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Auditing for a Better Oregon

January 19, 2005

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

Paul Cleary, Executive Director
Oregon Public Employees Retirement System
11410 SW 68th Parkway
Tigard, Oregon 97223

Dear Mr. Cleary and Board:

We have completed our financial statement audit of the Oregon Public Employees Retirement System (PERS) for the year ended June 30, 2004. During our audit, we identified a reportable condition related to internal control. Professional auditing standards define reportable conditions as matters relating to significant deficiencies in the design or operation of internal control over financial reporting that, in our judgment, could adversely affect PERS' ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. The reportable condition was included within the Report on Compliance and Internal Control in the PERS 2004 *Comprehensive Annual Financial Report*.

Reconciling Items Not Cleared Timely

We found that the Oregon Public Employees Retirement Systems (PERS) is not promptly clearing reconciling items from three clearing accounts. The total unreconciled balance of these accounts exceeded $285 million as of June 30, 2004. Of this amount, reconciling items totaling $140 million (49 percent) have remained in the clearing accounts for more than one year.

Items are placed in the clearing accounts when there is a disagreement between amounts reported in the Membership and Benefit Reserve Subsystems of the Retirement Information Management System (RIMS). Each item remains in the clearing accounts until PERS staff can review and resolve the discrepancies. Uncorrected reconciling items may result in the over or under payment of refunds or benefits. Failure to correct reconciling items promptly may increase the magnitude of errors.

We recommend PERS management prioritize the correction of the RIMS clearing account reconciling items.

The reportable condition noted above, along with your response, will also be included in our statewide audit report. Including your response with responses from other state agencies satisfies the

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federal requirement that management prepare a Corrective Action Plan (CAP) covering all reported audit findings. Satisfying the federal requirement in this manner, however, can only be accomplished if the response to each finding includes the information specified by the federal requirement, and only if the response is received in time to be included in the audit report. The following information is required for each response.

1. Your agreement or disagreement with the finding. If you do not agree with an audit finding or believe corrective action is not required, include in your response an explanation and specific reasons for your position.
2. The corrective action planned.
3. The anticipated completion date.
4. The name of the contact person responsible for corrective action.

For the reportable condition, we must receive your written response by February 1st for it to be included in the final audit report.

In addition, we identified other matters needing corrective action and recently met with PERS management to present these conditions and our recommendations.

Account Reconciliations Not Timely

We found that cash account reconciliations and benefit clearing account reconciliations are not always prepared or reviewed timely. PERS' policy is to prepare reconciliations within thirty days after closing the general ledger, and review within 15 days of preparation. Untimely preparation or review of reconciling items increases the likelihood that items could become permanent differences, or fail to be appropriately adjusted on the financial statements. Reconciliations are an important control that helps ensure accurate and complete financial reporting.

We recommend PERS management ensure all reconciliations are prepared and reviewed timely.

Employee Altered Own Account

We identified two transactions from 1997 where a PERS employee entered to the account on which she was actively receiving beneficiary payments. The employee set up a one-time benefit payment to herself and increased the tax withholding amounts from her beneficiary payments. She reversed the transactions later that same day.

PERS does not have a formal policy disallowing employees from entering transactions on their own accounts, or the accounts of their friends or family members. Although PERS verbally communicated this to employees in 1997, the Retirement Information Management System (RIMS) did not prohibit employees from both setting up and authorizing a payment. Had the transactions not been reversed, the employee would have received a check for $4,270.13 and increased the amount of withholdings from future beneficiary payments received by $100. Although the system has since been modified to prohibit one person from setting up and authorizing the same payment, it does not have the capability to limit an employee's ability to update his or her own account.

We recommend PERS adopt and enforce a formal written policy prohibiting employees from performing any work associated with their own benefit accounts, or related party accounts. Further, PERS should implement controls to prevent or identify activity by an employee to his or her own account.

Lack of Segregation of Duties

Several PERS employees have update access to the Actuarial Equivalency Factor (AEF) tables in RIMS. RIMS uses the AEF tables when calculating benefits due to members or their beneficiaries. The employee primarily responsible for updating the AEF tables is also the first person to receive and review the monitoring report generated when changes are made to the AEF tables. The same person should not have both update and monitoring responsibilities. With these conflicting duties, the employee would be able to update the AEF tables without an independent review.

We recommend PERS ensure the person with primary responsibility for receiving and reviewing the monitoring report does not also have update access to those tables.

Lack of Documentation

We found that PERS does not have adequate documentation to support five of 21 benefit calculations and two of 31 pension charges reviewed. Missing documentation includes retirement applications, benefit calculations, notices of entitlement, and proof of age. In addition, our testing of pension charges noted that five of nine look-back calculations had no evidence of review.

PERS' record retention schedule requires member records, such as employment information and retirement applications, to be retained for 175 years. Without original source documents we were not able to verify, and PERS could not prove to us, whether correct variables were used to calculate some member benefits. PERS' policy also requires all manual benefit calculations, including look-back calculations, to be reviewed by a second person.

We recommend PERS retain all supporting documentation as required and ensure look-back calculations are reviewed by a second person.

Benefit Calculation Errors

PERS used incorrect information in three of 21 benefit calculations reviewed. Errors included using incorrect salary information, sick leave hours, retirement option factor, and Consumer Price Index (CPI) factor. PERS should use correct information when calculating a member's benefit to ensure reserves are established for the correct amount and benefits paid are accurate. In one retiree calculation tested, we identified two errors that resulted in underpayments totaling $285. The other two calculations included incorrect salary and sick leave amounts, but these errors did not affect the final benefit.

We recommend PERS ensure all calculations are completed using correct information and reimburse the member for underpayments identified by our audit.

Benefit Payment Errors

After PERS establishes a member or beneficiary annuity payment, there may be several reasons the benefit amount is adjusted. Typical reasons include CPI increases, ad-hoc adjustments required by legislation, and adjustments related to a retirees participation in the variable account. To ensure benefits paid by PERS are accurate, we recalculated a sample of payments based on the initial benefit calculation for that member.

We found that three of 54 benefit payments made during the audit period were incorrect. Two errors resulted from mistakes made in prior years, including the incorrect application of CPI and an incorrect current service amount used during benefit set-up. The cause of the third error is unknown because auditors and PERS staff were not able to locate all of the necessary information to determine the source of the error. The errors resulted in underpayments to one member of $30 and overpayments to two members totaling at least $1,560.

We recommend PERS correct the identified errors, research the cause of the unidentified error, and refund or invoice members for over and underpayments noted in our audit.

Other Matters Communicated to Management

We evaluated controls for PERS information technology systems pertinent to our audit. We identified other matters in this area and communicated those conditions and our recommendations to the PERS Board Chair and the Executive Director in a separate confidential letter. The confidential letter was prepared in accordance with ORS 192.501 (23), which allows exemption of such information from public disclosure.

We will follow up on PERS' progress in addressing these issues during our audit of fiscal year 2005 financial statements. Should you have any questions, feel free to contact Amy Palacios or me at (503) 986-2255.

Sincerely,
OREGON AUDITS DIVISION

Jason M. Stanley, CPA, CFE
Audit Manager

JMS:brk
cc: James Dalton, Audit Committee Chair
David Tyler, Administrator, Fiscal Services Division
Jenny Kumm, Acting Internal Audit Director
Laurie Warner, Acting Director, Department of Administrative Services