section related to modification or correction of known RIMS errors. While investigating one benefit payment error and its related work request, we found a second similar work request which has been outstanding since November of 1992. PERS should be addressing RIMS errors in a timely manner as this system is vital to the correct calculation of retirement benefits.
- PERS does not have a formal procedures manual available to employees that documents how pension benefits are calculated. Procedure documentation is essential as retirement calculations are inherently complex. Formal procedures would provide guidance and help ensure all PERS employees are calculating benefit allowances consistently and in accordance with statutes.
- PERS does not have the detailed investment information needed to correctly classify investments for financial statement purposes. Therefore, PERS needs to work with the Oregon State Treasury to obtain detailed reports of its equity portfolio investments.

In its response, which is included in this report, PERS agrees with all of the findings and recommendations.

## INTRODUCTION

### ORGANIZATION AND FUNCTIONS

The Oregon Public Employees Retirement System (PERS) is a statewide defined benefit retirement plan for units of state government, political subdivisions, community colleges, and school districts. At June 30, 1996 there were 822 employers that were members of PERS, including 116 state agencies, 450 political subdivisions, 17 Community Colleges and 239 School districts. For state agencies, community colleges, and school districts, PERS is a cost-sharing, multiple-employer system. It is an agent multiple-employer system for political subdivisions. While participation by state government units, school districts, and community colleges is mandatory, participation by most political subdivisions is optional but irrevocable if elected. There are more than 66,000 retirees and beneficiaries currently receiving PERS benefits and more than 179,000 current and terminated employees that are members who are not yet receiving benefits.

The PERS is administered under Oregon Revised Statutes (ORS) Chapter 238 by the Public Employees Retirement Board (board). The board consists of eleven members, all of whom are appointed by the Governor and confirmed by the Senate. The board appoints a director and employs staff to administer PERS' activities. PERS' principal administrative office is located in Portland, Oregon.

PERS, through its Member Services Division, provides counseling services at two external counseling centers as well as in the Portland office. This division also provides services to employers and employee members relating to retirements, deaths, and disabilities. PERS also has a Fiscal Services Division and an Information Systems Division that provide administrative support for the agency. The Deferred Compensation plan, which is authorized under Internal Revenue Code Section 457 and ORS 243.400 to 243.507, is also administered through the board.

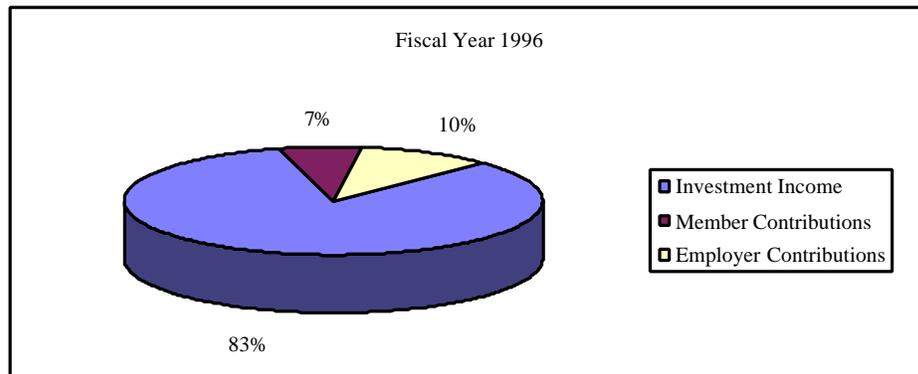
The board contracts for medical and hospital insurance on behalf of retired members. Members and their dependents are eligible for PERS health coverage if the member is

receiving a retirement allowance or benefit under the PERS system. There are two health insurance subsidy programs, the Retirement Health Insurance Account (RHIA) that is available to all qualifying PERS retirees and dependents, and the Retirement Health Insurance Premium Account (RHIPA) that is available only for qualifying *state* retirees and dependents. These accounts subsidize qualifying retirees' and dependents' health insurance premiums.

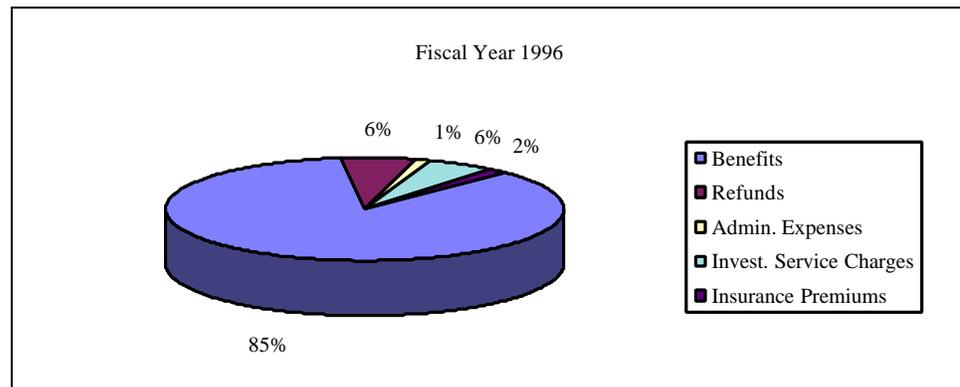
## FINANCIAL ACTIVITIES

PERS' financial activities are accounted for in a Pension Trust Fund. The primary sources of revenues are member and employer contributions and investment earnings.

### *Revenues*



Member contributions totaled \$290 million for the fiscal year 1996. Employer contributions for the same period totaled \$446 million. Investment earnings include interest earned on fixed-income securities, gains and losses on the disposal of investments, and changes in the market value of equity investments. Income from investments for fiscal year 1996 totaled \$3.6 billion. PERS benefits include service retirements, death, disability and post-retirement health care benefits.

*Expenses*

Expenses for retirement, death, and disability benefits paid to retirees in fiscal year 1996 totaled \$1.1 billion. PERS also paid out approximately \$75 million in refunds to members who decided to remove their accounts from PERS. Administration expenses and investment service charges were \$13.7 and \$68.2 million respectively. Insurance premium subsidies paid by PERS for fiscal year 1996 were approximately \$21 million.

## SCOPE AND METHODOLOGY

The audit was conducted for the purpose of reporting on the Oregon Public Employees Retirement System's financial statements for the year ended June 30, 1996. These financial statements, and our opinion thereon, are printed in a separate report published by the Public Employees Retirement System. Our Independent Auditor's Report gave an unqualified opinion, which is a conclusion that the financial statements are presented in accordance with generally accepted accounting principles.

This audit was also conducted for the purpose of reporting on the internal control structure and compliance with applicable laws and regulations, in accordance with *Governmental Auditing Standards* issued by the Comptroller General of the United States.



## **AUDIT RESULTS**



**Report on Internal Control based on an Audit of General-Purpose Financial Statements Performed in Accordance with Government Auditing Standards**

We have audited the general-purpose financial statements of the Public Employees Retirement System (PERS), as of and for the year ended June 30, 1996, and have issued our report thereon dated December 11, 1996. Our report is presented in the separately issued Public Employees Retirement System Comprehensive Annual Financial Report.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the general-purpose financial statements are free of material misstatement.

The management of PERS is responsible for establishing and maintaining internal control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures. The objectives of internal control are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of general-purpose financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the internal control to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of the general-purpose financial statements of PERS, for the year ended June 30, 1996, we obtained an understanding of the internal control. With respect to the internal control, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk in order to determine our auditing procedures for the purpose of expressing our opinion on the general-purpose financial statements and not to provide an opinion on the internal control. Accordingly, we do not express such an opinion.

We noted certain matters involving the internal control and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the entity's ability to record, process, summarize, and report financial data consistent with the assertions of management in the general-purpose financial

statements. These matters are presented in the FINDINGS AND RECOMMENDATIONS section of this report.

A material weakness is a reportable condition in which the design or operation of one or more of the specific internal control elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the general-purpose financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of internal control would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe none of the reportable conditions described is a material weakness.

We also noted other matters involving the internal control and its operation that we have reported to PERS management separately.

This report is intended for the information of the Public Employees Retirement Board, the management of PERS, the Governor of the state of Oregon, and the Oregon Legislative Assembly. However, this report is a matter of public record and its distribution is not limited.

OREGON AUDITS DIVISION

Sharron W. Goggins, CPA, CFE  
Deputy State Auditor

December 11, 1996

**Report on Compliance Based on an Audit of General-Purpose Financial Statements  
Performed in Accordance with Government Auditing Standards**

We have audited the general-purpose financial statements of the Public Employees Retirement System (PERS), as of and for the year ended June 30, 1996, and have issued our report thereon dated December 11, 1996. Our report is presented in the separately issued Public Employees Retirement System Comprehensive Annual Financial Report.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the general-purpose financial statements are free of material misstatement.

Compliance with laws, regulations, and policies applicable to PERS is the responsibility of the PERS' management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of PERS' compliance with certain provisions of laws, regulations, and policies. However, the objective of our audit of the general-purpose financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests disclosed certain instances of noncompliance with provisions referred to in the preceding paragraph which are included in this report, and can be found in the FINDINGS AND RECOMMENDATIONS section of this report.

We considered these instances of noncompliance in forming our opinion on whether PERS' general-purpose financial statements are presented fairly, in all material respects, in conformity with generally accepted accounting principles, and this report does not affect our report dated December 11, 1996, on those general-purpose financial statements.

This report is intended for the information of the Public Employees Retirement Board, the management of PERS, the Governor of the state of Oregon, and the Oregon Legislative Assembly. However, this report is a matter of public record and its distribution is not limited.

## OREGON AUDITS DIVISION

Sharron W. Goggins, CPA, CFE  
Deputy State Auditor

December 11, 1996

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## FINDINGS AND RECOMMENDATIONS

### Purchasing of Creditable Service

When a member leaves PERS-covered employment, the member has the option to have their member account balance refunded to them. If this member subsequently returns to PERS-covered employment, the member has the option, at their retirement, to purchase back the prior refunded account balance and related service time. This purchase requirement is guided by *Oregon Revised Statutes* (ORS) 238.115(1)(a). PERS is not applying this statute correctly.

The statute allows “restoration of one full month of creditable service forfeited by the withdrawal for each three full months of service as an *active member after* that reentry.” [emphasis added] PERS is allowing members to retire with larger service time credit and larger retirement benefits than is allowed under statute. PERS is allowing the member to count purchased wait time (the six months wait time required for each member before they can join PERS) as part of the amount of time worked as an active member. While this time does count toward the retirement calculation, it can not be counted toward repurchase because the statute states they can only repurchase one month’s time for each three months worked *after* reentry into the system.

PERS has requested an Attorney General’s opinion to verify the correct application of the statute. Based on that opinion, PERS may need to take action to ensure purchases and service time are granted in accordance with the statute.

### Information System Access

As part of our tests of internal control, we performed a limited security access review of PERS’ Retirement Information Management System (RIMS). RIMS is the computer system that processes all retirement information. Our review found PERS is not removing employees’ access to incompatible RIMS screens to which they do not need access.

Our testing found five out of the 16 employees in the membership and retirement services units have access to two or more screens that allow them to perform functions that may be incompatible with their duties and they should not be allowed to perform. Access to these incompatible screens could allow employees to set up or change either member benefit payments, account balances, or possibly make unauthorized payments. For instance, if an employee already has access to a screen that allows the set up of a member benefit payment amount, they should not be allowed to also gain access to a screen that allows changes to the name or address for that member. This degree of access increases the risk of unauthorized payments being made; therefore PERS should have controls in place to ensure account modification access is limited.

PERS has removed access to one or more screens for the five employees so they no longer have incompatible access. PERS management indicated the agency has a new computer program in place effective January 27, 1997. This program is designed to automatically track each employee's access and should not allow incompatible screen access. PERS also stated the internal auditor will test PERS system security, including this new program.

**We recommend** PERS review all employees access to RIMS screens to identify employees with incompatible access. Employees found to have incompatible access should have such access revoked.

### **Computer System Work Requests Backlog**

The PERS' Retirement Information Management System (RIMS) processes roughly 95 percent of all retirement calculations. As such, it is critical for RIMS to correctly and accurately process retirement information.

During our testing, we found a RIMS-calculated retirement which incorrectly allocated service time between job classifications. The error resulted in the retiree benefit being underpaid by \$11 per month and the associated reserve accounts being understated by \$1,446. This type of error has also been noted in prior years' audits. While researching the underlying cause of this error, we identified a work request which has been outstanding since November of 1992 that was intended to address service time errors.

Upon further review, we identified an additional 80 outstanding work requests to modify RIMS screens or correct known RIMS errors, dating back as far as 1989. These workorders are for a variety of purposes, some of which are to correct benefit calculation modules, while others may be minor issues. PERS should address workorders that relate to known RIMS errors in a timely manner as this system is vital to the correct calculation of retirement benefits.

PERS management indicated they keep a log of all of the outstanding workorders and prioritize them monthly. However, some of the workorders stay outstanding for a substantial period of time because external mandates such as Measure 8, Tier Two, and House Bill 3349 have taken all of the agency's staff resources.

**We recommend** PERS' management review the outstanding work requests and put a high priority on addressing those work requests that affect the accuracy and validity of benefit calculations, in a timely manner.

### **Policies and Procedures Manual**

PERS' retirement services section does not have a current written procedure manual available to them that documents how pension benefits are calculated. Procedure documentation is essential as retirement calculations are inherently complex. The benefit calculation requires several sub-calculations (service time allowances, final average salary, unused sick leave hours, wait and refund purchases) to be determined before the benefit allowance can be calculated.

Training of new employees, who will be responsible for pension calculations, is currently done orally and through "on the job" training with another retirement counselor. Formal written procedures would provide guidance for employees and help ensure PERS employees are calculating allowances consistently and in accordance with statutes.

PERS retirement services section employees told us that no procedures manual existed or was available for their use. However, PERS management indicated some procedures were documented on-line in an old computer system, but are not easily accessible in the current system for staff to use. They also said these policies are available in hard

copy in the personnel section, but most employees are also unaware of this.

**We recommend** PERS create and/or update retirement calculation methods and related policies and procedures for the retirement services section, as well as evaluate the need for updates to other policies throughout the agency. These policies and procedures should then be made available to employees.

## Financial Reporting

PERS uses reports from the Oregon State Treasury's custodian to determine amounts and classification of investments to report in their financial statements. Several financial portfolios contain not only equity securities, but cash and cash equivalents, corporate obligations, foreign bonds, convertible bonds, accrued interest receivable, accounts receivable, and accounts payable. We found that PERS was reporting the entire market value of debt securities (corporate obligations, foreign bonds, and convertible bonds) contained in the portfolios as equity securities. These debt securities total approximately \$397 million at June 30, 1996, or 2.4% of PERS' total equity securities and 8.1% of PERS' total debt securities. According to governmental accounting standards, bonds should not be classified as equity securities.

PERS reclassified its securities in their fiscal year 1996 financial statements to bring them into compliance with these standards.

We also found that cash and cash equivalents totaling \$4.5 million were incorrectly reporting as equity investments at June 30, 1996. The Department of Administrative Services' related policy indicates that amounts a money manager is holding as cash that are not invested in equities at fiscal year end should be classified as cash and not investments for financial statement purposes provided the holding account possesses the characteristics of a demand deposit account.

OST or its custodians should be able to provide detailed reports of fiscal year end balances in all equity portfolios that would allow PERS to correctly report investment balances in its financial statements. The changes in reporting required by the implementation of two new accounting standards, GASB 25 and GASB 28, make it important that PERS receive accurate and detailed information from OST about its investment holdings.

OST is required by statute to provide financial information requested by PERS. Therefore, PERS needs to determine exactly what detailed financial information is required under reporting standards and formally request that information from OST.

**We recommend** PERS and OST establish a work group or task force to determine what information is needed by PERS for the upcoming financial reporting period and then periodically review ways to improve the financial reporting information.

## **REPORT DISTRIBUTION**

This report is a public record and is intended for the information of the Board of Trustees of the Oregon Public Employes Retirement System, the Retirement System's management, the Governor of the state of Oregon, the Oregon Legislative Assembly, and all other interested parties.

## **COMMENDATION**

The courtesies and cooperation extended by management and staff of the Oregon Public Employes Retirement System during the course of our audit were very commendable and are sincerely appreciated.

## **AUDIT TEAM**

Stephanie Schutzler, CPA, Audit Administrator  
Sandra Horst, CPA  
Craig Stroud, CPA  
Anne Lawrence  
Mark Montgomery



**AGENCY'S RESPONSE TO THE AUDIT REPORT**



April 30, 1997

Secretary of State Audits Division  
255 Capitol St. NE, Suite 500  
Salem, OR 97310

**PUBLIC**  
**EMPLOYEES**  
**RETIREMENT**  
**SYSTEM**

Re: PERS Audit Response to June 30, 1996, Audit Report

PERS' response to the 1995-96 Secretary of State's annual financial audit is detailed as follows. As you will note, PERS agrees with the findings and recommendations made by the Audits Division.

### **Purchasing of Creditable Service**

PERS agrees with this finding and recommendation. Guidance has been requested from the Attorney General's office on this issue. Appropriate corrective action will be taken once the guidance is received.

### **Information System Access**

PERS agrees with this finding and its recommendation. PERS has implemented a new security system on January 27, 1997. Procedures to preclude incompatible screen access are built into the new security system. Future security access problems are not expected, because the system is designed to automatically reject any screen access request which would create an incompatibility in use between two or more screens.

### **Computer System Work Requests Backlog**

PERS agrees there are many outstanding work requests, and they should be reviewed periodically. PERS recently completed a comprehensive review and prioritization of all outstanding work requests. This process will be conducted on an annual basis in the future and will sort the work requests into the categories of (1) *enhancements* and (2) *mission critical*. The next review is expected to be completed September 30, 1997.

The highest priority is given those work requests that have the greatest member benefit and/or financial implications. Work requests that correct errors that result in isolated or one-time benefit miscalculations are occasionally deferred in lieu of more immediate or widespread demands. Likewise, the benefit calculation problems highlighted in the Audits Division report are both limited in nature and affect a very small number of members. To protect against system errors, experienced staff members monitor all retirement calculations. Benefit errors that are identified are manually corrected.

John A. Kitzhaber  
Governor



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Secretary of State Audits Division  
April 29, 1997  
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Unresolved benefit calculation problems will be corrected with the planned revision of the RIMS system.

### **Policies and Procedures Manual**

PERS agrees with the finding and the recommendation. In 1997, PERS will create and/or update retirement calculation methods and related policies and procedures for the Retirement Services Section. The agency will begin a process to evaluate the need for updates to other policies throughout the agency. Once reviewed and/or updated, the policies and procedures will be made available to appropriate staff members. All appropriate agency staff will be trained how to access agency policies and procedures.

### **Financial Reporting**

PERS agrees with the audit finding and recommendation. OST should provide investment and other financial information in the manner required by PERS for reporting purposes. PERS will compile a detailed list of needed financial information and will forward it to OST staff prior to June 30, 1997. This month (April), the first of several meetings has been scheduled with OST staff to discuss PERS' needs and reporting requirements in order to comply with the Audits Division recommendation.

We appreciate the courtesy and professionalism received from the Audits Division staff during the course of the audit. Please contact Dale Orr, Fiscal Services Division Administrator, if you have any questions.

Sincerely,



Fred McDonnal  
Executive Director

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