

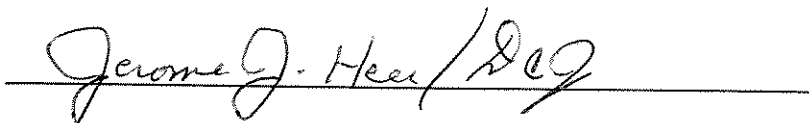
**Excessive Manual Review and Intervention
is Required to Ensure Pension Benefit
Calculations from Milwaukee County
ERS' Automated V-3 System are Accurate**

March 2012

Committee on Finance and Audit

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Milwaukee County Department of Audit

A handwritten signature in black ink, reading "Jerome J. Heer" followed by a stylized flourish, positioned above a horizontal line.

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March 9, 2012

To the Honorable Chairman
of the Board of Supervisors
of the County of Milwaukee

We have completed an audit of the Milwaukee County Employees' Retirement System (ERS) pension benefit payments.

The attached audit report notes that the ERS began the process of purchasing and installing a fully automated pension processing system (the Vitech V-3 Pension System) in 2006, with an ERS estimated total project cost of approximately \$12 million. In 2009, the V-3 system became operational. The V-3 system was intended to provide faster, more accurate pension estimates and retirement processing, complete integration of pension and post-employment benefits, and enhanced customer service.

The audit concludes that while base monthly pension benefit calculations are generally accurate, the automated V-3 system cannot currently be relied upon to generate accurate pension calculations and disbursements without extensive manual review and intervention.

Throughout the audit, we brought errors identified (including both base monthly benefit and lump-sum backDROP calculations) to the attention of ERS management. ERS management is to be commended for researching and addressing those errors, as well as identifying an apparent error in the computer formula for calculating backDROP payments that resulted in average underpayments of about \$500, totaling approximately \$300,000.

The report provides recommendations to address specific problems noted during the audit.

A response from the Department of Human Resources is included as **Exhibit 2**. We appreciate the cooperation extended by ERS and Department of Human Resources management and staff during the course of this audit.

Please refer this report to the Committee on Finance and Audit.

Jerome J. Heer
Director of Audits

JJH/JAT/cah

Attachment

cc: Milwaukee County Board of Supervisors
Chris Abele, Milwaukee County Executive
Patrick Farley, Director, Department of Administrative Services
Terrence Cooley, Chief of Staff, County Board Staff
Pamela Bryant, Interim Fiscal & Budget Administrator, DAS
Steve Cady, Fiscal & Budget Analyst, County Board Staff
Carol Mueller, Chief Committee Clerk, County Board Staff

Excessive Manual Intervention is Required to Ensure Pension Benefit Calculations From Milwaukee County ERS' Automated V-3 System are Accurate

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Summary

The Milwaukee County Employees' Retirement System (ERS) was created to encourage qualified personnel to enter and remain in the service of the County by providing a system of retirement, disability and death benefits for County employees. Details of the County retirement benefit are included in the **Background** section of this report.

In 1938, ERS maintained paper records to calculate pension benefits for members. In 1992, the ERS began using the Genesys Def-Ben (Def-Ben) computer system. Def-Ben was a partially automated system that was not maintained well by the County, resulting in questionable data, manual work-arounds and inconsistent processing. The ERS began the process of purchasing and installing a fully automated pension processing system in 2006, with an ERS estimated total project cost of approximately \$12 million. In 2009, the Def-Ben system was replaced with the Vitech V-3 Pension System (V-3) to provide faster, more accurate pension estimates and retirement processing, complete integration of pension and post-employment benefits, and enhanced customer service.

ERS pension payment calculations are generally accurate and resulted in appropriate monthly payments to retirees and most beneficiaries in the sample reviewed.

Our detailed review was based on a statistically valid random sample of 30 cases generated from a population of 6,677 retired members and beneficiaries receiving checks from the Milwaukee County Employee Retirement System in February 2011. Additionally, two cases for members that retired in 2011 were added to our review to address questions that came to our attention during the audit, bringing our total sample size to 32 cases. Two separate tests resulted in the following general conclusions:

- ***Base monthly pension benefit calculations in our statistically random sample were generally accurate.***
- ***While base monthly pension calculations were generally accurate, numerous disbursement errors were identified due to a problem with annual Cost of Living Adjustments (COLAs). Most of these errors were detected and corrected by ERS quality assurance efforts.***

Based on the 30 cases that were drawn on a statistically valid random basis, we can state with a confidence level of 90% and within a margin of error of +/- 5%, that one in 30 ERS pension

payments contains some type of disbursement error. Actual disbursement errors would include both overpayments and underpayments.

Despite these positive general conclusions, our examination of V-3 imaged documents and backup paper files, as detailed in this report, raised concerns that led us to a third general conclusion:

- ***The automated V-3 system cannot currently be relied upon to generate accurate pension calculations and disbursements without extensive manual review and intervention.***

Supplemental tests we performed involving non-standard pension options—selected by a small minority (less than 4%) of County retirees—identified continuing problems with the accuracy of data contained in the V-3 system, which begins its fourth year of implementation in 2012. Since all future County retirements will be processed using the V-3 system, it is critically important that the ERS quickly identify and resolve remaining system problems. ERS management stated that discussions with peers who have implemented major system conversions for pension administration indicate that a two- to three-year implementation effort is typical.

Inadequate internal controls to track and cut-off benefit payments to members that selected the 10-Year Certain Annuity retirement option (Option 6) have resulted in numerous payment errors to beneficiaries.

Option 6 is an actuarial reduced pension benefit that is payable over the life of the member, with a 10-year guaranteed payout. If the member dies before receiving 120 payments, the beneficiary/ies receives the balance of the payments. If the member dies after the 10-year certain period, no payments are made to the beneficiary/ies.

At the time of our review there were 196 members in the V-3 System under Option 6 (about 3%). Nineteen of the members were deceased with a combined total of 30 beneficiaries. We reviewed the disbursement histories of each deceased member to test the accuracy of monthly payments and the internal controls that trigger the cut-off of benefits once the guaranteed payments are exhausted.

- ***Of the 30 beneficiary payment disbursements reviewed, 20 (67%) contained some type of error that resulted in an overpayment or underpayment of benefits.***
 - Nine of the 30 beneficiary disbursements paid under Option 6 contained errors that resulted in total overpayments of \$31,707.
 - Eleven of the 30 beneficiary disbursements paid under Option 6 contained errors that resulted in total underpayments of \$33,146.

We notified ERS management of our findings throughout the audit process and payment adjustments have already been initiated to correct payments going forward in several instances. According to ERS management, action has been initiated to address remaining discrepancies and fully correct previous overpayments and underpayments identified, following protocols established in an ERS procedures manual.

- ***Data errors in the V-3 system compromise a critical internal control of cutting off Option 6 payments to beneficiaries after a total of 120 monthly payments have been issued from a member account.***

While there is no written procedure for processing Option 6 retirements, ERS management stated that when a member selects the 10-Year Certain option and receives a lump-sum backDROP (deferred retirement option plan) payment; the 10-year period starts with the backDROP date. We reviewed the cut-off dates for all 196 members that had selected Option 6 and found 55 that received backDROP payments. Each of the 55 Option 6 accounts had cut-off dates in the V-3 system that exceeded the 120-month limit because the cut-off dates were based on the retirement dates rather than the backDROP dates. These data errors compromise a critical internal control over Option 6 payments and, if undetected, could potentially result in substantial overpayments should members die prior to their 10-year minimum guarantees.

It should be noted that the V-3 system also automatically generates a workflow that triggers an ERS staff member to manually terminate payments after the 120 payment limit, but such termination is not automatically computer generated.

ERS has established effective controls to identify and cut off or reduce benefit payments upon the death of a retiree or beneficiary.

- ***We compiled a list of 10 individuals known to have died while retired from Milwaukee County. We found that in each case reviewed, benefits were discontinued or reduced within an average of 46 days of the retiree's death.***

ERS management indicated that it is notified of retiree and survivor deaths in several ways:

- Contact from an active member with knowledge of a death.
- Contact from a retiree with knowledge of a death.
- Contact from a family member of the deceased.
- Daily review of the obituary section of the Journal/Sentinel by ERS staff.
- A quarterly match (recently upgraded to a monthly match) of ERS membership against a continuously updated national death list purchased from a private service.

There are problems associated with actuarial equivalent payment option (Option 7) that can affect both current and future pension payments.

Option 7 (chosen by fewer than 1% of retirees) is a customized form of payment approved on an individual basis by the Pension Board. This option is at the discretion of the Pension Board and must be certified as the actuarial equivalent of the member's maximum pension benefit.

We encountered numerous concerns evaluating Option 7 cases. These included:

- Key documents regarding members' Option 7 request and approval were missing from both the V-3 system and back-up paper files.
- Documentation indicating selection of conflicting retirement options.
- Incorrect data in the V-3 system.
- A fiscal processing issue.

Beginning its fourth year of operation, the automated V-3 system requires an inordinate amount of manual review and intervention to prevent or rectify inaccurate pension payment calculations.

- ***Multiple layers of ongoing maintenance, troubleshooting and quality assurance are performed to ensure accurate pension benefit calculations and payments.***
 - ERS staff and consultants perform ongoing maintenance, troubleshooting and quality control checks of the V-3 system.
 - ERS management recognizes and continues to identify and address numerous data, system and processing errors during implementation of the V-3 system. This has led to heavy reliance on manual review and intervention to ensure accuracy. It has also contributed to heavy ongoing reliance on outside contractors to maintain daily administrative functions, including some with final disbursement authority. We will be examining the appropriateness of this reliance in greater detail in a separate report on County contracting practices.
- ***Our review confirms both the general accuracy of pension payments and the need to continue an inordinate amount of manual review and intervention for an automated system beginning its fourth year of implementation.***

Despite the diligent and sustained efforts to systematically identify and correct errors in the V-3 system, our review confirms both the general accuracy of pension payments and the need to continue extensive manual reviews and intervention in the processing of retirement benefits.

Examples of errors detected during our audit, described in detail in this report, include:

- Service credit errors.

- Final Average Salary errors.
- COLA errors.
- Pension benefit payment option errors.
- Errors related to incorrect benefit cutoff dates.

Some of the same issues identified in this report have been identified and described in Internal Control reports from the County's independent outside auditors, Baker Tilly Virchow Krause, LLP. ERS management has stated that its goal is to be paperless in five years, relying on the electronic data and imaging capabilities of the V-3 pension system. If that goal is achieved at some point in the future, it is imperative that the information stored in V-3 is both accurate and complete.

A process of scanning and destroying key documents during conversion to the V-3 automated pension payment system has resulted in an inability to reconstruct and verify the accuracy of some pension payment calculations for retirements before 2009.

In 2008, ERS began to deal with cumbersome paper files in preparation for implementing the V-3 pension system. The ERS began to streamline its records through formatting, data cleansing and preliminary document scanning. To assist with the process of streamlining records, ERS hired five temporary employees in 2008 and seven in 2009.

- ***Lack of controls over the document scanning and purging process resulted in the destruction of key documents necessary to recreate and verify the accuracy of some member pension calculations.***

Throughout several audit tests conducted, we reviewed a total of 328 pension cases in detail. Each audit test included a search for specific documents to verify the accuracy of original benefit calculations, subsequent adjustments, or to validate choices made by ERS members upon retirement. These document searches included the V-3 system (scanned images) and, if necessary, backup paper files. During our document searches, the following items could not be located:

- Signed retirement documents—missing in 61 of 328 cases reviewed.
- Retirement Estimate letters—missing in 24 of 162 cases reviewed.
- Manual spreadsheets/calculations of benefit amounts—missing in 109 of 152 cases reviewed.
- Data on Retiring Employee forms—missing in 19 of 69 cases reviewed.

- Eight of 162 paper files could not be located including three files that did not have any retirement documents scanned into the V-3 system.
- Actuarial letter showing factors used to calculate the Option 7 benefits—missing in 80 of 83 cases reviewed.
- Member's letter to the Pension Board requesting Option 7—missing in 80 of 83 cases reviewed.
- Final decision letter from the Pension Board to the member regarding Option 7 request—missing in all 83 cases reviewed.

The prevalence of missing documents indicates that ERS had insufficient quality controls in place to ensure the data needed to support, verify and document important retirement documents were retained.

The report contains recommendations to address specific problems identified. We wish to acknowledge the cooperation of ERS and Department of Human Resources management and staff throughout our review. A management response from the Department of Human Resources appears as **Exhibit 2**.

Background

The Milwaukee County Employees' Retirement System (ERS) under the Division of Employee Benefits within the newly created Department of Human Resources was created to encourage qualified personnel to enter and remain in the service of the County by providing a system of retirement, disability and death benefits for County employees. The Retirement System was created by Section 201.24 of the General Ordinances of the County. The authority to manage and control the Retirement System is vested in the Pension Board, which consists of nine members. The ERS manages the pension fund, maintains the general ledger and related books, administers the Milwaukee County pension payroll, conducts retirement seminars, prepares estimates and processes benefits for members eligible for retirement, beneficiary or survivor benefits.

The normal retirement benefit is a monthly pension for the life of the member beginning at normal retirement age, which for most is either 60 or 64 depending on ERS enrollment date and collective bargaining agreement. A few labor agreements also require a minimum of five years creditable service in addition to the age requirement. Some active members are eligible to retire when their age added to their years of creditable service equals 75 (the 'Rule of 75'). Following are descriptions of the available pension options, with the percentage of members that have chosen each option.

- **Maximum Benefit** – is payable for the member's lifetime and ceases upon member's death. (Chosen by 46% of retirees.)
- **Option 1** – Membership Account Refund is an actuarial reduced benefit that ceases upon member's death. This option guarantees that the member will receive the total Membership Account balance as of the retirement date. The Membership Account balance is reduced monthly by an actuarial determined amount. Any balance remaining after the member's death will be paid to the beneficiary. (Chosen by 6% of retirees.)
- **Option 2** (50% Joint and Survivor Annuity) – This option is an actuarial reduced pension benefit that is payable over the life of the member. Upon the member's death, 50% of the pension benefit is payable over the life of a beneficiary. (Chosen by 15% of retirees.)
- **Option 3** (100% Joint and Survivor Annuity) – This option is an actuarial reduced pension benefit that is payable over the life of the member. Upon the member's death, 100% of the pension benefit is payable over the life of a beneficiary. (Chosen by 20% of retirees.)
- **Option 4** (25% Joint and Survivor Annuity) – This option is an actuarial reduced pension benefit that is payable over the life of the member. Upon the member's death, 25% of the pension benefit is payable over the life of a beneficiary. (Chosen by 6% of retirees.)

- **Option 5** (75% Joint and Survivor Annuity) – This option is an actuarial reduced pension benefit that is payable over the life of the member. Upon the member’s death, 75% of the pension benefit is payable over the life of a beneficiary. (Chosen by 3% of retirees.)
- **Option 6** (10 Year Certain) – is an actuarial reduced pension benefit payable over the member’s life but is guaranteed for a period of 10 years, in the event the member should die within 10 years after the retirement date. (Chosen by 3% of retirees.)
- **Option 7** (Board Discretion) – is at the Pension Board’s discretion and is a payment of a benefit in a form other than those set forth above. The payment must be the actuarial equivalent of the benefit otherwise payable. A member requesting this option is responsible for all expenses incurred in the application for and calculation of the benefit. (Chosen by less than 1% of retirees.)

A backDROP (deferred retirement option plan) payment option permits an eligible employee to receive a lump-sum payment plus a reduced monthly pension benefit upon retirement. The backDROP benefit was established in 2000 and has subsequently been eliminated for various classes of new hires thereafter until no County employee hired after February 2006 is eligible. According to the 2010 ERS Annual Report (latest available), ERS membership totaled 13,382 (see **Table 1**).

**Table 1
ERS Participants**

Members	December 31, 2010	December 31, 2009
Retiree and beneficiaries currently receiving benefits	7, 441	7,292
Vested and terminated employees not yet receiving benefits	1,493	1,659
Current employees	4,448	4,808
Total participants:	13,382	13,759

Source: ERS 2010 Annual Report of the Pension Board

In 2011, benefits of approximately \$150 million were paid to over 7,300 retirees. **Table 2** lists the following expenditures, revenue and full-time equivalent positions for the DAS—Employee Benefits Division.

**Table 2
DAS—Employee Benefits Division**

	2011	2010
Expenditures	\$2,671,054	\$2,521,191
Revenue	\$1,861,560	\$1,703,243
Levy	\$809,494	\$817,948
FTE’s	23.0	21.9

Source: 2011 Adopted Budget

In 1938, ERS maintained paper records to calculate pension benefits for members. In 1992, the retirement division used the Genesys Def-Ben (Def-Ben) computer system which provided a partially automated system; which was not maintained well by the County, resulting in questionable data, manual work-arounds and inconsistent processing. The ERS began the process of purchasing and installing an automated pension processing system in 2006, with an ERS estimated total project cost of approximately \$12 million. In 2009, the Def-Ben system was replaced with the Vitech V-3 Pension System (V-3) to provide faster, more accurate pension estimates and retirement processing, complete integration of pension and post-employment benefits, and enhanced customer service.

The Department of Audit initiated this audit to analyze the implementation of the V-3 Pension System including the accuracy of the pension payments to retirees and beneficiaries. We focused on whether internal controls were in place and functioning as designed to ensure pension payments were accurate and appropriate for retirement activities that primarily occurred in 2009 and 2010. We included prior years as needed to fully address issues identified during our audit work. A more detailed description of the audit scope and methodology is presented as **Exhibit 1**.

Section 1: ERS pension payment calculations are generally accurate and resulted in appropriate monthly payments to retirees and most beneficiaries in the sample reviewed.

Our detailed review was based on a statistically valid random sample of 30 cases generated from a population of 6,677 retired members and beneficiaries.

Our detailed review was based on a statistically valid random sample of 30 cases generated from a population of 6,677 retired members and beneficiaries receiving checks from the Milwaukee County Employee Retirement System in February 2011. Additionally, two cases for members that retired in 2011 were added to our review to address questions that came to our attention during the audit, bringing our total sample size to 32 cases. Thirty of the cases were initially processed either manually or in the former Genesys' Def-Ben system and converted to the V-3 system in 2009, while two were processed exclusively in V-3. We performed two tests to analyze monthly pension calculations and payment disbursements, as stated below.

Base monthly pension benefit calculations in our statistically random sample were generally accurate.

We evaluated the cases to examine the accuracy of the base monthly benefits determined by ERS. We used the same excel spreadsheets used by the retirement division to recreate the base monthly benefits. Initially, the spreadsheets were a manual system used to calculate pension payments. ERS subsequently used the spreadsheets as a validation tool during the conversion from Def-Ben to V-3. Now the spreadsheets are used as a quality control tool to verify the accuracy of pension calculations in V-3.

We were successful in recreating a majority of the cases using the spreadsheets. However, the remaining cases had to be recreated by ERS, due in part to the manner in which the ERS calculates final average salaries (FAS) for pension benefit purposes.

Milwaukee County Ordinance s. 201.24, Section II 2.8 states:

Final average salary for a member whose continuous membership began prior to January 1, 1982, means the average annual earnable compensation for the three (3) consecutive years of service during which the member's earnable compensation was the highest, or, if he should have less than three (3) years of service, then his/her average annual earnable compensation during such period of service. Final average salary for a member whose continuous membership began after January 1, 1982, means the average annual earnable compensation for the five (5) consecutive years of service during which the member's earnable compensation was the highest, or, if he should have less than five (5) years of service, then his/her average annual earnable compensation during such period of service.

There is an unwritten practice of calculating the Final Average Salary for a five-year period using 130.5 pay periods instead of 130.

The Milwaukee County payroll system issues pay checks on a bi-weekly basis, resulting in 26 pay periods in a typical calendar year. ERS staff stated that there is an unwritten practice of calculating the FAS for a five-year period using 130.5 pay periods instead of 130. The practice started in 1982 in an effort to maintain a standard calculation while acknowledging there are some years with 27 pay periods, a situation that occurs about once every 11 years. ERS staff stated that the V-3 System is also programmed to calculate five-year FAS using 130.5 pay periods.

However, if the practice of modifying the number of pay periods used to calculate five-year FAS is to recognize the occasional 27-pay period year, it is curious that the pay periods used to calculate a three-year FAS are not similarly modified. According to ERS staff, a three-year FAS is calculated using 78 pay periods in all instances (three years times 26 pay periods per year). If the three-year period contains a year with 27 pay periods, the pay period with the lowest total on either end of the period (the first pay period or the 79th pay period) is removed from the calculation, so that 78 pay periods are used in all instances.

We also noted that in one of our sample cases, the five-year FAS was calculated by ERS using 130 pay periods, an indication that the unwritten nature of the practice may have led to inconsistent application by staff.

We believe the intent of the ordinance governing the calculation of final average salaries would be met using the same procedure currently applied for three-year FAS calculations to all FAS calculations.

The practice of averaging salaries over a five-year period using 130.5 pay periods appears to be an unnecessary adjustment for an event that occurs once every 11 years. It is counterproductive to marginally skew the results of all five-year FAS calculations to partially (but not entirely) account for a phenomenon that occurs so infrequently. We believe the intent of the ordinance governing the calculation of final average salaries would be met using the same procedure currently applied for three-year FAS calculations to all FAS calculations. That is, using 78 pay periods to calculate three-year FAS and 130 pay periods to calculate five-year FAS, irrespective of the occurrence of a 27-pay period year within the time frame used.

While base monthly pension calculations were generally accurate, numerous disbursement errors were identified due to a problem with annual Cost of Living Adjustments.

We used the same sample drawn for testing base monthly pension calculations to analyze the accuracy of subsequent monthly pension disbursements, including the two percent, simple interest (non-compounding) Cost of Living Adjustments (COLAs) applied annually to all monthly pension benefits. The COLA is calculated on the initial base monthly pension benefit and remains constant until the benefit expires or is reduced upon death of the retiree. COLAs are applied annually on the anniversary month of the member's retirement date or, if applicable, the backDROP date.

We created a spreadsheet calculating the payments using the base monthly pension amount and annually adding the two percent COLA increases to compare to the disbursement amounts tracked in the V-3 system. This review indicated that

there were errors related to COLA adjustments in eight of the 32 cases in the sample. Our review also showed that ERS detected and corrected these errors for all retirees and beneficiaries in the sample with one exception:

- In 2004, ERS overpaid a beneficiary \$30 per month in benefits, including incorrect COLA increases over a period of about eight years. In 2009, an adjustment was made correcting the COLA going forward, but the prior monthly payment errors were not addressed. We brought this case to the attention of ERS management, which determined that a total overpayment of \$2,444 was made to the beneficiary, and action was taken to recover the money.

ERS management said numerous problems associated with COLA errors have been corrected through V-3 system programming changes, and manual reviews will be conducted until resolution of the problems are confirmed.

Additional errors in the calculation of annual COLA increases were identified in our separate review of the 10-Year Certain Annuity Option (see **Section 2**). According to ERS management, the numerous problems associated with COLA errors have been corrected through V-3 system programming changes going forward, and that manual reviews of virtually 100% of COLA adjustments will be conducted until resolution of the problems are confirmed.

Recommendations

Ultimately, we determined that ERS payments and disbursements were accurate for all but one of the 32 cases reviewed in our sample. Based on the 30 cases that were drawn on a statistically valid random basis, we can state with a confidence level of 90% and within a margin of error of +/- 5%, that one in 30 ERS pension payments contains some type of disbursement error. Actual disbursement errors would include both overpayments and underpayments.

To address issues identified in our review of a statistically valid random sample of ERS payments, we recommend that ERS management:

1. *Develop written protocols defining the number of pay periods used to calculate three-year and five-year Final Average Salary figures, respectively, for determining ERS retiree*

benefits in compliance with s. 201.24, Section II 2.8 of the Milwaukee County Ordinances. We suggest consistent application of the 78 highest consecutive pay periods for three-year FAS and the 130 highest consecutive pay periods for five-year FAS.

- 2. Continue monitoring COLA adjustments and document efforts to verify reliable application of appropriate COLAs by the V-3 system.*

Tests of non-standard pension options, a small percentage (less than 4%) of total pensions, indicate numerous inaccuracies in V-3 system data that require manual detection and intervention to ensure accurate benefit payments.

Testing of a statistically valid random sample of ERS pensions indicate both pension calculations and disbursements are generally accurate. However, it is important to understand that selection of a statistically valid random sample provided an equal chance of selecting each of the County's approximately 7,000 current pensions for review. As a result, our sample, while representative of the entire population, was primarily composed of pensions calculated prior to implementation of the V-3 system in 2009 (just two of the 32 pensions in our sample were calculated post-V-3).

To provide additional insight into retirement calculations since the V-3's 'go live' date of January 2009, we randomly selected another 10 retirement cases that were processed in 2010 and 2011.

To provide additional insight into retirement calculations since the V-3 'go live' date of January 2009, we randomly selected another 10 retirement cases that were processed in 2010 and 2011. We verified the accuracy of base monthly pension calculations in all 10 cases. However, we noted that ERS had identified COLA problems with one of the cases, resulting in a corrective payment to a member of approximately \$155, and we identified another which resulted in a corrective payment of \$307. Further, one complete backup paper file could not be located, and we continued to see problems with missing documents (see **Section 5** of this report). We also had to rely on hand-written adjustments by ERS staff that conflicted with

information in V-3 in order to verify the accuracy of the calculations.

Supplemental tests we performed involving non-standard pension options—selected by less than 4% of County retirees—identified continuing problems with the accuracy of data contained in the V-3 system.

Supplemental tests we performed involving non-standard pension options—selected by a small minority (less than 4%) of County retirees—identified continuing problems with the accuracy of data contained in the V-3 system, which begins its fourth year of implementation in 2012. Since all future County retirements will be processed using the V-3 system, it is critically important that the ERS quickly identify and resolve remaining system problems. ERS management stated that discussions with peers who have implemented major system conversions for pension administration indicate that a two- to three-year implementation effort is typical.

As the remaining sections of this report will detail, the automated V-3 system cannot currently be relied upon to generate accurate pension calculations and disbursements without extensive manual review and intervention.

Section 2: Inadequate internal controls to track and cut-off benefit payments to members that selected the 10-Year Certain Annuity retirement option (Option 6) have resulted in numerous payment errors to beneficiaries.

Before retirement, members have a variety of actuarial equivalent payment options from which to choose (see **Background** section of this report). During this audit, we examined all current pension payments distributed under the 10-Year Certain option (Option 6) to evaluate the accuracy of the monthly payments to members and beneficiaries; and to review and test the controls in place to initiate the cut-off of payments once benefits are exhausted.

Option 6 is an actuarial reduced pension benefit that is payable over the life of the member, with a 10-year minimum guaranteed payout.

Option 6 is an actuarial reduced pension benefit that is payable over the life of the member, with a 10-year minimum guaranteed payout. If the member dies before receiving 120 payments, the beneficiary/ies receives the balance of the payments. If the member dies after the 10-year certain period, no payments are made to the beneficiary/ies.

Milwaukee County Ordinance s. 201.24 Appendix B s. 1013 (1)(c) states:

Option 6 - 10-year certain annuity. This form of benefit provides a reduced monthly benefit payable to the member for his or her lifetime. If a member who is receiving this form of benefit dies before receiving one hundred twenty (120) monthly payments, then monthly payments in the amount payable at the time of the member's death shall continue to the member's designated beneficiary until a total of one hundred twenty (120) payments have been made in the aggregate to the member and his or her designated beneficiary (or, if the member's designated beneficiary has predeceased the member or dies before a total of one hundred twenty (120) payments have been made, then to the member's spouse, or, if none, then to the member's estate).

At the time of our review, there were 196 members in the V-3 System under Option 6 (about 3%). Nineteen of the members were deceased with a combined total of 30 beneficiaries. We reviewed the disbursement histories of each deceased member to test the accuracy of monthly payments and the internal controls that trigger the cut-off of benefits once the guaranteed payments are exhausted.

Of 30 beneficiary payment disbursements reviewed, 20 (67%) contained some type of error that resulted in an overpayment or underpayment of benefits.

Of the 30 beneficiary payment disbursements reviewed, 20 (67%) contained some type of error that resulted in an overpayment or underpayment of benefits.

Nine of the 30 beneficiary disbursements paid under Option 6 contained errors that resulted in total overpayments of \$31,707.

Errors included failed cut-off controls, incorrect COLAs and/or incorrect monthly payments. For instance, one beneficiary was overpaid \$14,839 due to receiving both an excessive COLA increase for 18 months and an additional seven months of pension payments in excess of the 120 payment limitation in effect for beneficiaries of deceased Option 6 retirees.

In another case, a member exhausted her guaranteed 120 payments before death. However, her three beneficiaries were paid \$4,120 each for five months for a total overpayment of \$12,360.

Of the nine beneficiaries that were overpaid:

- Four were due to benefits exceeding the cut-off dates.
- Two were because of incorrect COLAs.
- One was a result of benefits exceeding the cut-off date and incorrect COLAs.
- Two were because of errors with monthly payments consisting of an unequal payment to two equal beneficiaries;

and a duplicate monthly payment to a deceased member and a beneficiary.

Payments for the five beneficiaries that received benefits after the cut-off period were discontinued in each instance, but the ERS did not attempt to recover the overpayments.

Eleven of the 30 beneficiary disbursements paid under Option 6 contained errors that resulted in total underpayments of \$33,146.

Errors included inaccurate annual COLAs and/or missed and incorrect monthly payments. For example, a member died in December 2009, a little more than nine years into her retirement. She listed a primary beneficiary that predeceased her and a contingent beneficiary on her retirement application. Although, the contingent beneficiary received a small payment in December 2010, a year after the member's death, no guaranteed pension payments were issued. This resulted in an underpayment of \$12,429.

Another example is a member that died 54 months into her retirement without a beneficiary. Her monthly payments stopped without her estate receiving the remaining 66 payments, resulting in an underpayment of \$9,713.

In another instance, one of three beneficiaries did not receive his share of the pension benefits including COLA increases for 49 months after the death of the member, resulting in a total underpayment of \$7,452.

Of the 11 beneficiaries that were underpaid:

- Seven were a result of incorrect COLAs.
- Four were due to premature cut-off of monthly payments.

We notified ERS management of our findings throughout the audit process and payment adjustments have already been

initiated to correct payments going forward in several instances. According to ERS management, action has been initiated to address remaining discrepancies and fully correct previous overpayments and underpayments identified, following protocols established in an ERS procedures manual.

Data errors in the V-3 system compromise a critical internal control of cutting off Option 6 payments to beneficiaries after a total of 120 monthly payments have been issued from a member account.

When a member selects the 10-Year Certain option and receives a lump-sum backDROP payment; the 10-year period starts with the backDROP date.

While there is no written procedure for processing Option 6 retirements, ERS management stated that when a member selects the 10-Year Certain option and receives a lump-sum backDROP payment; the 10-year period starts with the backDROP date. For instance, a member that retired in March 2003 and selected a backDROP retirement date of August 1, 1997 has a 10-year guaranteed pension starting August 1, 1997 through July 31, 2007.

ERS management indicated that, two months prior to the benefit cut-off date (120 payments), the V-3 system automatically generates a workflow that triggers a notification letter to the survivor. The system also automatically generates a workflow that triggers an ERS staff member to manually terminate payments after the 120 payment limit; such termination is not automatically computer generated.

We reviewed the cut-off dates for all 196 members that had selected Option 6 and found 55 that received backDROP payments. Each of the 55 Option 6 accounts had cut-off dates in the V-3 system that exceeded the 120-month limit because the cut-off dates were based on the retirement dates rather than the backDROP dates. These data errors compromise a critical internal control over Option 6 payments and, if undetected, could potentially result in substantial overpayments should members pass away prior to their 10-year minimum guarantees.

ERS has established effective controls to identify and cut off or reduce benefit payments upon the death of a retiree or beneficiary.

ERS management indicated that it is notified of retiree and survivor deaths in several ways:

- Contact from an active member with knowledge of a death.
- Contact from a retiree with knowledge of a death.
- Contact from a family member of the deceased.
- Daily review of the obituary section of the Journal/Sentinel by ERS staff.
- A quarterly match (recently upgraded to a monthly match) of ERS membership against a continuously updated national death list purchased from a private service.

We compiled a list of 10 individuals known to have died while retired from Milwaukee County. We found that in each case reviewed, benefits were discontinued or reduced within an average of 46 days of the retiree's death.

ERS controls are effective in identifying and processing changes in pension payments due to retiree deaths in a timely manner.

Based on the cases reviewed, it appears ERS controls are effective in identifying and processing changes in pension payments due to retiree deaths in a timely manner.

However, our review of 10 death cases resulted in the identification of two problems:

- One deceased member's file could not be located.
- Another deceased member's survivor was processed under the wrong retirement option. In this case, the survivor benefits were calculated using Option 2 (50% Joint and Survivor Annuity) instead of Option 3 (100% Joint and Survivor Annuity). This error resulted in an underpayment to the survivor of approximately \$117,556.

We notified ERS management of this error. Management agreed with this finding and indicated an adjustment would be processed to make the beneficiary whole.

Recommendations

To address the issues identified concerning 10-Year Certain Option 6 pensions, we recommend that ERS management:

3. *Review and correct all Option 6 cut-off date errors in the V-3 System.*
4. *Work with Corporation Council to revise s. 201.24 of the County Ordinances to codify the backDROP cut-off dates.*
5. *Develop written procedures regarding the processing of Option 6 pension applications, including measures to ensure cut-off dates for Option 6 members with backDROP dates are entered into V-3 appropriately and to ensure remaining benefits are paid to the estates of members who die without a beneficiary before receiving 120 guaranteed payments.*
6. *Create an automatic computer-generated cutoff for Option 6 beneficiary payments once the guaranteed 120 payment requirements has been met.*
7. *Expedite review of all remaining instances of benefits overpayments and underpayments referred by the Department of Audit during the course of this audit and take appropriate corrective action.*

Section 3: There are problems associated with actuarial equivalent payment option (Option 7) that can affect both current and future pension payments.

Option 7 (chosen by fewer than 1% of retirees) is a customized form of payment approved at the discretion of the Pension Board and must be certified as the actuarial equivalent of the member's maximum pension benefit.

Another retirement option that appears to be problematic is Option 7 (known as Option 4 prior to 1996, when additional payment options were added). Option 7 (chosen by fewer than 1% of retirees) is a customized form of payment approved on an individual basis by the Pension Board. This option is at the discretion of the Pension Board and must be certified as the actuarial equivalent of the member's maximum pension benefit. Section 201.24(2.13) of the County Ordinance defines actuarial equivalent as follows:

Actuarial equivalent shall mean equality in value of the aggregate expected payments under different forms of pension payments considering expected mortality and interest earnings on the basis of tables adopted from time to time by the board.

The Pension Board may approve members' Option 7 requests under s. 201.24(7.2), which states:

The board may, in its sole discretion, at the request of a member or contingent pensioner, direct that any benefit provided by the system be paid in some form other than that expressly set forth in the system, provided that payments in such other form shall be the actuarial equivalent of the benefit otherwise payable.

However, under rules adopted by the Pension Board, Option 7 requests are clearly discouraged. Appendix B: Rules of the ERS, General Regulations s. 1013(1)(d) states:

Option 7. Any other form. A member may apply to the board to receive his or her benefits in any other form permitted by section 201.24(7.2) of the Milwaukee County Code of General Ordinances. The board will generally deny any such request on the grounds that the standard six (6) optional forms of benefit set forth in section 201.24(7.1) and in Rule 1013(a)(1),(2) and (3) provide sufficient options to members and that any other form of benefit subjects

the system to unnecessary administrative expense and burden.

To evaluate the internal controls for this option, we obtained a complete list of all pensioners in the V-3 System under Option 7 at the time of our fieldwork, which totaled 56 members. We examined information in the V-3 System, the member's paper file, and the Pension Board minutes to verify the accuracy of the options selected and survivor benefits paid. During a review of the Board minutes, we found 27 additional members approved by the Board for Option 7 that were not on the list. Upon further review, all 27 members were listed under other options in the V-3 system. Since the members were initially approved by the Board for Option 7, we added them to the initial list provided for a total of 83 members.

We encountered numerous concerns evaluating Option 7 cases.

ERS informed us that documents supporting Option 7 are kept in the members' files and consisted of the written request from the members to the Pension Board requesting the option, letters from the actuarial firm listing the factors used to calculate benefits, Pension Board minutes showing the action taken, and written notification of the approval from the Pension Board to the member.

We checked members' records, including documents scanned into V-3 as well as those stored in paper files, and could not find many of the documents supporting the process required for Option 7 approvals.

However, we checked members' records, including documents scanned into V-3 as well as those stored in paper files, and could not find many of the documents supporting the process required for Option 7 approvals. The lack of complete supporting documentation contributed to difficulties in verifying that Option 7 requests were processed appropriately.

Concerns regarding Option 7 pension cases reviewed include:

- Key documents regarding members' Option 7 request and approval were missing from both the V-3 system and back-up paper files.
- Documentation indicating selection of conflicting retirement options.
- Incorrect data in the V-3 system.
- A fiscal processing issue.

Key Documents Missing

- Written requests for Pension Board approval of Option 7 pensions were missing from 80 of 83 cases.
- Actuarial letters showing factors used to calculate the Option 7 benefits were missing in 80 of 83 cases.
- Minutes indicating Pension Board approvals of Option 7 requests were not identified for 18 of 56 members listed in the V-3 system as having selected Option 7 pensions.
- Final decision letters from the Pension Board to the members documenting the Board's approvals of Option 7 requests were missing in all 83 cases reviewed.

Documentation Indicating Selection of Conflicting Retirement Options

Even though a member may obtain approval from the Pension Board for an actuarial equivalent payment option, they can change options prior to retirement. For this reason, it is important that ERS maintain clear and complete documentation of members' chosen retirement payment options.

ERS staff indicated that even though a member may request an Option 7 approval, pay the special administrative fee, and obtain approval from the Pension Board for an actuarial equivalent payment option, they are not bound by that approval and can change options prior to retirement. For this reason, it is important that ERS maintain clear and complete documentation of members' chosen retirement payment options.

However, we identified nine instances in which members have retirement documents that conflict with the options listed in the V-3 system. This includes one member who is listed in the V-3 system under Option 5, which pays the beneficiary 75% of the member's pension upon death. The member's retirement application shows that the member selected Option 7, with a 5% survivorship payable to the beneficiary. Additionally, Pension Board minutes document approval of the member's request for

an Option 7 pension. If unresolved, the member's V-3 system's Option 5 designation could potentially lead to significantly excessive survivorship benefits (75% of member's monthly payment rather than 5%). We brought this case to the attention of ERS staff for resolution.

Incorrect Data in the V-3 System

Throughout the audit, we identified numerous instances in which data contained in various V-3 system fields was incorrect.

For instance, in our review of Option 7 retirements, two members have the wrong base monthly pension amounts listed in V-3. The base monthly pension benefit is the amount calculated for the initial full monthly payment made to a member, before adding annual COLAs. In both instances, the figure appearing in the base monthly pension benefit field of V-3 is actually the survivor's reduced monthly benefit amount, not the member's base amount. While in these two instances the inaccurate data in V-3 has no impact on the accuracy of benefit payments, the prevalence of data inaccuracies in the system reduces confidence in the integrity of calculations generated by the system, and is partially responsible for the extensive manual intervention required of ERS staff to ensure that retirements are processed accurately.

The prevalence of data inaccuracies in the V-3 system reduces confidence in the integrity of calculations generated by the system, and is partially responsible for the extensive manual intervention required to ensure that retirements are processed accurately.

Fiscal Processing Issue

The 2001 retirement of a currently deceased member appears to have been processed using the wrong pension option, resulting in an overpayment to him and an underpayment to his surviving spouse. On retirement documents, the member selected Option 4 (25% Joint & Survivor) with one beneficiary. This form of benefit provides a reduced monthly benefit payable to the member for his or her lifetime with monthly payments continuing upon the death of the member for the life of a designated

beneficiary in an amount equal to 25% of the amount that was paid to the member at the time of the member's death.

This member's retirement was initially processed in the Def-Ben system and subsequently downloaded into V-3. Even though the member selected Option 4, the V-3 system lists him under Option 7. Def-Ben shows that this member's retirement benefits were calculated under two different pension scenarios. This is a common occurrence, as members request multiple calculations to compare benefit payments under different available options before making a final selection.

The member's benefit payments were calculated using Option 4 (25% survivorship) for the pension benefits without a lump sum backDROP payment, and under Option 7 (4% survivorship) for the pension benefits with a lump sum backDROP payout.

Records show the member actually received a lump sum backDROP payment, indicating the member's pension payments were based on the Option 7 scenario. ERS confirmed that the pension disbursements received by both the member and his beneficiary were based on the 4% survivorship amount calculated for the Option 7 scenario.

However, we reviewed Pension Board minutes from 1969 through 2006 and the member did not appear before the Board for an Option 7 approval, nor were there any retirement documents supporting an Option 7 selection in V-3 or the member's paper file. To the contrary, a signed document in the file indicates the member selected Option 4, but there is a hand-written card, with no attribution, scrawled across the document indicating "4%."

We brought this case to the attention of ERS management, which stated that both the member's and survivor's benefits were calculated and paid correctly, except for a period of about 24

months during which the beneficiary's payments did not include applicable COLA adjustments.

We believe documentation supports a conclusion that the member's retirement was incorrectly processed. Taking into consideration the backDROP lump sum payment as well as subsequent monthly payments, we estimate the member was overpaid by approximately \$4,581 and the survivor was underpaid by more than \$12,500.

Recommendations

To address the issues identified, we recommend that ERS management:

8. *Conduct a manual review of member accounts in those instances where missing or contradictory information in the V-3 system and/or paper files cast doubt on the accuracy of Option 7 payments. This may require contacting retirees and/or survivors to resolve issues with Option 7 that were not satisfied during this audit.*
9. *Refer the Option 4 (25% Joint and Survivor) case that was processed as Option 7 to Corporation Counsel for a legal review and opinion as to appropriate action, if any.*
10. *Address all data errors in V-3 relating to the Option 7 cases that we have brought to management's attention in the course of this audit.*

Section 4: Beginning its fourth year of operation, the automated V-3 system requires an inordinate amount of manual review and intervention to prevent or rectify inaccurate pension payment calculations.

As previously noted, the ERS began the process of purchasing and installing an automated pension processing system in 2006, with an ERS estimated total project cost of approximately \$12 million. The V-3 system is a Vitech Corporation host service model in which annual releases and upgrades are provided, along with system fixes and enhancements. The County partners with Vitech to maintain the system. A Co-Development initiative, designed to transition some lower and middle-range level applications from Vitech to contracted on-site personnel, was created to expedite system applications, develop local control over project deadlines and reduce application costs.

The V-3 system was implemented to determine eligibility, calculate benefits and issue pension payments on an automated basis.

A Co-Development Team consisting of ERS, Vitech and The Joxel Group was developed. The V-3 system was implemented to determine eligibility, calculate benefits and issue pension payments on an automated basis. Conversion from the predecessor Def-Ben system to the V-3 system was completed with a V-3 'go live' date in January 2009.

Multiple layers of ongoing maintenance, troubleshooting and quality assurance are performed to ensure accurate pension benefit calculations and payments.

ERS staff and consultants perform ongoing maintenance, troubleshooting and quality control checks of the V-3 system.

These include:

- **Ceridian Interface:** Until recently, a Joxel Group consultant was responsible for loading the County's Ceridian human resources and payroll system files into an off-line area of V-3 before interfacing with the live V-3 system. According to ERS management, this task is now performed by a County

employee transferred from another County department in June 2011.

- **System Testing:** A Joxel Group consultant is responsible for testing the V-3 system's capabilities to make sure all specifications are met and that Milwaukee County is getting the outcomes expected. Vitech is notified when functionality issues develop in the system. This includes identifying fields that are not operating according to specifications as well as issues that require system changes that were not part of the initial specifications.
- **Troubleshooting:** Until recently, a Joxel Group consultant performed troubleshooting and research for the V-3 system, mainly for quality control and functionality processes. Significant time is spent researching system processing errors and calculation problems identified by ERS staff, including reviews of retiree files and other paper documents to identify the source of the problem. According to ERS management, a County employee who transferred from another County department in June 2011 currently performs these functions.
- **Maintenance:** On a regular basis, the County's Ceridian human resources and payroll system files are loaded into an off-line V-3 production area for updating. A Joxel Group consultant reviews the information to identify and report data errors to the Payroll Division for correction before data is interfaced into the V-3 on-line system.

When ERS staff identifies a data problem in V-3, a Request for Adjustment form is e-mailed to the consultants for review and follow-up.

- **Spreadsheet Validations:** ERS staff formerly used spreadsheet templates to manually calculate pension payments. Those spreadsheets are now used as quality control tools to validate the pension calculations produced by the V-3 system. If the calculations are different, ERS staff must research and identify the reason for the differences before proceeding with processing the retirement application.
- **Peer to Peer Review:** ERS developed a Pension Processing Checklist to track Peer to Peer Reviews, a system of providing at least two levels of validation on pension calculations prior to finalization. The purpose of this tool is to make sure that no task is performed, from correspondence to issuance of pension checks, without two staff members reviewing and signing off on the process. The ERS provides supervisory approval of each file to complete the pension payment process in the V-3 system. During the audit process, final validation was performed by Joxel Group consultants. According to ERS management, final validation

ERS developed a Pension Processing Checklist to track Peer to Peer Reviews, a system of providing at least two levels of validation on pension calculations prior to finalization.

is currently performed by a County employee. To date, this process has not been included in the ERS Procedures Manual.

- **Issues Database:** A Joxel Group consultant created and maintains an Issues Database to permit tracking of system problems encountered and reported to Vitech. A standardized incident reporting form is used to document problems encountered. The consultant also tests the steps related to a reported system problem to verify that a problem exists. If there is a problem, Vitech is notified.

Vitech analyzes all issues in the database to determine if they are system problems or staff errors.

Vitech analyzes all issues in the database to determine if they are system problems or staff errors. Confirmed problems are researched, resolved, tested and subject to approval by ERS management before going live.

ERS management recognizes and continues to identify and address numerous data, system and processing errors during implementation of the V-3 system. This has led to heavy reliance on manual review and intervention to ensure accuracy.

During interviews, ERS staff, management and consultants, brought to our attention on-going control weaknesses and other issues encountered during the first three years of the V-3 system implementation. These include:

- **Ceridian Def-Ben System:** During our interview with a consultant from SysLogic, Inc., who was involved in the V-3 implementation phase, there was no verification, recalculation or validation performed for approximately 7,300 retirees in the Def-Ben system prior to conversion into the V-3 system. In part due to concerns that ERS staff would be unable to reliably validate past calculations because of poor documentation protocols/practices with the Def-Ben system, a strategic decision was made to assume that the information in Def-Ben was correct. As a result, any errors contained in the Def-Ben system were downloaded into V-3.
- **Conversion Dates:** An area of concern identified by the Joxel Group consultants is the use of 'conversion dates' for some member accounts in V-3. Prior to 1991, active employees were not included in the Def-Ben system--their employment information was stored on Service Cards. When the V-3 system went live, the start and termination data fields could not be left blank so June 1, 1991 was inserted as a default date for purposes of system conversion for those cases. Staff was subsequently assigned to manually key-enter the appropriate start and termination

dates into V-3 using the employee Service Cards. Efforts were made to 'clean up' those dates in the V-3 system; however, those fields remain suspect due to their manual key-entry.

- **Service Credits:** Somewhat related to the conversion date issue, ERS staff indicated early in the audit process that service credits in V-3 are problematic. While the errors frequently originated in Def-Ben or the conversion process, other problems include V-3 inaccurately calculating the number of service credit years due to broken credit years stemming from unpaid Family Medical Leave, suspensions and other unpaid time off.
- **Cost of Living Adjustment (COLA):** The Joxel Group consultants indicated that some COLA increases are not correct in V-3. According to ERS management, this error has been identified and corrected going forward.
- **Spreadsheets:** Problems developed with ERS staff use of the spreadsheets for manual verification of V-3 system calculations. Use of the wrong manual spreadsheet template for different retirement multipliers applicable during different time periods for different classes of employees was one problem cited by a Joxel Group consultant. The ability to change information in certain fields that should not be altered in a spreadsheet was another problem identified by the consultant. To eliminate this problem, a consultant is working on creating a single new manual spreadsheet template that will allow for all the retirement multipliers and will limit ERS staff's ability to change certain fields. However, this could be an indication that additional staff training and reinforcement of procedures is needed.
- **Final Average Salary Calculations:** The Joxel Group consultants indicated there are some problems with the V-3 system's calculations of Final Average Salaries in the computation of retirement benefits. Suspected problems include not recognizing all appropriate earnings codes to be used, missing hours worked that could potentially impact the proper pay periods selected for the highest consecutive years' earnings, and possible problems in applying the proper time period.

Our review confirms both the general accuracy of pension payments and the need to continue an inordinate amount of manual review and intervention for an automated system beginning its fourth year of implementation.

Despite the diligent and sustained efforts to systematically identify and correct errors in the V-3 system, our review confirms

both the general accuracy of pension payments and the need to continue extensive manual reviews and intervention in the processing of retirement benefits. It has also contributed to heavy ongoing reliance on outside contractors to maintain daily administrative functions, including some with final disbursement authority. We will be examining the appropriateness of this reliance in greater detail in a separate report on County contracting practices.

Examples of errors detected during our audit, described in detail in previous sections of this report, include:

- Service credit errors.
- Final Average Salary errors.
- COLA errors.
- Pension benefit payment option errors.
- Errors related to incorrect benefit cutoff dates.

Some of the same issues identified in this report have been identified and described in Internal Control reports from the County's independent outside auditors, Baker Tilley Virchow Krause, LLP.

Some of the same issues identified in this report have been identified and described in Internal Control reports from the County's independent outside auditors, Baker Tilly Virchow Krause, LLP. ERS management has stated that its goal is to be paperless in five years, relying on the electronic data and imaging capabilities of the V-3 pension system. If that goal is achieved at some point in the future, it is imperative that the information stored in V-3 is both accurate and complete.

Recommendations

To address the issues identified, we recommend that ERS management:

- 11. Continue ongoing problem identification and resolution processes, including manual reviews and intervention to V-3 and correct all system data that is incorrect to make sure the system is a true account of each record.*
- 12. Revise ERS procedures manual to include the Peer to Peer Review Process.*

13. Identify those problems attributable to staff errors and develop additional focused training and reinforcement efforts to improve performance.

Section 5: A process of scanning and destroying key documents during conversion to the V-3 automated pension payment system has resulted in an inability to reconstruct and verify the accuracy of some pension payment calculations for retirements before 2009.

A Records Strategic Plan was established in 2009.

In 2008, ERS began to deal with cumbersome paper files in preparation for implementing the V-3 pension system. At the time, ERS had accumulated approximately 70,000 files in two storage areas at the Courthouse. Each file contained multiple documents. The ERS began to streamline its records through formatting, data cleansing and preliminary document scanning. A Records Strategic Plan was established in 2009 with the following goals:

- Scan an additional 100,000 documents into the V-3 system.
- Review, format, and reorganize the records in storage.
- Conduct a major culling project to reduce records volume, eliminate unnecessary paperwork and reduce storage costs.

To assist with the process of streamlining records, ERS hired five temporary employees in 2008 and seven in 2009.

Lack of controls over the document scanning and purging process resulted in the destruction of key documents necessary to recreate and verify the accuracy of some member pension calculations.

Throughout several audit tests conducted, we reviewed a total of 328 pension cases in detail. Each audit test included a search for specific documents to verify the accuracy of original benefit calculations, subsequent adjustments, or to validate choices made by ERS members upon retirement. These document searches included the V-3 system (scanned images) and, if necessary, backup paper files. During our document searches, the following items could not be located:

- Signed retirement documents—missing in 61 of 328 cases reviewed.
- Retirement Estimate letters—missing in 24 of 162 cases reviewed.
- Manual spreadsheets/calculations of benefit amounts—missing in 109 of 152 cases reviewed.
- Data on Retiring Employee forms—missing in 19 of 69 cases reviewed.
- Eight of 162 paper files could not be located including three files that did not have any retirement documents scanned into the V-3 system.
 - Actuarial letter showing factors used to calculate the Option 7 benefits (previously noted)—missing in 80 of 83 cases reviewed.
 - Member's letter to the Pension Board requesting Option 7 (previously noted)—missing in 80 of 83 cases reviewed.
 - Final decision letter from the Pension Board to the member regarding Option 7 request (previously noted)—missing in all 83 cases reviewed.

The prevalence of missing documents indicates that ERS had insufficient quality controls in place to ensure the data needed to support, verify and document important retirement documents were retained.

The prevalence of missing documents indicates that ERS had insufficient quality controls in place to ensure the data needed to support, verify and document important retirement documents were retained. A list of 18 documents to be retained in the records culling process was provided to each temporary worker assigned to the task. However, a review of the list verified that Option 7 documents were not included.

Recommendations

To safeguard important retirement documents and files, we recommend that ERS management:

14. *Review the Benefit Division's policy on the retention of records and ensure all documents necessary to recreate and verify retirement benefits calculations are retained in the V-3 system.*

Audit Scope

The objective(s) of this audit was to focus on whether internal controls are in place and are functioning as designed to ensure pension payments are accurate and appropriate. The audit focused on retirement activities that primarily occurred in 2009 and 2010, and we went back into prior years to fully address issues identified during this audit work.

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

We limited our review to the areas specified in this Scope Section. During the course of the audit, we:

- Reviewed Adopted Budget information relating to the Employee Benefits – Employees’ Retirement System (ERS).
- Reviewed internal control reports and internal control management letters regarding ERS from the independent external audit firm of Baker Tilly Virchow Krause, LLP.
- Reviewed Milwaukee County Ordinance Chapter 201.24 governing ERS.
- Reviewed Pension Board minutes for various verification purposes.
- Interviewed retirement division staff and consultants to obtain a clear understanding of how ERS operations are performed.
- Performed a risk assessment to identify areas of exposure to potential fraud, that fall within the parameters of our audit scope and objectives.
- Reviewed cases from a statistically valid random sample of 30 members whose retirements were processed in Def-Ben, an additional 10 randomly selected cases processed in V-3, and added two additional members for known anomalies. For each case reviewed, we examined documentation from the V-3 system and backup paper files to recreate pension

calculations using spreadsheets used by ERS staff; and to determine whether ERS staff complied with County ordinances and retirement division policies and procedures.

- Reviewed cut-off controls in place to ensure monthly pension benefit checks are appropriately handled in cases of death of retirees, 10-year pay-out options, and special retirement options approved by the Pension Board.
- Evaluated the V-3 Pension System to identify controls in place to ensure accuracy in processing retirement payments.

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Department of Human Resources
Division of Employee Benefits

Date: 03/06/12

TO: Jerome Heer, Director of Audits

FROM: Kerry Mitchell – Executive Director of Human Resources
 Matthew Hanchek, Employee Benefits Administrator
 Marian Ninneman, ERS Manager

SUBJECT: Response to Internal Audit of Milwaukee County ERS

Overview

The Employee Benefits Division of the Department of Human Resources has reviewed the report by the Department of Audit, and generally agrees with the findings and recommendations. The pension calculations and disbursements performed by the Employees Retirement System (ERS) are accurate, and upon death of a pension recipient, ERS ends benefits in an efficient and effective manner.

However, despite this success there are noted areas in the Audit report that require improvement. Specifically, ERS must address the calculation of annual Cost of Living Adjustments (COLAs), the processing of non-standard pension options (less than 4% of the pensions processed by ERS), and ERS must improve the documentation of its procedures. ERS agrees on each of these counts.

Finally, the audit notes concerns regarding records retention and the use of consultants in daily administration. ERS shares similar concerns and has made clear progress in utilizing consulting support in its intended role, and in implementing a records retention policy.

A review of the recommended actions and ERS comments are included below:

Section 1: We concur with the Department of Audit findings that ERS pension payments calculations are generally accurate. The Audit noted two recommendations for improvement.

Recommendation 1: *Develop written protocols defining the number of pay periods used to calculate three-year and five-year Final Average Salary figures, respectively, for determining ERS retiree benefits in compliance with s. 201.24, Section II 2.8 of the Milwaukee County Ordinances. We suggest consistent application of the 78 highest consecutive pay periods for three-year FAS and the 130 highest consecutive pay periods for five-year FAS.*

Comments: ERS agrees with the recommendation and will update procedure manuals accordingly. It is anticipated that this will be completed / effective May 1, 2012.

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www.county.milwaukee.gov/HumanResources

Recommendation 2: *Continue monitoring COLA adjustments and document efforts to verify reliable application of appropriate COLAs by the V-3 system.*

Comments: ERS agrees and will continue its ongoing quality assurance efforts regarding Cost of Living Adjustments. Further, ERS has identified a programming issue with COLAs related to backDROPS, which will be resolved by May 2011.

Section 2: ERS agrees with the Audit findings that internal controls must be improved with regard to the 10-year certain annuity (Option 6).

Recommendation 3: *Review and correct all Option 6 cut-off date errors in V-3.*

Comments: ERS agrees, and is in the progress of correcting all known option 6 errors. It is anticipated that this will be completed by July 2012.

Recommendation 4: *Work with Corporation Counsel to revise s. 201.24 of the County Ordinances to codify the backdrop cut off dates.*

Comments: This has been referred to Corporation Counsel, but a timeframe has not been set. It is anticipated to be completed prior to 6/30/2012

Recommendation 5: *Develop written procedures regarding the processing of option 6 pension applications, including measures to ensure cutoff dates for option 6 members with backDROP dates are entered into V-3 appropriately and to ensure remaining benefits are paid to the estates of members who die without beneficiary prior to the completion of the 120 guaranteed payments.*

Comments: ERS agrees with this recommendation, and the written procedures are in progress. ERS is researching the most effective way to ensure backDROP dates are correctly applied for establishing the 10-year certain period, but anticipates this will be completed prior to 6/30/12.

Recommendation 6: *Create an automatic computer generated cutoff date for Option 6 beneficiary payments once the guaranteed 120 payment requirements have been met.*

Comments: The current system configuration creates a report of Option 6 beneficiary payments that are expiring 2 months in advance of the completion of the 120 day period. This triggers a staff member to send the notice and enter a benefit end date in V-3.

ERS is amenable to creating additional safeguards to limit the possibility of beneficiary payments extending beyond the guaranteed 120 payments. However, as a general rule ERS requires a staff member to review any termination of pension benefits rather than automatically ending payments. ERS will research alternative safeguards for ensuring the timely termination of beneficiary payments, and is willing to discuss ideas for improvement with the department of Audit, but ERS remains generally opposed to automating the termination of pension benefits.

Recommendation 7: *Expedite the review of all remaining instances of benefit overpayments and underpayments referred by the Department of Audit during the course of this audit and take*

appropriate corrective action.

Comments: ERS agrees, and is in the process of making all appropriate corrections. This is anticipated to be completed by 6/30/12

Section 3: ERS agrees there are issues with the actuarial equivalent payment option (Option 7). However, ERS would like to note that this option is only granted upon approval of the Pension Board, and is very infrequent (less than 1% of pension recipients). Further, the Pension Board has adopted rules discouraging the approval of this option, making the exposure to future occurrences somewhat limited.

Recommendation 8: *Conduct a manual review of member accounts in those instances where missing or contradictory information in the V-3 system and/or paper files cast doubt on the accuracy of option 7 payments. This may require contacting retirees and/or survivors to resolve issues with option 7 that were not satisfied during this audit.*

Comments: ERS agrees in principal and will all reasonable attempts to follow Recommendation 8. However, given the age and limited documentation available, ERS would like it recognized that it may not be possible to fully resolve these issues.

Recommendation 9: *Refer the option 4 case that was processed as an option 7 to Corporation Counsel for a legal review and opinion as to appropriate action, if any*

Comments: ERS will refer this item to Corporation Counsel and will proceed as advised.

Recommendation 10: *Address all data errors in V-3 relating to the Option 7 cases that we have brought to management's attention in the course of this audit.*

Comments: ERS agrees, with a similar caveat as Recommendation 8, that the age of the cases and document retention issues may limit the ability to resolve all questions. ERS has made significant strides to assure the accuracy of the data entered into the V-3 system (including cleansing data from the legacy system), and will continue to make all reasonable efforts to ensure data integrity.

Section 4: ERS acknowledges the need to reduce overall reliance on manual intervention on automated payment calculations, however, quality assurance reviews will need to continue beyond the point where manual intervention becomes a rare occurrence. ERS has made significant progress, most notably in June 2011, in removing consultants from day-to-day administrative functions and returning consultants to their intended purpose of system testing and programming.

Recommendation 11: *Continue ongoing problem identification and resolution processes, including manual reviews and intervention to V-3 and correct all system data that is incorrect to make sure the system is a true account of each record.*

Comments: As mentioned above, ERS will continue all reasonable quality assurance reviews

and will work to identify and resolve all issues. This will remain an ongoing effort.

Recommendation 12: *Revise ERS procedure manuals to include the peer-to-peer review process.*

Comments: ERS agrees that the peer-to-peer review process needs to be included in the procedure manuals. This is anticipated to be completed by 6/30/2012

Recommendation 13: Identify those problems attributable to staff errors and develop additional focused training and reinforcement efforts to improve performance.

Comments: ERS agrees, and this will continue to be a management objective going forward. This will be a key focus of the vacant ERS Coordinator role that is currently posted for hire. This is also consistent with a renewed focus on training and staff development for the Department of Human Resources as a whole.

Section 5: While streamlining the paper records may have been an appropriate action, it is not clear why all documents necessary for validating pension calculations were not retained in some instances. In 2009 the Employee Benefits Division created an updated records retention policy that has been reviewed and approved by the County Records Retention Committee and corporation counsel. Further, ERS has upgraded the scanning equipment available to staff to help to ensure timely and complete scanning of required documents.

Recommendation 14: *Review the Benefits Division's policy on the retention of records to ensure all documents necessary to recreate and verify retirement benefits calculations are retained in the V-3 system*

Comments: In addition to the comments at the start of this section, ERS will redistribute the Benefits Division records retention policy and will review scanning and filing procedures with staff to assure that the policies and steps in place are adhered to.

CC: Chris Abele, Milwaukee County Executive
Amber Moreen, Chief of Staff
Kimberly Walker, Corporation Counsel
John "Mickey" Maier, Chairman - Milwaukee County Pension Board