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The Honorable Pat McCrory, Governor
The General Assembly of North Carolina
The Honorable Janet Cowell, State Treasurer
Department of State Treasurer

This letter presents the results of our financial related audit of the Department of State Treasurer's (Department) monitoring of participant data for the Teachers' and State Employees' Retirement System (TSERS) and the Local Government Employee's Retirement System (LGERS).

Objective

The objective of this audit was to determine whether the State Treasurer's Retirement Division (Division) has procedures to effectively monitor the accuracy and completeness of active employee data, such as compensation, birth date and gender, submitted by employer agencies. The employer-submitted data is relied upon by the Department when determining the net pension liability or assets and related actuarially based pension disclosures reported in the *State's Comprehensive Annual Financial Report (CAFR)*.

Results and Recommendations

Auditors determined that the Division needs to improve its procedures to monitor the accuracy and completeness of participant data submitted by employing entities. Recently published guidance from the American Institute of Certified Public Accountants (AICPA) states pension plan management should verify active employee census data to the participating employers' underlying payroll records. The Division does not obtain and review supporting documentation for the participant data or compare the employee data to independent sources.

Instead, the Division performs high-level reasonableness tests to ensure that the data is of the type expected (such as numbers or letters) and within expected ranges. While there are many reasonableness tests in place, the parameters used in the tests are too broad to provide sufficient details to adequately monitor the accuracy of compensation, birth date, and gender. For example, the Division's computer system checks to ensure information is complete (no blanks in required fields) and to identify significant anomalies, such as salary increases greater than 250% and a birth date indicating an age of less than 14 or more than 100 years.

As a result, salary increases of 245% or birth dates indicating an employee 98 years old would not require verification.

While we noted no reportable errors in the active employee data tested in our samples, the Department should enhance its monitoring of participant data. Subject to legal restrictions and cost effectiveness, some areas to consider include:

- Periodic detailed checks of employer data. If sufficient internal staff is not available, the Treasurer could consider using independent auditors to conduct agreed-upon procedures engagements at employers.
- Periodic reviews of reported salary to assess whether compensation is being inflated in order to receive larger pension benefits.
- Implementing more precise parameters to make current monitoring more effective. For example, lower the 250% threshold currently used for investigating monthly salary changes and reduce the range of less than 14 years old or more than 100 years old for identifying questionable birth dates.
- Data sharing agreements with other state agencies to periodically match birth date and gender information.
- Training and/or question and answer sessions with employers regarding eligible members, how to correct reported data, and eligible compensation types.

Department Response

The Department agrees with the Auditor's recommendation to improve procedures to monitor the accuracy and completeness of participant data submitted by employing entities. We are pleased that the Auditor did not find any reportable errors in the active employee data tested in the samples and we appreciate the Auditor's suggestions of ways to improve. The Director of the Retirement Systems Division will evaluate the cost effectiveness and extent of existing legal authority to implement the suggested administrative changes.

Beginning in FY 2013-14, the Department worked with OSA to request attestations from the independent auditors of a sample of employer participants in both the Teachers' and State Employees' Retirement System and the Local Governmental Employees' Retirement System. The attestations are conducted in conjunction with the required independent annual audits of the employers. These attestations, together with the employers' independent audits, provide assurance that selected data elements deemed most critical in assuring the validity of our actuarially calculated data are materially correct. Audit work focuses on internal controls surrounding the ORBIT data gathering and input process as well as several specific data elements. These data elements include compensation, classification, date of birth, eligibility, gender and dates of enrollment and termination. We will continue working with OSA to require employers to provide attestations to the accuracy of their submissions on an annual basis using a sample of participating employers.

With regard to the Auditor's suggestion to periodically review reported salary, the Contribution-Based Benefit Cap enacted in Session Law 2014-88 addresses concerns about the practice of pension spiking, whereby employers artificially inflate salaries in order to substantially increase pension benefits. Because this new law will make it substantially more difficult for any artificial increase in salary to affect pension benefits, it may be of limited value to conduct additional reviews of employer-reported salary information to assess whether compensation is being inflated in an attempt by the employer to increase pension benefits.

Regarding the precision of parameters used in reasonableness tests, the Department agrees that implementing more precise parameters around birth date may make current monitoring more effective, and we will carefully consider the costs and benefits associated with this suggested measure to determine whether it is financially and operationally feasible. The reasonableness tests currently in place are designed to prevent egregious data errors and to monitor the accuracy of employer-reported data in an automated, efficient manner and capture any annual payments greater than 12.5% of salary using the 250% monthly parameter. While we agree that increasing the precision of these parameters could potentially identify questionable data that the current parameters fail to detect, we must also consider that the increased volume of data exceptions generated as a result impact the process of posting employer contributions and crediting service to active employees, would require additional resources to investigate, and could result in under or overpayments to individuals at retirement. We will continue to periodically assess the reasonableness tests for additions or adjustments.

With regard to data sharing agreements, the Department intends to consider the use of data sharing agreements to match birth date and gender information when adequate resources to do so become available. Session Law 2014-100 established two new Compliance Team positions within the Retirement Systems Division. Once these positions are filled, the Compliance Team will be responsible for identifying and evaluating potential data sharing opportunities and for implementing appropriate data matching processes.

As for employer training, the Compliance Team will also be responsible for reviewing the existing curriculum used to train employers about submitting monthly contributions and corresponding participant data. Although the Division already offers employer education seminars each year and maintains an extensive online library of training materials that address covered compensation types, employee eligibility, error correction procedures, and other issues employers may encounter in submitting their monthly contributions, there may nevertheless be room for improvement. The Compliance Team will review the materials, processes, and procedures currently in place to identify potential areas of improvement in an effort to educate employers more effectively on how to submit complete and accurate participant data.

Background

The Department of State Treasurer (Department) administers various retirement plans. The Retirement Systems Division (Division) oversees the statutory retirement and benefit plans that cover more than 900,000 active and retired public employees. The Division is responsible for collecting employer and employee contributions, processing applications for retirement benefits, calculating benefits, and processing monthly payments.

This audit focused on two plans: the Teachers' and State Employees' Retirement System (TSERS); and the Local Governmental Employees' Retirement System (LGERS).

This audit was performed in anticipation of new pension accounting standards that upon implementation will have a significant and material effect on the State's *Comprehensive Annual Financial Report (CAFR)*. The net pension liability or asset of TSERS and LGERS will be presented in notes of the State's June 30, 2014, *CAFR*. At June 30, 2015, employers that participate in the plans will report a pro-rata share of the net pension liability or asset in their individual financial statements.

The new standard prescribes a methodology for calculating a plan's net pension liability or asset. This methodology uses plan participant data in the calculations.

The American Institute of Certified Public Accountants (AICPA) recently published guidance on new financial reporting standards for pensions (State and Local Government Expert Panel Pension Whitepaper Series). The guidance states that effective plan management processes for active employee data include procedures to verify the accuracy and completeness of employer records.

Scope and Methodology

Our audit scope included participant data for the Teachers' and State Employees' Retirement System (TSERS) and the Local Governmental Employees' Retirement System (LGERS) during the period January 1, 2012 – December 31, 2012. For key elements such as compensation, birth dates, and employee gender, auditors gained an understanding of the Department's internal control and evaluated the design of the internal control. Auditors then performed further audit procedures consisting of tests of control effectiveness and/or substantive procedures that may reveal significant deficiencies in internal control for both the Department and a sample of 200 active employees from 61 participating employers. Specifically, auditors performed procedures such as interviewing personnel, observing operations, reviewing policies, analyzing accounting records, and examining documentation supporting recorded transactions and balances.

We conducted this audit in accordance with generally accepted government auditing standards applicable to performance audits. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

If you have any questions, please do not hesitate to contact my office.

Best regards,



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