



Jacksonville Retirement System Audit - #731

Executive Summary

Why CAO Did This Review

This audit was performed due to the ongoing conversation regarding pensions throughout the nation and the size of the annual pension payroll. The General Employees and Correction Officers Retirement Plans had a combined annual pension payroll of over \$128 million in FY 2010/11. The audit focused on payments to members of the General Employees' and Corrections Officers' Retirement Plans. It did not include an analysis of the investment of pension funds nor did it include a review of the contributions made to the plan. The scope of our audit for testing purposes was October 1, 2010 through September 30, 2011 unless otherwise noted.

What CAO Recommends

We recommend that the Pension Office work with the Office of General Counsel and the Board of Trustees to determine how to best address the exceptions noted in this report as well as create and institute new procedures which will prevent these exceptions from occurring in the future.

We further recommend the Administration explore breaking out the members of the General Employees Pension Plan that are not City employees.

Overall, the Pension Office needs to better utilize the capabilities of JaxPension (pension payroll and information system).

What CAO Found

Overall, although we did note some exceptions, we found that refunds, time service connections, and COLAs were materially accurate in calculation and payment. Additionally, pension benefits that were terminated appear to have been done so properly.

However, we found a significant number of issues with the calculation and payment of pension benefits to retirees. The main exceptions included:

- Error with Early Retirement Penalty Calculation in JaxPension
- Inaccurate Inclusion of Retro Pay Associated with Periods Outside of Final Compensation Period
- Wrong Pay Amounts and/or Periods Included in Final Compensation Calculation
- Inaccurate Inclusion of Ineligible Period for Calculating Final Compensation for DROP Members
- Inaccurate Amount of Credited Service due to Leave Without Pay
- Wrong Interest Rate for BACKDROP Calculation
- Error with Switch from Active Payroll to Pension Payroll
- Error with DROP Participation Period

These exceptions cause pension payments to be inaccurate.

Other Issues

There are multiple aspects of calculating pension benefits where the Municipal Code either contradicts current policy or is vague as to the intent of the law.

We found internal control issues in JaxPension related to the segregation of duties and user rights.

The Pension Office policy and procedures were found to be inadequate, outdated and disorganized.

(Please refer to the full report for more detailed information)



Council Auditor's Office

Jacksonville Retirement System Audit

*General Employees Pension Plan
&
Correction Officers' Retirement Plan*

May 8, 2012

Report #731

Released on: March 11, 2013

EXECUTIVE SUMMARY

AUDIT REPORT #731

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OFFICE OF THE COUNCIL AUDITOR
Suite 200, St. James Building



May 8, 2012

Report #731

Honorable Members of the City Council
City of Jacksonville

INTRODUCTION

Pursuant to Section 5.10 of the Charter of the City of Jacksonville and Chapter 102 of the Municipal Code, we examined the operations of the City's Pension Office. The audit focused on payments to members of the General Employees' and Corrections Officers' Retirement Plans. It did not include an analysis of the investment of pension funds nor did it include a review of the contributions made to the plan. The scope of our audit for testing purposes was October 1, 2010 through September 30, 2011 unless otherwise noted.

Pursuant to Chapter 120 of the Municipal Code, the Pension Board of Trustees is tasked with administering the General Employees' and Corrections Officers' Retirement Plans which also includes the separate Disability Plan for General Employees' and the Defined Contribution Plan. Our audit did not include any testing relating to the Defined Contribution Plan.

The Pension Office is tasked with calculating pension benefits which encompass the calculation of base monthly benefits, Deferred Retirement Option Program (DROP), BACKDROP, partial lump-sum distribution (PLOP) and any refund payments. During FY 2010/11 this resulted in the office processing a total pension payroll of \$128 million and refunds of \$20 million. Furthermore, upon request staff must determine periods of time service with the City (or other allowable agencies) and military service that are eligible for purchase and calculate the cost to purchase the associated time. The overall guidance for the Pension Office is Chapter 120 of the Municipal Code which is supplemented by Board Policies and Procedures where needed.

The next page is an overview of the current benefits available under the General Employees Retirement Plan (GEPP) and Corrections Officers' Retirement Plan (Corrections). This is not meant to be all inclusive, but is provided to assist in the reader's understanding of the benefits afforded under each plan and to assist in understanding terminology and the procedures undertaken during the audit. This information should not be relied upon for determining individual benefits. The Municipal Code and Summary Plan Description approved by the Board should be consulted for those purposes.

	GEPP	Corrections
Employee Contributions	Members contribute 8% of earnable compensation toward pension (7.7%) and disability pension (.3%).	Members contribute 8% of earnable compensation.
Employer Contributions	City shall make such contribution together with pick up's on behalf of members and the plans earnings that will maintain the plan on a sound actuarial basis determined by the Board.	City shall make such contribution together with pick up's on behalf of members and the plans earnings that will maintain the plan on a sound actuarial basis determined by the Board.
Final Monthly Compensation	Highest paid 36 consecutive months (78 pay periods) within the prior 10 years.	Highest paid 36 consecutive months (78 pay periods) within the prior 10 years.
Normal Benefit Percentage	Members earn 2.5% per credited year if they have over 30 years of credited service, or, they are age 55 and have 20 years of credited service, or, they are over age 65 with 5 years of credited service. Amount shall not exceed 80%.	First 20 years the member is multiplied by 3% and the next 10 years are multiplied by 2%. Amount shall not exceed 80%.
Early Retirement Benefit Percentage	Completion of 25+ years of service, but less than 30 years, regardless of age with benefit of 2% per year of credited service; or Attaining age 50 and completion of 20 years credited service with benefit of 2.5% per year of credited service with a .5% penalty for each month less than age 55.	None
Vested Retirement	Member can receive benefits starting at age 65 based on 2.5% per credited year of service.	Member can receive benefits starting at age 65 based on 3% per credited year of service.
Base Pension Benefit	Final Monthly Compensation x Benefit Percentage	Final Monthly Compensation x Benefit Percentage
Supplemental Benefit	Shall receive monthly supplement benefit equal to \$5.00 multiplied by number of years credited service, in addition to cost of living benefits. Minimum \$25, Maximum \$150	Shall receive monthly supplement benefit equal to \$5.00 multiplied by number of years credited service, in addition to cost of living benefits. Minimum \$25, Maximum \$150
COLA	Receive 3% COLA, to commence the first full pay period in April after waiting period of five years after the fiscal year the retirement began.	Receive 3% COLA the first full pay period each December.
Survivor Benefits	Surviving spouse of retiree (or member eligible for normal retirement) will receive 75% of the base benefit the employee was eligible for plus the supplement and COLA increases. The base benefit is increased by 10% for each child not to exceed 100% of the benefit the member was eligible.	Surviving spouse of retiree (or member eligible for normal retirement) will receive 75% of the base benefit the employee was eligible for plus the supplement and COLA increases. The base benefit is increased by 10% for each child not to exceed 100% of the benefit the member was eligible.
	Surviving spouse of dead active member who is not eligible for retirement, the base benefit percentage is calculated as if the member reached normal retirement stage and was 55 years old and had 20 years of credited service or the number of years of credited service was stepped up to the amount the member would have had at age 65, whichever is less. The base benefit is increased by 10% for each child not to exceed 100% of the benefit the member was eligible. The spouse also receives the supplement and COLA increases.	Surviving spouse of dead active member who is not eligible for retirement, the base benefit percentage is calculated as if the member reached 20 years of credited service or the number of years of credited service was stepped up to the amount the member would have had at age 65, whichever is less. The base benefit is increased by 10% for each child not to exceed 100% of the benefit the member was eligible. The spouse also receives the supplement and COLA increases.
	If surviving children are orphaned, unmarried children under age 18 receive same benefit as surviving spouse without children until age 18.	If surviving children are orphaned, unmarried children under age 18 receive same benefit as surviving spouse without children until age 18.
	Upon the death of a member or retiree, unmarried children under 18 shall receive a \$300 benefit per child per month, not to exceed the maximum benefit allowable when no other survivorship benefit is available.	Upon the death of a member or retiree, unmarried children under 18 shall receive a \$300 benefit per child per month, not to exceed the maximum benefit allowable when no other survivorship benefit is available.
	Dependent parents with no income receive 75% for life if no other survivor.	Dependent parents with no income receive 75% for life if no other survivor.
	Minimum Retirement Benefit for Normal and Early Retirement	The minimum monthly benefit for a normal or early retiree shall be \$25 per year of credited service with the \$25 minimum amount being increased every October 1 starting in 1995 for members who retire during that fiscal year. The minimum benefit for a spouse is 75% of this amount.
DROP	N/A	Member effectively retires on date of participation. Continue to work for City for period not to exceed the maximum allowable period (under no circumstances more than 5 years). During DROP member contributes 2% to pension plan. Retirement is based on the date the member enters DROP and the base pension benefit accrues in the account plus COLAs plus interest which is calculated at the rate earned by the plan.
BACKDROP	Member makes election upon leaving employment. Maximum allowable period of participation is five years while not going back to a date prior to 30 years of credited service. Retirement is based on BACKDROP date and a calculation is made to determine the base pension benefit the member would have received during the BACKDROP period. Interest rate is the same interest rate earned by the plan within a range of +/- 4% annual rate of return.	N/A
PLOP	Member makes election upon leaving employment. Member may elect to receive the actuarial equivalent value of 5%, 10% or 15% future pension benefits. Electing this results in the base benefit being reduced by the corresponding percentage.	N/A

SCOPE AND METHODOLOGY BY OBJECTIVE

Objective 1

Statement

To determine whether payments to pensioners were properly calculated and paid.

Scope

Our scope included all pensioners with an effective retirement date between October 1, 2010 and November 30, 2011. We decided to extend the testing period to include October 1, 2011 through November 30, 2011 due to the restructuring of the City government causing an unusually high number of layoffs, in turn creating a higher workload for the Pension Office.

Methodology

To compile this listing we utilized the payroll register and COLA reports from JaxPension (the City's Pension Payroll and Information System).

A sample size of 50 out of a population of 251 was judgmentally determined to be a reasonable amount to give us an understanding of the accuracy of the calculation of the Pension Office. Each file was then randomly selected for testing.

We subsequently added 10 additional files for testing since the original sample did not include any in the Corrections Officers' Retirement Plan. Of the 10 that were added, five were members who had been paid DROP payments and five were members who were still in DROP as of November 30, 2011.

Furthermore, after the results of the DROP testing, we determined we needed to do further testing by selecting one calculation from each DROP class (total of 15 pensioners) to confirm whether the error with the calculation of the final compensation amount of DROP members was systemic.

Our testing involved confirming:

- The correct amount of credited service was calculated.
- The benefit percentage was accurate based on the years of credited service and the age of the employee.
- The correct final compensation amount was calculated.
- The correct biweekly benefit was calculated including the monthly supplement.
- The BACKDROP, DROP and PLOP payments were correctly calculated and paid.
 - We did not perform work to confirm the interest rates were properly calculated that were utilized to determine DROP and BACKDROP payments. We did confirm the interest rates were consistent with the information provided as being the correct amount.
 - We reviewed the accuracy of the information input into the PLOP calculation spreadsheets when possible, but we did not perform any work to confirm the accuracy of the spreadsheet which is created by a third party actuary.
- The payment information provided by the retiree matched that of the actual payments.

Objective 2

Statement

To determine whether refunds of pension contributions were correctly calculated and distributed.

Scope

Our scope included all refunds paid between October 1, 2010 and November 30, 2011. We decided to extend the testing period to include October 1, 2011 through November 30, 2011 due to the restructuring of the City government causing an unusually high number of layoffs, in turn creating a higher workload for the Pension Office.

Methodology

To compile this listing we utilized reports from JaxPension and compared them to the City's Financial and Management Information System (FAMIS) to confirm completeness. A sample size of 85 was statistically determined to be reasonable based on the assessed risk and population of 473. We randomly selected the files for testing and requested the refund packet from the Pension Office to confirm the refunded amount was proper.

Objective 3

Statement

To determine whether time service connections and military time service purchases were properly calculated and that the member paid the complete amount owed.

Scope

Our scope included all completed time service connections (including military time service purchases) on the Board of Trustees' Consent Agendas between October 1, 2010 and November 30, 2011. We decided to extend the testing period to include October 1, 2011 through November 30, 2011 due to the restructuring of the City government causing an unusually high number of layoffs, in turn creating a higher workload for the Pension Office.

Methodology

A sample size of 54 was statistically determined to be reasonable based on the assessed risk and population of 203. We randomly selected the files for testing to confirm that the time was permitted to be purchased, there was support for the amount agreed to be paid, the amount was actually paid and the pension date after the connection was properly adjusted.

Objective 4

Statement

To determine whether Cost of Living Adjustments (COLA) were computed and applied accurately.

Scope

Our scope for this objective included pensioners with a retirement date of October 1, 2002 through December 9, 2011. We included retirement dates back to October 1, 2002 so that we

could include multiple COLA while still limiting us from timing issues of different COLA laws prior to October 1, 2002. We included information up to December 9, 2011 because this was the day on which we pulled this information from the system.

Methodology

We compiled a listing of all pensioners receiving payments as of the December 9, 2011 pay date. We added the retirement date to the pension payroll by matching the payroll register report with the COLA reports which list the retirement date. Based on Municipal Code Section 120.206 (h) for General Employee Pensioners and Municipal Code Section 120.306 (e) and (f) for Correction Officer Pensioners, we created a multiplier for the base benefit to arrive at what amount should be currently paid for all pensioners within our audit scope.

Objective 5

Statement

To determine whether all pensions terminated were done so properly and determine whether the Pension Office has appropriate controls in place to detect and remove ineligible pensioners.

Scope

Our scope was October 1, 2010 through September 30, 2011 for our testing of the detection and removal of ineligible pensioners. We reviewed to confirm there was proper support for payments that were stopped, that annual affidavits were being properly filed, child benefit payments were being terminated upon the child turning 18, and that the City was using all available mechanisms to detect deceased pensioners.

Methodology

To confirm there was support for pension payments terminated during our audit scope we compiled a listing of all pensions terminated throughout the year based on the biweekly terminated pensioner reports. In total there were 296 pension payments terminated throughout the year for different reasons. We statistically determined a sample size of 43 was reasonable based on the assessed risk and population of 296. We verified there was support in the file to substantiate why payments ceased and if applicable, why the payments resumed for each file that was randomly selected for testing.

To confirm that all pension benefit payments ceased if an annual affidavit was not filed on time, we compiled a listing of all non-responders throughout the audit scope based on the monthly non-responder reports. Non-responders are individuals who must file the annual affidavit within 30 days to avoid their pension payments being stopped. We statistically determined a sample size of 83 was reasonable based on the assessed risk and population of 240. For files randomly selected for testing, we verified that either the payments stopped or there was an affidavit in the file that was received prior to the required date. If payments were stopped and then resumed we confirmed there was proper support.

To confirm that all child benefits ceased upon the child turning 18 we compiled a listing of all individuals receiving a child benefit payment per the system. We verified that each was under 18 years old or classified as disabled child and approved by the Board of Trustees.

To confirm what controls exist in other pension plans to detect deceased pensioners we contacted other pension plans to find out what they did to detect deceased pensioners.

REPORT FORMAT

Our report is structured to identify Internal Control Weaknesses, Audit Findings, and Opportunities for Improvement as they relate to our audit objectives. Internal control is a process implemented by management to provide reasonable assurance that they achieve their objectives in relation to the effectiveness and efficiency of operations and compliance with applicable laws and regulations. An Internal Control Weakness is therefore defined as either a defect in the design or operation of the internal controls or is an area in which there are currently no internal controls in place to ensure that objectives are met. An Audit Finding is an instance where management has established internal controls and procedures, but responsible parties are not operating in compliance with the established controls and procedures. An Opportunity for Improvement is a suggestion that we believe could enhance operations.

SUGGESTED ADDITIONAL AUDIT WORK

In limiting the scope of this audit, we did not pursue the mechanics behind employee and employer contributions to the plan. We feel it would be beneficial to perform this work in the future especially in relation to agencies outside of the City's normal payroll process.

STATEMENT OF AUDITING STANDARDS

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.

AUDITEE RESPONSES

Responses from the auditee have been inserted after the respective finding and recommendation in the appendix for each objective. We received these responses from the Finance Department, from Joey Greive, City Treasurer, through C. Ronald Belton, City Chief Financial Officer, in a memorandum dated March 1, 2013.

AUDIT CONCLUSIONS

1. While it appears that the total dollar amount of pension benefits calculated and paid to pensioners was materially accurate, we found an alarming number of smaller dollar value

exceptions and concluded that the language in the City's Municipal Code needs to be revisited.

2. It appears that refunds were properly calculated and distributed.
3. It appears that time service connections and the purchase of military time were properly calculated and paid.
4. It appears that COLA payments were materially accurate.
5. It appears that pension benefits that were terminated were done so properly, but it does not appear as though the Pension Office has the most efficient and effective controls in place to detect deceased pensioners.

OVERALL CONCERN

Due to the growing financial concerns surrounding the City, it appears to be counterintuitive to have Independent Agencies participating in the City's General Employees' Retirement Plan. For example, existing and newly hired employees of the Jacksonville Housing Authority (JHA) and JEA are members of the City's General Employees' Retirement Plan. It may not make sense for these employees to be included in the General Employees Retirement Plan since the financial stability and position of those agencies could be extremely different than that of the City. Furthermore, existing and newly hired Clerk of Court court-related employees who perform a state function and are in fact funded by the state continue to be members of the City's General Employees' Retirement Plan as well.

Many of these employees are members of the plan based on commitments made in the past to existing employees that were grandfathered into the plan. However, today it is a questionable practice to allow new employees from an Independent Agency or state personnel of the Clerk of Court to be admitted to the City's General Employees' Retirement Plan since the salaries of those employees are not funded by the City.

We recommend the Administration research this issue further to determine the best course of action for the City, the other agencies, the applicable employees, and the residents of Duval County as it relates to existing and newly hired employees. Any changes considered would have to take into account the entities' share of the Unfunded Actuarial Accrued Liability (UAAL). This is a major consideration for any changes made related to JEA since a material portion of the UAAL is associated with JEA personnel.

Auditee Response to Overall Concern

Agree Disagree Partially Agree

We are in conversation now with JEA regarding this matter. The list of potential positives and negatives below are the driving forces that have not allowed for an agreeable solution as of the date of this report. This will be resolved in the near future.

Positives:

-JEA and the City have different financial positions

-At some point JEA will comprise a very large portion of assets and liabilities to the plan. Their decisions on pay and size of workforce may impact City contributions
 -Cost and Liabilities of funding benefits for JEA employees growing to 50%+ of plan. This is projected to continue to grow as they have higher pay scales and are not always impacted by freezes of pay and layoffs/budget-cuts at the same rate as the City of Jacksonville
 -This would allow for a possible shift of the responsibility and support which we provide to handle their employees' retirement related requests. These have been, and will continue to be, a growing demand on the Pension Office's resources

Negatives:

-From an administrative standpoint, it is cheaper to the taxpayer and utility customer as a whole to operate both plans together. Ex.) One administrative office, one investment consultant, one custodian, cheaper investment manager fees due to quantities of scale, and one technology platform. Splitting them out would increase these costs.
 -There is a chance that offloading these participants and their assets would negatively impact the City as, with JEA growing to greater than 50% of contributions, we could be transferring them out at the wrong time. We would be losing a large piece of the contribution force that was here during the creation of the liability and is currently helping to pay it down. This impact is unknown, potentially large, and requires further follow-up with the system's actuary.

OBJECTIVE 1

To determine whether payments to pensioners were properly calculated and paid.

Finding 1 – 1 *Pension Benefit Calculation Errors*

We found issues with 33 of the 60 pension files we tested to confirm the benefit amount. These 33 files had 52 different individual exceptions which are listed below:

Exceptions		
Description	Root Cause	Count
Error with Early Retirement Penalty	System Error	2
Inaccurate Inclusion of Retro Pay Associated with Periods Outside of Final Compensation Period	System Limitation/ Management Decision	14
Wrong Pay Amounts and/or Periods Included in Final Compensation Calculation	System Limitation/ Manual Overrides	9
Inaccurate Benefit Percentage Due to Indeterminable Reasons	Unknown	1
Inaccurate Inclusion of Ineligible Period for Calculating Final Compensation for DROP Members	Manual Overrides	8
Inaccurate Amount of Credited Service due to Leave Without Pay	System Limitation/ Manual Processes	2

Wrong Interest Rate for BACKDROP Calculation	Manual Processes	3
Error with Switch from Active Payroll to Pension Payroll	Manual Processes	10
Error with DROP Participation Period	Manual Processes	3
Total Count		52

The dollar impact of the 52 exceptions resulted in a net overpayment as of March 2, 2012 of \$5,966. Due to the fact that many of the files tested had multiple exceptions, it is not possible to accurately depict the impact by exception; however, below is a detailed explanation of the impact by type of pension benefit.

- Biweekly Benefit - To the 55 pensioners currently receiving payments, there was a net overpayment per pay period of \$124 (\$48 under and \$172 over). This resulted in a net overpayment as of March 2, 2012 of \$2,390 (\$1,118 under and \$3,508 over).
 - The remaining five people of the sixty tested that were still active City employees were being credited with an additional \$5 biweekly in their DROP account.
- BACKDROP – 7 of the 17 BACKDROP distributions tested had errors which resulted in a net overpayment of \$4,430 (\$5,026 under and \$9,456 over).
 - Four of the seven errors were the result of the monthly benefit calculation being incorrect. The errors in the monthly benefit calculation caused the BACKDROP calculation to be incorrect.
- DROP – All five of the DROP payments tested had errors which resulted in a net overpayment of \$3,280 (\$6,236 in overpayments due to monthly benefit errors and \$2,956 in underpayments due to timing issues with the members exiting DROP).
 - There were errors with the calculation of the monthly benefit amount due to the inclusion of non-permissible retroactive payments and/or ineligible pay periods. As a result, we tested other DROP files and determined that this is a systemic problem that appears to affect nearly all DROP participants. The systemic problem resulted from a manual adjustment being made to the electronic pension system calculation, which was already correct and should not have been adjusted.
- PLOP – Three of the seven PLOP payments tested had errors with the monthly benefit calculation which resulted in a net overpayment of \$187 (no underpayments).
 - All errors were the result of inaccurate monthly benefit calculations and not with the actual process of calculating the PLOP.
- Timing Issues with First Pension Check – 10 of the 55 current pensioners tested had errors with the first pension payment. The result was a net underpayment of \$4,321 (no overpayments).

It is important to note that the scope of our audit was pension benefits that were calculated between October 1, 2010 and November 30, 2011 and that most of the errors will continue to accumulate until the death of the member or spouse if not corrected. Therefore, although the net amount appears to be immaterial to the pension as a whole, it is an amount that will only increase each biweekly pension pay period. Additionally, if processes are not changed, errors will be made to the calculations of new pensioners as well.

Overall, these errors appear to be caused by a lack of management oversight. This includes the poor implementation process of the current pension system, which has resulted in a complex system of both manual and system driven calculations, and the overall failure of management to push for clarification from the Office of General Counsel, the Board of Trustees and City Council in areas that lacked clarity in the Municipal Code.

Recommendation to Finding 1 – 1

The Pension Office, with direction of the Board and the City’s CFO, needs to determine how to correct the noted inaccurate payments in our audit and others that were not tested so that any noted issues are handled in a manner equitable to all. The Pension Office should also stop the use of manual adjustments on the calculations for the DROP participants and instead rely on the computerized system calculation. Furthermore, the Pension Office needs to obtain official guidance from appropriate parties for all matters in which the Municipal Code is not clear or they have questions about how to handle a certain aspect of calculating pension benefits.

The Pension Office also needs to work with the Information Technology Division to resolve the system issues identified to prevent these same items from occurring in the future.

Auditee Response to Finding 1 – 1

Agree Disagree Partially Agree

We agree that there are too many instances where manual adjustments and calculations are being performed. We also agree that the majority of these issues result from poor implementation of the JAXPENSION system by the pension office and lack of management oversight of several processes. We have recently focused on changing leadership within the pension office. This is still underway. During this time, we have been working on increasing staff confidence in JAXPENSION and have been working with ITD to identify and correct errors in coding and logic of the system. We have engaged OGC in many instances as well to match up current process with municipal code. Unfortunately, just as with this audit, we found many small items, which when added together and allowed to play out over time, result in a larger impact to the fund. These have been, and are being, corrected as they are identified.

We have been working with ITD with the goal of identifying and correcting software coding errors. These, at times, were in error due to interpretations of municipal code by those in management at the time. The ITD group is generally happy to make adjustments to the system with the guidance of the pension office and Board of Trustees in order to bring the software into alignment with law and intent. They have been a strong partner recently in working with us to help ensure accurate and efficient operations of the software to meet our administrative needs. Unfortunately, we are still not where we need to be but will be working to get there. A clear goal of our office is to move in the direction of automating more of what we do in effort to minimize the room for human error which sometimes occur while processing the high volume of our various calculations. The two areas which we acknowledge needing the most work are Time Service Connections and Monthly Benefit Calculations. Monthly benefit calculation errors appear to be the driving force behind many of the errors identified in finding 1-1.

DROP, BackDROP, and PLOP calculations also appear in finding 1-1. We have made operational adjustments to DROP, backDROP, and PLOP calculations over the past 10-12 months which we feel will help to increase the accuracy of calculations. The correction to many of these items will also come when manual adjustments to monthly benefit calculations are significantly reduced.

Going forward, we will work with ITD with the objectives of a.) using JAXPENSION and other systems more fully and b.) looking for technology fixes/enhancements which allow for greater automation. In addition to increasing accuracy of our calculations, this will also increase the productivity of the office and will minimize the risk to the Plan and the City by reducing the likelihood that manual intervention is needed as often going forward.

Beyond improving the use of current technology and seeking future enhancements to technology, we will seek out guidance from the Pension Board of Trustees and OGC when situations come up where guidance is vague in Code, the Board Rules, and/or internal policy and procedure manuals. We have done this several times in the past 10-12 months, the Board has been receptive, and this has allowed us to make positive changes to our operations. We plan to continue this going forward, with the goal of addressing the items mentioned in this finding, as well as others.

Finding 1 – 2 *Legal Issues*

There are multiple aspects of calculating pension benefits where the Municipal Code either contradicts current policy or is vague as to the intent of the law. During the course of the audit, we requested a legal opinion on numerous items that the Pension Office had not previously consulted with the Office of General Counsel to confirm whether the current practice was proper.

Below are descriptions and examples of the vague laws where the Office of General Counsel's advice provided to our office stated the Pension Office was correctly applying the law.

- Current law does not expressly mention credit for partial years of service; however, it is practice to account for and give credit for partial years in calculating the pension benefit.
 - *Impact – Can have a monthly impact between 0% and 2.29% of the final monthly compensation each month of the pension benefit (e.g. if pensioners final annual compensation was \$40,000, the pensioner could be paid an additional \$916 per year).*
- Current law does not expressly allow for leave without pay (LWOP) periods to be excluded from the calculation of the Final Compensation amount.
 - *Impact – Could vary based on the amount of LWOP, the impact could easily be anywhere from \$0 to \$960 per year per pensioner.*
- Current law does not expressly allow for adjusting the final compensation amount based on a partial final pay period, thereby allowing the final compensation to be based on potentially more than 78 pay periods.
 - *Impact – Typically this will only result in the pensioner's benefit being an additional \$3 to \$5 per month.*

- Current law does not appear to be clear on how to calculate the pension benefit for a surviving spouse of a dead active member.
 - *Impact – This issue has a large range in the possible impact. If final annual compensation is \$40,000 depending on the actual number of years of credited service the impact could be a positive impact of \$12,000 all the way to a negative impact of \$6,000 per year to the survivor.*

Below is a description and example of a law where the Office of General Counsel’s advice stated the Pension Office was not correctly applying the law.

- Current law prohibits retroactive pay from being included in the final monthly compensation calculation for a pay period outside of the 78 pay periods utilized for the final monthly compensation calculation. More specifically, current law states that retroactive payments shall be credited to the time period in which such payments would have been received had they been timely paid.
 - *Impact – This is typically less than \$3 per pay period.*

Below is a description and example of a vague law that came up after our request for legal services. We did not request legal advice from the Office of General Counsel due to the fact that it was outside the scope of our audit since we relied on the calculation of the interest rate to be accurate.

- Current law does not appear to create a minimum interest rate of 0% for Corrections Officers in DROP; however, a 0% interest floor is being utilized each month.
 - *Impact – There could be as little as no impact up to a \$30,000 overpayment in extreme cases for a single DROP member.*

Recommendation to Finding 1 – 2

For areas of the law which are vague, the Pension Office should consult the Office of General Counsel to determine if any changes need to be made to the Municipal Code or whether the Pension Board needs to revise any existing policies to provide clarity to the law. Additionally, in the future we recommend that the Pension Office take a more proactive role with the Office of General Counsel for any areas of the law that are vague. For any areas in which the Pension Office is not following the Municipal Code, it needs to revise its current practices to ensure that full compliance with the law is met.

Auditee Response to Finding 1 – 2

Agree Disagree Partially Agree

We agree that there are areas of ambiguity in current code which have led to decisions by the administrative office, through the Pension Board of Trustees, which may not line-up with the interpretation of Code by all parties. In these instances, the pension office plans to work with the Board and OGC to draft up a list of items that need to be made clearer. We will then work toward introducing a "clean-up" bill to City Council with the goal of more clearly defining the method of carrying out such aspects of administering the pension plan. This applies to bullet points one through four of finding 1-2. Even though OGC agrees that we are correctly applying

the code in these areas, we acknowledge that Code is unnecessarily vague and all those involved would be benefitted by the introduction of such a clean-up bill.

For bullet point five of finding 1-2, where current practice conflicts with the interpretation of municipal code by the Council Auditor's Office and Office of General Counsel, we will explain this to the Board and seek corrective action. We will recommend that we adjust our process to ensure that our office is correctly applying retro-pay to the time periods in which it was earned when we are calculating a member's average pay. This finding most likely resulted from a decision that accurate positioning of retro pay is not always feasible and practical due to inadequate records when such is granted. Attempting to apply retro pay over the appropriate time periods will require correspondence with other divisions and/or reliance on educated guesswork. We will work to implement an improved process for determining on which pay periods this retro-pay is to be applied so as to become more accurate. We will recommend this as a going forward adjustment to our practice. Although this has only an occasional and small impact when viewed at the individual pensioner level, this problem will grow over time due to the law of large numbers if left uncorrected. We will work to correct this item upon approval from the Board of Trustees.

Regarding bullet point number six, we have brought the past practice of not applying negative interest to Corrections Officer's DROP accounts to the attention of OGC in the past. At that time, we were referred to a 2008 opinion from outside counsel, sought by OGC on this topic. In this opinion, it was concluded that we could not apply negative interest rates as this would be a reduction of principal. There is case law mentioned in the opinion which confirms that we should not apply negative interest to reduce principal. The portion that the opinion left open for future amending was that some plans carry forward losses and apply them to offset future gains. Being that this would be a change to the benefit practices in place however, it was mentioned that this may be subject to collective bargaining.

We will review this with the Board and OGC to determine if further action is warranted.

OBJECTIVE 2

To determine whether refunds of pension contributions were correctly calculated and distributed.

Finding 2 – 1 *Overpayment of Refund*

We noted one overpayment of a refund to a member who left City employment. Pursuant to Sections 120.203 (f) and (g) of the Municipal Code, upon termination of employment, members with less than five years must and members with five or more years may elect to receive a refund of contributions made by the member to the pension fund without interest less any applicable taxes. We found where one refund out of the 85 tested resulted in an overpayment. This resulted in \$7,722 out of \$863,435 in refunds tested being paid improperly. This appears to have been

caused by an error in the system counting the amount paid for a time service purchase twice; however, since this was the only issue noted it may not be a systematic error.

Recommendation to Finding 2 – 1

The Pension Office should seek reimbursement from the pensioner that was overpaid. We recommend the Pension Office and the City’s Information Technology Department work together to determine whether this issue could reoccur in the future.

Auditee Response to Finding 2 – 1

Agree Disagree Partially Agree

The pension office acknowledges this error. We will recommend that the Board authorize us to seek repayment from the affected former employee. We will also review the process in place with staff and ITD to ensure that this was simply a one off event and to minimize the probability of a reoccurrence.

OBJECTIVE 3

To determine whether time service connections and military time service purchases were properly calculated and that the member paid the complete amount owed.

Finding 3 – 1 *Issues with Calculation of Time Service Connections*

We found 6 of the 54 (or 11.11%) sampled time service connections had errors caused by human error and/or miscalculation through manual processes that were utilized rather than JaxPension. For the 54 time service connections that we tested, we determined that the total purchase price for the amount of time bought back by employees should have been \$649,232, while the actual amount paid was a total of \$651,272. There were overpayments of \$3,970 and underpayments of \$1,930 for a net overpayment of \$2,040. In addition, the adjusted pension dates of two time service connections were inaccurate. The miscalculation of time service connections prices could cause the fund to lose the trust of their members and the inaccurate adjusted pension dates result in some members being credited more (and some with less) time than actually served, which affects the pension benefit paid upon retirement.

Recommendation to Finding 3 – 1

The Pension Office, with direction of the Board and the City’s CFO, needs to determine how to correct the inaccurate time service calculations noted in our audit and others that were not tested so that any noted issues are handled in a manner equitable to all.

Going forward we recommend that time service connection calculations be performed within JaxPension.

If any issues need to be worked out prior to switching to JaxPension, we recommend the worksheet currently used be replaced with a secured excel spreadsheet which will reduce incorrect calculations due to human error. In addition to the current practice of a second staff member reviewing time service connections calculations, the reviewer should place a mark (noting their approval) next to unsecured data within the spreadsheet before signing off. Prior to Board approval, an employee should sign off that the amount paid matches the time service connections purchase price.

Auditee Response to Finding 3 – 1

Agree Disagree Partially Agree

Time Service Connections are being handled with more than necessary manual processing. This leads to an unacceptable error rate of 11% of tested cases. Fortunately, the dollar amounts of errors in this area tend to be small. Regardless, we will work to correct our processes and will seek to better use the technology available. This effort will likely streamline, automate, and increase the accuracy of this calculation.

These errors likely result from a few different issues. First, each employee's situation of past employment varies and Code is not always clear with how to handle each situation. Due to this the Board and pension office have written out procedures to handle these. Unfortunately, these efforts are still not all-encompassing. To add to this, employment records from many years ago are not as adequate as they are today. It is difficult at times for staff to assess eligible time available for purchase due to payroll records which are kept on micro film only noting hours worked by pay-period, not by day, and employment records which use employee codes which are either no longer used and/or are used in a different way. Due to these many areas of imperfection with past data management and the varying scenarios from employee to employee, significant research and human manual intervention is required for each case. This unfortunately leads to errors being made.

We fully agree that a focus on using JAXPENSION is needed for the calculation of the purchase amount after the manual work has been done to determine eligible time. We recently took action in this area by having ITD come over for a demonstration to staff on how to better work these calculations within JAXPENSION. It is our general aspiration in the pension office to move away from manual calculations, where possible with current technology, and to also work with ITD on projects to enhance technology going forward. This will reduce errors with the calculation of TSCs and with benefit calculations.

While the resulting net error on those 54 cases tested is relatively small, this number is likely to be larger if all Time Service Calculations were tested. We are in the process of improving this area of our operations and will continue to work toward more precise calculations. A shift toward a greater reliance on technology will help reduce errors in this area. This area would also benefit from a look at Pension Code to determine if there are simpler ways to allow employees to connect time.

Corrections that are recommended by the pension office to the Board of Trustees regarding this finding are going to be forward looking adjustments so as to minimize future errors.

OBJECTIVE 4

To determine whether Cost of Living Adjustments (COLA) were computed and applied accurately.

Finding 4 – 1 *Inaccurate COLA Payments*

We found that the COLA was incorrectly calculated for four of the 1,494 pensioners that we tested. This resulted in a total overpayment of \$15,298 to these four pensioners as of March 2, 2012. It appears the cause for these errors was a result of unique factors in each case.

Recommendation to Finding 4 – 1

The Pension Office needs to correct the problems on these four cases. Since the process appears to be working for most, it appears that the Pension Office needs to be careful when dealing with cases that have abnormal circumstances.

Auditee Response to Finding 4 – 1

Agree Disagree Partially Agree

We acknowledge that system/human errors occur from time to time which result in COLA being applied improperly. These issues seem to be very infrequent and not related to any systemic issue that we can find. We will recommend to the Board that it task the pension office with correcting the errors causing the overpayments, for those cases identified, and also with continuously watching this process to identify any trends in COLA mis-application.

OBJECTIVE 5

To determine whether all pensions terminated were done so properly and determine whether the Pension Office has appropriate controls in place to detect and remove ineligible pensioners.

ICW 5 – 1 *Failure to Implement Proper Controls Relating to the Detection of Deceased Members*

The controls in place to detect deceased pensioners do not appear to be adequate. The Pension Office does not actively utilize the Death Master File of the Social Security Administration on a mass scale to determine whether pensioners receiving benefits are currently alive. This leaves the

Pension Office open to vulnerability that someone could defraud the fund by falsifying the annual affidavit. In addition to the annual affidavits, the Pension Office does search the obituaries in the local newspaper; however, not all members of the plan would have an obituary in the local newspaper and, since this is a manual process, there is a high risk that a match could be missed. The match of the pension payroll to the Death Master File has not occurred in the past because the prior administrator did not feel that the Death Master File was a reasonable verification and that it would create too many false positives. Not using the Death Master File could result in the Pension Fund making pension payments to ineligible people and the City and other Agencies contributing more to the fund than would otherwise be required.

Recommendation to ICW 5 – 1

The Pension Office needs to get a subscription to the Death Master File that allows them to check all pensioners at least four times a year. This would cost less than \$5,000 and could also possibly be utilized for the City's Police and Fire Pension Fund. Finding a single pensioner or survivor each year that is not eligible for benefits would more than pay for the cost of this service.

Auditee Response to ICW 5 – 1

Agree Disagree Partially Agree

We agree that it is a great idea to begin using a system that is more quick to identify a deceased pensioner.

Beyond the obvious benefit of catching these instances faster and reducing the amount lost by the plan due to overpayments, another positive side effect would be that we could re-look at the annual affidavit process and possibly send these out less frequently. The time and monetary cost of mailing and processing these documents may be reduced and allow for a more efficient operation of the pension office.

We will recommend that the Board authorize a \$5000 subscription to quarterly access of the Death Master File. This will allow the pension office to scan this system and identify those we miss through our regular process of reviewing local obituaries. To reduce the financial burden to the plan of investing this extra \$5000 per year, we will also recommend that the Board task staff with running this by the City's Risk Management Department and Police and Fire Pension office for a potential splitting of the cost as both may benefit in some way as well.

SUPPLEMENTAL ISSUES

Supplemental Finding 1 *Related Party Transactions*

We found errors with time service connections and retirement benefit calculations for current and former employees of the Pension Office. We found no evidence to support the cause of these errors other than there were multiple issues occurring at once that possibly complicated the

matter more than normal calculations; however, that does not exclude the possibility that the errors could have been made intentionally.

We found one instance where the wrong pension benefit payment is being made to a former employee. The pensioner is being over paid \$28 each pay period, and, as of March 2, 2012, this has resulted in a total of \$620 being overpaid. Additionally, this error caused the individual's BACKDROP to be over paid by \$1,945.

We noted issues with three different employees' time service connections. Specifically, we found:

- One current employee who purchased past time service underpaid the total amount owed by \$1,426.
- The support for the purchase of time for two other former employees was missing.
 - For one, it appears the purchased time was not permissible since it appears to be for part-time service. However, even if the time was allowable, we were unable to determine if the correct amount was paid.
 - For the other, we were unable to determine whether the time was permissible without the file; however, if the time was eligible, it does appear the correct price was paid.

Recommendation to Supplemental Finding 1

The City needs to recover these losses and put in added safeguards, such as supervisory review, for any pension transactions involving employees that work in the Pension Office.

Furthermore, for missing files, the Pension Office needs to research any records it may have and request any additional support that may be needed from the former Pension Office employees so that the office can recreate the file. At that point, the Pension Office, with the guidance of the Board of Trustees, can determine what course of action is needed.

Auditee Response to Supplemental Finding 1

Agree Disagree Partially Agree

We agree with this finding. We will be recommending to the Board that the pension office institute a new process whereby any transactions involving pension office staff go through two higher levels of approval. For example, if a staff member wants to purchase allowable time, the calculation must be reviewed by the Administrative Manager and Treasurer. If the Administrative Manager is making a similar request, the Treasurer and Chief Financial Officer must perform a review. Such transaction will still also go through the Board monthly as with any other transaction processed by the pension office. This new process will minimize the likelihood of wrongdoing and will serve as a check and balance to ensure accurate calculations are being performed.

We have located the files which suspiciously disappeared and re-appeared during the audit process regarding two employees of the pension office. Both employees no longer work for the

pension office as of March 2012. This has shed light on security concerns which we are in the process of addressing.

We will bring the identified items to the Board and recommend that deficiencies be collected and that these items be corrected going forward. Absent evidence of wrong-doing, we will make an effort to treat these corrections the same as we would with any other employee or pensioner.

Auditor Follow-Up Comment to Response to Supplemental Finding 1

On February 26, 2013, the two missing files were provided to our office for review. At that time, we reviewed the files to determine whether the time connected was eligible to be purchased, the time service connection purchase price was accurately calculated, and that the correct amounts were paid.

For the former employee identified in the first bullet above regarding missing files, we found that part of the time purchased was not permissible (less than three months) based on the Pension Office's interpretation of the law at that point in time. This means the Pension Date would need to be adjusted and a partial refund (\$771) of the purchase amount paid would need to be processed.

For the former employee identified in the second bullet above regarding missing files, we were able to confirm that the time was eligible for purchase; therefore, based on our testing, the time service calculation was properly calculated and paid.

Supplemental Finding 2 *Inaccurate Minimum Pension Benefits*

We found where the minimum benefit was calculated incorrectly for some pensioners during our testing of COLA payments. The pension base for three individuals was discovered to be wrong due to the minimum pension benefit being applied inaccurately. Section 120.206 (g) of the Municipal Code states that there shall be a minimum monthly pension benefit calculated by multiplying \$25 times each year of credited service (up to a maximum of 30 years) and the minimum amount shall increase by 4% each October 1 starting in 1995. The problem was that the retirement date utilized to calculate the minimum benefit was the effective date for the survivor, which allowed for the annual 4% increase to be incorrectly applied and payments to be inflated. As of March 2, 2012, the incorrect payments to two of the three resulted in a total overpayment of \$16,483. We were unable to confirm the exact impact to the third since the original retiree's pension base may have been inaccurate.

Recommendation to Supplemental Finding 2

The Pension Office needs to correct these files and confirm on an ongoing basis that the proper information is utilized for calculating survivor benefits. For future calculations, the effective date for the surviving spouse should never be used in the calculation of the pension benefit.

Auditee Response to Supplemental Finding 2

Agree Disagree Partially Agree

We agree with the Council Auditor's interpretation of Code in this area and have taken corrective action. Upon discovering this early to mid last year, we asked ITD to review and correct the flaw in the programming logic to bring this into alignment with Code. This was corrected as of November 4th 2012 to where the retiree date is now used as the date to which the 4% growth in the \$25 minimum from 10/1/1995 is applied. For those cases occurring after this date in November 2012, they will be calculated in the manner described as is the understanding of Council Auditor's office and as we also understand Code. For cases calculated before this date, we will discuss with the Board whether or not a retroactive application is appropriate and practicable. The pension office will recommend, that the adjustment be made on a going-forward basis.

Supplemental ICW 1 *Segregation of Duties*

The user rights within JaxPension are not maintained in a manner consistent with good internal controls. One employee has the capability to perform the payroll function and retirement function, which enables her to process everything for a pensioner without any review by a third party. This could easily allow for a fictitious retiree to be set up. This was caused by the improper assignment of back-up roles which allowed the employee that does the benefit calculation function to also be the back-up for the payroll.

In a separate internal control weakness, we found employees that can process the payroll or the annual affidavits are also able to update the pensioners' addresses in the system. This could result in an employee with annual affidavit access rights fraudulently diverting funds of a deceased member by changing the address and marking that the annual affidavit was received when it was not. An employee with the payroll process could divert payments as well. While we believe neither role should be able to update the address field, the annual affidavit role is the more serious risk.

Recommendation to Supplemental ICW 1

A strong internal control structure either prevents or detects fraud. Management must create an environment with proper segregation of duties to reduce the risk of fraud occurring and not being detected.

Auditee Response to Supplemental ICW 1

Agree Disagree Partially Agree

We agree with and will work toward the proper separation of responsibilities. These segregations will be challenging given the current limited staff level of four members, however, we have identified a structure that we feel will accomplish these separations while fully staffed. We will take immediate action to review JAXPENSION access rights to ensure only those whom

need access to varying levels of data and reports have it. Going forward, as we re-staff at the administrative manager level and seek a replacement for our recently lost Time Service Connection staff member, we will split the assignments of the pension office tasks of payroll from address changes, payroll from setting up a retiree, and affidavits from address changes. Segregating these processes will minimize the potential for fraud.

Supplemental ICW 2 *Failure to Remove Former Employee Access Rights*

We found two former employees still had user rights within JaxPension. One was a former employee of the City's IT Department and had a Developer role and the other was a former employee of JEA and had a JaxPension JEA role. It is good practice to immediately remove former employees' access to a system once they leave employment. The fact that these two employees retained access rights is partially caused by the large number of parties with access needs in the system, which makes it more difficult to have someone take ownership of who does and does not have access.

Recommendation to Supplemental ICW 2

We recommend the user rights of the former employees be removed. We also recommend management review the current standard procedures and make any necessary updates to assist in removing former employees from the system immediately upon their termination from the City.

Auditee Response to Supplemental ICW 2

Agree Disagree Partially Agree

We have removed all former employee access rights as of the date of this report. We will also be careful to take immediate action for the removal of employee rights upon termination or re-assignment of an employee of the pension office. We will also work with ITD, JEA, PFPF, and internal management of other areas, whom have access, to ensure that when they experience turnover or changes in employees' roles, their access rights to JAXPENSION are adjusted accordingly.

Supplemental ICW 3 *Inadequate Policy and Procedures*

We found that the policy and procedures of the office were overall inadequate, outdated and disorganized. It appears that Pension Office tried to update the procedures when there was a change in the law, but without any reasonable organization they are difficult (at best) to follow. JaxPension is only mentioned in one procedure. This system is involved with every (or nearly every) aspect of the pension process and this indicates that the procedures are insufficient and/or not up-to-date.

Recommendation to Supplemental ICW 3

Overall, it appears that the policy and procedures need to be reviewed and updated to be consistent with what the office views as the proper procedures. This would lead to a consistent application throughout the office.

Auditee Response to Supplemental ICW 3

Agree Disagree Partially Agree

During the onboarding of the new Administrative Manager, the Treasurer will work with this person and staff to ensure that policies and procedures documents are updated and organized into an understandable and usable format. Should a clean-up bill come to pass, as mentioned in earlier responses to findings, we will work to ensure procedural documents are updated to reflect the new guidance. The Pension Office, staff, and the Board recently revised the Board Rules, are currently finalizing changes to the Summary Plan Description, and also created a manual to give to new Trustees in 2012. This manual, which includes the Summary Plan Description, Board Rules, actuarial reports, investment policy statement, chapter 120 of local municipal code, and Florida Statutes 215.47, will be the base document which guides our actions at a high level. For the more detailed and day to day procedures, which involve many steps each, we will work to update our current documents and will place them in a format which allows for frequent access by current and new staff members and Trustees of the Board. This will be an improvement to the procedural documents kept by each member of staff pertaining to their specific functions and to the documents kept on the division's shared drive which are very basic, outdated in some cases, and hard to follow.

CLOSING COMMENT

Overall, there appear to have been many breakdowns in the implementation process of the new pension system. No one party is solely at blame for system implementation issues. The issues appear to be caused by failures by both the management of the pension fund and the City's Information Technology Division. The Pension Office continues to operate as if it is still in a test phase mode of the system implementation process, performing many manual calculations outside of the system and expressing a lack of confidence in the system. The system went live December 26, 2009 and as of the close of our fieldwork it would be difficult to classify the implementation as being complete. While there will always be minor issues that arise with any system implementation, by now any major issues should have been raised by the Pension Office and corrected. If these issues were not being corrected by the Information Technology Division, the Pension Office should have formally notified the Board of Trustees, the CFO, the Office of General Counsel and the Council Auditor's Office. While our audit work did reveal some minor issues with the pension system, for the most part, we found that the system appears to be working as intended. Therefore, the Pension Office should be able to rely on the system to process pension benefit calculations, refunds and time service connections with limited manual intervention.

We appreciate the assistance and cooperation we received from the Pension Office throughout the course of this audit.

Respectfully submitted,

Kirk A. Sherman, CPA

Audit Performed By:

Kim Taylor, CPA
Brian Parks, CPA
Aaron Wilkins