



**Continuous Audit of Final Average Salary  
Calculations (Q3 2023)**

**Report Date: March 28, 2024**

**Internal Audit Department**

**OCERS Internal Audit**  
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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 used in new benefit payments setup by OCERS' Member Services, on a continuous basis.

A total of 128 new service retirement benefits were set up by Member Services for the 3<sup>rd</sup> Quarter of 2023. Internal Audit reviewed the FAS calculations for 40 of these benefits.

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.

OCERS Management established a \$10 reportable threshold for benefit errors below which items are not included in the FAS error rate calculation. The reportable threshold was reviewed and approved at the December 2022 Audit Committee meeting. OCERS Management will continue to correct all errors, regardless of the dollar amount of the error. Internal Audit included a summary of the errors below the reportable threshold as an appendix in this report.

## Conclusion / Executive Summary

### Opinion: *Opportunities for Improvement*

During our review, Internal Audit noted two reportable FAS calculation errors with our test sample for a 5.0% error rate.

<p><b>Priority Observations</b></p> <p>0</p> <p><b>Important Observations</b></p> <p>1</p>	<p><b>Priority Observations</b></p> <p>None</p> <p><b>Important Observations</b></p> <p>1. Internal Audit noted a 5.0% error rate (two errors) with the 40 FAS calculations sampled from the 3<sup>rd</sup> Quarter of 2023.</p>
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## Background

To finalize each retiree's FAS, Member Services uses a retirement transaction Excel spreadsheet. In the spreadsheet, Member Services inputs a preliminary FAS number calculated by the pension administration system after reviewing it, and also inputs other

manually calculated pensionable pay amounts not captured or calculated by the pension administration system. To calculate these amounts, the Retirement Program Specialist (RPS) must reference a variety of external data sources provided by employers, such as hourly rate history, timesheet data, and relevant Employer MOUs. A Member Services Quality Assurance team member then reviews the final FAS calculated by the RPS.

Internal Audit independently tested 40 FAS calculations from the July, August, and September 2023 benefit payroll months, and performed the following:

- Recalculated the member’s preliminary FAS calculation and reviewed the documentation used by Member Services to support the preliminary FAS calculation.
- Recalculated Member Service’s manual calculations of other pensionable pay item amounts (typically pensionable paid time off, or PTO) manually added to the preliminary FAS and reviewed the documentation used by Member Services to support their calculations.

Below is a summary of IA’s error rate noted in the current audit, plus error rates noted in prior 2021, 2022, and 2023 audits:

<b>Error Rates Prior to establishment of \$10 Reportable Threshold</b>				
<b>Quarter</b>	<b>Benefit Applications</b>	<b>Tested by Internal Audit (IA)</b>	<b>IA Error Count</b>	<b>IA Error Rate</b>
Q3/2021	75	75	6	8.0%*
Q4/2021	154	134	2	1.5%*
Q1/2022	196	50	2	4.0%*
Q2/2022	607	41	1	2.4%*
Q3/2022	151	40	0	0.0%
<b>Error Rate using the \$10 Reportable Threshold</b>				
Q1/2023	102	40	0	0.0%
Q3/2023	128	40	2	5.0%

\*Each of these quarters contained at least one month with 100% accuracy

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Observation Details	Management Action Plan (MAP) /MAP Responsible Party / Completion Date
<b>Important Observations</b>	
<p><b>1. Internal Audit noted a 5.0% error rate (two errors) with the 40 FAS calculations sampled from the 3<sup>rd</sup> Quarter of 2023.</b></p> <p>a. For one retiree, Member Services incorrectly interpreted the member’s Memorandum of Understanding (MOU) when determining the number of Paid Time Off (PTO) hours allowable in the member’s FAS measuring period.</p> <p>b. For a second retiree, Member Services incorrectly entered PTO pay into the PAS, resulting in the PTO pay being incorrectly prorated, when there should have been no proration at all.</p> <p>The details of the errors are noted in the FAS Calculation Summary table below.</p> <p><b>Risk:</b> An oversight when reviewing FAS calculations can lead to errors in the monthly benefit paid to OCERS members.</p>	<p><b>Management Action Plan:</b> Management takes all errors very seriously.</p> <p>1(a) Response: In reviewing this specific transaction and the corresponding MOU section as shown below attached to this document, our Member Services team member had difficulty interpreting the language due to the many decision points within the vacation section of the document.</p> <p>We will provide additional training to our team to address this risk. We are also in the process of creating a guidance sheet for the team members so they do not have to interpret the legal language in the individual MOU’s.</p> <p>In the future, our ongoing meetings with the employers in 2024 to address the missing data in the transmittals, will help eliminate the possibility of this type of error from happening.</p> <p>1(b). Response: This error occurred post Quality Assurance (QA) when the representative was entering the approved calculation into the system.</p> <p>Our new Member Services Robotic Process Automation robot (Bot), that performs a final check of a processed benefit after it has been processed in the system, will catch this type of error and prevent this from occurring in the future.</p> <p><b>Management Action Plan Responsible Party:</b> Jeff Lamberson, Director of Member Services</p>

<b>Observation Details</b>	<b>Management Action Plan (MAP) /MAP Responsible Party / Completion Date</b>
	<b>Completion Date:</b> <b>12/31/2024</b>

**Internal Audit - FAS Calculation Summary (Q3 2023) – Above the \$10 reportable threshold**

<b>Sample</b>	<b>Nature of FAS Error</b>	<b>Monthly FAS Error</b>	<b>Monthly Benefit Payment Error</b>	<b>Months With Error</b>
1	<p><u>Annual Leave Hours – Manual</u></p> <p>Per the member’s MOU, the employee is allowed to cash out up to 90 hours per year of Vacation hours on an annual basis, this is considered pensionable for Legacy members. However, if the employee has any remaining accrued Annual Leave hours on the books, then the employee can cash up to a combined 120 hours of both Vacation and Annual Leave hours, this is also considered pensionable for Legacy members.</p> <p>For the 2<sup>nd</sup> year of the Member’s three-year measuring period, the Member had a combined total of 120 Vacation and Annual Leave hours accrued that should have been used in the FAS calculation. However, Member Services only used 90 hours of Vacation for the FAS calculation instead of the combined 120 hours.</p> <p>The understated 30 hours of PTO led to the monthly FAS being understated by \$62.20.</p>	Original monthly FAS of \$13,524.98 understated by \$62.20.	Original monthly benefit of \$9,671.46 <b>underpaid by \$44.49</b> . The new benefit amount is \$9,715.95.	7 months
2	<p><u>Proration – Manual</u></p> <p>The Member Services representative input the dollar amount of the final average salary adjustment into the wrong pay period in the PAS. This resulted in the final average salary adjustment amount being incorrectly prorated downward when there should have been no proration at all.</p> <p>The data entry error resulted in FAS being understated by \$29.01.</p>	Original monthly FAS of \$7,448.89 understated by \$29.01.	Original monthly benefit of \$4,354.99 <b>underpaid by \$16.96</b> . The new benefit amount is \$4,371.95.	6 months



**Appendix 1**

**FAS Error Summary - Below the \$10 Reportable Threshold (Q3 2023)**

<b>Sample</b>	<b>Monthly Benefit Payment Error</b>	<b>Nature of FAS Error</b>	<b>Systemic</b>
1	Original monthly benefit of \$8,232.99 <b>overpaid by \$9.90.</b>	PTO pay – Manual	No
2	Original monthly benefit of \$6,171.01 <b>underpaid by \$3.23.</b>	Retro pay - Employer paid incorrect pay rate *	No
3	Original monthly benefit of \$2,886.75 <b>underpaid by \$3.12.</b>	PTO pay - Manual	No
4	Original monthly benefit of \$2,647.51 <b>underpaid by \$0.99.</b>	Premium pay item – Manual	No

\* Member Services will be changing its administrative procedures regarding the application of retro-active pay to a member’s FAS calculation.

## Appendix 2

### **Attachment for above Management Action Plan Response to Observation #1: (MOU used)**

MOU  
ADMINISTRATIVE MANAGEMENT UNIT  
2019-2023

#### ARTICLE IV VACATION

##### Section 1. Accumulation of Vacation

A. For the purpose of this Section, each biweekly pay period for which a full-time employee receives his or her full biweekly salary shall be considered the equivalent of eighty (80) regularly scheduled paid hours.

B. During the first three (3) years of employment, an employee in a full-time regular or limited-term position shall earn .0577 hours of vacation for each hour of pay during his or her regularly scheduled workweek (approximately three [3] weeks per year). Part-time employees will earn vacation on a pro-rated basis.

C. Commencing with the pay period following that in which a full-time employee completes three (3) years of continuous County service (6240 hours), a full-time employee in a regular or limited term position shall earn .077 hours of vacation for each hour of pay during his or her regularly scheduled workweek (approximately four [4] weeks per year). Commencing with the pay period in which a part-time employee completes 6240 hours of continuous County service, a part-time employee in a regular or limited term position shall earn .077 hours of vacation for each hour of pay during his or her regularly scheduled workweek.

D. Commencing with the pay period following that in which the employee completed ten (10) years of continuous full-time County service, an employee in a regular or limited-term position shall earn .0962 hours vacation for each hour of pay during his or her regularly scheduled workweek (approximately five (5) weeks per year). Commencing with the pay period in which a part-time employee completes 20,800 hours of continuous County service, a part-time employee in a regular or

limited term position shall earn .0962 hours of vacation for each hour of pay during his or her regularly scheduled workweek.

**E.** The maximum allowable vacation credit an employee may accrue at any one (1) time for employees with less than ten (10) years of continuous County service shall be three hundred sixty (360) hours. The maximum allowable vacation credit an employee may accrue at any one (1) time for employees with ten (10) or more years of continuous C o u n t y service shall be four hundred eighty (480) hours. An employee who has accrued the maximum allowable vacation credit will not accrue additional credit until the employee's vacation credit drops below the maximum allowed.

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**K.** Except as set forth below, during each fiscal year an employee may request to cash out accrued vacation either in two (2) separate increments of up to forty-five (45) hours each or one (1) increment of up to ninety (90) hours.

1. Except as set forth in subsection 2 below, an employee may not cash-out vacation time if he/she has at the time of the request a balance of accrued unused annual leave.
2. An employee with an annual leave balance may cash-out vacation time under the following limited circumstances:
  - a. The employee's accrued vacation bank is such that s/he will reach the applicable cap (as set forth in section 1.F above) sometime during the fiscal year (ie., the employee has at least 201 hours of accrued vacation if employed less than ten years or at least 281 hours of accrued vacation if employed ten or more years) unless the employee is able to cash-out vacation time.
  - b. (If subsection "a" is satisfied) the employee may cash out vacation time or a combination of annual leave and vacation time twice during the fiscal year up to an aggregate of 120 hours.

Notwithstanding subsection 2.b. above, an employee with less than 120 hours of accrued annual leave, may cash-out their remaining annual leave balance and accrued vacation time necessary to reach the combined annual cash-out cap of 120 hours, irrespective of an

employee reaching their maximum vacation accrual cap during the same fiscal year.

- L. Notwithstanding any other provision of this Memorandum of Understanding, if a Probation Safety Manager is killed in the line of duty (in accordance with Penal Code section 830.5), one hundred (100) percent of the employee's vacation balance will be paid to the employee's estate.

### **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.