

**Montgomery County, Maryland
Office of the County Executive
Office of Internal Audit**



**Montgomery County Pension Benefit Payments
Employees' Retirement System**

July 30, 2012

Prepared by Cherry, Bekaert & Holland, L.L.P.

Highlights

Why MCIA Did this Audit

This audit was conducted as part of the implementation of the County's risk-based three-year Audit Plan. The Plan was developed through a comprehensive Countywide Risk Assessment in May 2010 by the County Executive's Office of Internal Audit (MCIA). The County Government has three employee retirement plans: the Employees' Retirement System (ERS), the Retirement Savings Plan (RSP) and the Deferred Compensation Plan (DCP). This audit focused on the ERS plan, which is the largest of the three with 5,516 active participants and 5,712 retirees and beneficiaries receiving benefits as of June 30, 2011¹. ERS ended fiscal year 2011 with \$2.8 billion in net assets and paid out \$178.7 million in retirement benefits during the year². The Office of Human Resources(OHR) was responsible for administering the retirement benefit plans from enrolling plan participants, counseling potential retirees, determining eligibility for retirement, calculating retiree benefit payments, and maintaining retiree records. As of July 1, 2012 the Montgomery County Employee Retirement Plans (MCERP) organization has oversight of the activities previously performed by OHR except for employee enrollment in retirement plans.

What MCIA Recommends

MCIA is making five recommendations. One recommendation addresses the need to research and correct payment errors we found. The other four are aimed at to improving existing internal controls, including implementing of procedures to review Cost of Living Adjustments (COLA), reinforcing the use of checklist by benefit specialists, developing a documentation archival plan and formalizing procedures for notifying retirees of payment changes. OHR and MCERP responses in Appendix D indicate agreement with recommendations

¹ Source: The County Executive Recommended FY13 Operating Budget

² Source: The FY11 County Wide CAFR Supplementary Section

and outline corrective actions being taken by management.

July 2012

Montgomery County Pension Benefit Payments – Employees' Retirement System

What MCIA Found

The Office of Human Resources (OHR) has generally designed and implemented effective internal controls to ensure retirement payments from ERS are in accordance with applicable Montgomery County regulations. However, in testing 113 retirees (including testing of deceased participants) we noted exceptions with 20 or 18% of the sampled retirees. Of the 20 retirees with exceptions noted, four had exceptions associated with the amounts of retirement payment received.

We found the following areas where internal controls need improvement: (1) review of elected retirement payment adjustments, retiree payment elections and calculation of average final earnings; (2) the use checklist by benefit specialists; (3) OHR documentation archival and retention; and (4) formal documentation of department procedures.

Four retirees were found to have errors with their current payments, ranging from \$320 to \$24,850. Two of the four errors relate to a retiree elected adjustment in retirement payments. These errors involved required adjustments in benefits to account for cost of living increases (COLA) from the retiree's initial date of retirement until the date the retiree reached the Social Security Natural Retirement Age (SSNRA); which for two retirees were 16 and 10 years, respectively. One of the errors was a clerical error in the recording of the retiree payment option elected, which resulted in a change in retirement payment occurring three years earlier than elected. The remaining error was a mathematical error in the calculation of the retiree's average final earnings.

We found weaknesses in the consistent use and completion of the retiree file checklist by benefit specialists for 12 of the 76 retirees that required the use of the checklist. OHR implemented the requirement for the use and completion of the checklist in 2011.

In addition, we found some of the retirement program details and COLA figures needed to recalculate retirement benefits were either not readily available to be provided or inaccessible, which resulted in CBH making assumptions that had to be validated in completing recalculations. We also noted inconsistencies in the documentation retained in the retiree's files. While OHR staff worked diligently to find the information needed for us to perform our audit, considerable effort was needed by OHR to search and double check the information provided, which contributed to the length of time needed to complete this audit.

Lastly, department procedures regarding notification of retirees of payment adjustments were not formally documented. We were unable to find evidence of notification for three (3) retirees.

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Objective

This report summarizes the work performed by Cherry, Bekaert & Holland, L.L.P. (CBH) in an internal audit of the Montgomery County Office of Human Resources (OHR) pension benefit payments. The scope of this engagement included reviewing the underlying data and processes from the County defined benefit plan that support the determination of eligibility, years of service and payment of benefits to retirees and survivors in the plan, including disability based retirements. The objectives of the audit were as follows:

- Review and test whether pension benefit payments from the Employee Retirement System (ERS) of Montgomery County made to retirees, including disability based retirements, are being made in accordance with the applicable Montgomery County Regulations and Labor Agreements.
- Review and test whether the system of internal control over the calculation and payment of pension benefits, including disability based retirements, is operating efficiently and effectively. This encompassed reviewing whether pension expenses and payments are properly accounted for and computed including testing for:
 - The correct calculation of employee years of service.
 - The proper approval of pension benefits.
 - The proper calculation and approval of pension expense contributions and accruals.
 - Proper treatment of Death and Survivor benefits.
 - Whether new retirees are receiving their annuity in a timely manner.
 - Whether service and pension payments for the newly retired are calculated correctly and whether the retiree is receiving a correct annuity.

This internal audit report was performed in accordance with consulting standards established by the American Institute of Certified Public Accountants and generally accepted government auditing standards established by the Government Accountability Office as appropriate. Our proposed procedures, developed to meet the objectives stated above, were reviewed and approved in advance by Montgomery County Internal Audit (MCIA). Interviews, documentation review, and field work were conducted from February 2011 to April 2012.

Background

General

Montgomery County provides a system of retirement pay to ensure their employees have income in their retirement years. The County has three major retirement programs. Factors such as employee date of hire and position determine which program or programs an employee is eligible to join. Table 1, on the next page details the County's retirement programs:

Table 1 – Retirement Plans

Retirement Program	Description
Employees’ Retirement System (ERS)	<ul style="list-style-type: none"> • Defined benefit plan. • Established in 1965 • Provide a pension for full-time and career part-time paid employees of Montgomery County and certain outside agencies³ that elected to participate. • The outside agencies are fully responsible for the cost of coverage for their employees. • Currently closed to employees hired on or after October 1, 1994, except public safety bargaining unit employees and those employees who elect to participate in the Guaranteed Retirement Income Plan. • Participants contribute a percentage of their salary to the plan and that percentage is determined by their retirement group. • County contributions to the plan are determined by the actuary. • Retiree benefit payments are based on factors such as retirement group, retirement plan, years of service, salary and age.
Retirement Savings Plan (RSP)	<ul style="list-style-type: none"> • Defined contribution plan. • Established in 1994 to provide retirement benefits for non-public safety employees and certain public safety employees hired on or after October 1, 1994 as well as employees of outside agencies¹ that elected to participate. • Full-time eligible employees may elect to participate in the plan after 6 months of employment . • Participants contribute a percentage of their salary to the plan and the percentage is determined by the County Code. • County contributes to the plan for each employee equal to a percentage of the employee’s salary. This percentage is subject to change each fiscal year. • Employees are responsible for making investment decisions for their account. • Retiree benefit payments are determined by the amount in the participant’s account at the time of retirement
Deferred Compensation Plan (DCP)	<ul style="list-style-type: none"> • Deferred compensation plan (457(b)) • Available to all eligible County employees. • Employees contribute flat dollar amount up to IRS maximums on a pre-tax basis. • Employees are responsible for making investment decisions for their account. • Retiree benefit payments are determined by the amount in the participant’s account at the time of retirement.

³ Outside agencies participating in the ERS include the Housing Opportunities Commission, Montgomery County Revenue Authority, Strathmore Foundation, Town of Chevy Chase, Washington Suburban Transit Commission, Maryland State Department of Taxation, and District Court of Maryland.

Employees’ Retirement System Overview

Our audit concentrated on the Employee’s Retirement System (ERS). There were 5,786 active members and 5,591 annuitants in the ERS as of June 30, 2010⁴. The Montgomery County ERS is governed by the Montgomery County Code, Part II, Chapter 33, Article III. The code defines the ERS and its policies, administration, eligibility criteria, and benefit payment requirements. Contributions to the program are made by the County and employees. The County’s contribution into the ERS program is determined each fiscal year by an actuarial calculation computed based assumptions approved by the CAO. Employees’ contributions to the program are defined by the County Code and made from payroll deductions.

Benefit payments from the ERS are determined by the formula detailed below. The factors used in the benefit payment formula are defined in the County Code.

$$[\text{Defined Percentage}] \times [\text{Average Final Earnings}] \times [\text{Years of Credited Service}]$$

The contributions and benefit payment formula are defined within the Code and can include collective bargaining agreements that the County Council has approved. The County currently has agreements with the following employee groups:

- Fraternal Order of Police, Montgomery County Lodge 35 (FOP) represents sworn police officers.
- Local #1664, Montgomery County Career Fire Fighters Association of the International Association of Fire Fighters, AFL-CIO (IAFF) represents paid firefighters, paid fire officers and paid rescue service personnel.
- Municipal & County Government Employees Organization, United Food and Commercial Workers, Local 1994 (MCGEO) represents public safety employees such as sworn deputy sheriffs and correctional officers and certain designated non-public safety employees.

There are several parties, both internal and external, that are involved in the administration, management and oversight of the ERS. Table 2 below details these parties and their roles.

Table 2 – Pension Program Roles

Party	Responsibility
The Montgomery County Board of Investment Trustees (BIT)	Responsible for overseeing the investments of the retirement system with exclusive authority to manage the assets of the retirement system. The BIT makes day-to-day investment decisions and reviews functions that Aetna, the third-party payer of benefits, provides.
The Montgomery County Office of Human Resources – Benefits(OHR)	Responsible for administering the County’s retirement benefit plans, maintaining retiree records, and providing direct service to employees and retirees regarding retirement benefits. The benefits team processes the paperwork to set up new retirees and is responsible for calculating each retiree’s benefit payment.
The Montgomery County Office of Human Resources – Occupational Medical Services(OMS)	Responsible for providing disability case management and processing.

⁴ Source: Montgomery County Employees’ Retirement System 2010 Actuarial Valuation Report

Party	Responsibility
The Montgomery County Department of Finance	Responsible for processing ERS refunds and DROP payments. Finance also transfers funds monthly for the DRSP program. Finance is also responsible for collecting money from outside agencies for ERS contributions, preparing the monthly journal entry to record the expense, and preparing quarterly reports for the Board of Investment Trustees.
The Montgomery County Attorney's Office (OCA)	Responsible for reviewing investment contracts for the BIT. OCA also handles questions and issues as they arise regarding the pensions. In addition, the OCA drafts legislation affecting retirements and prepares the summary plan documents for each retirement plan based on the County code.
Aetna	Third-party responsible for making the pension benefits payments. Effective <Month>2012 the responsibility for making pension benefit payments was assumed by the County ⁵ .
Fidelity	Third-party responsible for the recordkeeping for the Discontinued Retirement Service Program DRSP program. Fidelity holds the funds and makes the payouts for the program.
International City/County Management Association (ICMA)	Third-party responsible for the recordkeeping for the Deferred Retirement Option Plan DROP program. Pay outs for the program are made on behalf of the County by Northern Trust.
Mercer (Actuary) -	Third-party responsible for providing actuarial estimates of the pension plan's liabilities and expenses. Mercer also calculates the contribution rates that the County should pay into the plan.

Starting in fiscal year 2013, the Retirement Program administration duties performed by OHR will move to a new organization, the Montgomery County Employee Retirement Plans. The new organization will oversee all facets of the retirement plans including investment, administration, and accounting.

The County has several plans within the ERS program. Membership in a particular plan depends on an employee's enrollment date. The plans include an integrated plan that adjusts for Social Security benefits, a non-integrated plan that is independent of Social Security benefits, and a cash balance plan known as the Guaranteed Retirement Income Plan (GRIP). See Table A-1 in Appendix A for a summary of plan descriptions. Members of the ERS program in the integrated or non-integrated plans are also divided into retirement groups depending on their position (police officer, firefighter, sheriff's deputy, etc.) with the County during active employment. The retirement groups are defined in the County Code and include collective bargaining agreements if approved by the County Council. See Table A-2 in Appendix A for details of the retirement groups and plan combinations.

There are seven retirement types in which an employee can retire under the ERS plans. Along with the traditional retirement types of Normal, Early and Disability the County has the Discontinued Retirement Service Program (DRSP) and Deferred Retirement Option Plan (DROP). The two retirement types are special programs in which a police officer or firefighter can continue working for up to three years after they have declared they are retiring. During the last three years of employment the monthly pension benefit they would have received, upon actual retirement, is invested. When the member officially stops working, they start receiving their pension benefits along with the accumulated value of the invested benefits. Table 3 below summarizes the different retirement types.

⁵ During the scope of this audit February 2011 to March 2012 Aetna had responsibility for benefit payments

Table 3 – ERS Retirement Types

ERS Retirement Types	Summary Description
Normal	Depends on group, age, and years of credited service
Early	Retire earlier than normal retirement. Depends on group, age, and years of credited service.
Disability Service Connected	Totally disabled by occupational disease incurred or accident occurring while performing job and unable to perform job as a result.
Disability Non-Service Connected	Become mentally or physically incapacitated from further performance of job as a result of illness or injury that is not job related and have 5 years of credited service.
Discontinued Service Retirement	Employment ends because of administrative action and employee has more than 10 years of continuous service. Benefits begin on early retirement date.
Discontinued Retirement Service Program (DRSP)	Available only to members of group F, FZ, and FK. Monthly pension benefit is deposited in self-directed investment account while employee continues to work. At the end of participation, employee receives account balance. Employee may participate for up to 3 years and then must retire.
Deferred Retirement Option Plan (DROP)	Available only to members of group G, GZ, and GK. Monthly pension benefit is recorded in a recordkeeping account along with active employee contributions and quarterly compounded interest while the employee continues to work. At the end of participation, employee receives account balance. Employee may participate for up to 3 years and then must retire.

IT Systems

In January 2011, the County converted all legacy benefit systems to a new Enterprise Resource Planning (ERP) system. As a result of the system conversion, the ERS program is now administered using the Oracle and Peoplesoft systems. See Table A-3 in Appendix A that details the legacy systems that were converted to Oracle and Peoplesoft.

Retirement Process Overview⁶

Retirement Consideration and Preliminary Benefit Calculation

An employee considering retirement must attend either a group counseling meeting or have a retirement counseling session with an OHR benefits specialist. At that meeting, the OHR benefits specialist determines if the employee is eligible for retirement based upon age and years

⁶ In January 2011 OHR transition to a new retirement benefit system as part of the County’s ERP system implementation. This report reflects the procedures performed prior to the transition to the new system.

of service as defined by the applicable retirement plan. See Table A-4 in Appendix A that details the applicable age and years of service per retirement type. The OHR benefits specialist reviews the calculated the employee's earnings as of the date the employee wants to retire, verifies years of service with the County and reviews the preliminary calculation of the employee's retirement benefits based upon the benefit payment formula established for the employee's benefit plan and group and the employee's selected payment option.

Application and Initial Benefit Calculation

At least 30 days before he or she wishes to officially retire, an employee must complete a retirement application as well as a beneficiary designation form, direct deposit form and tax forms and submit them to OHR. The OHR benefits specialist receives the completed paperwork and enters the employee's retirement information into the retirement system⁷ and completes a Retiree Information Report detailing the employee personal information, retirement type, payment option, payment amount, and withholding information and sends it to the County's third-party payer, Aetna⁸.

Initial Benefit Payment

Aetna, who makes the benefits payments to the retirees, will set up the retiree in their system and generate a live check for the retiree's first pension benefit payment. The check is sent to OHR. Upon receipt of the check the OHR benefits specialist will send the check and a letter to the retiree detailing the enclosed check, the monthly pension payment, whether or not payments continue to a beneficiary in the event of death and information regarding life insurance and health insurance. The documents should be received by the retiree by his or hers effective retirement date.

Revised Benefit Calculation

After the employee has officially retired, an OHR benefits specialist, who did not process the initial calculation, reviews the benefit calculation and performs a recalculation of the benefit payment based upon finalized earnings and years of service figures. If the retiree's benefit payment needs adjustment, the OHR benefits specialist will send a letter to the retiree notifying them of the change in their benefit amount. The OHR benefit specialist will send an adjusted Retiree Information Report to Aetna, to have them revise the monthly check amount. The benefits specialists are also responsible for completing a checklist to ensure all processing for each retiree has been completed.

Disability Retirement Overview

Application

An employee that believes they qualify for a disability retirement must have a counseling session with OHR Benefits. The OHR benefits specialist will go through a checklist with the employee explaining procedures and benefits and then both the employee and benefits specialist must sign and date the form to acknowledge that the counseling session took place. An employee that decides to apply for disability retirement, must fill out an Application for Disability Benefits and an authorization for release of medical records. OHR Benefits will forward the completed forms to the Office of Medical Services (OMS). If an employee is selecting service connected

⁷ At the time of this audit the Human Resource Benefit (HRB) system was used by the OHR benefit specialist prior to the transition to the County's ERP system.

⁸ During the scope of this audit Aetna had responsibility for benefit payments; therefore this report reflects the procedures performed by Aetna.

disability an application must be submitted within one year from separation from County service or if the member is a sworn police officer, within five years after the date of the accident.

Application Review and Approval

The employee is then required to have 5 years of medical records forwarded to OMS within 30 days of OMS receiving the application from OHR Benefits. The Application for Disability Benefits is reviewed by the Disability Review Panel, a panel of medical doctors, who make a determination of whether there is a disability and whether it is service connected or not. The panel's recommendation regarding their disability determination is forwarded to the County Attorney's office. The County Attorney will review the case and ensure all laws, policies, and procedures were complied with. The County Attorney will sign off on the case and send it to the Chief Administrative Officer who, by regulation, makes the final decision on whether or not to grant a disability retirement. Once the disability retirement is approved, OHR Benefits will send a letter to the employee notifying him or her of the decision. The OHR benefits specialist will then hold a retirement counseling session with the new retiree and the required forms and calculation of the benefit payment follow the same process as for a regular retiree described above.

Survivor Benefits Overview

Initial Benefit Payment

OHR Benefits receives notifications of retiree deaths from retirees' families or from Aetna. Upon receipt of a valid death certificate, the OHR benefits specialist will review the retiree's payment option selection and beneficiary designation form to determine what benefits the survivor is entitled to receive. If the survivor is entitled to a monthly benefit, then the OHR benefits specialist will calculate the survivor's benefit payment and the processing is the same as for a regular retiree as described above.

Pension Benefit Payment Calculation

A retiree's annual pension benefit is calculated using the formula detailed below, the retiree's monthly payment is 1/12th of the annual payment:

$$[\text{Defined Percentage}]^9 \times [\text{Average Final Earnings}] \times [\text{Years of Credited Service}]$$

The factors in the formula are determined by the employee retirement plan and group. The OHR benefit specialist must confirm all the factors prior to calculating a retiree's annual pension benefit.

- **Defined Retirement Percentage:** This is the percentage of salary the retiree is entitled to receive annually in retirement based on years of service. This percentage is pre-determined within the County Code and varies depending on the retirement group to which the retiree is a member. The percentage is documented in the Summary Plan Descriptions. For example for Group E the percentage is 2.4% up to 25 years of service and 2% for years of service beyond 25 years and below 31 years.
- **Average Final Earnings (AFE):** Includes all eligible wages an employee has earned including any applicable differentials for either a period of 12 or 36 months. The time period for consideration is determined by a retiree's plan¹⁰ and is documented in the

⁹ Percentage is determined by retirement plan and retirement type

¹⁰ Plan Designations: Optional Non- Integrated and Integrated -12 months, Mandatory Integrated- 36 months

Summary Plan Descriptions. If a retiree's retirement type is discontinued service retirement or service connected disability, final earnings is used in the calculation instead of average final earnings. Overtime wages are excluded from determining average final earnings. Due to economic conditions, the County did not have a general wage adjustment (GWA), or salary increase, in fiscal year 2010. As part of its negotiations with the unions, the County agreed to calculate average final earnings as if the salary increases had happened for that year. The percentage increase added to earnings was also negotiated and varies according to retirement group. See Table A-5 in Appendix A for the applicable AFE calculation by employee status and plan.

- **Years of Credited Service:** Retirees must have a minimum number of years of credited service to be eligible to retire. The minimum number of years is determined by their retirement group and is documented in the Summary Plan Descriptions. Credited service includes regular service, purchased service, transferred service, military service and unused sick leave up to a maximum of 2 years. The maximum years of credited service allowed is determined by the retirement group to which the retiree is a member.

Pension Benefit Payment Additional Calculations, Adjustments and Factors

Depending on the retiree's retirement plan there are additional calculations, adjustments and factors that must be considered at determining retirement benefits.

- **Social Security Considerations:** Retirees in the optional or mandatory integrated plans must have their pension benefit payments calculated in two parts. In addition to the basic calculation detailed above, a second calculation of benefits for when the retiree reaches Social Security Normal Retirement Age (SSNRA) must be performed. The second calculation includes the IRS-determined Social Security Covered Compensation Level (SSCCL)¹¹ for the retiree in the calculation. The second calculation is detailed below.

$$\frac{([\text{Defined Percentage} \times \text{AFE up to SSCCL}] + [\text{Defined Percentage} \times \text{AFE above SSCCL}]) \times \text{Years of Credited Service}}$$

- **Cost of Living Adjustment (COLA):** Per the County Code¹², pension benefits are adjusted annually to reflect the increased or decreased cost of living as determined by the Consumer Price Index (CPI). Members of the optional non-integrated and optional integrated plans receive an adjustment of 100% of the CPI change. Members of the mandatory integrated plan receive an adjustment of 100% of the CPI change up to 3% and 60% of the CPI change greater than 3% up to a total adjustment of 7.5%. The maximum of 7.5% does not apply to disability retirees or retirees over age 65.
- **Disability Retirement Benefit Minimums:** Per the County Code¹³, retiree's under the retirement type Non-service connected disability cannot have a benefit amount less than 33 1/3% of the retiree's final earnings. If the calculated benefit is below 33 1/3% of final earnings, the OHR Benefits specialist will use 33 1/3% of final earnings as the benefit amount. Retiree's under the Service connected disability retirement type cannot have a benefit amount less than 66 2/3% of the retiree's final earnings. If the calculated benefit is

¹¹ This is the maximum dollar amount of earnings upon which social security benefits are based. It is based on the average of 35 wage base years prior to SSNRA. The amount used in the calculation is determined by the retiree's date of birth.

¹² Montgomery County Code Part II, Chapter 33, Section 44.

¹³ Montgomery County Code Part II, Chapter 33, Section 43.

below 66 2/3% of final earnings, the OHR Benefits specialist will use 66 2/3% of final earnings as the benefit amount.

Benefit Payment Options

Retirees have seven benefit payment options they can select. All of the payment options ensure payment for the retiree's lifetime. Adjustment to the benefits paid will be done if the retiree selects options that provide for benefit payments to be made to a survivor upon the retiree's death. In addition, some payment options include adjustment in benefits paid when the retiree reaches SSNRA. See Table A-6 in Appendix A for a summary table of payment options available to an ERS retiree.

Reemployment Overview

The County allows retirees to return to work with the County. The effect on the pension payments is determined by the employee's original retirement designation. Disability retirees returning to employment will have pension payments stopped and must rejoin the retirement system and resume making employee contributions to the program. Normal retirees returning to employment as an elected County official or in a full time position that is eligible for the retirement program will have pension payment stopped and must rejoin the retirement system and resume making employee contributions to the program. Normal retirees returning to county employment within 25 months can rejoin the ERS program or if they return after 25 months the must join the Retirement Saving Plan or Guaranteed Retirement Income Plan. If the normal retiree returns to County employment in a part-time position, depending on their retirement plan they may be subject to a reduction in retirement benefits equal to the compensation being received from the County.

Scope and Methodology

We performed our review of pension benefit payments in two phases. Phase I consisted interviewing responsible officials from OHR, BIT, and Finance to gain an understanding of the pension benefit process. See Appendix B for a listing of individuals we interviewed and their responsibilities. In addition, we reviewed documentation of the ERS Summary Plan Descriptions and performed testing on a limited number of samples. Phase II involved detail testing of a substantial number of sample payments. Results of the procedures performed in Phase I were used as the basis for developing the approach to Phase II testing. We designed the testing to provide coverage over all annuitants receiving benefits payments from the County.

Phase I Sample Selection

For our limited testing, we obtained from OHR Benefits the following listings for July 2010 to February 2011¹⁴:

- Annuitants who had retired or become surviving beneficiaries
- All current DROP and DRSP participants
- Annuitants for which OHR Benefits had received notification that the annuitant had died

¹⁴ We limited our sample to annuitants from July 1, 2010 to February 1, 2011 because OHR Benefits was going through an IT system conversion during the time period of our Phase I testing and was experiencing many challenges including a limited ability to produce reports.

The items tested were selected based on the inherent level of risk associated with the various retirement types and plans. We determined that a sample size of 35 was sufficient based on the objective of ascertaining whether internal controls over pension benefits had been implemented and were operating as designed. Our 35 samples were chosen as follows:

Table 4 – Phase I Sample Breakdown

Category	Sampling Method	Number of Samples
Regular Retirees	Judgmentally	15
Survivors/Beneficiaries	Judgmentally	2
Disabled Retirees	Judgmentally	3
DROP Participants	Judgmentally	3
DRSP Participants	Judgmentally	2
Deceased Annuitants	Randomly	10
Total		35

Phase I Sample Testing

Our testing used criteria from *Montgomery County Employees’ Retirement System – Summary Descriptions* dated July 2010¹⁵. These summary descriptions contain key provisions of the ERS as detailed in the Montgomery County Code, Part II, Chapter 33, Article III. See Phase I test attribute descriptions in table C-1 in Appendix C. We performed the following:

- Recalculation of the average final earnings, credited service, and benefit payment amounts for each annuitant and compared them to that which was calculated by OHR Benefits.
- Verification that any subsequent changes to the benefit payment were communicated to the annuitant.
- For each annuitant and DROP/DRSP sample, we verified that the annuitant or employee was eligible for benefits and that all required paperwork for retirement processing was present and had proper signatures.
- For each DROP/DRSP sample, we verified that benefit payment amounts and contributions were communicated to the record keepers of the programs.
- For each deceased annuitant sample, we verified that the decedent was listed on the Social Security Death Index and that they were no longer listed on the benefit payment report provided by the County’s third-party payer of benefits.

Phase I Results

Fourteen of our sample items tested had exceptions based upon the attributes tested. Six of the regular retiree samples had incomplete or missing checklists. One regular retiree sample item was missing the checklist and application for benefits, as well as other documentation necessary to verify average final earnings and the benefit payment. For one regular retiree, we were unable to match our benefit payment calculation to OHR Benefits’ calculation. For one sample item we were unable to verify subsequent communication with the retiree. One survivor sample had documentation missing in OHR’s files that prevented us from verifying either the average final earnings or the benefit calculation. Two disability samples and two DRSP/DROP samples had checklists that were missing or incomplete. None of our deceased annuitant samples had exceptions. See the table of Phase I exceptions in Appendix C.

¹⁵ The most recent ERS Plans descriptions were updated in July 2011, after the time period of our testing.

Phase II Sample Selection

For our detailed testing, we obtained from OHR Benefits the following listings:

- All annuitants who had retired or become surviving beneficiaries as of June 3, 2011.
- All current DROP and DRSP participants as of June 1, 2011.
- Annuitants for which OHR Benefits had received notification through June 3, 2011 that the annuitant had died.

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CBH selected a random sample for Phase II from a population of 5,352 annuitants. We determined that a sample size of 75 annuitants and 15 DROP/DRSP participants was sufficient based on the objective of ascertaining whether internal controls over pension benefits had been implemented and were operating as designed. In addition, we determined that a sample size of 25 for deceased testing was sufficient based on our Phase I deceased testing in which we noted no exceptions. Our samples were chosen as follows:

Table 5 – Phase II Sample Breakdown

Category	Number of Samples
Regular Retirees	56
Survivors/Beneficiaries	5
Disabled Retirees	14
DROP Participants	8
DRSP Participants	7
Deceased Annuitants*	25
Total	115

After selection and testing the Deceased Annuitants sample we confirmed with OHR that two of the 25 annuitants selected were not participants in the ERS program and the department procedures followed for deceased annuitants did not apply. We removed the two from our sample resulting in a deceased annuitant sample of 23 and total audit sample of 113.

Phase II Detailed Testing

Our testing for Phase II followed the same methodology as Phase I using the attributes listed below:

Table 6 – Pension Testing Attributes

	Attribute	Test Step
Normal, Survivor, Disability Retirees	Attribute A	Verify that retiree signed and dated application for benefits form and submitted within required timelines.
	Attribute B	Verify that the retirement checklist to be completed by OHR Benefits has been properly completed.
	Attribute C	Verify that each participant is eligible by performing the following: <ol style="list-style-type: none"> a. Verify that each participant is properly vested per plan documents. (10 years prior to 1989, 5 years after 1989). b. Verify that each participant has met age requirements relevant to the retirement plan and type. c. Verify that each participant has met credited service requirements relevant to the retirement plan and type.
	Attribute D	<ul style="list-style-type: none"> • Recalculate average final earnings and agree recalculation to pension department calculation. • If information is not available to recalculate data due to age of file, simply test clerical accuracy of information provided by OHR.
	Attribute E	Recalculate beginning benefit payment relevant to the retirement plan, retirement type, and payment option and agree recalculation to pension department calculation.
	Attribute F	Review effective retirement date and compare to date of distribution of first payment.
	Attribute G	Verify that first benefit payment agrees to benefit calculation.
	Attribute H	Review recalculation of payment after employee retires, if applicable. If there is a difference between initial payment calculation and final payment calculation, ensure payment was adjusted and new amount was communicated to the retiree.
	Attribute I	For existing annuitants, recalculate current payment by applying applicable COLAs and/or Social Security reductions and agree to current benefit payment.
Survivor Beneficiaries	Attribute J	For survivors, ensure the survivor is eligible by reviewing applicable designation forms.
	Attribute K	For survivors, recalculate the beginning survivor payment and agree the recalculation to pension department calculation.
	Attribute L	For survivors, recalculate current payment by applying applicable COLAs and/or Social Security reductions and agree to current benefit payment. Follow up on any differences.
Disability Retirees	Attribute M	For disabled retirees, verify that a signed and dated application for disability retirement is on file and was submitted within required timelines
	Attribute N	For disabled retirees, verify that disability checklist was properly completed and signed by employee and benefits specialist.
	Attribute O	For disabled retirees, review approval for benefits from Chief Administrative Officer.

	Attribute	Test Step
	Attribute P	For disabled retirees, verify that evidence of medical re-examination or doctor's certificate is on file if participant is within age requirements (<55 years old).
	Attribute Q	For disabled retirees, recalculate beginning benefit payment relevant to the retirement plan, retirement type, and payment option and agree recalculation to pension department calculation.
	Attribute R	For disabled retirees, recalculate current payment by applying applicable COLAs and/or Social Security reductions and agree to current benefit payment.
	Attribute S	For disabled retirees, verify that employee's medical information has been released.

In addition to Attributes A-E above we tested the following for DROP and DRSP participants:

Table 7 – DROP & DRSP Testing Attributes

Attribute	Test Step
Attribute F	Verify that benefit payment amounts and contributions are being communicated to the record keepers (ICMA for DROP and Fidelity for DRSP).

In addition to Attributes A-S above we tested the following for annuitants that were from outside agencies that are participants in the ERS.

Table 8 – Outside Agency Testing Attributes

Attribute	Test Step
Attribute T	Verify that letter or form with retiree information (AFE, Service, Unused Sick Leave) have been provided by the outside agency.

Deceased Annuitants Testing Attributes

For each sample, CBH researched the decedent utilizing the Social Security death index feature of Rootsweb at <http://ssdi.rootsweb.ancestry.com/>. In addition, CBH reviewed the Aetna GA-007679 and GA-001920 Reports to verify that payments had been stopped. These reports were as of February 2011; therefore anyone who died after this date would still be included in the report.

Table 9 – Deceased Annuitants Testing Attributes

Test Step
Listed in Social Security Death Index?
Listed in Aetna Report?

Results

Our review found that pension benefit payments we tested are being made in accordance with applicable County regulations. We also found that policies and procedures established and implemented by OHR generally contain internal controls designed to ensure program compliance. However, we identified areas in need of additional improvements or enhancements including documentation retained to support the earnings and pension benefit calculations. Of the 113 items tested, we identified 29 or 26%, that were non-compliant with one or more of 23 attributes tested.

The following tables provide a summary of the exceptions noted during testing and provide a summary of all exceptions by test attribute from the pension benefit payment and deceased annuitant samples.

Table 10 - Summary of Exceptions from Phase II Testing

Attribute Tested	Retirees	Survivors	Disabilities	DRSP/DROP	Deceased	Total Exceptions	Samples Tested Per Attribute	% Exceptions Per Attribute
Attribute A	1	0	NA	0	NA	1	76	1%
Attribute B	1	0	NA	11	NA	12	76	16%
Attribute C	0	0	NA	0	NA	0	76	0%
Attribute D	0	0	NA	1	NA	1	76	1%
Attribute E	0	0	NA	0	NA	0	76	0%
Attribute F	0	NA	NA	NA	NA	0	56	0%
Attribute F-DRSP/DROP	NA	NA	NA	0	NA	0	15	0%
Attribute G	0	NA	NA	NA	NA	0	56	0%
Attribute H	3	0	0	NA	NA	3	75	4%
Attribute I	3	0	0	NA	NA	3	75	4%
Attribute J	NA	2	NA	NA	NA	2	5	40%
Attribute K	NA	0	NA	NA	NA	0	5	0%
Attribute L	NA	0	NA	NA	NA	0	5	0%
Attribute M	NA	NA	0	NA	NA	0	14	0%
Attribute N	NA	NA	0	NA	NA	0	14	0%
Attribute O	NA	NA	0	NA	NA	0	9	0%
Attribute P	NA	NA	0	NA	NA	0	14	0%
Attribute Q	NA	NA	0	NA	NA	0	14	0%
Attribute R	NA	NA	0	NA	NA	0	14	0%
Attribute S	NA	NA	0	NA	NA	0	14	0%
Attribute T	0	0	0	0	0	0	4	25%
Listed in SS Index	NA	NA	NA	NA	0	0	23	0%
Listed in Aetna Report	NA	NA	NA	NA	0	0	23	0%
Total Exceptions	8	2	0	12	0	22		

	Retirees	Survivors	Disabilities	DRSP/DROP	Deceased	Total
Total Samples Tested	56	5	14	15	23	113
# of Samples with at Least One or More Exceptions	6	2	0	12	0	20
% of Samples with Exceptions	11%	40%	0%	80%	0%	18%

Following is a summary of the exceptions noted and which of the following observations provides additional details regarding the exception:

Attribute A – one exception for missing application supporting request for benefits (Observation 3)

Attribute B – 12 exceptions for incomplete or missing checklist (Observation 2)

Attribute D – one exception for error in Average Final Earnings (Observation 1)

Attribute H – three exceptions for missing letter supporting notice of changes in retirement payment (Observation 3)

Attribute I – three exceptions noted non-agreement of current benefit payment to CBH recalculated benefit payment (Observation 1)

Attribute J – two exceptions for missing marriage certificates supporting right to survivor benefits. (Observation 3)

Based on our review we have the following observations/findings:

1. Incorrect Payment of Pension Benefits to retiree

We noted two (2) instances in which COLA adjustments were not properly applied, one (1) instance in which an elected benefit payment change occurred three years too early, and one (1) instance where Average Final Earnings was calculated incorrectly. In reviewing the calculations, CBH found benefit payment factors or criteria were misapplied either at the initial calculation of benefit or when subsequent adjustments were made to benefit payments. One of the fiduciary duties of the County is to ensure employees and retirees are accurately compensated.

- Retiree #52¹⁶ – Retired from Group E.
 - CBH agrees with the initial monthly payment amount calculated and paid to the retiree upon retirement. Applicable COLAs were applied to this initial payment going forward until the retiree reached SSNRA, when the retiree-elected change in benefit amount was to occur.
 - CBH also agrees with OHR’s initial calculation of the benefit payment to be paid to the retiree upon reaching SSNRA. Since this figure was calculated upon the employees retirement, when the retiree reached SSNRA it was adjusted for

¹⁶ The exception is identified with the number from our sample and the retirement group.

- applicable COLAs for the 16 years between retirement and reaching SSNRA to arrive at the actual benefit payment amount to be paid to the retiree upon reaching SSNRA.
- CBH's recalculation of the monthly benefit payment does not agree with the retiree's actual February 2011 benefit payment. CBH was unable to verify the propriety of the benefit payment amounts adjusted for COLA for the 16 years between retirement and reaching SSNRA and from SSNRA to 2011. The retiree's file did not contain any documentation that indicated or supported a validation of the benefit payment when it changed from the initial payment to the retiree-elected reduction. The retiree has been overpaid for roughly 14 years, by a cumulative estimated total of \$24,850.
- Retiree #66¹⁶ – Retired from Group H.
 - CBH agrees with the initial monthly payment amount calculated and paid to the retiree upon retirement. Applicable COLAs were applied to this initial payment going forward until the retiree reached SSNRA, when the retiree-elected change in benefit amount was to occur.
 - CBH also agrees with OHR's initial calculation of the benefit payment to be paid to the retiree upon reaching SSNRA. Since this figure was calculated upon the employee's retirement, when the retiree reached SSNRA it was adjusted for applicable COLAs for the 10 years between retirement and reaching SSNRA to arrive at the actual benefit payment amount to be paid to the retiree upon reaching SSNRA.
 - CBH's recalculation of the monthly benefit payment does not agree with the retiree's actual February 2011 benefit payment. CBH was unable to verify the propriety of the benefit payments amount adjusted for COLA for the 10 years between retirement and reaching SSNRA and from SSNRA to 2011. The retiree's file did not contain any documentation that indicated or supported a validation of the benefit payment when it changed from the initial payment to the retiree-elected reduction. The retiree has been underpaid by a cumulative estimated total of \$11,601.
 - Retiree #64¹⁶ – Retired from Group H.
 - CBH agrees with initial monthly payment amount under the payment option combining Social Security Adjustment at Age 65 with Joint & Survivor 20% (Combined SSAO). However, when the retiree reached the age of 62, a reduction in retirement benefits was applied three (3) years earlier than the retiree elected due to an error in the OHR recording of the option selected by the retiree.
 - Under the employee elected payment option, the employee was to continue to receive the initial (higher) benefit payment for three additional years until the age of 65 when the elected reduction in benefits was to occur. When the retiree did reach age 65, the retiree continued to receive the reduced payment amount that began at age 62 instead of the elected reduction that was to occur at age 65.
 - In addition, the unelected change in benefit payment that occurred when the retiree reached age 62 was less than the elected reduction that was to occur when the retiree reached age 65, therefore, the retiree has continued to receive incorrect benefit payments since reaching the age of 65.

- The result was the employee being underpaid roughly \$34,050 from age 62 to 65, and overpaid roughly \$32,800 from age 65 to present (8 years). The result is a net underpayment of approximately \$1,250.
- Retiree DRSP #11¹⁴ - Group F employee
 - CBH found an error in the Average Final Earnings (AFE) calculation, which is the starting point for calculating the monthly benefit amount to be deposited into an elected investment option Fidelity account on behalf of the employee. CBH believes the figure capturing the pro-rated earnings of the last pay period was incorrectly added twice to arrive at the highest three-year earnings amount.
 - The result of this error caused AFE to be overstated by \$1,334.95. The result of the variation in AFE is an overpayment by the County of approximately \$80 per month for 4 months and \$320 to date.

2. Weakness in Checklist Use and Completion

We noted eight (8) instances in which the DROP/DRSP checklist was not properly completed and four (4) instances in which the applicable checklist was not present in the retiree file. Seventy-six (76) of the records tested required the use of a checklist. The eight (8) incomplete checklists were not completed to evidence performance of a secondary review of the applicable retiree file and benefit calculation. Five (5) of the eight (8) incomplete checklists were also incomplete for steps such as obtaining a copy of the employee's birth certificate, auditing the employees AFE, sick leave and credited service, enrolling via ICMA website, joint applicant birth certificate, and marriage certificate. In addition, as program requirements were changed or modified and the checklists were updated to reflect changes, effective dates for the checklist were not noted on the checklist to help ensure the correct checklist was used when developing the retirement file and determining the benefit calculation. Starting in 2011 OHR implemented a requirement that checklists be used by staff to ensure that all applicable items are addressed during the establishment of a new retiree/survivor or DROP/DRSP participant.

The effectiveness of a checklist as an internal control for ensuring all requirements are met is compromised when steps are left uncompleted and there is no accountability for ensuring its use. The continued development and evolution of the checklist without any clear documentation of required procedures effective when a specific checklist version was used, makes it difficult to assess the effectiveness of the checklist in having staff perform required procedures. The inconsistent use of checklist could lead to errors including establishment of eligibility, benefit payment calculation, elected payment option, or designated survivor or beneficiary. Inadequate review or lack of review can lead to benefit payment calculation mistakes going undetected, which in turn could cause the County to either overpay or underpay the annuitant, as we have found.

3. Weakness in Documentation Retention

Department historical records of key information were not readily available or retained in a consistent manner.

- Copies of the historical Summary Plan Descriptions were not provided by OHR until December 6, 2011, at the end of audit field work. Request for this documentation was formally made on September 9, 2011. The absence of these documents impacted the

- determination of eligibility, accurate calculation of AFE and accurate calculation of monthly pension benefit amount before and after SSNRA.
- Historic COLA factors are retained OHR in various documents and in varying formats. It was difficult to apply COLAs for employees retiring prior to 2003 due to the level of detail retained and the multiple documents in which information was retained.
 - We found inconsistencies were found in the level of documentation retained in individual case files maintained by OHR. We noted the absence or lack of completion of the following:
 - Retirement Benefit Applications
 - Initial, future, and adjusted (due to subsequent audit) benefit payment amount calculation details,
 - documentation of correspondence between the County and employee for changes in payment amount,
 - copies of first pension paycheck and subsequent paychecks if changes were made,
 - checklists to verify all necessary documentation was complete, and
 - marriage certificates for spouses in cases where they were to receive benefits upon the death of the original retiree.

While the department does follow the County's formal record retention policy regarding the length of time to retain documents, the department does not have a formal retention plan that ensures a library of key historical documents is centrally maintain. In addition, a base line of key documents to be retained in retiree files based upon effective dates of plan requirement has not been formally established. Incomplete or missing documentation impacts an in house or independent reviewer's ability to recalculate and/or verify the accuracy of retirement compensation determined for retirees. We had to make assumptions about files and make and additional inquiries to other departments to obtain information which should have been in OHR's files in order to perform our audit.

4. Lack of Written Procedures For Department Practices Regarding Notification of Adjustment in Retiree Benefits and Retiree Death

OHR did not have formal written procedures that department staff are to follow when there is a change in a retiree benefit. OHR developed and implemented the standard practice of sending notification letters to a retiree to indicate that an audit of their pension benefit has been conducted and an adjustment will be made to their monthly benefit amount. CBH found 5 (five) instances in which a retiree's original benefit payment changed from the initial calculation due to an audit of their file, however we were unable to verify that a notice of the change had been sent to the retiree.

Not having a written policy that clearly states the department's practice exposes the County to potential claims of unfair or unequal treatment by retirees and can undermine employee's ability to follow a department's procedures.

Other Matters

During the course of the audit County management raised two matters related to the current retirees receiving payment and the potential noncompliance with County regulations regarding reemployment and the IRS Section 415 rule. CBH discussed each issue with staff from the Board of Investment Trustees and OHR to gain an understanding of the respective matters and

what had been done to address each matter. Following is a summary of each of the matters raised.

- Reemployment
 - It was brought to our attention that certain Montgomery County retiree's had come back to work for the County and were being paid their normal pension in addition to their current paychecks. According to the Montgomery County Code, if an employee is re-employed with the County after retiring, their pension benefit must be offset.
 - Based on our discussions with OHR we learned that they were able to identify potentially non-compliant retirees through their review of data from PeopleSoft and Oracle databases which contained the listing of retired and active employees. To the extent that retired employees appeared in the active employee database, OHR has performed a review to determine what action should be taken regarding their current retirement payments.
 - OHR described to CBH the detective system control that had been implemented that will 1) verify if a new employee social security number is already in the retired employee database and 2) display an error message to let the user know the social security number is already in use.

- IRS Section 415 Benefit Limitation
 - CBH was made aware that Mercer, the plan Actuary had performed an analysis of the retirees and beneficiaries whose pension benefits could be subject to the IRS Section 415 limitation that places a dollar limit on the benefit a person can receive in one year.
 - CBH was provided with the result of the Mercer analysis that included a listing of 58 retirees that had been identified as potentially being subject to the 415 limit. CBH compared the listing from the Mercer report to our sample and did not find any individuals which were subject to the 415 limit.
 - The Mercer report did indicate that their analysis did not include several factors, such as retirement type, that could exempt individual from the limit and recommended that the County perform additional research to determine if any of the 58 identified retirees would be exempt.
 - OHR provided additional information to Mercer on the 58 retirees identified by Mercer as being potentially over the IRC 415 limits. OHR determined that within the population of 58 retirees, 57 were not properly classified when their benefits began.
 - The 57 retirees should have been classified as public safety or survivors, but were in fact classified as other types of retirements. Once the misclassification were corrected the 57 retirees were found to be in compliance with the applicable 425 limit for public safety retirees or exempt from the regulation because the individual was receiving survivor benefits.
 - The benefit payments to the 58th retiree were found to be non-compliant with the limits. Per staff from the Board of Investment Trustee, the current benefit payment to the retiree are now being split between qualified benefit, paid by the plan and the unqualified benefit, amount over the 425 limit, paid by the County. The Plan is requesting reimbursement from the County for the amount which should not have been paid by the Plan.

- OHR staff stated that prior to FY2012 a Benefit Specialist did perform calculations to determine if a retiree would be subject to the 415 limit, however performance of the calculation was not documented. OHR staff indicated that starting with FY2012 the department checklist was updated to include the performance of the 415 limit test as a required procedure. The checklist is signed off by the performer of the test and the manager who reviews the checklist.
- CBH was told that in connection with the planned reorganization of how the County administers the retirement plans, new procedures have been designed that will have a retiree's initial payment calculation be reviewed by a compliance person to verify the applicability of the 415 limit for any new retiree. In addition, an IT system control has been designed that will compare current payments for existing retirees to the 415 limits criteria. The operation of the system control will be tested in June 2012.

CBH obtained reports and other relevant documentation regarding each of the issues described above to review and identify if any retirees in our test sample of 113 retirees were identified as being potentially non-compliant. None of the 113 retirees CBH tested were identified as being non-compliant, therefore no additional testing on sample items was required for this report.

Conclusions

OHR has designed controls intended to ensure compliance with Montgomery County Regulations and Employee's Retirement System Plan requirements to determine benefit payments for retirees. We found that, for the most part, controls were operating as intended. However, our audit disclosed that weaknesses exist and controls can be further strengthened. We believe that the recommendations described below will provide the County an effective means of addressing the issues outlined in this report.

Recommendations

We are making five recommendations to improve internal controls over the Montgomery County pension benefit payments process. CBH recommends that the Director Human Resources or the Executive Director of the Montgomery County Retirement Plans:

1. Research the four retirement payment errors and correct as necessary and coordinate restitution efforts with the appropriate County departments and agencies as needed.
2. Implement procedures to have appropriate staff review retiree elected payment reductions when retirees reach SSNRA and are entitled to receive the new benefit amount. Such review will help ensure that any new benefit payments have been properly adjusted from the initial calculation as of the retirement date, to the date the elected payment change takes effect.
3. Reinforce with staff the requirement to use the checklist to evidence secondary reviews of retirement files and confirm information obtained to support payment calculations.

4. Develop and implement a record archival plan and retention policy that ensures record retention and easy accessibility of critical documentation such as Plan Summary Descriptions, COLA Adjustment listing, retirement payment formula factors (e.g., Defined Percentages), and department forms (with effective dates) used in the development and adjustment of benefit payments
5. Update and issue written procedures to address the following:
 - Sending notification letters to retirees to inform of payment adjustments.
 - Requesting and obtaining death certificates to support the cessation of retirement payments to retirees and the establishment of payments to survivors or beneficiaries.

Comments and MCIA Evaluation

We provided OHR and the Montgomery County Employee Retirement Plans (MCERP) with a draft of this report for review and comment on June 8, 2011. OHR responded with written comments on June 25, 2012 and MCERP provided written comments on July 9, 2012. The written responses from OHR and MCERP have been incorporated in the report at Appendix D. Both OHR and MCERP concurred with all 5 recommendations; however OHR disagreed with two of the four payment error exceptions noted. Both OHR and MCERP indicated in their respective responses that research was continuing on the exceptions and a final conclusion had not been reached on all four. We found both OHR and MCERP's responses to the five recommendations show that they have either begun action or put forth reasonable action plans to address the internal control weaknesses and opportunities for improvement noted in the report.

Appendix A: Summary of ERS Program

Table A-1 – ERS Program Plans¹⁷

Plan	Description
Optional Non-Integrated	<ul style="list-style-type: none"> • Retirement benefits independent of social security retirement benefits. • Employees enrolled before July 1, 1978 are members of this plan but have the option of transferring to the Optional Integrated Plan.
Optional Integrated	<ul style="list-style-type: none"> • Full retirement benefits until the member is eligible for full social security retirement benefits and supplemental benefits thereafter. • Employees enrolled before July 1, 1978 who are members of the Optional Non-Integrated plan, have the option of transferring to the Optional Integrated Plan.
Mandatory Integrated	<ul style="list-style-type: none"> • Full retirement benefits until the member is eligible for full social security retirement benefits and supplemental benefits thereafter. • Employees enrolled on or after July 1, 1978 are members of this plan.
Guaranteed Retirement Income Plan (GRIP)	<ul style="list-style-type: none"> • Tax-deferred cash balance defined benefit retirement plan that provides retirement benefits based on a guaranteed rate of return • As of December 2010 7.25% was the rate of return on employer and employee contributions. • No retirees as of July 1, 2010.

Table A-2 – ERS Membership Groups¹⁷

Group	Group Code	Plan	Enrollment
Non-public safety employees not in bargaining unit positions or employees of outside agencies.	A	Optional Non-Integrated	Hired before July 1, 1978
	AZ	Optional Integrated	Hired before July 1, 1978
	AK	Mandatory Integrated	Hired on or after July 1, 1978
Sheriff's Deputies and Public Safety Correctional Staff	E	Optional Non-Integrated	Hired before July 1, 1978
	EZ	Optional Integrated	Hired before July 1, 1978
	EK	Mandatory Integrated	Hired on or after July 1, 1978
Sworn Police Officers	F	Optional Non-Integrated	Hired before July 1, 1978
	FZ	Optional Integrated	Hired before July 1, 1978
	FK	Mandatory Integrated	Hired on or after July 1, 1978

¹⁷ Source: July 2010 Montgomery County Employees' Retirement System Summary Descriptions

Group	Group Code	Plan	Enrollment
Paid Fire Fighters, Paid Fire Officers, and Paid Rescue Service Personnel	G	Optional Non-Integrated	Hired before July 1, 1978
	GZ	Optional Integrated	Hired before July 1, 1978
	GK	Mandatory Integrated	Hired on or after July 1, 1978
Non-public safety employees in bargaining unit positions.	H	Optional Non-Integrated	Hired before July 1, 1978
	HZ	Optional Integrated	Hired before July 1, 1978
	HK	Mandatory Integrated	Hired on or after July 1, 1978

Note: Two additional groups – B and D – are not represented in the above table. These two groups stopped accepting new members many years ago. They have no active members and have very few remaining annuitants. Group B includes any correctional officer, fire prevention officer, or deputy sheriff appointed on or before June 30, 1978 who has not elected to transfer to another membership group. Group D includes any full-time police officer appointed on or before August 15, 1965 who has been continuously employed as a police officer and has not elected to transfer to another membership group.

Each retirement group is classified based on the plan its members are participating in. A single letter designates the optional non-integrated plan as the ERS was originally set up. If a “Z” is added, it designates the optional integrated plan that members could transfer to in 1978. If a “K” is added, it designates the mandatory integrated plan that became required for new hires in 1978.

Table A-3 – Pension Program IT Systems

Old System	New System
Human Resources Management System (HRMS)- Legacy human resources system.	Oracle – The County’s new ERP system that replaced HRMS in 2011
Human Resources Benefits (HRB) - Legacy pension system	PeopleSoft – The County’s new pension system that replaced HRB.
	Imaging System – This system contains scanned copies of all employee personnel records

Table A-4 – Retirement Eligibility¹⁷

Retirement Type	Group	Credited Service	Age Eligible to Retire
Early	A or H	At least 15 years	50
		At least 20 years	45
	E	At least 15 years	45
		At least 20 years	41
	F	At least 15 years	45
		At least 20 years	41
	G	Not eligible	Not eligible
		Not eligible	Not eligible

Retirement Type	Group	Credited Service	Age Eligible to Retire
Normal	A or H	At least 5 years	60
		At least 30 years	55
	E	At least 15 years	55
		At least 25 years	46
	F	At least 15 years	55
		At least 25 years	Any age
	G	At least 15 years	55
		At least 20 years	Any age
Discontinued Service	A, E, F, and H	At least 10 years of continuous service	Same as early retirement
	G	At least 10 years of continuous service	Same as normal retirement
Non-service connected	All groups	At least 5 years	Any age
Service connected	All groups	Any service	Any age
DRSP Program	F	At least 25 years	46
DROP Program	G	At least 15 years	55
		At least 20 years	Any age

Table A-5 – Average Final Earnings¹⁷

Employee Status	Plan	Calculation
Full-time	Optional non-integrated	Highest consecutive 12 months of earnings before retirement, excluding overtime
Full-time	Optional integrated	Highest consecutive 12 months of earnings before retirement, excluding overtime
Full-time	Mandatory Integrated	Average of highest consecutive 36 months of earnings before retirement, excluding overtime.
Part-time	Optional non-integrated	Average of highest hourly rate over consecutive 12 month period multiplied by 2080. Average hourly rate is total earnings divided by total number of hours worked, excluding overtime.
Part-time	Optional integrated	Average of highest hourly rate over consecutive 12 month period multiplied by 2080. Average hourly rate is total earnings divided by total number of hours worked, excluding overtime.

Employee Status	Plan	Calculation
Part-time	Mandatory Integrated	Average of highest hourly rate over consecutive 36 month period multiplied by 2080. Average hourly rate is total earnings divided by total number of hours worked, excluding overtime.

Table A-6 – ERS Program Payment Options¹⁷

Forms of Benefit	Description
Modified Cash Refund Annuity (MCR)	Monthly benefit for the retiree's lifetime. If the retiree dies before receiving benefits equal to all of his or her member contributions plus interest, the remaining amount is paid to the beneficiary in a lump sum. This is the normal form of benefit for members of the mandatory integrated plan unless elected otherwise.
10 Year Certain & Continuous (10 Yr C&C)	Monthly benefit for the retiree's lifetime. If the retiree dies before receiving 120 monthly payments, the beneficiary will receive monthly payments for the remainder of the 10 year period. This is the normal form of benefit for members of the optional integrated and optional non-integrated plans unless elected otherwise.
Social Security Adjustment Option (SSAO)	Option that is combined with either MCR or 10 Yr C&C. The retiree receives a larger initial monthly benefit until normal Social Security retirement benefits begin and a smaller monthly payment thereafter. The benefit is actuarially equivalent to the retiree's normal benefit.
Joint and Survivor Option (J&S)	Option that provides a monthly benefit for the retiree's lifetime. At the retiree's death, the surviving joint annuitant will receive a percentage of the benefit for the rest of his or her life. The larger the percentage chosen for the surviving joint annuitant, the less the amount paid to the retiree during his or her lifetime. Any percentage over 10% can be chosen.
Joint and Survivor Annuity Pop-Up Option	Variation of J&S. If the retiree and the joint annuitant divorce or the joint annuitant dies before the retiree, the monthly payment will "pop up" to the amount it would have been if the retiree had selected MCR.

Forms of Benefit	Description
Social Security Adjustment Option Combined with Joint & Survivor Annuity Option	Variation of J&S. The retiree receives a larger monthly benefit under the J&S Option until normal Social Security retirement benefits begin and a smaller monthly payment thereafter.
Social Security Adjustment Option Combined with Joint & Survivor Annuity Pop-Up Option	Variation of J&S Pop-Up. The retiree receives a larger monthly benefit under the J&S Option until normal Social Security retirement benefits begin and a smaller monthly payment thereafter. If the retiree and the joint annuitant divorce or the joint annuitant dies before the retiree, the monthly payment will "pop up" to the amount it would have been if the retiree had selected MCR.

Appendix B: Interviews

We conducted an entrance meeting with the OHR Director, as well as other key personnel responsible for pension calculations and payments on February 9, 2011. The table below lists all of the personnel by title that participated in various interviews and meetings throughout the course of our Pension Benefits review.

Position Title	Process Role
Director	Overall administration of the Human Resources Department and its programs.
Benefits Manager	Benefits team supervision, prioritization and assignment of work, and day-to-day management of the department.
Benefits Manager	Detailed to the ERP project. Assisting with the testing of the County's new ERP system, Oracle and the new pension system, Peoplesoft.
Benefits Specialist	Meet with employees contemplating retirement and performing all retirement processing.
Executive Director	Day-to-day management of the Board of Investment Trustees and oversight of investment activities.
Compliance Analyst	Preparation of the retirement plan CAFR and monitoring of Aetna.
Sr. Financial Specialist	Processing of ERS refunds and DROP payments, transferring funds to third parties, collecting ERS contributions from outside agencies, preparing monthly pension expense journal entry, and preparing quarterly reports for the Board of Investment Trustees.
Associate County Attorney	Reviewing investment contracts for the Board of Investment Trustees, handling legal questions issues regarding the pension plan, and preparing pension plan summary descriptions.

Appendix C: Phase 1 Results

Table C-1 – Phase I Test Attribute Descriptions

Sample	Attribute	Attribute Description
Retirees	A	Participant signed and dated application for benefits form and submitted within required timelines.
	B	ERS checklist has been properly completed.
	C	Retiree is eligible for benefits.
	D	Recalculated average final earnings agree to pension department calculation.
	E	Recalculated beginning benefit payment agrees to pension department calculation.
	F	Distribution of first payment coincides with effective retirement date.
	G	Distributed payment agrees to benefit calculation.
	H	For payment amounts requiring adjustment after participant retired, subsequent adjustment was made and communicated to retiree.
	I	For existing retirees, recalculated current payment agrees to actual current pension benefit payment.
	S	Annuitant is not deceased.
Survivors	J	For survivors, survivor or beneficiary is eligible for benefits.
	K	For survivors, recalculated beginning payment agrees to pension department calculation.
	L	For survivors, recalculated current payment agrees to actual current pension benefit payment.
	S	Annuitant is not deceased.
DRSP/ DROP	M	For DRSP/DROP, benefit payment amounts, adjustments, and contributions are being communicated to the recordkeepers.
	N	For DROP, interest accrual is being properly calculated.
	S	Participant is not deceased.
Disability	O	For disabled retirees, participant signed and dated application for benefits form and submitted within required timelines.
	P	For disabled retirees, disability checklist has been properly completed and signed by employee and benefits specialist.
	Q	For disabled retirees, retiree was approved for benefits.
	R	For disabled retirees, continuing eligibility for disability benefits was reviewed by County.
	S	Annuitant is not deceased.
Death Testing	T	For deceased annuitants, decedent is actually deceased.
	U	For deceased annuitants, payment has been stopped.

Table C-2 - Summary of Exceptions from Phase I Testing

Attribute Tested	Retirees	Survivors	Disabilities	DRSP/DROP	Deceased	Total Exceptions	Samples Tested Per Attribute	% Exceptions Per Attribute
Attribute A	1	0	0	0	NA	1	25	4%
Attribute B	7	0	2	2	NA	11	25	44%
Attribute C	0	0	0	0	NA	0	25	0%
Attribute D	1	1	0	0	NA	2	25	8%
Attribute E	2	1	0	0	NA	3	25	12%
Attribute F	1	0	0	NA	NA	1	20	5%
Attribute F-DRSP/DROP	NA	NA	NA	0	NA	0	5	0%
Attribute G	1	0	0	NA	NA	1	20	5%
Attribute H	2	0	0	NA	NA	2	20	10%
Attribute I	NA	NA	NA	NA	NA	0	0	0%
Attribute J	NA	0	NA	NA	NA	0	2	0%
Attribute K	NA	1	NA	NA	NA	1	2	50%
Attribute L	NA	0	NA	NA	NA	0	2	0%
Attribute M	NA	NA	0	NA	NA	0	3	0%
Attribute N	NA	NA	0	NA	NA	0	3	0%
Attribute O	NA	NA	0	NA	NA	0	3	0%
Attribute P	NA	NA	0	NA	NA	0	3	0%
Attribute Q	NA	NA	0	NA	NA	0	3	0%
Attribute R	NA	NA	0	NA	NA	0	3	0%
Attribute S	NA	NA	0	NA	NA	0	3	0%
Listed in SS Index	NA	NA	NA	NA	0	0	10	0%
Listed in Aetna Report	NA	NA	NA	NA	0	0	10	0%
Total Exceptions	15	3	2	2	0	22		
Total Samples	15	2	3	5	10	35		
# of Samples with Exceptions	9	1	2	2	0	14		
% of Samples with Exceptions	60%	50%	67%	40%	0%	40%		

Appendix D - 1: Responses to Audit - OHR



OFFICE OF HUMAN RESOURCES

Isiah Leggett
County Executive

Joseph Adler
Director

MEMORANDUM

June 25, 2012

TO: Larry Dyckman, Manager
Office of Internal Audit

FROM: Joseph Adler, Director
Office of Human Resources

SUBJECT: Response to Audit of the Pension Benefit Payments Employees' Retirement System

Thank you for the opportunity to respond to the draft report of the contract auditor's (Cherry, Bekaert & Holland, LLP) audit report on the County's Pension Benefit Payments Employees' Retirement System. Please find below my response to the recommendations made in the draft audit.

Recommendation 1. Research the four retirement payment errors and correct as necessary. OHR should also coordinate restitution efforts with the appropriate County departments and agencies as needed.

➤ OHR is working with the newly formed Retirement unit, Montgomery County Employee Retirement Plans (MCERP) to ensure that any documentation as well as assistance is provided so that these issues are resolved. It should be noted that OHR does not agree in 2 instances that an error was made. However, Research continues in reviewing and recalculating these issues to insure that any errors are corrected.

Recommendation 2. Implement procedures to have OHR staff review retiree elected payment reductions when retirees reach SSNRA and are entitled to receive the new benefit amount. Such a review will help ensure that any new benefit payments have been properly adjusted from the initial calculation as of the retirement date, to the date the elected payment change takes effect.

➤ We agree with your recommendation and, beginning with the in-sourcing of retiree payroll in March 2012, reports were run from PeopleSoft of those retirees who had reached

their social security integration date. Those on the report have had their integration calculation audited and, where corrections were necessary, they have been made and communicated to the retiree. Beginning July 1, 2012, MCERP will be expanding the audit of the payment amount by reviewing their initial retirement calculation of the social security integration amount and bringing it forward with COLAs reflecting the amount that should be paid.

Recommendation 3. Reinforce with staff the requirement to use the checklist to evidence secondary reviews of retirement files and confirm information obtained to support payment calculations.

➤ Use and completion of the retirement checklist became mandatory in response to the recommendation of the auditors after completion of Phase I of the audit. Effective July 1, 2012, MCERP will be adding another level of review to the payment process, which will require the checklist to be included in the packet to establish the retiree in PeopleSoft.

Recommendation 4. Develop and implement a record archival plan and retention policy that ensures record retention and easy accessibility of critical documentation such as Plan Summary Descriptions, COLA Adjustment listing, retirement payment formula factors (e.g., Defined Percentages), and department forms (with effective dates) used in the development and adjustment of benefit payments.

➤ Currently, OHR sends all documents to DGS for scanning. Effective July 1, 2012 these documents will be scanned by MCERP personnel instead of being sent to DGS.

Recommendation 5. Update and issue written procedures to address the following: sending notification letters to retirees to inform of payment adjustments, and requesting and obtaining death certificates to support the cessation of retirement payments to retirees and the establishment of payments to survivors or beneficiaries.

➤ It is our understanding that MCERP is in the process of developing procedures to address these issues.

Appendix D - 2: Responses to Audit - MCERP



MONTGOMERY COUNTY EMPLOYEE RETIREMENT PLANS

MEMORANDUM

July 9, 2012

To: Larry Dyckman, Manager
Office of Internal Audit

From: Linda A. Herman, Executive Director

Subject: Audit Response – Employees’ Retirement System – Payment of Benefits

We appreciate the opportunity to respond to the findings and recommendations in the draft report issued by Cherry, Bekaert & Holland related to the payment of benefits from the Employees’ Retirement System. As these functions were being performed by the Office of Human Resources (OHR) until July 1, 2012, we reviewed the recommendations cited in the report to see if we concurred with the findings based on the information available to us. Our response to the recommendations is based on how the matter will be handled by the Montgomery County Employee Retirement Plans (MCERP) organization after July 1, 2012.

1. **Recommendation:** Research the four retirement payment errors and correct as necessary. OHR should also coordinate restitution efforts with the appropriate County departments and agencies as needed.

• **Response:**

- i. OHR could not provide the calculation to support their review of the payments made to this individual and we could find no evidence that he has repaid the amounts due. We recalculated the total amount paid to him and are awaiting Aetna’s verification for prior years. Once we verify the overpaid amount we will take the necessary steps to reclaim the overpaid from the retiree, Aetna, and/or the County’s insurance fund.
- ii. OHR could not provide the calculation to support their review of the payments made to this individual. We are reviewing the file to determine if the payments were made properly.
- iii. OHR could not provide the calculation to support their review of the payments made to this individual. We are reviewing the file to determine if the payments were made properly.
- iv. OHR could not provide the calculation to support their review of the payments made to this individual. We have reviewed and recalculated the AFE used in the retirement benefit calculation and the adjustment made to the participant’s account. We have determined that the participant’s account was adjusted in April 2012 for the overpayment of contributions and her monthly amount was changed in May 2012.

2. **Recommendation:** Implement procedures to have OHR staff review retiree elected payment reductions when retirees reach SSNRA and are entitled to receive the new benefit amount. Such a review will help ensure that any new benefit payments have been properly adjusted from the initial calculation as of the retirement date, to the date the elected payment change takes effect.

Montgomery County Employee Retirement Plans

101 Monroe Street, 15th Floor • Rockville, Maryland 20850

Investments 240.777.8220 Benefits 240.777.8230 Fax 301.279.1424

- **Response:** MCERP began an audit of all Social Security integrations, and other benefit options that are reduced due to the payment option selected, effective July 1, 2012. We have created a PeopleSoft exception report which is run several months in advance of an actual reduction taking place to allow us time to review the change in the benefit amount prior to it actually occurring. Those retirees who have a reduction date within 30 days of the next payroll period will have their reduced amount audited to determine the initial integrated benefit calculation and COLAs that should have been applied to the initial integrated benefit calculation, resulting in the proper amount to be paid going forward. In addition to this process, we have created an exception report which will flag those retirees, and other payees, whose benefit reduction date does not agree with the date they turn 62 or 65.
3. **Recommendation:** Reinforce with staff the requirement to use the checklist to evidence secondary reviews of retirement files and confirm information obtained to support payment calculations.
 - **Response:** ERS checklists have been included in the retirees' package during the internal review process for the new retirees and adjustment of retiree benefits since April 2012 when the County brought the retiree payroll in-house. We are currently reviewing and revising the format of the checklist.
 4. **Recommendation:** Develop and implement a record archival plan and retention policy that ensures record retention and easy accessibility of critical documentation such as Plan Summary Descriptions, COLA Adjustment listing, retirement payment formula factors (e.g., Defined Percentages), and department forms (with effective dates) used in the development and adjustment of benefit payments.
 - **Response:** Effective July 1, 2012 we have created a new scanning and retrieval process for retirement related documents in conjunction with the Department of Technology Services including the purchase of scanning equipment which will be located within the department. In addition, we have hired the prior OHR Benefits Manager on a part-time basis to assist us with creating procedures and process manuals which will include critical dates of when benefit law changes were enacted.
 5. **Recommendation:** Update and issue written procedures to address the following: Sending notification letters to retirees to inform of payment adjustments. Requesting and obtaining death certificates to support the cessation of retirement payments to retirees and the establishment of payments to survivors or beneficiaries.

Response: We currently send notifications after the audit of the final adjustment amount. One of the new checklists for the adjustment of payment will include the notification letter to the retiree as part of the required documentation. It is our policy to request the death certificate to support for the cessation of retirement payments to the deceased retirees. In addition, an electronic employee verification file is sent from Oracle to the Social Security Administration to verify the status of all persons receiving annuity payments. If the response from the SSA indicates that a retiree is deceased, the payment is stopped, and we notify the survivor or beneficiary of the requirement of obtaining a death certificate.

Please let me know if you have further questions or if I can provide additional assistance.