

FY 2016 Risk Assessment

The auditor's consideration of materiality is a matter of *professional judgment*. It reflects what the auditor perceives as the view of a reasonable person who is relying on the financial statements. While other qualitative factors must be considered in determining materiality, a common rule of thumb is that total (aggregated) misstatements of more than about 3 to 5 percent of net income before tax would cause the financial statements to be materially misstated.

Statement of Fiduciary Net Position:

Total Asset:	7,268,967,203.00
3% Misstatement:	218,069,016.09
Total Liabilities:	248,097,620.00
3% Misstatement:	7,442,928.60

Items to Test on Statement of Fiduciary Net Position:

Securities Lending Collateral (DB) —
Investments (DB)

Assets: Testing these two areas gives us 90% coverage

Total Tested Assets: 6,510,523,980.00

Securities Lending Liability (DB) —

Liabilities: Testing this area gives us 98% coverage

Total Tested Liabilities: 243,915,318.00

Statement of Changes in Fiduciary Net Position:

Total Additions:	\$649,406,989.00
3% Misstatement:	\$19,482,209.67
Total Deductions:	\$449,301,204.00
3% Misstatement:	\$13,479,036.12

Items to Test on Statement of Changes in Fiduciary Net Position:

Contributions Employer
Plan Member & State Contributions —
Investments

Additions: Testing these areas gives us 87% coverage

Total Tested Additions: \$ 567,997,180.00

Benefits —
Refunds/Distributions

Deductions: Testing these areas gives us 98% coverage

Total Tested Deductions: \$409,707,595

Investments & Security Lending

No testing is needed for defined benefit investing due to the fact that the Board of Investments (BOI) has a fiduciary responsibility to invest the defined benefit retirement plans' assets on behalf of the defined benefit plan members. Investments are determined in accordance with the statutorily and constitutionally mandated *prudent-expert* principle. MPERA relies on the Unified Investment Program under Article VIII, Section 13 of the Montana Constitution which requires that the legislature provide for a unified investment program for public funds and that the program be audited annually by the Legislative Audit Division. MPERA however, should review LAD reports annually from BOI to ensure not material findings are found.

PERS-DCRP and Deferred Compensation Plan's fixed investments within the Stable Value Group Trust are administered by third party vendors, including the Pacific Investment Management Company (PIMCO) and State Street Bank (SSB), and by a third party insurer, Transamerica. Empower (formerly Great-West), the third party record manager, tracks and reports daily trading and valuations of all investment options. In addition, PERS-DCRP investments are governed by section 19-3-2122, MCA, and Deferred Compensation Plan investments are governed by Title 19, chapter 50. PERB reviews several investment policies on an annual basis while a third party consultant and an investment analyst reviews investment options on a quarterly basis.

Risks- Third Party Administrator (TPA) Contracts

- Contract provisions are inadequate
- TPA does not understand its fiduciary duty
- Public pension system management does not appropriately monitor the TPA
- An annual Statement on Standards for Attestation Engagements (SSAE) No. 16, Type II (formerly SAS 70) audit is not performed by the TPA's independent auditor, not transmitted to the public pension system by State Street Bank or Empower, and not reviewed by the public pension system staff

Controls to mitigate the risks

- For defined benefit plans, they are audited on an annual basis by Legislative Audit Division.
- Require standard contract language in RFPs and contracts
- Require the legal counsel to review TPA contracts
- Include a contract clause that identifies the owner of the records
- Include a contract clause on records retention schedule
- Include contract provision requiring the proper safeguard and destruction of sensitive data
- MPERA accountants reconcile third party transactions to what they record monthly to ensure all transaction balance and make sense.

Audit Procedure: Determine if MPERA reviews the SAS 70 reports and LAD reports on an annual basis.

Contributions Employer & Plan Member

MPERA statutes require employers to send payroll reports and contributions to us within 5 working days after each regular payday. Reporting agencies use MPERA's Web Reporting System to remit payment via automated clearing house. Reports should list all employees (active, inactive, working retiree, and non-contributing). Per ARM 2.43.2114, each report must be accompanied by employer & employee contributions. There are 541 employers that contribute to the MPERA-administered defined benefit retirement plan (DBRP). An individual account is established once

payroll has been submitted and interest accrues until a request for retirement or refund is processed.

Payroll Data and Enrollment of Members

Risks:

- Eligible employees are not enrolled
- Ineligible employees are enrolled
- Incorrect compensation/contribution data is received and/or recorded
- An agency is paying contributions on ineligible earnings
- Contributions received are not credited to the correct accounts
- Public pension system applies incorrect interest rates when collecting contributions from different fiscal/calendar years
- Payment for employer and/or member contributions are incorrect

Controls to mitigate the risks:

- Provide education and/or training sessions to employers
- Communicate to employers changes or issues affecting member eligibility
- Provide standardized enrollment forms which require completion of all information necessary to determine eligibility
- Web based reporting system that has certain edits which requires the most up-to-date rates.
- Require periodic audits of employer payrolls
- Send employer newsletters and bulletins
- Develop a website for employer information and questions
- The system receives data promptly and records information into each member's account in a timely manner
- Follow-up on payroll reports not received
- Statutes and/or rules created that penalize employers for submitting late reports or receipts

Detection Tests:

- Develop tests to ensure compensation reported to MPERA is allowable per:
 - *PERS: 19-3-108 (1B), 19-3-315 (1a), and 19-3-316 (1), MCA.*
 - *SRS: 19-7-101 (1b), 19-7-403 (1), and 19-7-404 (1), MCA.*
 - *HPORS: 19-6-101 (1), 19-6-402 (1), and 19-6-404, MCA.*
 - *MPORS: 19-9-104 (1b), 19-9-710 (1c), and 19-9-703, MCA*
 - *JRS: 19-5-101 (1b), 19-5-402 (1), and 19-5-404 (1), MCA*
 - *FURS: 19-13-104(2a), 19-13-104(2a), 19-13-601 (2a), 19-13-601 (2b), 19-13-601 (3), and 19-13-605, MCA.*
 - *GWPORS: 19-8-101 (1b), 19-8-502 (1), and 19-8-504, MCA*
- Determine if pay included on each timesheet is in compliance with the definition of compensation as defined in the following statutes:
 - *PERS: 19-3-108 (1a) and 19-3-108 (1b)*
 - *SRS: 19-7-101 (1a) and 19-7-101 (1b)*

- HPORS: 19-6-101 (1a) and 19-6-101 (1b)
- MPORS: 19-9-104 (1a) and 19-9-104 (1b)
- JRS: 19-5-101 (1a) and 19-5-101 (1b)
- FURS: 19-13-104(2a) and 19-13-104(2b)
- GWPORS: 19-8-101 (1a) and 19-8-101 (1b)
- Determine if the employer and employee contributions are using the rates set in statutes:
 - PERS: 19-3-315 (1a) and 19-3-316 (1), MCA
 - SRS: 19-7-403 (1) and 19-7-404 (1), MCA
 - HPORS: 19-7-403 (1) and 19-7-404 (1)
 - MPORS: 19-9-710 (1c) and 19-9-703, MCA.
 - JRS: 19-5-402 (1) and 19-5-404 (1), MCA.
 - FURS: 19-13-601 (2a) 19-13-601 (2b), 19-13-601 (3), and 19-13-605, MCA
 - GWPORS: 19-8-502 (1) and 19-8-504, MCA.

Census Data:

GASB 68 requires employers to include census data in their audits. Census data, including a member's name, social security number, date of birth, date of hire, and gender, needs to be complete and accurate for actuarial reasons. The frequency and extent of verification may be determined by the plan based on the assessed level of risk of error for each of the participating employers.

Risks- Collection and Maintenance of Member Data

- A member may intentionally or mistakenly misrepresent their age and receive retirement benefits before they are actually eligible
- Correct beneficiaries are not recorded
- Beneficiary splits are not recorded correctly
- Correct address is not received and/or recorded
- Incorrect Social Security Number (SSN) is received and/or recorded
- Incorrect gender is entered into the system, affecting actuarial calculations

Controls to mitigate the risks

- Provide some type of validation of employment status and employment category
- Require a copy of Social Security card for member file or completed IRS Form I-9
- Have a procedure for authenticating changes of address (signatures, passwords, voice identification, questions that only the member would know)
- Require copy of birth certificate when a member gets ready to retire.

Detection Tests:

-Develop tests to ensure employee information reported to MPERA is reliable and in compliance with 19-2-506 (4), MCA and ARM 2.43.2114.

Please see Employer Audit Risk Assessment

Benefits

PERS provides service retirement benefits, disability retirement benefits and survivor benefits, if eligible, to defined benefit members and their beneficiaries based on age and service requirements. The amount of time a member works and contributes to PERS will directly affect the amount of the retirement benefit. A member earns one month of service credit for each month of full-time service. Defined benefit retirement plans use a defined formula to calculate a member's benefit which incorporates a factor, years of credited service and the highest consecutive 36 month of compensation.

Risks - Benefits

- Benefit amount is incorrectly calculated
- Benefits are paid to unauthorized persons
- Benefit is fictitious
- Benefits are paid to deceased persons
- Benefits are not paid timely
- Paper checks are lost
- Payments are not in compliance with IRS regulations for automatic distributions
- An employee is allowed to work on calculations of a relative or friend
- Federal/state tax withholding amounts are incorrect or are not adjusted as conditions change

Controls to mitigate the risks

- Agency has written policies and procedures to ensure that benefits are processed accurately, uniformly, and timely in compliance with statutory provisions, administrative rules, IRS requirements, and management directives
- Adequate segregation of duties among staff processing benefits, including reissuing stale-dated checks
- Authenticate person requesting a benefit
- Conduct death matches for annuitants/non-annuitants using SSA Death Master Death File/updates, state Vital Records, and/or outside vendors
- Send confirmation letters to persons who are listed as deceased on death match reports and require a (notarized) signature before making payment to applicants or continuing monthly benefits to annuitants
- Record dates of death on member records immediately
- Develop a well-controlled account receivable process

Internal Auditor from DOA, will be performing detection tests for the above.

- **Pull Actuary Report for FY15 for Benefits. This will give complete benefits for the entire year they can grab a sample for it.**

Refunds

Risks

- Refund is made to the wrong person
- An incorrect amount is paid
- Member contributions and service credit are not reduced to zero after refund

- Refund payments are not made according to statutes and/or policies
- Someone steals member's identity and fraudulently claims the account
- Staff fraudulently issues a refund payment for personal gain

Controls to mitigate the risks:

- Refund form must be submitted and approved before payment is released
- All new claims and adjustments should be reviewed and authorized by someone other than the staff processing the claim
- Check each application for completeness and verify the application and supporting record for accuracy
- Require adequate identity documentation when an individual is refunded
- Require supervisory review and approval of each refund prior to payment
- Authenticate persons requesting refunds
- Retain records for extended period of time based upon state law and life expectancy

Internal Auditor from DOA, will be performing detection tests for the above.

- **Pull Actuary Report for FY15 for Refunds. This will give complete refunds for the entire year they can grab a sample for it.**