

KANSAS

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

August 26, 2015

Mr. Scott Frank, Legislative Post Auditor
Kansas Legislative Division of Post Audit
800 SW Jackson, Suite 1200
Topeka, Kansas 66612

Dear Post Auditor Frank:

On behalf of the Kansas Public Employees Retirement System, I would like to express our appreciation for the work performed by Legislative Post Audit. Staff have been courteous, professional and fully engaged in ensuring accuracy. Thank you as well for this opportunity to respond to the audit report.

The fiduciary standard is KPERS' guiding principle. It is the highest standard of care and accountability. An audit of controls to detect and prevent fraud and abuse addresses areas that are central to KPERS' mission. For this reason, we especially value the audit's findings of no fraud or abuse and its confirmation that KPERS' overall processes function as designed. We also appreciate the third-party review as a means to identify areas for improvement. More specific comments about each of those areas follow.

KPERS Fiscal Services Field Audit Plan

Data accuracy is essential to accurate benefit calculations and the integrity of the System and its 1,500 employers. For this reason, KPERS maintains a comprehensive system of data checks and balances throughout a member's career.

- Two full-time staff assigned to monitor and reconcile contributions.
- Over the last three years, built the foundation for a more vigorous field audit program by expanding from one field auditor to six field auditors.
- Hundreds of edits in KPERS' information technology system that perform validation checks.
- Desk audits and field audits of employer records.
- At retirement, review of member data to ensure accurate benefit calculation.
- Training and assistance for KPERS' employers to process membership and payroll records.
- Pay period reporting of employer and employee contributions (started January 1, 2015), which enables a more timely review and correction of payroll errors than the annual reporting system historically used by KPERS.
- GASB 68 audits of employers. Attachment A is a list of employers whose Calendar Year 2013 census data was audited during the preparation of the 2014 GASB 68 report, as well as the employers that will be audited for the 2015 GASB 68 report. Although their scope is not identical to field audits, they overlap in large part. Very few errors were identified through these audits.

KPERS concurs that including field audits as an element of this larger system of checks and balances is a best practice. The audit report correctly noted that KPERS temporarily suspended field audits for a period beginning in 2013 due to the need to focus all available resources on simultaneous implementation of three major projects – the new KPERS 3 cash balance plan, pay period reporting, and the new GASB 67 and 68 accounting standards. These projects involved massive changes for both KPERS and the 1,500 employers KPERS supports. In early 2015, the final annual employer reporting occurred at the same time

as the new pay period reporting, which further increased the demand on resources required for both KPERS and employers.

It is important to note that all other checks continued throughout the entire period. We have resumed field audits and have a full audit plan for FY 2016. (See Attachment B for the employers included in this year's plan.)

Eligibility for Disability Benefits

Because the inability to work is a key criteria to qualify for KPERS disability benefits, the plan limits members' earned wages. In addition to monitoring member eligibility through third-party contractor reviews, KPERS requires members receiving disability benefits to report earned income. *De minimus* (minimal) income is permitted by law, and the plan includes rules for offsetting income earned during limited, approved periods of rehabilitative employment (with the goal of returning individuals to gainful employment). Out of 3,300 members receiving disability, the audit identified 38 receiving income during 2013 or 2014. To date, we have concluded that 22 of the 38 situations appear to be within the law and plan provisions. We are following up on the remainder to identify the nature of the income and appropriate next steps.

We wish to thank LPA for working with Department of Revenue and Department of Labor officials to facilitate ongoing income reports to KPERS. We are in the process of developing memoranda of understanding with both agencies to routinely transmit wage and income data for members receiving disability benefits. This will be a valuable tool for monitoring continued eligibility under the plan.

KPERS Service Credit

Among the more than 85,000 active school members, the audit identified seven instances in which service credit for school members was incorrectly reported while members were performing services for the Kansas National Education Association (KNEA). All seven have been or will be corrected shortly.

Statutory definitions of compensation refer to "personal services performed for a participating employer." Services performed for another entity, such as KNEA, would not meet this criteria. With 1,500 employers and over 154,000 active members, comprehensive audits to verify that members are in fact working at the employer's place of business would not be cost effective. KPERS communicates the concept of "personal services" as the basis for covered service to employers through training and its business procedures and practices. KPERS also uses information technology system edits to identify compensation below certain thresholds that may suggest employment at levels not meeting eligibility.

KPERS will take additional steps to help prevent future errors of the nature identified by the audit.

- Adding a standard question to all field audits for employer verification that each member is performing personal services for the employer and that service has not been reported for any member who remained on the employer's payroll while performing services for another entity.
- Updating employer communications to explicitly say that services provided to another entity do not qualify for service credit, even if the member remains on the participating employer's payroll.
- Exploring additional fields and edits to employer reporting in KPERS' information technology system to identify potential eligibility issues.

Final Average Salary

Current law provides for "additional compensation" to be included as part of the final average salary for members in a closed and declining group. The audit confirmed that KPERS is correctly following the law in these cases. Additional compensation, or "add-ons," is lump-sum payments from an employer for certain amounts of unused sick or vacation leave, holiday pay, comp-time, etc.

The actuarial impact of this provision is limited by both the declining number of members it covers and the relatively low incidence of members whose benefits increase significantly as a result. KPERS estimates this closed group will continue to decrease over a fairly short period – by almost 60 percent in the next five years and downward to about 3,800 members by 2025 (out of nearly 150,000 active KPERS members). A graph illustrating this projected decline is provided in Attachment C. And according to the audit, the number of recent retirees whose final average salaries increased by more than 15 percent due to additional compensation was quite small, only about 0.2 percent. In those instances, the actuarial liability from any increase in benefits attributable to the excess over 15 percent is paid by the employer.

The Legislature periodically revisits how final average salary is calculated. Effective July 1, 1993, the Legislature amended the final average salary definition to exclude vacation and sick leave for all new KPERS and KP&F members, thereby creating the aforementioned closed group. In 1998, the Legislature established the requirement that the employer pay the actuarial cost of liabilities resulting from benefit increases caused by add-ons that raise the final average salary of its employees by more than 15 percent. Due to case law regarding the contractual nature of KPERS' benefits, changes to final average salary calculations that could adversely affect member benefits have been for future members only or have permitted options to avoid disadvantaging vested members.

The issue was revisited during the 2015 Legislative Session. The audit report provided an estimate of the impact on KPERS' unfunded actuarial liability if no more than 240 hours of vacation leave paid at retirement could be included, as was proposed in two bills. The audit report recognized that this estimate was not developed like an actuarial projection and that it likely overstates any actual savings.

KPERS concurs and cautions against reliance on such an estimate. The estimate, by its nature, involved a number of assumptions. The assumptions used collectively tend to increase estimated savings. Also, according to KPERS' consulting actuary, there is insufficient data to provide an actuarial calculation, and therefore, the reliability of other methodologies for estimating the impact are also likely to be uncertain.

The audit report correctly noted that enactment of such a limit is likely to provide an incentive for members to retire in advance of its effective date, limiting any reduction in the System's unfunded actuarial liability. Furthermore, additional benefits paid to the members retiring earlier than they would have in the absence of the legislation (i.e., paying benefits for a longer period of time) would also offset any reduction in the unfunded actuarial liability. Therefore, we concur that the actual savings from limiting vacation leave payouts in final average salaries would be lower than estimated – perhaps significantly lower.

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KPERS is committed to detecting and preventing fraud and abuse, including carrying out the actions recommended by the Legislative Post Audit staff. Thank you again for this opportunity to respond to the report. We look forward to discussing the audit with members of the Legislative Post Audit Committee. If you need additional information or assistance regarding any of the areas addressed by the audit, please feel free to contact me at 785-296-6880 or by e-mail at aconroy@kpers.org.

Sincerely,


Alan D. Conroy
Executive Director

cc: Laurel Murdie, Principal Auditor, Legislative Division of Post Audit
KPERS Board of Trustees

SCOPE OF GASB 68 AUDITS OF SUPPORTING KPERS EMPLOYER CENSUS DATA REVIEW

In light of the new GASB 68 pension accounting standards, the American Institute of Certified Public Accountants (AICPA) State and Local Government Expert Panel issued guidance requiring pension plan auditors to test the completeness and accuracy of census data provided to the plan by participating employers.

In preparing the 2014 GASB 68 report, KPERS asked a sample of participating employers to submit 2013 payroll information to its auditor, CliftonLarsonAllen, which was then used in testing for the annual audit of KPERS. In response to the AICPA guidance, individual employee documents supporting payroll and demographic information for a sample of active employees were also tested. Examples of requested documents included:

- A copy of the employer's 2013 W-2 summary report
- A birth certificate or I-9 documentation (copy of driver's license or passport)
- Employment Contract (to document start date)
- Human resource form (signed by the participant) showing approved pay rate
- Human resource form (signed by the participant) showing start and, if applicable, term date
- A screen print of the information in the employer's HR/Payroll System and the paystub nearest to year end with the YTD totals and the details of the different pay types (i.e., overtime, sick leave, etc.)
- For non-covered positions included in the sample, records of hours worked in 2013, or other documentation to support job was not a KPERS-covered position

Lists of employers tested during the 2014 GASB audit and those scheduled for testing during the 2015 GASB 68 audit follow.

Kansas Public Employers Retirement System
Completed Audits of CY 2013 Employer Data for 2014 GASB 68 Report*

Attachment A

Employer*	Employer*
1 Barton County	36 USD 343 Perry
2 Comanche County	37 USD 216 Deerfield
3 Ellis County	38 USD 444 Little River
4 Gove County	39 USD 229 Blue Valley
5 Gray County	40 USD 355 Ellinwood
6 Lyon County	41 USD 450 Shawnee Heights
7 Marshall County	42 USD 466 Scott Co
8 Stanton County	43 USD 481 Rural Vista
9 City of Arkansas City	44 USD 387 Altoona-Midway
10 City of Ellinwood	45 USD 495 Fort Larned
11 City of Frontenac	46 USD 499 Galena
12 City of Hesston	47 USD 247 Cherokee
13 City of Lindsborg	48 USD 248 Girard
14 City of Newton	49 USD 511 Attica
15 City of Norton	50 USD 509 South Haven
16 City of Pratt	51 Southeast Kansas Mental Health Center
17 City of Augusta	52 SE Kansas Education Service Center
18 City of Manhattan	53 Sumner County Education Services
19 City of Mission	54 Disability Rights Center of Kansas
20 City of Overland Park	55 Smoky Hill Education Service Center
21 City of Edwardsville	56 Pawnee Mental Health Services Inc
22 Kansas Turnpike Authority	57 Labette Center for Mental Health Service
23 USD 233 Olathe	58 Cottonwood Inc
24 USD 266 Maize	59 USD 106 Western Plains
25 USD 421 Lyndon	60 Salina Area Technical College
26 USD 457 Garden City	61 Kansas Bureau of Investigation
27 USD 458 Basehor-Linwood	62 Kansas Housing Resource Corporation
28 USD 342 McLouth	63 Kansas Historical Society
29 USD 380 Vermillion	64 Kansas Public Employees Ret Sys
30 USD 464 Tonganoxie	65 Lansing Correctional Facility
31 USD 482 Dighton	66 Larned Correctional Mental Health Facility
32 USD 254 Barber County North	67 Dept of Revenue
33 USD 379 Clay Center	68 Dept for Children and Families
34 USD 382 Pratt	69 Judicial Branch
35 USD 256 Marmaton Valley	70 Winfield Correctional Facility

* Employers were randomly selected by independent auditing firm, CliftonLarsonAllen, in accordance with American Institute of Certified Public Accountants guidance.

Kansas Public Employers Retirement System
Scheduled Audits of CY 2014 Employer Data for 2015 GASB 68 Report*

Attachment A

Employer*	Employer*
1 Chase County	36 USD 367 Osawatomie
2 Jewell County	37 USD 419 Canton-Galva
3 Meade County	38 USD 212 Northern Valley
4 Osborne County	39 USD 381 Spearville-Windthors
5 Thomas County	40 USD 393 Solomon
6 Wichita County	41 USD 311 Pretty Prairie
7 Woodson County	42 USD 356 Conway Springs
8 City of Dodge City	43 USD 447 Cherryvale
9 City of Girard	44 Cloud County Community College
10 City of Junction City	45 USD 297 St Francis Schools
11 City of Larned	46 USD 369 Burrton
12 City of Osawatomie	47 USD 405 Lyons
13 City of Sabetha	48 USD 416 Louisburg
14 City of Wellington	49 USD 334 Southern Cloud County
15 Stafford County	50 USD 397 Centre
16 Trego County	51 USD 374 Sublette
17 City of Hiawatha	52 USD 388 Ellis
18 Olathe Public Library	53 USD 484 Fredonia
19 City of Tonganoxie	54 USD 345 Seaman
20 Graham County Hospital	55 USD 246 Arma
21 City of Fairway	56 USD 426 Pike Valley
22 USD 202 Turner	57 USD 506 Labette County
23 USD 206 Remington-Whitewater	58 USD 507 Satanta
24 Hamilton County Hospital	59 Seward Cty Comm College/Area Tech Sch
25 USD 348 Baldwin City	60 NE Kansas Education Service Center
26 USD 373 Newton	61 Educ Serv&Staff Dev Ctr of Cen Kansas
27 USD 420 Osage City	62 Nemaha County Training Center Inc
28 USD 443 Dodge City	63 Community Living Opportunities Inc
29 USD 449 Easton	64 Coffeyville Regional Medical Center Inc
30 USD 456 Marais Des Cygnes Valley	65 Manhattan Area Technical College
31 USD 470 Arkansas City	66 Kansas Corporation Commission
32 USD 215 Lakin	67 Kansas Highway Patrol
33 USD 284 Chase County	68 State Board of Indigents' Defense
34 USD 440 Halstead	69 Parsons State Hospital & Training Center
35 USD 281 Hill City	70 Kansas Water Office

* Employers were randomly selected by independent auditing firm, CliftonLarsonAllen, in accordance with American Institute of Certified Public Accountants guidance.

**Kansas Public Employees Retirement System
FY 2016 Field Audit Plan**

Attachment B

Name	Organization Type	Category
1 City of Iola	Local Non-School	City
2 City of Junction City	Local Non-School	City
3 City of Sterling	Local Non-School	City
4 Jackson County	Local Non-School	County
5 Gove County	Local Non-School	County
6 University of Kansas Hospital Authority	Local Non-School	Hospital
7 Topeka Metropolitan Transit Authority	Local Non-School	Instrumentality
8 Futures Unlimited Inc	Local Non-School	Instrumentality
9 USD 329 Mill Creek Valley	Local School	Unified School District
10 USD 372 Silver Lake	Local School	Unified School District
11 USD 335 North Jackson	Local School	Unified School District
12 USD 337 Royal Valley	Local School	Unified School District
13 USD 343 Perry	Local School	Unified School District
14 USD 434 Santa Fe Trail	Local School	Unified School District
15 USD 339 Jefferson County North	Local School	Unified School District
16 USD 330 Mission Valley	Local School	Unified School District
17 USD 341 Oskaloosa	Local School	Unified School District
18 USD 260 Derby	Local School	Unified School District
19 Pottawatomie County	Local Non-School	County
20 Geary County Community Hospital	Local Non-School	Hospital
21 Bert Nash Community Mental Health	Local Non-School	Mental Health Center
22 USD 323 Rock Creek	Local School	Unified School District

An additional 26 employers have been selected for field audit in FY 2016, but those employers have not yet been notified. The 26 employers include:

- Six cities;
- One county;
- Two hospitals;
- One instrumentality;
- One mental health center;
- One township; and
- 14 unified school districts.