FREDERICK COUNTY, MARYLAND
Frederick County Employees Retirement Plan and Retirement Benefit Calculations
Frederick, Maryland

PERFORMANCE AUDIT REPORT

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INDEPENDENT AUDITORS' REPORT AND EXECUTIVE SUMMARY

Interagency Internal Audit Authority
Frederick County, Maryland

Frederick County, Maryland (the County) engaged CliftonLarsonAllen LLP (CLA) to conduct a performance audit of the benefit calculations for accuracy and compliance with the County code, laws, regulations, policies, and procedures. The two plans include the Uniformed Employees Retirement Plan and the Non-Uniformed Employees Retirement Plan, adopted by the County effective July 1, 1993. Our audit was conducted in accordance with *Governmental Auditing Standards* issued by the Comptroller General of the United States.

Retirement and pension calculations were being performed internally by Frederick County Government Human Resources Division for retiring personnel. In FY 2021, the County outsourced these calculations to a 3rd party vendor, Retirement Focus. An audit of the transfer of original retirement benefit calculations and new retirement benefit calculations with the new third-party vendor would allow the County to understand better that the calculations were and are being performed accurately and in accordance with County code, laws, regulations, policies and procedures.

The objective of our testing included the Annual Member Statements as of July 1, 2021, distributed to members on April 25, 2022. We sampled employees and recalculated the estimated retirement benefits.

We did not identify any errors in calculations for the estimates using the projection assumptions provided by the third-party administrator or the Deferred Retirement Option Program (DROP) and retirement benefits. We identified several best practice recommendations to enhance policies and procedures regarding pension benefits.

A summary of observations are as follows:

Observation #	Area	Observation
1	Frederick County Government Human Resources Policies and Procedures Manual	We identified a formula difference between the plan document and the policy and procedures manual for Non-Uniformed Employees hired on or after July 1, 2011.
2	Annual Member Statements – Timeliness	Administrator distributed the fiscal year 2021 annual member statements to participants on April 25, 2022 more than 3 quarters after year-end.

Interagency Internal Audit Authority
Frederick County, Maryland

Observation #	Area	Observation
3	Annual Member Statements - Inaccurate Normal Retirement Dates	Inaccuracies in the normal retirement date listed on the member statements.
4	Annual Member Statements – Accrued Benefit Estimates	Accrued benefit estimates printed on the statements were challenging to recalculate and the administrator offers a modeler for participants to use for greater accuracy.
5	Annual Member Statements - Beneficiaries	Annual member statements have a beneficiaries section providing instructions on how to view online, however, a better practice is to list the beneficiaries on the statement.
6	Third-Party Vendor Risk Management – SOC Report	Retirement Focus' SOC report should be reviewed by management at least annually.

The responses from the County's Human Resources Division are included after each observation in the observations, recommendations, and management's responses section.

CliftonLarsonAllen LLP

CliftonLarsonAllen LLP

Baltimore, Maryland
December 21, 2022

BACKGROUND

Frederick County, Maryland (the County) engaged CliftonLarsonAllen LLP (CLA) to test benefit calculations for accuracy and compliance with the County code, laws, regulations, policies, and procedures. The two plans include the Uniformed Employees Retirement Plan and the Non-Uniformed Employees Retirement Plan, adopted by the County effective July 1, 1993.

Uniformed Employees

Per review of the Plan Document for Uniformed Employees as amended July 1, 2021, an employee reaches eligibility for normal retirement when -

Hired before July 1, 2011

The participant completes 25 years of eligible service or attains the age of 55 with 5 years of eligible service completed.

Hired on or after July 1, 2011

The participant completes 20 years of eligible service or attains the age 50 with 5 years of eligible service completed.

Non-Uniformed Employees

Per review of the Plan Document for Non-Uniformed Employees amended July 1, 2021, an employee reaches eligibility for normal retirement when -

Hired before July 1, 2011

The participant either completes 25 years of eligible service or has attained one of the following age and eligible service requirements:

(1) age 60 and 5 years;
(2) age 61 and 5 years;
(3) age 62 and 5 years;
(4) age 63 and 4 years;
(5) age 64 and 3 years;
(6) age 65 or older and 2 years.

Hired on or after July 1, 2011

The participant completes 30 years of eligible service or has attained at least age 65 with 5 years of eligible service completed.

The formula for the monthly retirement amount is calculated differently depending on the plan.

As of October 1, 2020, the County outsourced the service and administration of the retirement plans to Retirement Focus, managed by USI Consulting Group. Previously, retirement and pension calculations were being performed internally by Frederick County Government Human Resources Division. The County remains the plan sponsor of the retirement plans. Plan participants have self-service tools available through the Retirement Focus's portal, including a Retirement Focus Modeler to project benefits based upon inputted variables.

The objective of our testing included the Annual Member Statements as of July 1, 2021, distributed to members on April 25, 2022. We sampled employees and recalculated the estimated retirement benefits.

This report provides the results of the testing and recommendations.

OBJECTIVES, SCOPE AND METHODOLOGY

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards (GAGAS) established by the U.S. Government Accountability Office (GAO). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our observations and conclusions based on our audit objectives. The evidence obtained provides a reasonable basis for our observations and conclusions based on the audit objectives. Because of the inherent limitations, a performance audit made for the limited purposes of our review would not necessarily disclose all weaknesses related to the County's compliance.

The audit objectives are as follows:

1. Gain an understanding of the current Frederick County Government Human Resources Policies and Procedures Manual, focusing on Section 7 – Benefits and Services; 7.7 Pension Plans – Defined Benefit Plans as updated in July 2021.

2. From the policies and procedures, determine the basic benefit calculation for employees pre- and post-July 1, 2011, for both Uniformed and Non-Uniformed participants.

3. Test on a sample basis, accrued benefit estimate calculations as of July 1, 2021, distributed to members in April 2022 for both Uniformed and Non-Uniformed employees to ensure agreement with the County policies and procedures.

    a. New employees within the past two years fully under third-party administration.
    b. Employees who have been with the County since July 1, 2011.
    c. Employees who have been with the County before July 1, 2011.
    d. Employees who transferred from 35 hours to 40 hour work weeks.

4. From the policies and procedures, understand the Deferred Retirement Option Program (DROP) – Uniformed Employees and test a sample basis of benefit calculations for participating employees.

5. Test, on a sample basis, new retirees that went into pay status under the third-party administrator.

As part of the testing phase of the audit, we:

- Obtained complete population data sets from Human Resources and made our selections.

- Tested a sample of 160 accrued benefit estimates for active members as of July 1, 2021,

- Tested a sample of 7 DROP calculations by the third-party administrator, and

- Tested a sample of 30 newly retired calculations by the third-party administrator.

Specifically, for all testing, we determined:

- The demographic information, date of hire, and enrollment date agreed to member files maintained by human resources,

- Service credit recalculated and confirmed purchases of service/transfers, as well as gaps in employment,

- Average pay used in the accrued benefit estimates, DROP calculations and retired calculations agreed to payroll records, and

- The administrator calculated the benefits properly based on the appropriate service retirement formula.

OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT'S RESPONSES

Although we did not identify any errors in calculations for the estimates using the projection assumptions provided by the third-party administrator or the DROP and retirement benefits, we identified several best practice recommendations to enhance policies and procedures over pension benefits. These items are discussed below and include our observations, recommendations, and management's responses.

A. Human Resources Policies & Procedures Manual (Section 7.7)

Observation #1:

During our review of the Policies and Procedures Manual (Section 7.7) compared to the Plan Documents, we identified a formula error for Non-Uniformed Employees hired on or after July 1, 2011. Based on the Plan Document, the normal retirement formula should be 1.67% x Average Pay x Years of Creditable Service up to 36 years. The policies and procedures manual states 2% x Average Pay x Years of Creditable Service up to 36 years.

Recommendation:

We recommend management review and update its human resources policies and procedures manual and make revisions as necessary to ensure agreement with Plan Documents. Participants are more likely to review the Human Resources Policy over Plan Documents.

Management's Response:

The formula in Section 7.7 of the HR Policies and Procedures has been corrected effective November 2022. HR always refers employees to the Plan Documents.

B. Annual Member Statements

Observation #2:

We noted the administrator distributed the fiscal year 2021 annual member statements to participants on April 25, 2022, more than 3 quarters after year-end. Membership information presented on the statements and used in the accrued benefits estimates is outdated by the time it reaches participants.

Recommendation:

We recommend management work with the administrator to achieve more timely distribution. Based on the practices of many peer pension plans, the administrator distributes statements before the end of the next quarter.

Management's Response:

The administrator mailed the July 1, 2022 statements on November 11, 2022.

Observation #3:

We noted significant inaccuracies in the normal retirement date listed on the member statements. More than 50% of our selected sample had an inaccurate normal retirement date, suggesting an algorithm error with the administrator. For example -

- A uniformed employee, hired after July 1, 2011, had a normal retirement date improperly listed at age 50, when eligibility for normal retirement is either 25 years of service or age 55 with 5 years of service. We noted a similar concern with a non-uniformed employee, hired after July 1, 2011.

- A non-uniformed employee, hired after July 1, 2011, had a normal retirement date improperly listed at age 65, when eligibility for normal retirement is either 30 years of service or age 65 with 5 years of service. The employees in this scenario would reach 30 years of service well before reaching age 65.

- Two participants with dual service had a normal retirement date improperly calculated based on the uniformed plan. Per the plan document, the normal retirement date for a dual service participant with fewer than 10 years of eligible service earned as a uniformed participant shall be the same as the normal retirement date for non-uniformed participants. Both employees had fewer than 10 years in the uniformed plan.

Recommendation:

The County and administrator should make every effort to ensure the accuracy of the membership statements, including the normal retirement date. We recommend the algorithm used by the administrator be corrected to incorporate the correct age based on the hire date and whether participants reach eligibility service provisions first.

Management's Response:

The administrator has changed the statements to use the retirement date based on the earlier date using service or age whichever the employees reach first. This change was made to the November 2022 letters.

Observation #4:

The accrued benefit estimates printed on the statements were challenging to recalculate. The calculations contain many nuances and projection assumptions, such as –

- The rate of pay used in the estimate is the most current pay rate, not the actual pay rate used for calculating benefits.
- Projections for service credit are not calculated to the normal retirement date; instead, a quarter increment is used in the year of retirement.
- Participants continuing to work after their normal retirement date resulted in an accrued benefit estimate of zero.

Participants receiving their statements and relying on these estimates could be misinformed on their accrued benefits. Generally, these assumptions would provide a more conservative estimate; however, they may create confusion.

Recommendation:

We recommend the County discontinue including the estimated benefits on the statements, improve the calculation's accuracy, or instruct participants to utilize the Retirement Focus Modeler to provide an approximate calculation of the retirement benefit to assist with retirement planning. The modeler is a planning tool to give members an idea of their retirement benefits at the time of retirement. The modeler will automatically access specific personal information, including the highest 36-month pay rate utilized in the actual calculation and service credit maintained in the database. Additionally, participants can then choose future retirement dates for planning purposes. This recommendation is a best practice observed with peer plans.

Lastly, we recommend including additional disclosures, such as the estimator is a planning tool only, and the calculated estimate will not bind the County.

Management's Response:

The County does recommend to employees to run retirement projections and not solely rely on the benefit statements as this is communicated in an email HR sends to all County employees when the statements are mailed by the Administrator. The County does intend to include the retirement projection in future statements. Employees expect to receive this information every year. The disclaimer on the statement has been the same disclaimer that was used before the administrator began processing the statements. The County will have the plan attorney review the statement disclaimer and advise of any changes to be made for the 2023 statements.

Observation #5:

We noted the annual member statements have a beneficiaries section providing instructions to participants on how to view their current beneficiaries and make updates. This section does not list the participants' current primary beneficiaries.

Recommendation:

We recommend the annual member statements list the primary beneficiaries of the participants. It is crucial this information is reviewed carefully and updated promptly. It is more likely that a participant will notice they need to change after seeing their current designation. This recommendation is a best practice observed with peer plans.

Management's Response:

When the County started with the Administrator, all employees elected beneficiaries through them via a paper form, but the employees were not able to view their beneficiaries online. The County decided to maintain beneficiaries through Employee Hub in Infor. This allows the employees to view and update their beneficiaries at any time. The beneficiaries are not on the statement since they are maintained by the County and due to limitations of Infor the County cannot provide them to the Administrator easily. If an employee dies, then the County provides the beneficiary information to the Administrator.

C. Third-Party Risk Management

Observation #6:

We noted the third-party Statement on Standards for Attestation Engagements – Service Organization Control (SOC) report is not being reviewed on an annual basis by management.

Recommendation:

We recommend proper management oversight of the contracted third-party vendor, Retirement Focus, by requesting and reviewing the SOC report annually to provide assurance that controls are both designed and operating effectively.

Relevant sections of the SOC report we recommend be reviewed include the following:

- External Auditor's opinion on the operating effectiveness of controls
- Management's assertion
- Control exceptions and management's response, if applicable
- Subservice providers
- User Control Considerations (UCC) – County management should formally document a response to each UCC and link the UCCs to County controls

Management's Response:

The HR Administrator of the County that handles Retirement will review the annual SOC report within 2-3 months of the end of every fiscal year.