Legislative Audit Division

State of Montana

Report to the Legislature

November 1998   **EDP Audit**

Public Employees' Retirement Division Computer-Based Applications

This report provides information regarding the Public Employees' Retirement Division's (PERD) computer-based applications. It contains three recommendations for improving controls over PERD's electronic data processing environment. Audit issues address:

▸   **Restricting programmer access to production files and programs.**

▸   **Segregating responsibilities for the refund process.**

▸   **Search for inactive members.**

Direct comments/inquiries to:
Legislative Audit Division
Room 135, State Capitol
PO Box 201705
98DP-10   Helena MT 59620-1705

EDP AUDITS

Electronic Data Processing (EDP) audits conducted by the Legislative Audit Division are designed to assess controls in an EDP environment. EDP controls provide assurance over the accuracy, reliability, and integrity of the information processed. From the audit work, a determination is made as to whether controls exist and are operating as designed. In performing the audit work, the audit staff uses audit standards set forth by the United States General Accounting Office.

Members of the EDP audit staff hold degrees in disciplines appropriate to the audit process. Areas of expertise include business and public administration.

EDP audits are performed as stand-alone audits of EDP controls or in conjunction with financial-compliance and/or performance audits conducted by the office. These audits are done under the oversight of the Legislative Audit Committee which is a bicameral and bipartisan standing committee of the Montana Legislature. The committee consists of six members of the Senate and six members of the House of Representatives.

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September 1998

The Legislative Audit Committee
of the Montana State Legislature:

This report is our EDP audit (98DP-10) of the Public Employees' Retirement Division's
internal controls relating to its computer-based retirement system applications. This report
addresses the control weaknesses we identified in the system. The department's written
response to our audit recommendations is included in the back of the report.

We thank the administrator and his staff for their cooperation and assistance throughout the
audit.

Respectfully submitted,

Signature on file

Scott A. Seacat
Legislative Auditor

Legislative Audit Division

EDP Audit

Public Employees' Retirement Division Computer-Based Applications

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Appointed and Administrative Officials

**Public Employees'
Retirement Division**

		Term Expires <u>March 31</u>
Board of Directors	Terry Teichrow, President	2000
	Carole Carey, Vice President	2002
	Jean Thompson	1999
	Carol Lambert	2001
	Troy McGee	2003
	Robert Griffith	2003
Administrative Officials	Michael O'Connor, Administrator	
	Roxanne Minnehan, Operations Bureau Chief	
	Kim Flatow, Benefits Bureau Chief	

Introduction

This is an electronic data processing audit of controls relating to the computer-based applications which process and store contribution and disbursement information for members of the state retirement systems. These systems are managed and maintained by the Public Employees' Retirement Division (PERD).

Application Controls

The major functional areas of PERD's computer-based system can be broken down into the following three categories: 1) Contributions; 2) Maintenance of Member Accounts; and, 3) Disbursements. We reviewed controls over the input, processing, and output relating to these systems. Overall, we concluded *the PERD computer-based applications provide accurate processing of plan contributions and retirement benefits.* However, we found areas where access and input controls over the application could be improved.

Programmer Access to Production Programs Should be Restricted

We reviewed electronic access rights given for the PERD programs and data within the production system. We found that two ISD programmers and two independent programmers contracted by ISD have unrestricted access to the production programs and data, which includes access to the individual PERD members' accounts.

No one person should have incompatible duties that would permit the perpetration and concealment of material errors or irregularities. The present programmer access increases the risk of unauthorized changes to member information such as member contributions, retiree status, addresses, etc., as well as the risk of unauthorized changes to the system programs without detection.

Because of their high degree of technical knowledge, programmers should not have unrestricted access to production programs or files. Their programming activities should be restricted to test programs and files; or at a minimum, all changes made by the programmers should be logged, reviewed, and approved by PERD management.

Report Summary

Refund Payouts Should be Reviewed

When PERD members terminate employment with a public agency, their status on the retirement system becomes "inactive." Once inactive, members may request a refund of their contributions and the interest accumulated on those contributions. During our review, we determined that one employee is responsible for the entire refund process, which increases the risk that inappropriate refunds could be processed without detection.

In order to mitigate potential risk, prior to payout of the refunds another employee should compare the computer-generated report of pending refunds to member files to ensure there is proper authorization from the member.

Search for Inactive Members

When members terminate public employment, they are changed to "inactive" status on the contributions database. In our review, we found over 10,000 inactive members on the system with contributions and accumulated interest amounting to nearly $1.8 million.

Although active members receive annual statements of contributions and interest, inactive members do not receive statements unless requested. Through the years, the members may have forgotten they have contributions on account or may die without informing their beneficiaries of the contributions. This results in many aging member accounts that may never be claimed. In order to fulfill their fiduciary responsibility to the members, the division should establish procedures for inactive member notification on aging accounts.

Chapter I - Introduction and Background

Introduction and System Background

This is an electronic data processing audit of controls relating to the computer-based applications which process and store contribution and disbursement information for members of the state retirement systems. These systems are managed and maintained by the Public Employees' Retirement Division (PERD).

The Montana Public Employees' Retirement Division (PERD) manages the activities of seven retirement systems and a compensation act as listed below:

-- Public Employees' Retirement System (PERS)
-- Municipal Police Officers' Retirement System (MPORS)
-- Game Wardens' and Peace Officers' Retirement System (GWPORS)
-- Sheriffs' Retirement System (SRS)
-- Judges' Retirement System (JRS)
-- Highway Patrol Officers' Retirement System (HPORS)
-- Firefighters' Unified Retirement System (FURS)
-- Volunteer Firefighters' Compensation Act (VFCA)

The division administers defined benefit retirement plans for public employees in the State of Montana. The plans have net assets in excess of $2.4 billion. A total of 14,777 retired members and beneficiaries received retirement, disability, or survivor benefits of over $103 million, and 32,596 active members and their employers contributed over $124 million in fiscal year 1996-97. These contributions and disbursements are recorded, processed, and tracked with the aid of the division's computer applications.

Organization of Report

This report is organized into two chapters. Chapter I provides an introduction, background information, and audit objectives. Chapter II discusses the review of controls and audit issues pertaining to the PERD data processing function.

Chapter I - Introduction and Background

Audit Objectives

The objectives of this audit were:

1. To determine if controls are in place over the PERS computerized application, to ensure contributions to the plan by members and their employers are complete, accurate, and timely; and that the funds are accounted for properly for each member.

2. To determine if controls are in place over the PERS computerized application, to ensure benefits are authorized and approved, calculated correctly, input to the system correctly and in a timely manner, and distributed only to proper individuals.

Audit Scope and Methodology

The audit was conducted in accordance with government auditing standards. We compared the division's EDP controls against criteria established by the American Institute of Certified Public Accountants, United States General Accounting Office, and the information technology industry.

We reviewed the division's EDP controls in relation to PERD's computerized applications. We reviewed input controls such as input authorization, edits, access controls, and error correction procedures. We also reviewed output controls by evaluating the accuracy and validity of data on system generated reports.

Compliance

We reviewed the division's compliance with state law, related to contribution percentages, eligibility requirements, and methods for determining retirement benefits. We determined the division to be in compliance with laws applicable to collection of contributions and disbursement of benefits as tested.

Chapter II - Application Controls

Introduction

The major functional areas of PERD's computer-based system can be broken down into the following three categories: 1) Contributions; 2) Maintenance of Member Accounts; and 3) Disbursements.

Application controls consist of a combination of manual and automated procedures. Input controls ensure data input is authorized, all authorized data is input, and all data input is included in processing. These procedures, along with proper assignment and control of access privileges to the system, help ensure the overall integrity of data input, processed, and maintained on the system.

PERD Applications Provide Accurate Processing Results

The PERD computer-based applications provide accurate processing of plan contributions and retirement benefits. However, we found areas where access and input controls over the application could be improved, as discussed in the following sections.

Programmer Access to Production Programs Should be Restricted

To help facilitate system support duties, PERD contracts the services of the Department of Administration's Information Services Division (ISD) for programming and system administration support. During our review, we found that the ISD programmers, including two independent programmers contracted by ISD, have unrestricted access to the production programs and data, which includes access to the individual PERD members' accounts.

No one person should have incompatible duties that would permit the perpetration and concealment of material errors or irregularities. The present programmer access increases the risk of unauthorized changes to member information, such as member contributions, retiree status, addresses, etc., as well as the risk of unauthorized changes to the system programs without detection.

For example, the ISD programmers are state employees, with personal accounts on the PERD system. With unlimited access, they could make changes to their retirement accounts and possibly manipulate reports so the changes could not be detected. We reviewed their personal accounts and found no impropriety relating to their account balances, etc.

However, additional access controls should be put in place to ensure inappropriate changes could not be made without detection.

Because of their high degree of technical knowledge, programmers should not have unrestricted access to production programs or files. Their programming activities should be restricted to test programs and files. Once the programming changes have been tested and approved on the test system, PERD management should be responsible for transferring the changes to production.

Division personnel stated that because of the small size of the organization, the programmers need complete, unrestricted access in order to provide computer support to the PERD users. To mitigate the risk and ensure all changes made by the programmers are appropriate, all changes should be logged, reviewed, and approved by PERD management.

Recommendation #1
We recommend the division either:

A.   Remove programmer access to production programs and data; or,

B.   Log and review all changes to production programs and files made by the programmers.

Refund Payouts Should be Reviewed

When PERD members terminate employment with a public agency, their status on the retirement system becomes "inactive." Once inactive, members may request a refund of their contributions and the interest accumulated on those contributions. During our review, we determined that one employee is responsible for the entire refund process.

The PERD refund clerk processes the refund requests, and initiates payments to be sent to the members. Prior to printing the warrants, the system creates a report of all refunds processed. The refund clerk cross-checks the report against the member's file to ensure all necessary forms are present and calculations are correct. Since the refund clerk is the

only person involved in the process, unauthorized refunds could be processed without detection. The authorization of the refund and the ability to initiate the payment of the refund are incompatible duties when they are not monitored by a second party.

Division personnel indicated they were not aware of the potential risk, and that the members would eventually identify the loss to their account and notify PERD. However, as discussed below, there are over 10,000 inactive members with nearly $1.8 million in contributions and interest, many of whom have apparently forgotten that they have contributions on the system (some of the members, according to their dates of birth, are over 97 years old). Unless specifically requested, PERD does not send annual statements to inactive members. Therefore, a refund paid against their account may not be detected for years, if at all.

In order to mitigate potential risk prior to payout of the refunds, another employee should review the computer-generated report of pending refunds to ensure there is proper authorization from the member.

Recommendation #2
We recommend the division implement controls to ensure all refunds are properly authorized prior to payout.

Search for Inactive Members

When members terminate public employment, they are changed to "inactive" status on the contributions database. In our review, we found over 10,000 inactive members on the system, with contributions and accumulated interest amounting to nearly $1.8 million. Of those members, more than 300 are between age 65 and 97. Many of those accounts may never be claimed. Although active members receive annual statements of contributions and interest, inactive members do not receive statements unless requested. Division personnel stated it would be too difficult to maintain current addresses on all inactive members. Through the years, the members may have forgotten they have contributions on account or may die without informing their beneficiaries of the contributions. This results in many aging member accounts that may never be claimed. Twelve years ago, the division did a social security number match against the Department of Revenue's

database attempting to locate current addresses or death status for the inactive members. Notification cards were sent to members identifying unclaimed contributions on the system, encouraging them to request a statement from PERD. However, no searches have been done since 1985.

There is no state or administrative policy outlining the division's responsibility for notification to inactive members. However, the division should consider their fiduciary responsibility to the members, and establish procedures for member notification.
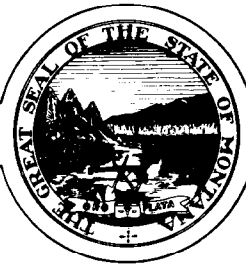
Recommendation #3
We recommend the division establish procedures for a periodic search for inactive members, to resolve aging accounts.

Agency Response

DEPARTMENT OF ADMINISTRATION
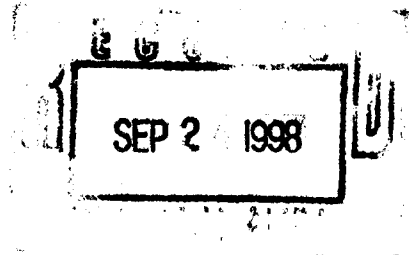## PUBLIC EMPLOYEES' RETIREMENT DIVISION

MARC RACICOT, GOVERNOR

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September 23, 1998

SEP 2 1998

Scott A. Seacat, Legislative Auditor
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Room 135, State Capitol Building
PO Box 201705
Helena MT   59620-1705

Dear Mr. Seacat:

During the recent audit of the Public Employees' Retirement Division's Computer-Based Applications there were three recommendations. The following is the division's response :

Recommendation #1: Remove programmer access to production programs and data; or, log and review all changes to production programs and files made by the programmers.

Response: We concur and have begun to log and review all changes to production programs and data. Contracted programmers now have test access only. We now have only two supervisory ISD programmers who have access to the production databases. We must be able to rely on them to responsibly provide the services we require. They must be able to perform production recovery and support as we do not have the technical expertise to move programs into production. There is a daily 'sys' journal that records all updates to the databases so all history is captured and identifiable to the programmer. To be more proactive we have requested that the user ID's of these two programmers access to the production database be "logged" on security activity reports for our daily review.

Recommendation #2: Implement controls to ensure all refunds are properly authorized prior to payout.

Response: We concur that controls need to be added to the refund process. We have added the job duty to our administrative support position. The incumbent will verify all refund applications to the refund run.

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Recommendation #3: Establish procedures for a periodic search for inactive members, to resolve aging accounts.

Response: We concur. Our active database does not have the capacity to maintain addresses and we do not have the man-power to track and update data which is constantly changing. We are establishing procedures to check social security numbers of inactive members against national death records on an annual basis and against the bureau of vital statistics on a monthly basis. We will also be attempting to locate inactive members through various methods, including using the Internet when we get our web page in September 1998. This will also assist us in our status as a qualified plan under the internal revenue code.

Thank you for the consideration extended to our staff during the audit. We endeavor to provide quality service to our members. Audits assist us in achieving our goal.

Sincerely,

Michael O'Connor
Administrator