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Auditing for a Better Oregon

January 22, 2004

The Board of Trustees
Public Employees Retirement System Board
11410 SW 68th Parkway
Tigard, Oregon 97223

Laurie Warner, Interim Executive Director
Public Employees Retirement System
11410 SW 68th Parkway
Tigard, Oregon 97223

Dear Ms. Warner and the Board:

We have completed our financial statement audit of the Oregon Public Employees Retirement System (PERS) for the fiscal year ended June 30, 2003. During our audit, we did not identify any reportable conditions related to internal control or to noncompliance with applicable laws and regulations. However, we did identify other conditions needing corrective action. We recently met with PERS' staff to discuss these conditions. We will follow up on PERS' progress in addressing these issues during our audit of the fiscal year 2004 financial statements.

Benefit Calculations

PERS was not able to provide documentation to support eight of the 42 benefit calculations included in our review. Missing documentation included retirement applications, salary certifications, and evidence of purchased time. In addition, we noticed that PERS used erroneous information in six of the 42 calculations reviewed. These errors included using incorrect years of service, date of birth, sick leave hours, and salary. As a result of the missing documentation, we were not able to verify whether PERS used correct variables to calculate some member benefits. Also, due to errors resulting from the incorrect calculations, PERS underpaid members $7,231 and overpaid a member $436.

PERS' record retention schedule requires member records, such as employment information and retirement applications, to be retained for 175 years. In addition, it is important for PERS to use correct information when calculating a member's benefit so that the benefit paid and related reserve accounts established are correct.

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We recommend that PERS retain all supporting documentation as required, ensure that all calculations are completed using correct information, and reimburse members for the underpayments and collect the overpayments noted from our audit.

Reconciliation Accounts

During the fiscal year 2002 audit, we noted that PERS was not promptly clearing items from one of the five Retirement Information Management System (RIMS) reconciliation accounts. During our fiscal year 2003 audit, we noted that PERS is not promptly clearing items from three of the five reconciliation accounts. The absolute value of transactions for each account as of June 30, 2003 was $6,309,856, $117,569,518, and $4,618,357, and each continues to grow.

PERS should require timely correction of reconciliation accounts to ensure that members (and ex-members) receive proper payment and reserve balances are accurately reflected in the accounting records. Uncorrected reconciling items may result in the over- or underpayment of refunds or benefits. Furthermore, failure to promptly correct reconciling items may increase the magnitude of errors.

According to PERS management, other priorities have taken precedence over the correction of reconciling items. We recommend that PERS' management review priorities to ensure that appropriate attention is given to the growing balances of these accounts.

Controls Over SBT Could Be Improved

We determined that five PERS accounting staff members had access to the financial reporting system that allowed a single person to create, post, and in some instances delete accounting transactions. Proper segregation of duties requires that no one individual has the ability to prepare, post and delete transactions. We also noted that two PERS employees were sharing a user account used to prepare manual checks. Furthermore, PERS did not deactivate the user account of an employee when he left PERS for an extended leave of absence.

Without proper segregation of duties, inappropriate or inaccurate transactions may be generated and not detected during the normal course of business. Without individual user accounts, PERS may not be able to trace an erroneous or inappropriate transaction back to its source. Further, staff with shared user accounts may have more access than required to perform their job duties. In addition, failing to deactivate a user account when an employee leaves his or her position increases the risk that users may access that account to process unauthorized transactions.

Upon notification by the audit team, PERS appropriately responded to these issues by taking the following actions:

- Creating individual user accounts for all persons requiring access to SBT.
- Removing user accounts for persons not currently working for PERS.

- Modifying four of the five user accounts identified as having inadequate segregation of duties so that better controls could be achieved. The fifth user has oversight of SBT and serves as back-up for other staff. PERS' Financial Reporting Manager determined that the level of access provided to this user was appropriate and necessary for him to perform his job duties.

Mailroom Cash Controls Could Be Improved

Mailroom procedures and controls over cash are not documented and checks are not endorsed upon receipt in the mailroom. PERS does not require two persons to be present while opening the mail even though checks may be included. In addition, PERS does not have controls to compensate for this weakness.

There is an increased risk of loss due to error or fraud when checks are not immediately endorsed upon receipt as required by the Oregon Accounting Manual (OAM). Further, the OAM states that if two persons cannot be present when opening mail, then compensating controls may be required.

We recommend that PERS restrictively endorse checks upon receipt by mailroom staff. In addition, PERS should have two employees present when opening mail. We also recommend that PERS document mailroom policies and procedures over cash and ensure that they are sufficient to mitigate the risk of loss.

Fiscal Services Cash Controls Could Be Improved

During our review of cash controls we noted that: (1) PERS does not perform an independent reconciliation to ensure that checks received in the mailroom and recorded on a check receipt log are actually deposited by the cashier, (2) cash controls related to the job duties of the cashier have not been updated to reflect current practice, (3) PERS has never changed the combination of the safe containing check stock, and (4) PERS' control over keys to the room containing check stock safe is not adequate.

To reduce the risk that errors or fraud may occur and not be detected in the normal course of business, we recommend that PERS:

- Perform an independent reconciliation to ensure that checks received in the mail room are actually deposited,
- Develop/update cash handling procedures that are adequate and reflect the cashier's current duties,
- Periodically change the combination to the safe containing check stock, including when an individual's access rights to the safe are removed, and
- Develop and enforce procedures for tracking physical keys.

Missing Documentation – Employer Contributions

During our review of Employer Contributions, we were not able to locate documentation to support PERS' receipt of two employer invoice payments.

An audit trail should exist to support the payments received. Without this audit trail we were not able to verify whether PERS properly recorded the employer remittance on RIMS.

We recommend that PERS review its policy regarding document retention to ensure that all appropriate documentation is properly retained. We also recommend that PERS consider training staff to ensure compliance with proper document retention policy and procedures.

Contribution Accrual – Posting Discrepancies

During the audit of PERS fiscal year 2002 financial statements, we noted that PERS recorded some contributions in the wrong year. Contributions received in July are recorded by paycheck date so that it can be determined to which fiscal year they are attributable. For fiscal year 2003, June paycheck dates should have been recorded in fiscal year 2003 and July paycheck dates should have been recorded in fiscal year 2004.

As part of our testing to follow up on the 2002 audit finding, we prepared an analysis of three days' worth of July receipts accrued at June 30, 2003. There were several discrepancies noted when comparing our analysis to the PERS' accrual. Some differences may have resulted from employers not properly indicating the paycheck date associated with each contribution.

We determined there was a potential net overstatement of $75,000 in contributions for fiscal year 2003. We could estimate only a potential effect because there was an inadequate audit trail to support the reason PERS posted some of the contributions to a certain year when the employer did not indicate the payment period.

We again recommend that PERS review the process used to prepare the contribution accrual entry to ensure that the adjustment is appropriately prepared. We also recommend that for those remittance advices received without a paycheck date clearly identified PERS follow up with the employer to determine the appropriate month and document the resolution.

Input Error Related to Set-up of Total Lump Sum

During our review of Total Lump Sum retirement benefits, we noted that controls were not in place to prevent monthly benefit payments from being inappropriately distributed to a member who had retired under the Total Lump Sum option.

When a member retires under the Total Lump Sum option, the member receives payment of his or her entire member account balance and the related employer portion and should not receive a monthly benefit. System limitations require manual intervention when preparing total lump sum payments. Without sufficient controls and review procedures, PERS may potentially make overpayments to members for significant amounts that would not be detected in the normal course of business.

We recommend that PERS review current policies and procedures and make any necessary changes to ensure that members do not receive inappropriate benefit payments when they have selected the total lump sum retirement option.

Again, we will follow up on PERS' progress in addressing these issues during our audit of the fiscal year 2004 financial statements. Should you have any questions, feel free to contact me or Janice Caley at (503) 986-2255.

Sincerely,
OREGON AUDITS DIVISION

Jason M. Stanley, CPA
Audit Administrator

JMS:brk

cc: Dale Orr, Administrator, Fiscal Services Division
Craig Stroud, Internal Auditor
Gary Weeks, Director, Department of Administrative Services