



## Defined Contribution and Other Deferred Compensation Plans - #815

### Executive Summary

#### *Why CAO Did This Review*

Pursuant to Section 5.10 of the Charter of the City of Jacksonville and Chapter 102 of the Municipal Code, we performed an audit of the general employees' defined contribution, 457(b) deferred compensation, and OBRA plans. We chose to audit this area due to pension reform that was recently passed. The reform closed the existing defined benefit plans to new members as of October 1, 2017. Instead, all new hires, including public safety, are now placed in a defined contribution plan. Since these plans will be growing significantly now, auditing the administration of such plans was timely and relevant.

#### *What CAO Recommends*

The City should design and implement system controls to ensure compliance with IRS regulations on maximum annual contributions and compensation. In addition, the City should ensure that contributions for employees on military leave are transferred to the employees' accounts. The City should also review each earnings element to verify it is classified properly for pension purposes. Finally, the City should better define the responsibilities of each party involved in the process of administration of the defined contributions plans.

#### *What CAO Found*

Overall, we found that the defined compensation, deferred compensation, and OBRA plans' contributions were accurately calculated by the City and were timely transferred and credited to the correct employees' accounts. However, we found some issues:

- There were either no controls or insufficient controls to ensure that employees comply with the IRS limits on maximum annual compensation and contributions.
- Twelve (12) employees on military leave did not receive a credit of \$30,486.55 into their defined contribution accounts.
- The list of pensionable earnings needs to be reviewed due to some inconsistencies with the pension classification.
- Roles of the areas involved in the administration of the Defined Contribution Plans should be better defined.
- Accuracy of the transfers from the vendor was not verified when unvested employees are terminated or when employees switch to the defined benefit plan.
- High fees charged to employees in the OBRA plan caused a 0.01% return per year for the past three years.
- Unvested portion of contributions were not recovered timely from terminated employees' accounts.

Plan Type / Name	Total Plan Assets 12/31/2016	Total Plan Assets 12/31/2017	Average Participant Balance 12/31/2016	Average Participant Balance 12/31/2017
457 Deferred Compensation	\$ 157,992,468	\$ 175,413,238	\$ 32,826	\$ 35,566
401(a) General Employee Defined Contribution	\$ 23,435,492	\$ 33,283,264	\$ 16,085	\$ 18,772
457 OBRA	\$ 2,230,495	\$ 2,486,894	\$ 608	\$ 624
401(a) Defined Contribution (inactive)	\$ 1,992,870	\$ 2,151,691	\$ 583	\$ 650
JHA 457 Deferred Compensation (inactive)	\$ 181,672	\$ 188,228	\$ 16,516	\$ 17,112
401(a) Public Safety Defined Contribution (new)	N/A	\$ 80,889	N/A	\$ 1,526

**TOTAL:**      \$ 185,832,997    \$213,604,204



**Council Auditor's Office**

**Defined Contribution and Other Deferred Compensation Plans**

**March 2, 2018**

**Report #815**

**Released on: September 11, 2018**

**EXECUTIVE SUMMARY**

**AUDIT REPORT #815**

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**OFFICE OF THE COUNCIL AUDITOR**  
Suite 200, St. James Building



March 2, 2018

Report #815

Honorable Members of the City Council  
City of Jacksonville

**INTRODUCTION**

Pursuant to Section 5.10 of the Charter of the City of Jacksonville and Chapter 102 of the Municipal Code, we conducted an audit of the general employees defined contribution plan (“defined contribution plan”). The audit focused on contributions made by members of the defined contribution plan that include City general employees, JHA employees, and JEA employees. When we commenced this audit, new full-time employees had to elect between the defined benefit and defined contribution options. The defined benefit option was eliminated after September 30, 2017 pursuant to the pension reform legislation approved in April 2017. This audit also covered a 457(b) deferred compensation plan that is a voluntary supplemental plan offered to City and JHA employees and the OBRA (Omnibus Budget Reconciliation Act) plan that is used only for City employees that do not qualify for any other plan (e.g., part-time employees). This is an alternative to Social Security that is used by the City, and it is categorized as a 457(b) deferred compensation plan.

The Employee Benefits Division administers these plans with assistance from the Treasury Division and help from a contracted third-party record-keeper (“vendor”) and a third-party consultant (“consultant”). The Employee Benefits Division, with assistance of those third parties and other areas of the City, performs various duties including, but not limited to, setting up and maintaining employees’ accounts, processing transfers and distributions, submitting biweekly contributions, and educating employees on retirement topics. This includes ensuring compliance with Internal Revenue Service (IRS) rules on maximum annual contribution/compensation limits.

Employees were required to contribute 8% (0.3% was forwarded to the disability program) and 7.5% of all earnable compensation to the defined contribution plan and the OBRA plan, respectively for every paycheck during pay periods tested. Defined contribution plan contributions were 100% matched by the employer at the time of the audit, but OBRA plan contributions were not matched. The voluntary deferred compensation plan contributions were made solely by the employee. All contributions must be within IRS thresholds. As noted above, with pension reform, which became effective on October 1, 2017, all new employees, including public safety employees, are no longer eligible to join a defined benefit plan. Instead, new employees have to join the applicable defined contribution plan (i.e. general employees or public safety employees). Contributions for members of the defined contribution plans became 8% for general employees and 10% for public safety employees with the employer contributing 12%

and 25% of earnable compensation, respectively (Note: 0.3% of each is transferred to fund disability and survivor benefits).

The table below summarizes all of the plans managed by the City:

Plan Type / Name	Within the Scope of the Audit?	Total Plan Assets 12/31/2016	Total Plan Assets 12/31/2017	Number of Participants 12/31/2016	Number of Participants 12/31/2017	Average Participant Balance 12/31/2016	Average Participant Balance 12/31/2017
457 Deferred Compensation	yes	\$ 157,992,468	\$ 175,413,238	Active: 4,099 Terminated: 714 Total: 4,813	Active: 4,178 Terminated: 754 Total: 4,932	\$ 32,826	\$ 35,566
401(a) General Employee Defined Contribution	yes	\$ 23,435,492	\$ 33,283,264	Active: 1,267 Terminated: 190 Total: 1,457	Active: 1,544 Terminated: 229 Total: 1,773	\$ 16,085	\$ 18,772
457 OBRA	yes	\$ 2,230,495	\$ 2,486,894	Active: 3,071 Terminated: 597 Total: 3,668	Active: 3,359 Terminated: 626 Total: 3,985	\$ 608	\$ 624
401(a) Defined Contribution (inactive)	no	\$ 1,992,870	\$ 2,151,691	Active: 2,596 Terminated: 821 Total: 3,417	Active: 2,501 Terminated: 808 Total: 3,309	\$ 583	\$ 650
JHA 457 Deferred Compensation (inactive)	no	\$ 181,672	\$ 188,228	Active: 11 Terminated: 0 Total: 11	Active: 10 Terminated: 1 Total: 11	\$ 16,516	\$ 17,112
401(a) Public Safety Defined Contribution (new)	no	N/A	\$ 80,889	Active: N/A Terminated: N/A Total: N/A	Active: 49 Terminated: 4 Total: 53	N/A	\$ 1,526
<b>TOTAL:</b>		<b>\$ 185,832,997</b>	<b>\$ 213,604,204</b>				

Data source: vendor's Plan Review Reports for 2016 and 2017

## **STATEMENT OF OBJECTIVES**

The objectives of the audit were as follows:

1. To determine if the City's employee and employer contributions to the general employees defined contribution plan were accurately calculated in the City payroll system.
2. To determine if the City, JEA and JHA timely transferred the general employees defined contribution plan contributions to the custodian and if the record-keeper credited the correct employees' accounts.
3. To determine if the City and JHA timely transferred the voluntary 457(b) deferred compensation plan employee contributions to the custodian and if the record-keeper credited the correct employees' accounts.
4. To determine if the City's employee contributions to the OBRA plan were accurately calculated in the City payroll system, if the City timely transferred the OBRA employee contributions to the custodian, and if the record-keeper credited the correct employees' accounts.

## **STATEMENT OF SCOPE AND METHODOLOGY**

The scope of our audit was the administration of the general employee defined contribution, OBRA and deferred compensation 457(b) plans administered by the City's Employee Benefits Division from October 1, 2015 through March 31, 2017, unless noted otherwise. We specifically excluded processes at JEA and JHA from the scope of our audit, and performed limited testing for JEA and JHA since they have separate accounting, payroll, and human resource systems. Therefore, unless noted that testing was performed for JEA and JHA, testing described was only performed for City employees.

To gain an understanding of the process, we conducted staff interviews and reviewed applicable rules, laws, regulations, and written policies and procedures. We also performed an analysis of different risk factors and applied various procedures to assess internal controls used to mitigate those risks. Based on this work, we identified the audit objectives and reviewed relevant information system controls. We performed the following audit procedures to reach our conclusions.

### *Objective 1*

We obtained payroll data from the City's Information Technologies Division (ITD) for three (3) payroll periods (pay dates were 2/12/16, 11/4/16, and 2/10/17). Those pay dates were chosen randomly (one per period as defined below). Since there was significant turnover in personnel in the City's Employee Benefits Division in late 2016, we picked the following periods: 1) FY 2015/16, 2) first quarter of FY 2016/17, and 3) second quarter of FY 2016/17. The data requested from ITD included various information (e.g., earnings, deductions, taxes, benefits). We reviewed the portion of that data related to the defined contribution plan to ensure that employee and employer contributions matched on an individual level for all employees in the population. We reconciled gross earnings and employer contributions from this data to the City's accounting system (FAMIS) for one (1) pay period to help confirm reliability of the data pulled from the system.

We then recalculated employee contribution amounts for each employee in the population based on the payroll data and our understanding of the applicable regulations regarding pensionable earnings. We also tested the eligibility of employees by reviewing supporting documentation for a randomly chosen sample of 81 employees that we selected from the population of 346 employees that appeared to be new members of the plan within our audit scope (i.e. all employees from the population who contributed on 2/10/17 and did not contribute on 2/12/16). Since only a small number of employees in the sample transferred in from the defined contribution plan, we judgmentally added 10 more employees to the sample who had made the switch.

### *Objective 2*

We extracted contributions data for the defined contribution plan from the payroll data provided by the City's ITD. We also obtained contributions data from the vendor, JEA, and JHA directly. We reviewed data from all three sources for reasonableness, and we tested to ensure employee and employer contributions matched on an individual level for all employees in the population. We then matched employee contributions per the vendor's data to the employee contributions

per data the City/JEA/JHA provided for each employee in the population. We then tied the totals to the transfers sent out and tested that transfers were made in a timely manner for each agency.

### Objective 3

We obtained the employee 457(b) deferred compensation plan pre-tax and post-tax contributions from the City's payroll data provided by the City's ITD, JHA, and the vendor. (Note that JEA does not participate in City's 457(b) plan and contributions to the plan are not matched by the employer.) Next, we reviewed contributions data from all three sources for reasonableness. We then matched contributions based on payroll data to the contributions per the vendor's data for each employee in the population for the City and JHA. Next, we tied the totals to the transfers out and tested that transfers were made in a timely manner from the City and JHA.

### Objective 4

We obtained OBRA plan employee contributions from the payroll data provided by the City's ITD (JEA and JHA do not participate in this plan, and there is no match by the City). We also obtained OBRA plan employee contributions data from the vendor. We reviewed both sets of data for reasonableness and tied both data sets on an employee level for each employee in the population. We recalculated contribution amounts for each employee in the population based on the payroll data and our understanding of the applicable regulations regarding pensionable earnings and compared to actuals in the payroll data. We tied the totals of the transfers out and verified transfers were made in a timely manner. We also tested if all employees in the population are in this plan or contribute to another retirement plan. Lastly, we reviewed the annual contribution report and tested to confirm that each employee in the population did not contribute beyond the maximum amount allowed by the IRS.

## **REPORT FORMAT**

Our report is structured to identify Internal Control Weaknesses, Audit Findings, and Opportunities for Improvement as they relate to our audit objectives. Internal control is a process implemented by management to provide reasonable assurance that they achieve their objectives in relation to the effectiveness and efficiency of operations and compliance with applicable laws and regulations. An Internal Control Weakness is therefore defined as either a defect in the design or operation of the internal controls or is an area in which there are currently no internal controls in place to ensure that objectives are met. An Audit Finding is an instance where management has established internal controls and procedures, but responsible parties are not operating in compliance with the established controls and procedures. An Opportunity for Improvement is a suggestion that we believe could enhance operations.

## **SUGGESTED ADDITIONAL AUDIT WORK**

In limiting the scope of this audit, we did not pursue the following areas, and as such they should be considered for future audit work:

- Administration of the defined contribution plans for police and fire employees and correctional officers.
- Administration of the defined contribution plan by JEA and JHA (accuracy of the contribution calculations, compliance with IRS maximum limits, enrolling all eligible employees, etc.).

## **STATEMENT OF AUDITING STANDARDS**

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 our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

## **AUDITEE RESPONSES**

Responses from the auditee have been inserted after the respective finding and recommendation. We received these combined responses from Diane Moser, Director - Employee Services Department, and Kevin Stork, Comptroller - Accounting Division, in a memorandum dated July 18, 2018.

## **AUDIT CONCLUSIONS**

By objective:

1. Overall, the City's employee and employer contributions to the general employees defined contribution plan were accurately calculated in the City payroll system; however, we noticed some issues with the classification of pensionable vs. non-pensionable earnings, internal controls related to IRS maximum contribution and compensation limits, and not crediting and transferring contributions related to employees on military leave.
  2. Overall, the City, JEA and JHA timely transferred the general employees defined contribution plan contributions to the custodian, and the record-keeper credited the correct employees' accounts.
  3. Overall, the City and JHA timely transferred the voluntary 457(b) deferred compensation plan employee contributions to the custodian, and the record-keeper credited the correct employees' accounts.
  4. Overall, the City's employee contributions to the OBRA plan were accurately calculated in the City payroll system, the City timely transferred the OBRA employee contributions to the custodian, and the record-keeper credited the correct employees' accounts.
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**OVERALL ISSUE**

**Overall Opportunity for Improvement 1 \*Defining Roles for the Parties Involved\***

The responsibilities related to administering the defined contribution plan need to be clearly defined so that all parties involved fully understand their responsibilities. This was evident from the beginning of the audit and is probably a byproduct of how the defined contribution plan has evolved from an optional plan to the main plan for the City going forward. The Employee Benefits Division, the Treasury Division, Payroll Office, Pension Office and the outside vendor and consultant are all involved with the process in some manner. The City would benefit if the roles were clearly defined for each of the responsible parties.

**Recommendation to Overall Opportunity for Improvement 1**

We recommend the parties work together to create a written policy that details the responsibilities of each party to prevent any misunderstandings or confusion in the future.

**Management Response to Overall Opportunity for Improvement 1**

Agree                       Disagree                       Partially Agree

*A meeting was held on 07/19/18 with all parties involved to discuss and document the roles and responsibilities of each party.*

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**AUDIT OBJECTIVE #1**

**To determine if the City’s employee and employer contributions to the general employees defined contribution plan were accurately calculated in the City payroll system.**

**Internal Control Weakness 1 – 1 \*Lack of Preventive Maximum Contribution and Compensation Controls\***

There were no preventive controls to ensure that employees in the defined contribution plan are in compliance with the IRS limits on maximum annual compensation and maximum annual contributions. For 2017, the maximum contribution limit was set to \$54,000 and maximum compensation limit was set to \$270,000. It appears that the City is currently working on implementing such controls in the payroll system where the contributions would be stopped automatically when either one of the two limits is reached.

**Recommendation to Internal Control Weakness 1 – 1**

The Employee Benefits Division should ensure that the system controls mentioned above are implemented. In addition, once system controls are implemented, the Employee Benefits Division should run summary reports towards the end of each calendar year showing total

compensation and total contributions for each employee to verify whether all employees will be within IRS limits. If any issues are identified then the Employee Benefits Division should address the issue and research why it was allowed to occur. The Employee Benefits Division should also run the report after the calendar year end to ensure nothing else changed that caused an issue.

**Management Response to Internal Control Weakness 1 – 1**

Agree                       Disagree                       Partially Agree

*ITD implemented controls in Oracle HRMS during the Pension Reform project, effective October 1, 2017. Employee Benefit's staff will run reports every year to ensure contributions are within the IRS limits and will run a report after calendar year end to ensure nothing changed to cause an issue.*

**Finding 1 – 1 \* City Is Not Making Contributions for Employees on Military Leave\***

We found that employees in the defined contribution plan on military leave were not receiving contributions to the plan. We found this issue while trying to reconcile employer contributions posted in the accounting system (FAMIS) to the employer contributions data pulled from the City's payroll system. We could not reconcile a small variance. After further research, we identified that the variance was related to contributions that were supposed to be made by the City on behalf of employees on military leave. This issue occurred due to the Accounting Division not including this element as an item that needed to be paid and the report run by the Employee Benefits Division not being properly set-up to include these employees.

We performed additional procedures to attempt to determine the extent of the impact. During those procedures, we identified that there had been at least 12 employees on military leave that did not receive a credit to their defined contribution account. As of January 25, 2018, the total amount not credited for the 12 employees was \$30,486.55. It appears this issue goes back to the time the City approved the Defined Contribution Plan in October of 2009.

**Recommendation to Finding 1 – 1**

The Employee Benefits Division should:

- 1) transfer the \$30,486.55 to the applicable twelve employee accounts that were supposed to receive the funds;
- 2) research if any other employees in the defined contribution plan who were on military leave in the past did not receive full credit;
- 3) modify its system-generated report used to identify contributions by employee so it includes contributions from the employer for employees on military leave for all plans.

The Accounting Division should:

- 1) change its procedures so contributions for employees on military leave are included in the total communicated to the Employee Benefits Division as the total to be sent to the custodian for the payroll period;

- 2) review its process to determine if a similar issue takes place with employees on military leave who are in different pension plans and address such issue, if found.

Discrepancies identified during the reconciliation of the contributions by employees and employer compared to the cash received by the custodian need to be investigated and resolved promptly to avoid this type of situation from occurring in the future.

**Management Response to Finding 1 – 1**

Agree                       Disagree                       Partially Agree

*Employee Benefits:*

*ITD modified the report to include military leave DC elements effective June 2018. Employee Benefits will now capture all military leave employees on the DC plan so appropriate funds can be remitted to Empower. Employee Benefits staff is currently working with ITD and Payroll to research and correct all employees that were on military leave from 2009 - June 2018.*

*Accounting Division:*

*Talent Management (TM), Payroll section, and Employee Benefits (EB) met to discuss the employees that are on Military Leave (ML). We will work together to improve the communication between offices to ensure appropriate handling when an employee notifies the City of a Military Leave absence. Preliminary efforts to improve this process will include 1.) TM continuing to send an excel spreadsheet to Payroll with information as to which employee is on military leave. Payroll will then set up the correct ML element. 2.) ITD has added the DC ML element on the report to include in balancing and submitting to the vendor. Payroll will submit totals to Employee Benefits for validation. Once agreed upon by both divisions, Payroll will upload the amounts to Accounts Payable for processing of payments. As stated in a prior response, we will be meeting to better define roles and responsibilities. That meeting will also include a discussion of appropriate treatment of pay element determination and modifications. The Finance and Administration Department agrees to continue performing periodic (quarterly) reconciliations. Discrepancies identified during this process will be investigated promptly to determine the nature of error and take the necessary corrective actions including any adjustments to the pay elements.*

**Finding 1 – 2 \*Issues with Pensionable Earnings Classification\***

While reviewing the City’s classification of pensionable earnings, we found some inconsistencies:

1. Some earnings were pensionable regardless if they were regular earnings or retro earnings (for example, Service Raise and Retro Service Raise). However, Supervisor Differential was classified as pensionable, while Retro Supervisor Differential was not included in the listing of pensionable earnings.
2. In our payroll data that we tested, there were various “differential” earnings (for example, “Job Differential” and “Out of Class Differential”) that were not pensionable based on the City’s classification. However, one “differential” type of earnings (“Supervisor Differential”) was included in the City’s listing of pensionable earnings.

We previously stated in Council Auditor Audit Report #780 on JSO Payroll, "The City treated City Education Incentive earnings as pensionable for employees in the Correctional Officers Retirement Plan (CORP), but not for employees in the General Employees' Pension Plan (GEPP), despite identical written provisions for pensionable earnings in the Municipal Code and essentially the same bargaining agreement language." The report went on to state that this element was pensionable for GEPP employees prior to October 2009.

Section 120.201 (l) states that "Earnable Compensation shall mean a member's base pay for regular hours worked as an employee, plus service raises and excluding bonuses, adjusted compensation, overtime or any extra compensation over and above regularly budgeted salaries. Earnable compensation shall not include payouts of accumulated leave taken as cash upon separation from service. Retroactive payments shall be credited to the calendar year in which such payments would have been received had they been timely paid." Per Section 120.503, member contribution amounts to the Defined Contribution Plan can be calculated by multiplying Earnable Compensation by 7.7%. If pensionable earnings were not identified correctly, the contributions for employee and employer would be inaccurate.

**Recommendation to Finding 1 – 2**

The Accounting Division with help from the Office of General Counsel should review the current listing of earnings to determine if pensionable elements are accurately identified for all plans (defined contribution and defined benefit for all types of employees). Also, there needs to be a well-documented process put in place for any earning elements added to the system which would include discussions with the Office of General Counsel to verify that it is properly set-up.

**Management Response to Finding 1 – 2**

Agree                       Disagree                       Partially Agree

*The current listings of pensionable elements are determined by the ordinance code. Payroll met with ES to review current elements. OGC, with the assistance of an outside attorney, is reviewing the elements in question. After that information is received, all parties will reconvene and take appropriate action. Additionally, the parties met to clearly define roles that are being documented in the form of a procedure. This procedure outlines the process from the beginning to the end and includes the role of the various stakeholders such as Employees Services (including all three divisions), Accounting and Payroll, Pension Office, OGC, and ITD.*

**Finding 1 – 3 \*Missing or Inappropriate Pension-Related Deductions\***

It is the City's responsibility to ensure that an appropriate pension-related deduction is applied on each employee's paycheck, when applicable, and forwarded to the applicable entity in charge (pension fund, social security administration, etc.). While reviewing pension-related deductions for all employees in the three payroll periods tested, we found some instances where this did not occur and was not resolved in a timely manner:

1. There were three separate instances when an employee did not have any pension-related deduction (e.g., Social Security, OBRA, City pension) when it appeared they should have had one. All three of them were listed on the exceptions reports that are generated by the City's payroll system and used to identify issues that need to be addressed during each payroll. One was corrected after 185 days and another after 629 days while the third was never resolved until the employee left City employment 829 days later.
2. There were three separate instances when an employee started as a special purpose employee and was originally eligible for Social Security, but who later became a civil service employee whose pension-related deductions were not adjusted. Those employees continued to contribute into Social Security for approximately three (3) years on average before they were switched to the defined contribution plan option.

### **Recommendation to Finding 1 – 3**

The Employee Services Department should review the issue of switching special purpose or part-time employees to civil service employees and implement a control to ensure that such employees' pension-related deductions are adjusted in a timely manner when a change in position type takes place.

The Accounting Division should create and implement a written standard operating procedure that would describe how each type of error message on each applicable exception report generated by the system should be addressed during every payroll period.

### **Management Response to Finding 1 – 3**

Agree                       Disagree                       Partially Agree

#### *Employee Services:*

*Employee Services has implemented a control. We now look at the report each payroll to identify and add an employee's assignment category and pension code. For example, there should be no civil service employee with a social security pension code.*

#### *Accounting:*

*Payroll currently runs two exception reports (Pre-Payroll and Pension) which lists errors associated when an employee is hired or transferred on both Payroll Monday and Tuesday. Employee Services runs the report as well. When an error message relates to a Pension, payroll notifies ES and makes the corresponding correction to the pension element. Currently, there isn't an SOP on the different types of error messages that are reflected on the exception reports. Payroll will prepare an SOP on error messages.*

**AUDIT OBJECTIVE #2**

**To determine if the City, JEA and JHA timely transferred the general employees defined contribution plan contributions to the custodian and if the record-keeper credited the correct employees' accounts.**

No specific issues found.

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**AUDIT OBJECTIVE #3**

**To determine if the City and JHA timely transferred the voluntary 457(b) deferred compensation plan employee contributions to the custodian and if the record-keeper credited the correct employees' accounts.**

No specific issues found.

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**AUDIT OBJECTIVE #4**

**To determine if the City's employee contributions to the OBRA plan were accurately calculated in the City payroll system, if the City timely transferred the OBRA employee contributions to the custodian, and if the record-keeper credited the correct employees' accounts.**

***Finding 4 – 1 \* Maximum Contributions Compliance Issue\****

The City's OBRA plan is a FICA-replacement plan used by the City for eligible employees who are not full-time employees. However, the OBRA plan is classified as a deferred compensation 457(b) plan for IRS purposes; therefore, contributions to the City's OBRA plan should be included in the calculation of the total 457(b) contributions along with 457(b) pre-tax and 457(b) post-tax contributions. However, OBRA contributions were being omitted from the calculation of the total 457(b) annual contributions. We found that this caused two (2) employees to contribute over the maximum limit for 457(b) plans (which was \$18,000 for 2016 and 2017) due to this issue.

**Recommendation to Finding 4 – 1**

The Employee Benefits Division should make changes in the City's payroll system to include OBRA contributions in the calculation of total 457(b) annual contributions.

**Management Response to Finding 4 – 1**

Agree                       Disagree                       Partially Agree

*ITD and Employee Benefits are currently working on this change. Controls have been implemented in the Oracle Test environment and Employee Benefits is performing user acceptance testing. Testing should be completed by 10/31/2018 with implementation estimated to be completed by 12/01/2018.*

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**SUPPLEMENTAL ISSUES**

**Supplemental Internal Control Weakness 1 \*Not Verifying Accuracy of Transfers In\***

The Pension Office and Employee Benefits Division did not verify if a payment received from the vendor is accurate. The City receives payments in two situations:

1. When an employee is terminated and is not fully vested, the City informs the vendor of the unvested amount which is refunded to the City and deposited by the vendor into the Unallocated Plan Assets account which is administered by the vendor;
2. When an employee switches from the defined contribution to the defined benefit plan, the vendor sends a check representing the employee’s defined contribution account balance to the Pension Office, and this payment is deposited into the defined benefit plan fund.

In both situations, the accuracy of the check amount was not verified.

**Recommendation to Supplemental Internal Control Weakness 1**

The Employee Benefits Division should change its current process to confirm that an accurate amount was received for each terminated employee who was not fully vested, and the Pension Office should check with the Employee Benefits Division that an accurate amount was received for each employee who transferred into the defined benefit plan.

**Management Response to Supplemental Internal Control Weakness 1**

Agree                       Disagree                       Partially Agree

*Employee Benefits has updated this procedure to verify the amount of the Empower check when notified by the Pension office of a DC to DB transfer. The Pension Office will verify receipt and accuracy of amounts transferred for DC to DB transfers going forward. Employee Benefits has also updated the procedure to verify an accurate amount was deposited into the UPA\Forfeiture account for terminated employees who were not fully vested at their termination date.*

**Supplemental Internal Control Weakness 2 \*Access to Shared Drive by Inappropriate Users\***

The access to a shared network drive with sensitive data was not strictly limited to Employee Benefits Division employees. Without a valid purpose for accessing the shared drives, sensitive data may be exposed if not restricted to appropriate users. We found six (6) employees outside of the division had access:

1. Three (3) employees from the Construction Trades Qualifying Board;
2. Three (3) employees from the Information Technology Division who appeared to be providing technical support to the board employees.

**Recommendation to Supplemental Internal Control Weakness 2**

We recommend the Employee Benefits Division ensure that access to shared drives used by the division is restricted to the division’s employees.

**Management Response to Supplemental Internal Control Weakness 2**

Agree                       Disagree                       Partially Agree

*Employee Services is requesting a list from ITD of users that have access to any Employee Services shared drive. Employee Services will review the list and inform ITD to remove users no longer requiring access. We will request and review this list every 6 months going forward.*

**Supplemental Internal Control Weakness 3 \* Not Following City’s Cash Receipts SOPs\***

We found that Pension Office employees were not following the City’s cash receipts standard operating procedures (SOPs). These procedures apply to all City departments that deal with cash, debit and credit cards, and checks. When an employee switches plans from the defined contribution plan to the defined benefit plan, the Pension Office receives a check totaling all contributions to the defined contribution account. This check is deposited into the defined benefit plan. The City’s cash receipts procedures describe in detail how checks should be handled. For example, when a check is received, it should be stamped “For Deposit Only”. The person who opened the mail should add a check to the prelist of all incoming checks. A different person should create a deposit in the Tax Collector’s system. A reconciliation of deposit receipts and the prelist of incoming checks and the accounting system should be periodically performed. Not following City’s cash receipts procedures could lead to various issues such as misappropriation of funds, unintentional errors, loss of checks/payments, etc.

**Recommendation to Supplemental Internal Control Weakness 3**

The Pension Office should establish a new process of handling incoming checks consistent with the instructions provided in the City’s cash receipts SOPs. Staff should be trained on all updated processes.



**Management Response to Supplemental Internal Control Weakness 3**

Agree                       Disagree                       Partially Agree

*Management will work with staff to improve check handling in accordance with the adopted Policies and Procedures. The Pension Office will work with Employee Benefits and Empower to attempt to eliminate hard-copy checks and establish electronic transfers for funds moving from Empower to the City and the City to Empower.*

**Supplemental Finding 1 \* Various Issues with 457 Maximum Contributions Compliance \***

IRS requirements limited total contributions to deferred compensation 457(b) plans to \$18,000 for 2016 and 2017. However, IRS regulations allowed two types of exceptions:

- a) employees who are 50 years and older were allowed to contribute an extra \$6,000 (bringing the total to \$24,000); and
- b) employees who are three (3) years away from retirement could double their contributions (bringing the total to \$36,000).

When an employee would like to use either exception, they must fill out paperwork with the vendor and the Employee Benefits Division. We have found various issues with controls and compliance in this area:

- 1) The City's payroll system was set up to automatically stop contributions if an employee has reached the maximum limit for deferred compensation 457(b) plan in pre-tax contributions. However, there was no similar "automatic shut off" process for other situations when employee's contributions were:
  - a. post-tax;
  - b. going to different 457(b) plans and/or there are pre- and post-tax contributions.
- 2) We tested the paperwork filled out by employees who contributed over the normal maximum allowed by the IRS and found that out of 29 employees tested:
  - a. 2 (or 6.9%) of the applicable employees (different than those mentioned above in Finding 4-1) contributed over the maximum limit;
  - b. 4 (or 14.81%) of the applicable employees did not have a 3 Year Catch Up Participant Action form on file;
  - c. 2 (or 11.76%) of the applicable employees did not have a 3 Year Catch Up Application form on file;
  - d. 5 (or 23.81%) of the applicable employees did not have a signature by the "Plan Administrator" on the 3 Year Catch Up Participant Action form;
  - e. 12 (or 92.31%) of the applicable employees did not have a signature by the "Plan Administrator" on the 3 Year Catch Up Application form.

**Recommendation to Supplemental Finding 1**

The Employee Benefits Division should:

- 1) Update settings in the City's payroll system, so that all contributions (pre-tax, post-tax, and OBRA) to 457(b) plans are included in the calculation of the total annual contributions and that contributions are stopped automatically when:

- a. An employee, who is under 50 years old at the end of the calendar year, reaches \$18,000;
- b. An employee, who is at least 50 years old at the end of the calendar year, reaches \$24,000;
- c. An employee, who requested a special three (3) year catch up and was appropriately marked in the City's payroll system, reaches \$36,000.

Once the system controls mentioned are implemented, the Employee Benefits Division should run summary reports at the end of the each calendar year showing total contributions for each employee to ensure that all employees are in compliance with IRS limits (similar to the recommendation in Internal Control Weakness 1 – 1).

- 2) Establish controls to ensure that all forms allowing an employee to contribute over the maximum amount set by the IRS are always signed by the appropriate Employee Benefits Division staff and filed appropriately.

**Management Response to Supplemental Finding 1**

Agree                       Disagree                       Partially Agree

*ITD and Employee Benefits are currently working on this change in Oracle. ITD has implemented controls in the Oracle test environment and Employee Benefits is performing user acceptance testing. Testing should be completed by 10/31/2018 with implementation estimated to be completed by 12/01/2018.*

*Employee Benefits has established a control and updated the procedure to ensure all forms are signed by appropriate personnel and filed appropriately.*

**Supplemental Finding 2 \*High Fees for OBRA Plan\***

Employees who participate in the OBRA plan (mostly part-time employees) are required to contribute 7.5% of their earnings into the OBRA plan that qualifies as a Social Security replacement. The City does not match employees' contributions and these employees cannot pick any investment options for their contributions except for a fixed fund option as required by the City's contract with the vendor.

When the audit was conducted, employees were charged a 1.5% annual record-keeping fee for the OBRA plan. This resulted in the OBRA participants returning on average a net return of 0.01% per year for the past three (3) years (2.19% fund return less 0.68% fund administrative fee less 1.5% record-keeping fee as required by the contract). The same 1.5% record-keeping fee was only 0.26% for participants in the defined contribution and other deferred compensation plans.

Of note, per the Treasury Division, the contract was recently renegotiated as we were finishing the audit, and the new annual fees were agreed to change to 0.10% for defined contribution and other deferred compensation plans and \$5 per person per year for OBRA plan participants.

**Recommendation to Supplemental Finding 2**

The City needs to ensure that all fees related to these plans are reasonable and competitive whether paid for by the participant or the City.

**Management Response to Supplemental Finding 2**

Agree                       Disagree                       Partially Agree

*The recent RFP resulted in a sizeable reduction in costs for both the employees and the employer effective 7/1/2018. As a result, the plan is now positioned in a competitive spot and we will work with our consultant to ensure this remains the case going forward.*

**Supplemental Opportunity for Improvement 1 \*Not Recovering Contributions Timely\***

The City was not timely recovering the unvested portion of employer contributions to the defined contribution plan when an employee who was not fully vested left employment. An employee has to work for the City for five (5) years to become fully vested; otherwise, a portion of the employer contributions has to be returned to the City. When this happened, the City would wait until a former employee attempted to withdraw the funds. This was when the Employee Benefits Division would calculate the unvested portion and direct the vendor to take that amount out of the former employee’s account and remit it to the City. It appeared there was no time limit on how long the funds could stay in the account until they were withdrawn; therefore, the losses and gains driven by the employees’ choice of investments that happened between termination and withdrawal dates affected the amount recovered by the City.

**Recommendation to Supplemental Opportunity for Improvement 1**

We recommend that the Employee Benefits Division work with the Treasury Division and the vendor to establish a process for recovering unvested employer contributions from employees upon the employees’ separation from service.

**Management Response to Supplemental Opportunity for Improvement 1**

Agree                       Disagree                       Partially Agree

*This process has been implemented with unvested portions being swept monthly from terminated employee accounts, or upon their withdrawal from the plan, whichever is sooner. Employee Benefits established a new procedure to fix this issue in October 2017.*

**Supplemental Opportunity for Improvement 2 \*Not Evaluating Stable Fund Performance\***

The City uses a committee that monitors performance of different investment options since Section 120.506A of the Municipal Code requires that the City “shall have continuing due diligence responsibility in the selection, monitoring and replacement of investment options.”

This process is administered through the periodic fund performance evaluation provided by a consultant. Any investment options not performing above a certain threshold for a certain period are placed on a watch list and could be removed.

However, when we reviewed one of the consultant's reports, we found that the performance of the stable fund that accounted for \$36M (or 19%) of \$186M of employees' investments across all plans was not being evaluated by the consultant. We asked the consultant about this and were told that while the consultant reports on the performance, no performance evaluation is done since availability of this fund is required by the contract. Changes to the stable fund would have to be negotiated and would most likely have a cost.

### **Recommendation to Supplemental Opportunity for Improvement 2**

We recommend the Treasury Division request the consultant, who has unique expertise in this area and is contracted to provide performance evaluation for all other investment options, provide a periodic report with an evaluation of the stable funds' performance.

### **Management Response to Supplemental Opportunity for Improvement 2**

Agree                       Disagree                       Partially Agree

*We have directed the consultant to add performance reporting of the new Guaranteed Interest Fund (which is replacing the stable value fund) to their quarterly investment report.*

### **Supplemental Opportunity for Improvement 3 \*Integrity of the Data During Upload Process\***

There was an issue with the upload process of the payroll contributions data to the vendor's system. A staff member in the Employee Benefits Division would obtain the contributions report from the City's payroll system. This report was saved on a shared drive, and it lists all contributions by employee name, type, and amount. The total contributions amount for all employees in this report was then checked against the total that was being processed by the Accounting Division. When the two numbers agree, the report was uploaded, and a payment was made by the Accounting Division.

The report that was uploaded by the Employee Benefits Division was in an Excel format, so it could be manipulated. If it was manipulated on an employee level before being uploaded to the vendor's system, it is possible that this scheme would not be discovered, or it could go undetected for a long time. For example, if there were 1,000 employees, and contributions for 999 employees were reduced by just \$1, than a contribution for one (1) employee could be increased by \$999. The total contributions amount for the City would still match to the cash sent to the vendor, so no red flag would be raised by the vendor or the Accounting Division.

### **Recommendation to Supplemental Opportunity for Improvement 3**

We recommend the Employee Benefits Division work with ITD and the vendor to explore the possibility of setting up an automatic interface between the two systems or creating a

compensating control where a second employee would periodically compare data from the City's payroll system to the vendor's system on an employee level.

**Management Response to Supplemental Opportunity for Improvement 3**

Agree                       Disagree                       Partially Agree

*Employee Benefits has submitted a service request with ITD to research if this is possible. ITD has submitted the request to the Project Management Office for approval. If this is not possible, Employee Benefits will setup a process where a second employee compares data from the City's payroll system to the vendor's system.*

**Supplemental Opportunity for Improvement 4 \*Issues with Transfers to the Vendor\***

The process of transferring funds from the City to the vendor for situations where employees switch between pension options needs to be improved. When an employee switches from the defined benefit plan to the defined contribution plan, the Treasury Division would issue a check to the vendor. The check was later picked up by the Pension Office and sent via interoffice mail to the vendor's on-site representatives at City Hall who handed it off to the City's Employee Benefits Division. The Employee Benefits Division would then mail the check to the vendor's corporate headquarters. Using electronic payments instead would likely improve the efficiency of the process and decrease the risk of a check being lost or misappropriated.

**Recommendation to Supplemental Opportunity for Improvement 4**

We recommend that the Pension Office work with the Employee Benefits Division to change the process so payments for switches from the defined benefit plan to the defined contribution plan are processed electronically or checks are mailed to the vendor's corporate headquarters by Treasury.

**Management Response to Supplemental Opportunity for Improvement 4**

Agree                       Disagree                       Partially Agree

*While we have not encountered problems resulting from the current process, we will explore the possibility of electronic transmission of funds for safer and more efficient processing. The Pension Office will work with Employee Benefits and Empower to attempt to eliminate hard-copy checks and establish electronic transfers for funds moving from the City to Empower.*

**Supplemental Opportunity for Improvement 5 \*Improving Pension Office SOPs and Forms\***

The Pension Office had vague SOPs for the situation when an employee switches retirement plans or requests a payout. Examples include the following items.

1. The SOP asked to confirm that the employee was requesting the switch from the defined contribution plan to the defined benefit plan before the start of their fifth year and that

they have not exhausted their three transfer options. The SOP does not explain how the employee can confirm this.

2. The SOP states that for employees who want to switch from the defined contribution option to the defined benefit option, it had to be done “before the start of their 5th year” which contradicts Section 120 of the Municipal Code that requires that the switch must happen “not later than the employee’s fifth anniversary”.
3. The SOP did not mention that all pension election forms must be approved by the Pension Board when an employee switches to the defined benefit plan.
4. The SOP did not explain what to do including who to contact and how long the office should wait for the form to be returned when the employee electing to switch is a JEA or JHA employee.
5. The SOP did not require the Pension Office to confirm with the Employee Benefits Division that the transfer amount was accurate when a check is received from the vendor for an employee who is switching from the defined contribution plan to the defined benefit plan.
6. The SOP did not mention to check that the input data provided by the employee agrees to the City’s data and what needs to be done if there was a discrepancy.
7. The SOP directed staff to use a spreadsheet created by an actuary to calculate the payout to employees who choose to move from the defined benefit plan to the defined contribution plan at termination; however, the SOP did not explain in detail:
  - a. how to fill out the spreadsheet;
  - b. if the spreadsheet needed to be reviewed, what needed to be reviewed, and who needed to review it;
  - c. how often the actuary should be asked to update the spreadsheet.

### **Recommendation to Supplemental Opportunity for Improvement 5**

The Pension Office should review and update their SOPs providing sufficient detail so that a new employee would understand the process.

### **Management Response to Supplemental Opportunity for Improvement 5**

Agree                       Disagree                       Partially Agree

*While the current employees understand the process we agree that a process/procedure would be helpful to future employees of the office and better documentation can improve the controls. The new pension administrator has been directed to add this to the list of policy and procedure updates.*

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We appreciate the assistance and cooperation we received from the Employee Benefits Division, the Information Technologies Division, the General Employees' Pension Office, the Central Payroll Office, and the Treasury Division throughout the course of this audit.

Respectfully submitted,

*Kyle S. Billy*

Kyle S. Billy, CPA  
Council Auditor

Audit Performed By:

Brian Parks, CPA, CIA, CGAP  
Elena Korsakova, CPA