



## **Audit of Alameda Benefit Recalculations**

**Report Date: April 5, 2023**

**Internal Audit Department**

**OCERS Internal Audit**  
**Audit of Alameda Benefit Recalculations**  
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## Audit Objective and Scope

The objective of this audit was to provide an independent review of Final Average Salary (FAS) calculations recalculated by OCERS' Member Services because of the Board of Retirement's adoption of the Alameda Supreme Court decision.

Internal Audit reviewed the FAS calculations for the 30 retirees whose original benefit payments were most impacted by the Alameda Supreme Court decision.

The audit was conducted in conformance with the International Standards for the Professional Practice of Internal Auditing issued by the International Internal Audit Standards Board.

## Conclusion / Executive Summary

### Opinion: *Opportunities for Improvement*

Overall, Internal Audit identified opportunities to improve controls to ensure that Alameda related FAS calculations are reliable and accurate. For further detail of the below observations please see page four.

<p><b>Priority Observations</b></p> <p>0</p> <p><b>Important Observations</b></p> <p>3</p>	<p><b>Priority Observations</b></p> <p>None</p> <p><b>Important Observations</b></p> <ol style="list-style-type: none"><li>1. Internal Audit noted a 6.7% error rate (two errors out of the sample of 30) with the FAS calculations sampled.</li><li>2. Internal Audit noted a 13.3% error rate (four errors out of the sample of 30) with the manual allocation of the total overpaid benefits to be recovered between the retiree and the employer (Not FAS Impacting).</li><li>3. For one retiree in our sample, three pay items in one partial pay period were not prorated in a consistent manner.</li></ol>
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Internal Audit independently tested FAS recalculations for the 30 retirees with the largest impact to their original benefits, with a range between \$500 and \$5,500 impact to the original benefit. The following testing was performed:

- Verified that Alameda related pay items were accurately and completely removed.

- Independently reperformed FAS recalculations which included the Alameda adjustment and reviewed the documentation used by Member Services to support their calculations.
- Reviewed Member Service's recalculation of net benefit overpayments.

## **Background**

On July 30, 2020, the California Supreme Court issued a unanimous decision (Alameda decision) regarding the pensionable designation of certain pay items (Alameda pay items). OCERS Board later adopted this decision and directed staff to recalculate benefits for affected members and recover benefit overpayments from employers and retirees. OCERS Audit Committee also directed Internal Audit to review these recalculations on a sample basis.

OCERS has estimated that a total of \$7.3 million in benefits had been overpaid to 662 retirees. To date, OCERS Member Services has recalculated benefits for 58 retirees, with an additional 110 pending Member Services' quality review process.

This audit of the 30 initial samples (out of the 58 retirees noted above) was carved out from a planned sample size of 66, with direction to be provided by the Audit Committee as to a sample size for further testing of the operating effectiveness of controls over Alameda recalculations. At a future Audit Committee meeting, Internal Audit will also report the results of its audit of Alameda contribution refund calculations, the recording of Alameda activity on OCERS accounting general ledger and the overall project oversight of the Alameda decision implementation.

### **Copies to:**

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Audit Committee Members

Observation Details	Management Action Plan (MAP) /MAP Responsible Party / Completion Date
<b>Important Observations</b>	
<p><b>1. Internal Audit noted a 6.7% error rate (two errors out of the sample of 30) with the FAS calculations sampled.</b></p> <p>For one retiree, a Member Services Contractor incorrectly overstated the amount of pensionable Paid Time Off included in the retiree’s revised FAS calculation as used specifically for the Alameda recalculation. The error resulted in an overpayment of \$129.50 in the monthly benefit payment.</p> <p>For a second retiree, a Member Services Contractor incorrectly prorated a partial pay period within the retiree’s FAS measuring period. The nature of the error is comparable to the errors noted in prior FAS Calculation audits. The error resulted in an overpayment of \$13.32 in the monthly benefit payment.</p> <p><b>Risk:</b> An oversight when reviewing FAS calculations can lead to errors in the monthly benefit paid to OCERS retirees.</p>	<p><b>Management Action Plan:</b></p> <p>These errors were associated to the first 30 transactions performed by external contractors. The prior 6 transactions (October and November 2022) where Member Services did not have any errors were performed by seasoned team members. From our review of these items, the contractors did not follow the documented processes and training they were provided; had the process been followed errors would not have occurred. The issue has been addressed with the contractors and they fully understand the need for following the documented process. The Member Services management team is also considering extending the payroll deadlines to allow for more time to perform the processing and QA. We believe rushing to get transactions processed before the deadline has contributed to the errors and think extending the timeline will help prevent future errors.</p> <p><b>Management Action Plan Responsible Party:</b></p> <p><b>Jeff Lamberson, Director of Member Services</b></p> <p><b>Completion Date: March 24,2023</b></p>
<p><b>2. Internal Audit noted a 13.3% error rate (four errors out of the sample of 30) with the manual allocation of the total overpaid benefits to be recovered between the retiree and the employer (Not FAS Impacting).</b></p> <p>As per Board approval, the repayment of total overpaid benefits due to the Alameda decision is to be allocated between the</p>	<p><b>Management Action Plan:</b></p> <p>These errors were on a new Excel tab specifically created for Alameda recalculations. With the Board direction to only collect overpayments from 10/1/2020 forward from the member, Member Services needed to create a manual calculation process. This tab was created so we could split the amount of the overpayment between the Member and the Employer. V3 automatically calculates the total</p>

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<p>employer and the retiree, with the retiree directly paying back OCERS their portion of the overpaid benefits from October 2020 to the month the benefit was recalculated and adjusted. Overpaid benefits prior to October 2020 are to be recovered from employers via the actuarial valuation process. Due to pension administration system limitations, Member Services Contractors have had to calculate the above allocation between retirees and employers via spreadsheet.</p> <p>However, due to spreadsheet data entry errors for the following retirees, there was a misallocation of the amounts due from the retiree. As a result, written notification to the retiree of their amounts owed to OCERS resulting from the Alameda decision contained incorrect dollar amounts.</p> <ul style="list-style-type: none"> <li>• Member #1 – The allocation of the total overpayment was under-reported by \$2,925 to the retiree and the employer was over-reported for the same amount.</li> <li>• Member #2 - The allocation of the total overpayment was over-reported by \$403 to the retiree and the employer was under-reported for the same amount.</li> <li>• Member #3 - The allocation of the total overpayment was under-reported by \$27 to the retiree and the employer was over-reported for the same amount.</li> </ul>	<p>overpayment, however V3 cannot automate the split between Member and Employer. The data in this tab is a direct extract from members' V3 accounts and the errors occurred when the contractors entered the data manually vs extracting it from V3. In addition, the Quality Assurance (QA) team did not validate the numbers thinking they were a direct extract. Member Services management team will be modifying our controls to ensure this new data tab is calculated separately by our QA team to validate the numbers.</p> <p><b>Management Action Plan Responsible Party:</b></p> <p><b>Jeff Lamberson, Director of Member Services</b></p> <p><b>Completion Date:</b></p> <p><b>March 15, 2023</b></p>

Observation Details	Management Action Plan (MAP) /MAP Responsible Party / Completion Date
<ul style="list-style-type: none"> <li>Member #4 - The allocation of the total overpayment was under-reported by \$20 to the retiree and the employer was over-reported for the same amount.</li> </ul> <p><b>Risk:</b> An oversight when reviewing overpayment calculations can lead to the incorrect allocation of the amount due from the retiree and the employer.</p>	
<p><b>3. For one retiree in our sample, three pay items in one partial pay period were not prorated in a consistent manner.</b></p> <p>These specific pay items should have been prorated by the employer based on 40 hours available in that pay period. The three premium pay items in one specific partial pay period were prorated as follows:</p> <ul style="list-style-type: none"> <li>Pay item 1 was reported at the full amount and not prorated by the employer, but was manually prorated properly by Member Services based on 40 hours available in the pay period</li> <li>Pay item 2 was reported prorated by the employer using 50 hours (instead of 40 hours)</li> <li>Pay item 3 was reported prorated by the employer using 29.75 hours (instead of 40 hours)</li> </ul> <p>We noted that if all three pay items were prorated using 40 hours, as per the Memorandum of Understanding and Final Average Salary Calculation OCERS Administrative Procedure, there would have been a benefit reduction, in this case less</p>	<p><b>Management Action Plan:</b></p> <p>Member Services followed a standing practice for this observation. OCERS current practice is to accept pay items that have already been prorated by the employer as reported in the transmittal. We will however ensure our current practice is documented in our procedure. We will also review our procedures to determine if it can be simplified even further to eliminate any manual proration of pay items passed to us from the employer.</p> <p><b>Management Action Plan Responsible Party:</b></p> <p><b>Jeff Lamberson, Director of Member Services</b></p> <p><b>Completion Date:</b></p> <p><b>April 15, 2023</b></p>

Observation Details	Management Action Plan (MAP) /MAP Responsible Party / Completion Date
<p>than \$10. As this is a process issue, there is potential for the existence of similar instances.</p> <p>Separately, as part of the employer payroll transmittal audits, Internal Audit verifies the proration of pay items submitted by the employers.</p> <p><b><u>Risk:</u></b> FAS errors may arise with inconsistencies in the application of FAS calculation procedures.</p>	



**Internal Audit – Observation #1 (Alameda FAS Calculation Summary)**

Sample	Nature of FAS Error	Monthly FAS Error	Monthly Benefit Payment Error
1	<p><u>Alameda adjustment - Manual</u></p> <p>The Member Services contractor did not manually remove the original amount of pensionable PTO (\$6,258) from the FAS calculation when inputting the revised amount of pensionable PTO. This resulted in an overstated FAS calculation.</p>	<p>Original monthly FAS of \$20,426.00 overstated by \$173.83.</p>	<p>Original monthly benefit of \$15,216.05 <b>overpaid by \$129.50.</b></p>
2	<p><u>Excel calculation error</u></p> <p>The Member Services contractor incorrectly prorated a partial-pay period using 32 hours of pay instead of 16 hours. This resulted in an overstated FAS calculation.</p>	<p>Original monthly FAS of \$12,030.78 overstated by \$29.11.</p>	<p>Original monthly benefit of \$5,501.56 <b>overpaid by \$13.32.</b></p>

### **Categories of Observations (Control Exceptions):**

#### **Priority Observations:**

These are observation(s) that represent critical exceptions to the audit objective(s) and/or business goals. Such conditions may involve either actual or potential large dollar errors or be of such a nature as to compromise OCERS' reputation or integrity. Management is expected to address Priority Observations brought to its attention immediately.

#### **Important Observations:**

These items are important to the process owner and they do impact the control environment and/or could be observations for improving the efficiency and/or effectiveness of OCERS' operations. Management is expected to address within six to twelve months.

### **Management's Responsibility for Internal Control**

Management has primary responsibility for establishing and maintaining the internal control system. All levels of management must be involved in assessing and strengthening internal controls. Control systems shall be continuously evaluated by Management and weaknesses, when detected, must be promptly corrected. The criteria for evaluating an entity's internal control structure are the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control – Integrated Framework. Our Internal Control Audit enhances and complements but does not substitute for department management's continuing emphasis on control activities and self-assessment of control risks.

### **Internal Control Limitations**

Because of inherent limitations in any system of internal control, errors or irregularities may nevertheless occur and not be detected. Specific examples of limitations include, but are not limited to, resource constraints, unintentional errors, management override, circumvention by collusion, and poor judgment. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or the degree of compliance with the procedures may deteriorate. Accordingly, our audit would not necessarily disclose all weaknesses in the department's operating procedures, accounting practices, and compliance with OCERS' policies.

### **Audit Report Opinions:**

#### **Satisfactory:**

No issues or a limited number of “Important Observations” (typically no more than two Important Observations).

#### **Opportunities for Improvement:**

Multiple issues classified as “Important Observations” (typically two or more Important Observations) with no more than one “Priority Observations”.

#### **Inadequate:**

Usually rendered when multiple issues are classified as “Priority” ” (typically one or more Priority Observations), together with one or more other issues classified as “Important Observations”. The Priority Observations identified have a major effect on processes, plan sponsors/members, financials, and/or regulatory requirements.