

**Performance Audit
Pension Payment Controls**

September 2010

**City Auditor's Office
City of Kansas City, Missouri**



Office of the City Auditor

21st Floor, City Hall
414 East 12th Street
Kansas City, Missouri 64106

(816) 513-3300
Fax: (816) 513-3305

September 29, 2010

Honorable Mayor and Members of the City Council:

Our audit of pension payment controls focused on the accuracy of pension and beneficiary payment amounts in the Employees' Retirement System and the Firefighters' Pension System. We also looked at whether the city has adequate controls in place to prevent improper pension and beneficiary payments.

We found that pension and beneficiary payment amounts are mostly accurate. The retirement benefit calculations largely follow city code, except when an elected official retires with over 27 years of service or a firefighter retires on non-duty disability with 30 or more years of service. In those rare instances, the division's retirement benefit calculation will provide a smaller benefit than the retiree is eligible to receive, according to the code. We also found that the annual cost-of-living adjustment (COLA) calculation was correct; however, in one case we reviewed, a retiree received an extra COLA resulting in him getting a higher monthly benefit than he was entitled to receive.

The Retirement Division has controls in place that help ensure pension payments do not continue once a recipient has died. The custodian of the pension systems' assets provides the city with a death audit on active recipients quarterly. Staff also research recipient status if benefit checks are returned or are not cashed. In response to findings in the 2009 financial audit of the pension systems, the city expanded its pension accountant's responsibilities to improve segregation of duties.

We found that some Retirement Division staff can both enter information into the pension assets custodian's database and approve it. We also found no evidence that the Retirement Division routinely verifies that deceased firefighters' children remain eligible for the monthly child allowance after reaching age 18. We make recommendations intended to ensure that pension benefits information and transactions entered into the pension custodian's database are accurate and appropriate, and to recoup COLA overpayments made to a retiree.

We shared a draft report with the director of human resources on August 23, 2010. His response is appended. We appreciate the courtesy and cooperation of staff in the Retirement Division and the pension accountant during this audit. The audit team for this project was Vivien Zhi and Deborah Jenkins.

Gary L. White
City Auditor

Pension Payment Controls

Table of Contents

Introduction	1
Objectives	1
Scope and Methodology	1
Background	2
Findings and Recommendations	5
Summary	5
Pension and Beneficiary Payment Calculations Are Mostly Accurate	5
Pension Benefit Calculations Largely Follow City Code	6
Cost-of-Living Adjustments Are Mostly Correct	7
Controls Are Generally Adequate to Prevent Improper Pension Payments But Could Be Strengthened	8
Controls Are in Place to Prevent Pension Payments to Deceased Recipients	8
Control Added to Address Inadequate Segregation of Purchases and Cash Disbursements	10
Some Controls Need to Be Strengthened	10
Recommendations	11
Appendix A	13
Director of Human Resources' Response	13

List of Exhibits

Exhibit 1. Comparison of Retirement Systems	3
---	---

Introduction

Objectives

We conducted this audit of pension payment controls under the authority of Article II, Section 216 of the Charter of Kansas City, Missouri, which establishes the Office of the City Auditor and outlines the city auditor's primary duties.

A performance audit provides assurance or conclusions based on an evaluation of sufficient, appropriate evidence against stated criteria. Performance audits provide objective analysis so that management and those charged with governance and oversight can use the information to improve program performance and operations, reduce costs, facilitate decision making, and contribute to public accountability.¹

This report is designed to answer the following questions:

- Are the pension and beneficiary payment amounts accurate?
- Are there adequate controls in place to prevent improper pension and beneficiary payments?

Scope and Methodology

Our review focuses on determining whether there are adequate controls in place to prevent improper pension and beneficiary payments and whether the pension and beneficiary payment amounts are accurate. Our audit methods included:

- Interviewing Retirement Division staff, the city's pension accountant, representatives of the third-party vendor which acts as the pension assets custodian, and the city's external auditor to gain an understanding of their concerns, practices, and policies related to pension payments.

¹ Comptroller General of the United States, *Government Auditing Standards* (Washington, DC: U.S. Government Printing Office, 2007), p. 17.

- Reviewing the Code of Ordinances and the Retirement Division's policies and procedures to understand the requirements and internal controls related to pension benefit payments.
- Analyzing retiree, beneficiary, and pension payment data to determine whether there were improper pension and beneficiary payments.
- Reviewing files of a judgmentally selected sample of active pension recipients with no date of birth in the system, whose date of birth would put them at 100 years of age or older, or who receive their check at an atypical address (P. O. Box or in care of another person) from both the Employees' Retirement System and the Firefighters' Pension System to determine whether there were improper pension payments.
- Reviewing twenty-five randomly selected retiree or beneficiary files from the Employees' Retirement System and twenty-five randomly selected retiree or beneficiary files from the Firefighters' Pension System to determine whether the pension benefit was accurate.
- Reviewing files of randomly selected active pension recipients (with a retirement date after 1995) from the Employees' Retirement System and the Firefighters' Pension System to determine whether the cost-of-living adjustments were accurate.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We did not review the Police Officers' Retirement System or Police Civilian Retirement System because they are not administered by the city's Retirement Division. No information was omitted from this report because it was deemed privileged or confidential.

Background

The Employees' Retirement System and the Firefighters' Pension System provide retirement benefits to their members. Both are defined

benefit plans in which participation by full-time, permanent employees is mandatory. Defined benefit plans provide a fixed monthly benefit amount based on years of service with the city and the highest two-year salary of employees in the last ten years of their employment. Financing of these systems is provided from employee contributions, city contributions, and investment earnings.

The Employees' Retirement System includes the Retirement System for Elected Officials. However, the elected officials' plan has separate benefit provisions and is funded separately.

Pension benefit payments to retirees and beneficiaries are significant. The Employees' Retirement System and Firefighters' Pension System paid out over \$41 million and \$26 million in benefit payments in fiscal year 2009, respectively. There were over 1,500 retirees and 400 beneficiaries in the Employees' Retirement System and about 650 retirees and 200 beneficiaries in the Firefighters' Pension System as of April 30, 2009. (See Exhibit 1.)

Exhibit 1. Comparison of Retirement Systems

	Employees' Retirement System	Firefighters' Retirement System	Retirement System for Elected Officials ²
No. of Active Members	3,379	931	21
Member Contribution (% of base salary)	4%	9.55%	4%
City Contribution (% of covered payroll)	12%	19.6% ³	19.5%
No. of Retirees	1,568	647	25
No. of Survivors	420	209	4
Benefit Payments	\$41.1 million	\$26.3 million	\$559,000

Source: 2009 Annual Reports for Employees' Retirement System and Firefighters' Pension System and Retirement Division staff.

The Human Resources Department's Retirement Division administers both systems. The Finance Department provides accounting support. Each retirement system has a board of trustees which serves as a policy making body and provides guidance and direction. The boards contract with a third-party vendor to be the custodian of pension assets and to disburse the pension benefit payments.

² Municipal judges may elect to become a member of this retirement system. The data in this column includes participating municipal judges as well as elected officials.

³ Members of the Firefighter's Pension System do not participate in Social Security.

Pension Payment Controls

Findings and Recommendations

Summary

Pension and beneficiary payment amounts are mostly accurate. The retirement benefit calculations largely follow the city ordinances, except when an elected official retires with over 27 years of service or a firefighter retires on non-duty disability with 30 or more years of service. In those rare instances, the division's retirement calculation will provide a smaller benefit than what the retiree is eligible to receive. In addition, the annual cost-of-living adjustment (COLA) was correct; however, in one case we reviewed, a retiree received an extra COLA resulting in him getting a higher monthly benefit than he was entitled to receive.

The Retirement Division has controls in place that help ensure pension payments do not continue once a recipient has died. The custodian of the pension systems' assets provides the city with a quarterly death audit on active recipients. Staff also research recipient status if benefit checks are returned or are not cashed. The city recently expanded its pension accountant's duties in response to material weaknesses identified in the 2009 financial audit of the city's pension systems.

The Retirement Division could strengthen some controls. We found that some Retirement Division staff can both enter information into the pension assets custodian's database and approve it. And, we found no evidence that the Retirement Division routinely verifies that deceased firefighters' children remain eligible for the monthly child allowance after reaching age 18. We make recommendations intended to ensure that pension benefits information and transactions entered into the pension custodian's database are accurate and appropriate, and to recoup COLA overpayments made to a retiree.

Pension and Beneficiary Payment Calculations Are Mostly Accurate

The Retirement Division's pension benefit calculations largely follow city code, except when calculating benefits for elected officials with over 27 years of service and for firefighters on non-duty disability retirement after 30 years of service. While these cases are rare, there is a potential

that an elected official or a firefighter will receive less than what he/she is entitled to receive because the calculation does not follow the code. We also found that the annual cost-of-living adjustment (COLA) was correct; however, in one case we reviewed, a retiree received an extra COLA resulting in him getting a higher monthly benefit than he was entitled to receive.

Pension Benefit Calculations Largely Follow City Code

The Retirement Division's pension benefit calculations largely follow city code, except when they estimate pension benefits for elected officials with over 27 years of service and pension benefits for firefighters with over 30 years of service on non-duty disability retirement. In both instances, the division's benefit estimates are less than what the retiree is entitled. These instances are rare, but there is a potential that an elected official or a firefighter will receive less than what he/she is entitled to receive.

Most pension benefit calculations follow the city code. We verified retirement benefit calculations work sheets that are based on different retirement scenarios, such as employees' normal retirement, optional retirement, early retirement, and firefighters' duty disability retirement, non-duty disability retirement, and voluntary retirement. The calculations were correct in all but two cases.

The Retirement Division's method for estimating elected officials' pension benefits does not follow city code. The code states that the maximum monthly pension benefit is "70 percent of the existing monthly salary for then serving elected officials of the same office."⁴ However, the Retirement Division uses 60 percent of the existing salary for then serving elected officials as the maximum monthly pension when estimating an elected official's retirement. In most cases, an elected official's maximum will not be over 60 percent because of term limits. An elected official would have to be in office for more than 27 years for the maximum to be over 60 percent. Although the likelihood that an elected official will serve the city longer than 27 years is low, it is possible.

To ensure that pension benefit estimates are accurate for elected officials, the director of human resources should revise the calculation used to estimate their benefit amounts to reflect the language in the city code.

⁴ Code of Ordinances, Kansas City, Missouri, Sec. 2-1332(c).

The Retirement Division's method for calculating firefighters' non-duty disability retirement does not follow city code. The code states that for non-duty disability retirement, "a member shall receive a monthly pension equal to 25 percent of the average final compensation per month plus two and one-half percent per year of the member's average final compensation per month for the number of years and months of creditable service in excess of ten years, not to exceed to any event, a maximum monthly pension equal to 80 percent of the member's average final compensation per month."⁵ The Retirement Division's method limits the years of creditable service used in the calculation to 30 years. The calculation results were the same when we compared the method the Retirement Division uses and the method described in the city code unless the firefighter's creditable service is longer than 30 years. If the Retirement Division uses its current method to calculate the non-duty disability pension benefit for a firefighter that has more than 30 years of creditable service, the firefighter will receive less than what he/she is entitled to receive.

Firefighters' non-duty disability retirement is not very common. However, to ensure accurate pension benefit estimates for firefighters' non-duty disability retirement, the director of human resources should revise the calculation used to estimate benefit amounts to reflect the language in the city code.

Cost-of-Living Adjustments Are Mostly Correct

According to city code, retirees and beneficiaries receive an annual cost-of-living adjustment (COLA) to their monthly retirement benefit on May 1 of each year. We checked COLA calculations for over sixty-five retirees or beneficiaries. All the calculations were correct. However, one retiree received an extra COLA in 2004 resulting in him getting a higher monthly benefit than he was entitled to receive. Ultimately, he received over \$2000 more than he should have. When we notified the Retirement Division about the overpayments, they corrected the issue so the retiree is now receiving the monthly benefit he is entitled to receive. However, that does not address the overpayments the retiree received since 2004. The Employees' Retirement System Board, which has a fiduciary responsibility to the pension system's members, should decide how to recoup the overpayments and repay the pension system.

To replace funds overpaid by the pension system, the retirement systems executive officer should present recoupment options to the Employees' Retirement System Board for recovering COLA overpayments to a retiree.

⁵ Code of Ordinances, Kansas City, Missouri, Sec. 2-1265(d).

Controls Are Generally Adequate to Prevent Improper Pension Payments But Could Be Strengthened

The Retirement Division has some controls in place that help ensure pension payments do not continue once a recipient has died. The custodian of the pension systems' assets provides the city with a quarterly death audit on active recipients. Staff also research recipient status if benefit checks are returned or are not cashed, and promptly update information in the pension custodian's database when they learn a pensioner or surviving spouse has died. In addition, the city expanded its pension accountant's duties in response to a segregation of duties issue identified in the 2009 financial audit of the pension systems.

The Retirement Division could strengthen some controls. Some Retirement Division staff can both enter information into the pension custodian's database and approve it. And, the Retirement Division does not routinely verify that deceased firefighters' children remain eligible for the monthly child allowance after reaching age 18.

Controls Are in Place to Prevent Pension Payments to Deceased Recipients

The Retirement Division has some controls in place to prevent pension payments to deceased recipients. Retirement Division staff promptly update information in the pension assets custodian's database when they learn a pensioner or surviving spouse has died. The custodian performs a death check quarterly on all active retirees and beneficiaries. Retirement division staff also review the custodian's monthly outstanding checks report for uncashed checks.

None of the active pension recipients we checked were found to be deceased. We randomly selected 50 active pension recipients from the Employees' Retirement System and 50 active recipients from the Firefighters' Pension System and used an online death check tool to determine whether there was a death record for any of them. We did the same test on a judgmental sample of active recipients.⁶ None of the recipients in our samples had a death record.

⁶ The judgmental sample included recipients with no date of birth in the system, recipients whose date of birth would put them at 100 years of age or older, and recipients who receive their check at an atypical address (e.g. P.O. Box or in care of another person).

Retirement Division staff promptly update the pension assets custodian's database when they learn a pension recipient has died.

Our review of pension files indicates that the Retirement Division staff update the recipient's status promptly, usually within two days, after being notified of a death so benefit payments will cease. According to Retirement Division staff, they mainly depend on the next of kin to notify them a pensioner or surviving spouse has died.

A death audit is performed quarterly. The custodian of the pension systems' assets provides the city with a quarterly death audit on active recipients for both the Employees' Retirement System and Firefighters' Pension System. The death audit compares the active recipients in the pension custodian's database with other databases to identify recipients who have died since the last audit. If the report includes a recipient whose death had not been previously reported to the Retirement Division, staff changes the recipient's status to "deceased" in the pension custodian's database to stop subsequent benefit payments.

Retirement Division staff pursue refunds for any payments made after a recipient's death. When the Retirement Division is not notified right away of a recipient's death, staff attempts to recover any overpaid amount by contacting the beneficiary on file to ask for a refund. If the overpayment occurred for a retiree with a surviving spouse, the overpayment can be deducted from the surviving spouse's benefit if a refund is not received. If an overpayment occurred because a surviving spouse's death was not reported right away and the overpayment is not refunded, Retirement Division staff told us they could pursue legal action, but would do so only if the amount of overpayment was substantial.

Retirement Division staff review the outstanding check report every month. The pension assets custodian sends a monthly report to the city listing checks returned to them as undeliverable or which have not been cashed within 60 days. If a check has not been cashed, Retirement Division staff will stop the check and reissue it. If the reissued check is not cashed, staff try to reach the recipient by phone. Staff told us that sometimes recipients hold on to their checks for several months before cashing them because they want to deposit several of them at one time because the amounts are so small. Staff told us that if the same recipient fails to cash checks for three or four months, an online death record search tool is used to research whether the recipient is deceased. The tool allows the user to find out whether Social Security records indicate a plan participant's death.

There are not large numbers of outstanding checks. We reviewed six months of "Outstanding Participant Check Reports" from the pension assets custodian. The number of outstanding checks varied by month from seven to fourteen. In the February 2010 report, there were three recipients who had a total of eight outstanding checks.

Control Added to Address Inadequate Segregation of Purchases and Cash Disbursements

The city expanded its pension accountant's duties in response to material weaknesses identified in the city's 2009 pension systems financial audit report. The external auditor reported that the retirement plans were not adequately reconciled or reviewed at certain times during the year, and that there was inadequate segregation of duties in the purchases and cash disbursements areas. In response, the city expanded the responsibilities of its pension accountant. The pension accountant, who is independent of the approval process, does monthly reconciliations of the pension custodian's statements with invoices and approvals in the board minutes, reviews disbursements, and maintains copies of the underlying documentation.

Some Controls Need to Be Strengthened

Some Retirement Division staff can both enter and approve transactions in the pension assets custodian's database. Retirement Division staff do not routinely require verification that minor children of deceased firefighters meet the requirements to receive a monthly benefit after 18 years of age. Additional controls can help ensure that transactions and benefits are appropriate.

Some staff are able to both enter and approve transactions in the custodian's database. A fundamental element of internal control is the segregation of certain essential duties. No employee should be in a position both to perpetrate and to conceal errors or fraud in the normal course of their duties. While the Retirement Division's procedures allow some staff to enter information into the pension assets custodian's database and other staff to approve the transactions, we found that staff who have approval authority can also enter or modify transactions. According to the Retirement Division manager, there are too few staff in the Retirement Division to always have one person enter and another approve transactions. He said it is important for key staff to be able to enter information (or correct another's entry) and approve it, especially when they must meet a deadline.

Since the Retirement Division manager does not think it is possible to always segregate the entry and approval of information into the custodian's database, the director of human resources should institute controls that help ensure these transactions are appropriate.

Education enrollment verification is not updated annually. When a retired firefighter dies, his or her children under the age of 18 receive a monthly child's allowance benefit of \$100. This benefit is extended to age 21 if the child is a full-time student at an accredited institution of higher learning. Retirement Division staff said a letter is sent annually requesting evidence of enrollment, and if there is no response, the child allowance is discontinued. We reviewed files of 6 children aged 18 to 21 who were receiving the child allowance benefit to find support that they were enrolled full-time in an accredited institution of learning. We found no evidence in the files that the Retirement Division requests this verification annually.

To ensure the child's allowance benefit is continued to age 21 only for those who meet the education criteria, the director of human resources should establish a process to annually verify that deceased firefighters' children remain eligible for the monthly child allowance after reaching age 18.

Recommendations

1. The director of human resources should revise the calculation used to estimate pension benefits for elected officials and firefighters on non-duty disability retirement to reflect the language in the Code of Ordinances.
2. The retirement systems executive officer should present recoupment options to the Employees' Retirement System Board for recovering COLA overpayments to a retiree.
3. The director of human resources should institute controls to ensure that any information or transaction entered into the pension assets custodian's database and approved by the same person are appropriate.
4. The director of human resources should establish a process to verify annually that deceased firefighters' children 18 and over remain eligible for the monthly child allowance.

Appendix A

Director of Human Resources' Response



Inter-Departmental Communication

RECEIVED

SEP 21 2010

CITY AUDITOR'S OFFICE

DATE: September 17, 2010
TO: Gary L. White, City Auditor
FROM:  Gary O'Bannon, Director of Human Resources
SUBJECT: Response to the Draft Report on Pension Payment Controls

My staff and I have reviewed the recommendations in the draft report on Pension Payment Controls. Our responses to the recommendations follow.

1. The director of human resources should revise the calculation used to estimate pension benefits for elected officials and firefighters on non-duty disability retirement to reflect the language in the Code of Ordinances.

Agree. All benefit estimate forms now conform to the Code of Ordinances.

2. The retirement systems executive officer should present recoupment options to the Employees' Retirement System Board for recovering COLA overpayments to a retiree.

Agree. The retirement system executive officer will present available options at a subsequent meeting of the Board.

3. The director of human resources should institute controls to ensure that any information or transaction entered into the pension assets custodian's database and approved by the same person are appropriate.

Agree. All transactions entered and reviewed by the same person are now reviewed by the Retirement Accountant.

4. The director of human resources should establish a process to verify annually that deceased firefighters' children 18 and over remain eligible for the monthly child allowance.

Agree. An annual verification process has been developed and implemented.