



# **Continuous Audit of Final Average Salary Calculations (Q2 2022)**

**Report Date: October 3, 2022**

**Internal Audit Department**

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**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.

In response to Internal Audit's 2020 Audits of FAS Calculations, Member Services reorganized the Retirement Program Specialist Team and modified the FAS calculation process including an updated retirement transaction excel spreadsheet as part of the Management Action Plan. The action plan was implemented in Q2 2021.

In this current audit's scope of Q2 2022, Member Services processed a total of 607 new service and disability retirement benefits. Internal Audit reviewed the FAS calculations for 41 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.

## Conclusion / Executive Summary

**Opinion: *Opportunities for Improvement***

During our review, Internal Audit noted opportunities exist to improve Member Services' quality control review over FAS calculations.

We noted a 2.4% error rate (one error) out of the 41 FAS calculations sampled from Q2 2022. The error resulted in a change of \$26.25 in the monthly benefit payment for the member.

Management has agreed to our finding. See below for additional detail and Management's responses.

## 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 (PAS) software after reviewing it, and inputs other manually calculated pensionable pay amounts not captured or calculated by the PAS software. 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, reciprocal salary 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 41 of the 607 FAS benefit calculations from the April through June 2022 benefit payroll months, and performed the following:

- Recalculated and traced the preliminary FAS used in the spreadsheet back to the preliminary FAS number calculated by the PAS software.
- Reviewed 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 the documentation used by Member Services to support their calculations.

Below is a summary of IA’s error rate noted in the current 2022 audit, plus error rates noted in prior 2020, 2021, and 2022 audits:

Quarter	Benefit Applications	Tested by Internal Audit (IA)	IA Error Count	IA Error Rate
Q1/2020	149	82	6	5.8%
Q2/2020	514	56	2	
Q3/2020	108	10	1	8.0%
Q4/2020	466	65	5	
Q2/2021	182	60	4	6.7%
<b>Applications Subject to the Revised FAS Calculation Procedure</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%*

\*Each of the quarters contained a month with 100% accuracy

<b>Monthly Breakdown of Q2 2022 Quarter Testing</b>				
Month	Benefit Applications	Tested by Internal Audit (IA)	IA Error Count	IA Error Rate
April	72	2	0	0.0%
May	238	30	1	3.3%
June	297	9	0	0.0%

### Important Observation

1. Internal Audit noted a 2.4% error rate (one error) with the 41 FAS calculations sampled from the 2<sup>nd</sup> quarter of 2022. An oversight when reviewing FAS calculations can lead to errors in the monthly benefit paid to OCERS members. The error occurred in the manual portion of the FAS calculation process when applying retroactive salary adjustment calculations for an Orange County Sanitation District (Sanitation District)

member. While this type of error is comparable to the type of errors Internal Audit had identified in prior FAS Calculation audits, the error was also due in part to incorrect reporting of salary components by the Employer. The error resulted in a change of \$26.25 in the monthly benefit payment. In response to the observation, Member Services will provide additional training to the team when calculating the FAS for Sanitation District. Member Services will also work with the Employer to correct the payroll transmittal information.

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Observation Details	Management Action Plan (MAP) /MAP Responsible Party / Completion Date
<p align="center"><b>Important Observation</b></p>	
<p><b>1. Internal Audit noted a 2.4% error rate (one error) with the 41 FAS calculations sampled from the 2<sup>nd</sup> Quarter of 2022.</b></p> <p>Member Services incorrectly added retroactive pay to the member's FAS when none was needed. The error occurred in the manual portion of the FAS benefit calculation for a Sanitation District member. The nature of the error is comparable to the errors noted in the prior FAS Calculation audits. However, in this instance the error was due in part to incorrect reporting from the Employer. For eight pay periods in 2019, the Employer transmitted incorrect earnable hourly pay rates in its payroll transmittal files. Due to the incorrect hourly rate reported by the Employer, Member Services incorrectly added retroactive pay to the member's FAS. Member Services also did not correct the member's FAS for retroactive pay paid by the employer in error for another pay period in 2019. The above errors resulted in a reduction of \$26.25 in the monthly benefit payment.</p> <p>The details of the error are noted in the FAS Calculation Summary table below.</p>	<p><b>Management Action Plan:</b></p> <p>Provide additional training to the Team members when calculating a Sanitation District FAS and benefit. This would include reiterating that Quality Assurance will need to perform a completely separate reperformance of the FAS calculation. Work with the Employer, Sanitation District, to correct errors in the transmittal before OCERS can begin the process of calculating the FAS and benefit.</p> <p><b>Management Action Plan Responsible Party:</b> Jeff Lamberson, Member Services Director</p> <p><b>Completion Date:</b> February 28, 2023</p>

Observation Details	Management Action Plan (MAP) /MAP Responsible Party / Completion Date
<b>Risk:</b> An oversight when reviewing FAS calculations can lead to errors in the monthly benefit paid to OCERS members.	

**Internal Audit - FAS Calculation Summary (Q2 2022)**

Sample	Nature of FAS Error	Monthly FAS Error	Monthly Benefit Payment Error	Months With Error
1	<u>Retro pay - Manual</u> The earnable hourly rate reported by the Employer did not match the earnable hourly rate actually paid to the member for eight pay periods in 2019. Due to the incorrect hourly rate reported by the Employer, Member Services incorrectly added retroactive pay to the member's FAS. Member Services also did not correct the member's FAS for retroactive pay paid by the employer in error for another pay period in 2019.	Original monthly FAS of \$11,349.54 overstated by \$34.62.	Original monthly benefit of \$8,605.70 <b>overpaid by \$26.25</b> . The new benefit amount is \$8,579.45.	5 months

### **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.