



# **PERFORMANCE AUDIT REPORT**

## **KPERS: Evaluating Controls to Detect and Prevent Fraud and Abuse**

**A Report to the Legislative Post Audit Committee  
By the Legislative Division of Post Audit  
State of Kansas  
September 2015**

# Legislative Division of Post Audit

---

The **Legislative Division of Post Audit** is the audit arm of the Kansas Legislature. Created in 1971, the division's mission is to conduct audits that provide the Legislature with accurate, unbiased information on the performance of state and local government. The division's audits typically examine whether agencies and programs are effective in carrying out their duties, efficient with their resources, or in compliance with relevant laws, regulations and other requirements.

The division's audits are performed at the direction of the **Legislative Post Audit Committee**, a bipartisan committee comprising five senators and five representatives. By law, individual legislators, legislative committees, or the Governor may request a performance audit, but the Legislative Post Audit Committee determines which audits will be conducted.

Although the Legislative Post Audit Committee determines the areas of government that will be audited, the audits themselves are conducted independently by the division's professional staff. The division's reports are issued without any input from the committee or other legislators. As a result, the findings, conclusions, and recommendations included in the division's audits do not necessarily reflect the views of the Legislative Post Audit Committee or any of its members.

The division conducts its audit work in accordance with applicable government auditing standards set forth by the U.S. Government Accountability Office. These standards pertain to the auditor's

professional qualifications, the quality of the audit, and the characteristics of professional and meaningful reports. The standards also have been endorsed by the American Institute of Certified Public Accountants (AICPA) and adopted by the Legislative Post Audit Committee.

## LEGISLATIVE POST AUDIT COMMITTEE

Representative John Barker, Chair  
Representative Tom Burroughs  
Representative Peggy Mast  
Representative Virgil Peck, Jr.  
Representative Ed Trimmer

Senator Michael O'Donnell, Vice-Chair  
Senator Anthony Hensley  
Senator Laura Kelly  
Senator Jeff Longbine  
Senator Julia Lynn

## LEGISLATIVE DIVISION OF POST AUDIT

800 SW Jackson  
Suite 1200  
Topeka, Kansas 66612-2212  
Telephone: (785) 296-3792  
Fax: (785) 296-4482  
Website: <http://www.kslpa.org>

**Scott Frank, Legislative Post Auditor**

## HOW DO I REQUEST AN AUDIT?

By law, individual legislators, legislative committees, or the Governor may request an audit, but any audit work conducted by the division must be directed by the Legislative Post Audit Committee. Any legislator who would like to request an audit should contact the division directly at (785) 296-3792.

The Legislative Division of Post Audit supports full access to the services of state government for all citizens. Upon request, the division can provide its audit reports in an appropriate alternative format to accommodate persons with visual impairments. Persons with hearing or speech disabilities may reach the division through the Kansas Relay Center at 1-800-766-3777. The division's office hours are 8:00 a.m. to 5:00 p.m., Monday through Friday.



LEGISLATURE OF KANSAS  
**LEGISLATIVE DIVISION OF POST AUDIT**

800 SOUTHWEST JACKSON STREET, SUITE 1200  
TOPEKA, KANSAS 66612-2212  
TELEPHONE (785) 296-3792  
FAX (785) 296-4482  
WWW.KSLPA.ORG

September 4, 2015

To: Members, Legislative Post Audit Committee

Representative John Barker, Chair	Senator Michael O'Donnell, Vice-Chair
Representative Tom Burroughs	Senator Anthony Hensley
Representative Peggy Mast	Senator Laura Kelly
Representative Virgil Peck, Jr.	Senator Jeff Longbine
Representative Ed Trimmer	Senator Julia Lynn

This report contains the findings, conclusions, and recommendations from our completed performance audit, *Kansas Public Employees Retirement System: Evaluating Controls to Detect and Prevent Fraud and Abuse*. We also identified a minor issue that was communicated separately to agency management. That issue was not included in this audit report. The audit was requested by Representative Highland. We would be happy to discuss the findings, recommendations, or any other items presented in this report with any legislative committees, individual legislators, or other state officials.

Sincerely,

Scott Frank  
Legislative Post Auditor

This audit was conducted by Laurel Murdie, Dan Bryan, Michael Shelton, Daniel McCarville, Brad Hoff and Clyde Meador. Chris Clarke was the audit manager. If you need any additional information about the audit's findings, please contact Laurel Murdie at the Division's offices.

Legislative Division of Post Audit  
800 SW Jackson Street, Suite 1200  
Topeka, Kansas 66612

(785) 296-3792  
Website: [www.kslpa.org](http://www.kslpa.org)

## Table of Contents

<b>Introduction .....</b>	<b>1</b>
 <b>Overview of the Kansas Public Employees Retirement System</b>	
<i>KPERS is a \$16 Billion Public Pension System for State and Local Public Employees.....</i>	<i>3</i>
<i>KPERS Has About 100 FTE Staff Who Operate in Five Divisions .....</i>	<i>4</i>
<i>KPERS Retirement Benefits are Funded Through Member Contributions, Employer Contributions, and Investment Earnings .....</i>	<i>5</i>
<i>As of December 2014, KPERS Had an Unfunded Liability of About \$9.5 Billion That is Projected to be Eliminated by 2033.....</i>	<i>6</i>
 <b>Question 1: Does the Kansas Public Employees Retirement System Have Sufficient Controls to Detect and Prevent Fraud and Abuse?</b>	
<i>Public Pension Plans Are at Risk for Fraud and Abuse.....</i>	<i>9</i>
<i>These Risks Can be Mitigated by Implementing Controls to Prevent and Detect Fraud and Abuse .....</i>	<i>10</i>
<i>KPERS Had Many, But Not All, Controls to Help Prevent and Detect Fraud and Abuse.....</i>	<i>11</i>
<i>Since Late 2013, KPERS Has Not Conducted Field Audits to Verify the Accuracy of Employer-Reported Information .....</i>	<i>12</i>
<i>KPERS Could Strengthen its Efforts to Identify Disability Recipients Who Are Not Eligible for Those Benefits .....</i>	<i>14</i>
<i>We Found Seven Teachers Who Were Incorrectly Awarded KPERS Service Credits While Working for Education Associations.....</i>	<i>15</i>
<i>When Calculating Members' Retirement Benefits, KPERS Handled Final Average Salary Calculations Appropriately .....</i>	<i>17</i>
<i>Legislation Considered During the 2015 Session Would Have Substantially Limited the Opportunity for Retirees to Include Unused Leave When Calculating Retirement Benefits.....</i>	<i>18</i>
<i>Restricting or Eliminating the Inclusion of Unused Leave Could Have Reduced KPERS' Unfunded Liability Up to \$80 Million, But the Actual Impact Likely Will Be Far Less .....</i>	<i>20</i>
 <b>Conclusion and Recommendations .....</b>	
	<b>23</b>

## List of Figures

<b>Figure OV-1:</b> KPERS Benefit Payments by Type – Fiscal Year 2014 .....	4
<b>Figure OV-2:</b> Source of KPERS Assets Used to Fund Member Benefits – Fiscal Year 2014 .....	5

## List of Appendices

<b>Appendix A:</b> Scope Statement.....	25
<b>Appendix B:</b> A Summary of the Methodology We Used for Estimating How a 240-hour Limit on Unused Leave Would Affect KPERS' Unfunded Liability .....	27
<b>Appendix C:</b> Agency Response .....	29

# Kansas Public Employees Retirement System: Evaluating Controls to Detect and Prevent Fraud and Abuse

---

The Kansas Public Employees Retirement System (KPERS) administers three statewide defined-benefit retirement plans for state and local public employees. Currently, about 100 KPERS employees help serve about 295,000 active, inactive, and retired members. KPERS employers include the State of Kansas, all 105 Kansas counties, more than 400 cities and townships, all 286 school districts and more than 700 other governmental employer and instrumentalities. KPERS manages approximately \$16.8 billion in assets for members' benefits.

Those employers regularly make contributions based on the compensation their employees receive. KPERS uses that information to help verify employees' years of service (an important factor in determining employees' benefit amounts at retirement) and to help reconcile employer and KPERS contribution records.

Legislators have expressed concern that some individuals might be finding ways to circumvent KPERS' current controls in order to continue receiving years of service credit or credit for employer contributions even when not working for a member employer. Additionally, legislators were interested in knowing what steps KPERS staff take to prevent fraud and abuse in other areas of its pension system.

This performance audit answers the following question:

## **1. Does the Kansas Public Employees Retirement System have sufficient controls to detect and prevent fraud and abuse?**

A copy of the scope statement for this audit approved by the Legislative Post Audit Committee is included in *Appendix A*.

To answer the question, we took a number of steps. We reviewed findings from recent KPERS financial and performance audits conducted or contracted by our office. We also reviewed literature to identify best practices for preventing and detecting fraud and abuse of retirement-related benefits. Next, we interviewed KPERS staff and reviewed internal control policies for KPERS' administrative, fiscal services, benefits and member services, and information technology divisions. Finally, we also compared best practices to KPERS' reported policies and noted any differences.

We tested KPERS' internal controls in several areas including: whether KPERS appropriately addressed benefit inflation when

calculating retirement benefits, whether disability recipients had unreported earned income, whether service credits were awarded appropriately, whether overrides to soft edits in KPERS' information system were appropriate, and whether field audits were being conducted regularly. Our work did not include assessing controls related to detecting and preventing investment fraud and abuse because the legislative concern that prompted this audit was related to administering benefits.

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

Finally, though we do not believe that it affected our findings, conclusions, or recommendations, we do want to call the reader's attention to an issue regarding auditor independence. Generally accepted government auditing standards require that auditors and audit organizations maintain independence so that their opinions, findings, conclusions, judgments, and recommendations will be impartial (and viewed as impartial) by reasonable and informed third parties. Auditors should avoid situations that could lead reasonable and informed third parties to conclude that the auditors are not independent and thus are not capable of exercising objective and impartial judgment on all issues associated with conducting the audit and reporting on the work.

The reader should be aware that as a state agency, the Legislative Division of Post Audit is a KPERS-covered employer. Although any changes in the management of those benefits could have an impact on the benefits our staff receive, we think this has not affected the impartiality of our opinions, findings, conclusions, judgments, and recommendations.

We also identified a minor issue that was communicated separately to agency management. That issue was not included in this audit report.

Our findings begin on page 9, following a brief overview of the Kansas Public Employees Retirement System.



## Overview of the Kansas Public Employees Retirement System

---

### ***KPERS is a \$16 Billion Public Pension System for State and Local Public Employees***

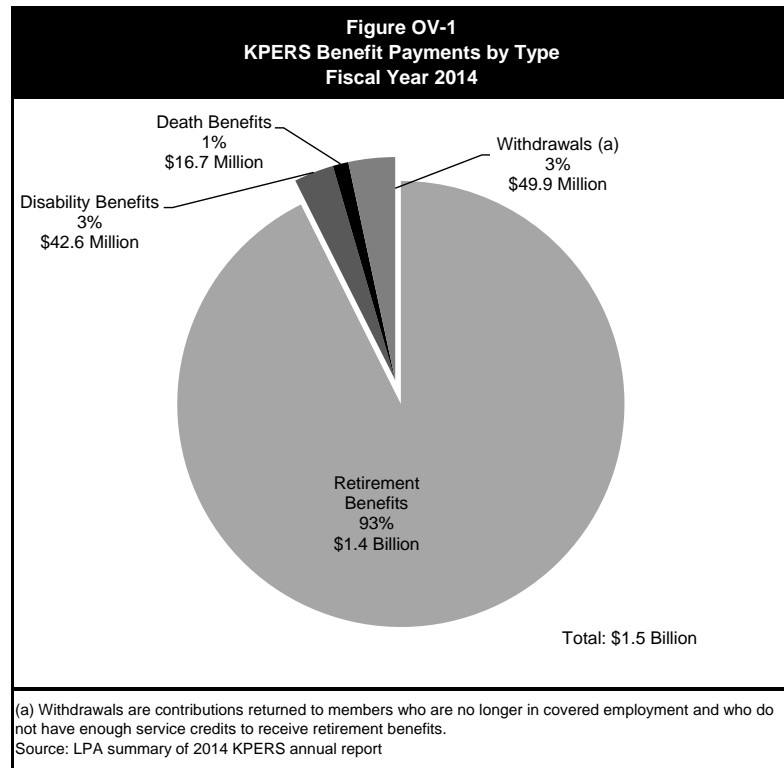
KPERS was created in 1962 to provide a financial foundation for Kansas public employees to retire. It is currently comprised of about 295,000 members from just over 1,500 employers. These employers, including the State of Kansas and various local government entities, are divided into three main groups.

- **The public employees group includes about 1,400 employers with a total of about 281,000 members.** This is the largest group, and includes the State of Kansas, as well as a number of local employers such as school districts and county employees.
- **The public safety group includes about 95 employers with about 13,000 members.** This group is made up of the Kansas Bureau of Investigation, Kansas Highway Patrol, local law enforcement agencies, and local firefighters.
- **The judges group is a single employer (the judicial branch) with about 500 members.** Employers include the Kansas Supreme Court, Kansas Court of Appeals, and district courts.

**The Legislature established KPERS and makes any ongoing policy decisions, and KPERS' staff administer pension benefits for retired members, as well as disability and death benefits for active members.** KPERS offers the following benefits to eligible members:

- **Retirement benefits are monthly payments made to the member upon retirement from public service.** These benefits accounted for about \$1.4 billion, or 92% of all payments made by KPERS in fiscal year 2014. In each of the past five years, about 5,000 to 7,000 members retired and began receiving these benefit payments.
- **Disability benefits are monthly payments to replace a portion of the member's income if he or she is disabled for a prolonged period as the result of an injury or sickness.** The injury or sickness does not have to be work related. In total, these benefits accounted for about \$43 million, or 3% of all payments made by KPERS in fiscal year 2014. Each year, approximately 3,300 members receive this benefit.
- **Death benefits are distributed to the designees of deceased members.** For deaths before retirement, contributions and interest are returned to beneficiaries or, in certain circumstances, the spouse receives monthly retirement benefits instead of receiving contributions. For service-connected deaths, beneficiaries may receive a lump-sum payment and monthly benefit payments. In total, these benefits accounted for about \$17 million, or 1% of all payments made by KPERS in fiscal year 2014. KPERS provides death benefits for about 3,000 members annually.

**Figure OV-1** below shows total benefits provided by KPERS during fiscal year 2014 and also shows the proportion of each benefit to total benefits. As the figure shows, retirement benefits are the primary benefit paid out by KPERS.



***KPERS Has About 100 FTE Staff Who Operate in Five Divisions***

The Legislature sets retirement policy and KPERS administers it. KPERS' five divisions and about 100 FTE staff are overseen by an Executive Director and a Board of Trustees. The Executive Director is responsible for daily operations and management of the following five divisions:

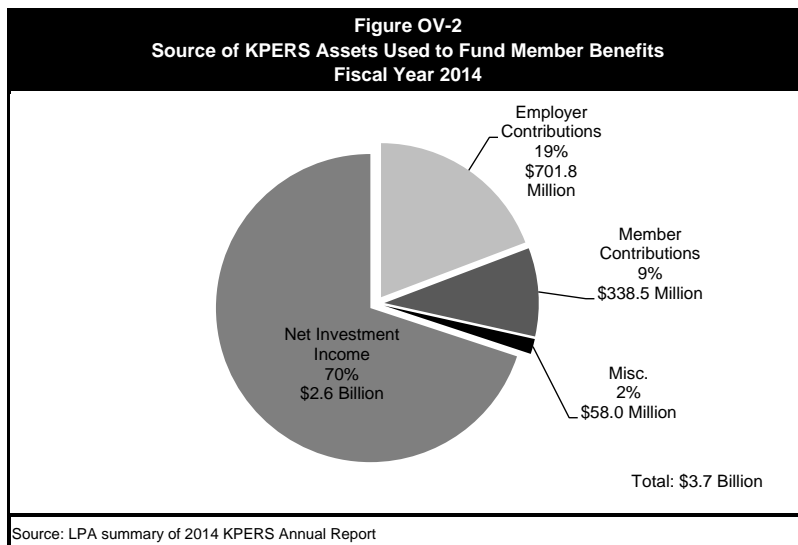
- **The administrative division is responsible for providing general oversight of KPERS.** This division includes executive staff, legal counsel, and the internal auditor. The division also oversees actuarial and investment services from third-party administrators.
- **The benefits and member services division is responsible for calculating and distributing the different types of benefits.** This includes entering, processing, and approving applications, as well as tracking and verifying any changes to member and retiree data.
- **The fiscal services division is responsible for collecting payroll information, retirement contributions and for auditing employers.** These contributions come from both employers and members. The division also maintains member demographic data, such as compensation records and service credits.

- **The information technology division is responsible for KPERS' information systems.** It ensures the security of confidential information by monitoring threats and access to the system, and helps to maintain segregation of duties between divisions at KPERS.
- **The investments division is responsible for investing retirement contributions amounts.** The division contracts with many investment management firms to make investment decisions for the employer and member contributions and aims for an 8% return on its investments. KPERS contracts with an investment consultant to help manage investment decisions and also contracts for actuarial services to monitor the system's financial condition.

***KPERS Retirement Benefits are Funded Through Member Contributions, Employer Contributions, and Investment Earnings***

In order to pay for the retirement, disability, and death benefits for eligible members, KPERS accumulates assets from three sources.

- **Members contribute a percentage of their compensation.** Member contributions are mandated by state statute. Currently, members in the public employees group and the judges group contribute 6% of their earnings to the system. Members in the public safety group contribute 7.15% of their compensation.
- **Employers make contributions based on the compensation their employees receive.** Employer contribution rates are developed by KPERS' consulting actuary, subject to statutory limitations and adjustments. The fiscal year 2016 contribution rate for state and school group employers in the public employees group was set in 2015 by Senate Bill 255 at 10.91%. Local group employers will contribute the full actuarially-required contribution rate of 9.48% in calendar year 2016. For the public safety group, the uniform employer contribution rates range from 21.32% to 21.36%, while the contribution rate for the judges group is 23.98%.
- **KPERS invests the employer and member contributions.** As of May 2015, the total assets for the system were about \$16.8 billion.



**Figure OV-2** at left shows the total contributions and investment income for KPERS for fiscal year 2014 and also shows the proportion that each asset type contributed to the total. As the figure shows, investments account for more than half of the funding to pay for fiscal year 2014 benefits.

KPERS members who leave employment before becoming eligible for a vested retirement benefit may withdraw their contributions or leave them invested for up to five years.

---

*As of December 2014, KPERS Had an Unfunded Liability of About \$9.5 Billion that is Projected to be Eliminated by 2033*

KPERS' unfunded liability—the value of benefits earned by public employees (what is owed) is greater than the value of the plan's assets (what can be used to pay)—is determined during its actuarial valuation. An actuarial valuation is a “snapshot” of the system's financial condition at a single point in time. It shows cash flows that have already occurred compared to those that are expected to occur in the future.

**Actuaries project KPERS currently has a shortfall of \$9.5 billion between the accrued actuarial liability and the system's assets.** This unfunded actuarial liability occurs when the amount of assets that should have been accumulated to fund benefits is less than the assets actually accumulated for the plan. KPERS has had an unfunded actuarial liability for more than a decade, which officials attribute to inadequate employer contribution rates and periods of economic recession. While the unfunded liability does vary over time, the most recent valuation was completed in December 2014 and it estimated the shortfall to be about \$9.5 billion at that time and projected it would be \$0 by the end of fiscal year 2033.

**The Legislature has taken several steps to improve KPERS' long-term funding, including raising statutory caps on contribution rate increases, calculating new members' retirement benefits differently, and by issuing bonds.** The Legislature is taking the following steps to eliminate the unfunded liability:

- **Beginning in fiscal year 2014, the state employer and member contribution rates increased.** The statutory rate for state employer contributions increased from 10.27% in fiscal year 2014 to 10.91% by fiscal year 2016. (After that the contribution rate for fiscal year 2017 will decrease to 10.81% in an effort to help with the state's budget shortfall, after which a 1.2% statutory cap on annual rate increases will be in place.) Member contribution rates increased from 4% to 5% in calendar year 2014 and to 6% in calendar year 2015..
- **Starting January 2015, new members' retirement benefits are calculated differently.** Members joining after January 1, 2015, will be part of a “cash balance plan,” in which monthly retirement benefits are calculated based on the employees' contributions and “retirement credits.” The credits are dollars (rather than years of service) and cannot be paid unless the employee retires, which also increases the amount of money that KPERS has available to invest.

- **In 2015, the Legislature gave KPERS the authority to issue \$1 billion in pension bonds and the bonds sold in August 2015.** Senate Bill 228 authorized the state to sell \$1 billion in pension bonds at the discretion of the State Finance Council. As required by state law, the money made from selling these bonds was placed in the KPERS trust fund and according to KPERS officials, immediately lowered KPERS' unfunded liability. The funds will be invested and the returns used to help fund future retirees' benefits. To control the cost, interest payable and bond issuance costs will not exceed a combined 5%. Finally, the bonds are a state obligation, not a KPERS' obligation, therefore according to KPERS officials, debt service will be appropriated from the State General Fund to repay the bonds.

The changes will not affect most members' monthly retirement benefits. With the exception of new members joining KPERS on or after January 1, 2015 (KPERS 3 members), monthly retirement benefits will continue to be calculated in the same way they are now.



## Question 1: Does the Kansas Public Employees Retirement System Have Sufficient Controls to Detect and Prevent Fraud and Abuse?

---

*Public pension plans are at risk for fraud and abuse (p. 9). However, these risks can be mitigated by implementing controls (p. 10). Our test work showed that KPERS had many, but not all, controls to help prevent and detect fraud and abuse (p. 11). We found that since late 2013, KPERS has not conducted field audits to verify the accuracy of employer-reported information (p. 12). We also found that KPERS could strengthen its efforts to identify disability recipients who may be ineligible for those benefits (p. 14). In addition, we found seven teachers who were incorrectly awarded KPERS service credits while working for education associations (p. 15).*

*We also found that when calculating members' retirement benefits, KPERS handled final average salary calculations appropriately (p. 17). Legislation considered during the 2015 Session would have substantially limited the opportunity for retirees to include unused leave when calculating benefits (p. 18). Finally, restricting or eliminating the inclusion of unused leave could reduce KPERS' unfunded liability up to \$80 million, but the actual impact likely will be far less (p. 20).*

---

### ***Public Pension Plans Are at Risk for Fraud and Abuse***

The legislative concern that prompted this audit was about whether individuals were finding ways to circumvent the Kansas Public Employees Retirement System (KPERS) controls in order to receive years of service credit without actually earning the credits. Therefore, our work focused on fraud and abuse risks related to administering KPERS' benefits.

**The two main risks when administering public pension plans are making inaccurate benefit payments and not collecting enough in contributions.** Our review of literature indicates that:

- **There is a risk the plan will make inaccurate benefit payments.** For example, without adequate controls, there is a risk that retirement benefits could be paid to people who did not earn them, that death benefits could be paid to members who are not deceased, and that people who are capable of working and earning income could be inappropriately paid disability benefits. In addition, if compensation or service credit information (years worked) is inaccurate, this could cause retirement benefits to be over or underpaid.
- **There is a risk the plan will not collect enough in contributions.** Retirement benefits are funded through employer and employee contributions, which are based on members' compensation and

investment earnings. Without adequate controls to help ensure that contribution amounts are accurate, the retirement plan may not collect as much as it should and that could affect the overall funding available to invest.

**These risks can be exploited and result in fraud and abuse.**

Public pension plans like KPERS are at risk for fraud and abuse because of the volume of applications, contributions and benefit payments handled on a regular basis. For example, without effective controls, pension plan employees or beneficiaries may be able to manipulate the plan so that they can receive benefits they did not earn. In addition, while incomplete or inaccurate employer contributions may not be deliberate, they still create the risk of over or underpaying beneficiaries.

---

***These Risks Can be Mitigated by Implementing Controls to Prevent and Detect Fraud and Abuse***

KPERS staff rely on employers to periodically report the compensation levels and service credits of their respective employees as well as the amounts they have contributed towards those employees' pension plans. Service credits awarded for each year worked are used to help determine when an employee is eligible to retire. Compensation (salary) is used to calculate the employer and employee share, as well as how much members will receive in retirement benefits. Consequently, to help prevent fraud and abuse, it is important that KPERS staff take steps to verify the accuracy of that reported information.

Although no system can fully protect a pension plan such as KPERS from fraud and abuse, pensions systems can implement best practices to detect problems early on. Further, these controls can also help prevent KPERS staff from abusive or fraudulent activity on behalf of themselves or members. We provide a summary of these best practices below.

- **Requiring proof of identity helps verify members' identities.** For example, requiring members to submit official copies of birth certificates and marriage licenses helps ensure that information about members is accurate and not misrepresented either deliberately or unintentionally. In turn, that helps ensure that benefits amounts are calculated correctly and that they are paid to the correct person.
- **Regular monitoring helps ensure that benefits are calculated correctly and that information used to calculate benefits is accurate.** Effective monitoring includes internal supervisory review of staff processing benefits and external field audits of employers and the data they provide. Supervisory review of the staff processing benefit applications helps ensure that retirement benefits, death benefits, and disability benefits are only paid to people who are eligible and that benefit amounts paid are accurate. Field audits of employer contributions, payroll records, and members' work



history help identify and correct problems before this information is used to calculate benefits for future retirees.

- **Segregating duties helps ensure that one employee cannot both enroll and approve benefits and also ensures that sensitive information is safeguarded from internal and external threats.** Further, using information technology controls to segregate duties helps ensure only appropriate staff have access to sensitive information and members only can access their information. This helps prevent external and internal fraudulent activity.

---

***KPERS Had Many, But Not All, Controls to Help Prevent and Detect Fraud and Abuse***

We interviewed staff and reviewed internal control policies and practices within four of KPERS' five divisions. We compared the controls that officials report having in place to best practices for preventing and detecting fraud and abuse. Based on risk, we tested select controls to determine if they appeared to be working. Our findings include that:

**Recent financial audits confirmed that KPERS requires proof of identity when processing benefits.** For example, when a member retires, their employer must provide proof of employment and payroll data to KPERS' benefits and members services division. In addition, the member must also provide official copies of documents such as birth and marriage certificates. KPERS' 2014 financial audit, which was conducted by an independent accounting firm under contract with our office, found KPERS staff had obtained certified copies of required documents, such as birth certificates and social security cards for the 22 current retirees and 22 new retirees sampled. We did not conduct any additional test work in this area.

**We confirmed KPERS monitors benefit processing through supervisory reviews.** KPERS officials told us that supervisors review 10% of applications processed and 10% of applications approved.. We did not conduct test work to determine whether supervisors reviewed this amount, but in conducting other test work we saw evidence that supervisors were reviewing staff applications and benefit payments. In addition, KPERS' 2014 financial audit also found that retirement benefits were calculated and paid accurately for retirees included in the sample.

KPERS uses another form of monitoring—field audits—as a way to help ensure that employers remit all the retirement contribution funding required and that payroll records are accurate. However, we found that few field audits had been conducted since late in 2013. We discuss this issue in more detail at the bottom of page 12.

**We confirmed KPERS segregates duties between staff who collect contributions and staff who distribute benefits.** These two staff groups work in separate divisions at KPERS and are physically located in separate work spaces. KPERS' information system also prevents a single employee from both entering information about a member's compensation and service and also approving them to receive retirement benefits. In addition, three different employees enter, process, and approve benefit applications. Finally, the KPERS information technology division helps ensure that staff duties are segregated and our 2013 audit of KPERS IT security found that KPERS had good processes in place to monitor and control employees' access.

**However, we also found evidence of inadequate controls in three areas.** Our test work showed that:

- KPERS had not conducted field audits to verify the accuracy of employer reported information since late 2013 (p. 12 to 14).
- KPERS could strengthen its efforts to identify recipients of disability benefits who may be ineligible for those benefits (p. 14 to 15).
- Seven teachers were incorrectly awarded KPERS service credits while working for education associations (p. 15 to 17).

Each of these is discussed in more detail in the following sections.

---

***Since Late 2013,  
KPERS Has Not  
Conducted Field Audits  
to Verify the Accuracy  
of Employer-Reported  
Information***

Regular monitoring helps ensure that the information used to calculate retirement benefits is accurate. Specifically, field audits of employer contributions, payroll records, and members' work histories helps identify and correct problems before this information is used to calculate benefits for future retirees.

**KPERS uses field audits as a control to help ensure retirement contributions are accurate.** KPERS retirement benefits are funded in part through employer and employee contributions. Employers are required to submit payroll data to KPERS which shows the members' salaries and work status. This information is used to calculate employer and member contribution amounts.

KPERS' field audit function can periodically verify employers' reported information. Officials told us that employers are selected for audit based on several factors, including whether the employer owes contributions or if there are known errors in their contribution amounts.

**However, KPERS temporarily suspended its field audit function for 20 months beginning in 2013 because of turnover and the need to implement other projects.** Our test work showed that KPERS started 9 audits in late 2013, but then little to no audit work was done until July 2015. KPERS officials told us that since August 2013, five audit staff have left the agency's field audit section. In addition, remaining audit staff were shifted to other duties including helping to prepare for implementing pay-period reporting and KPERS 3. Pay-period reporting is a system where all employers remit payroll and other information related to retirement contributions by payroll period, rather than annually. KPERS 3 is the cash balance retirement plan implemented for members employed on or after January 1, 2015.

**During the time when the field audits were suspended, KPERS was at increased risk of not collecting all the contributions it should.** Field audits are one part KPERS' monitoring efforts. (KPERS also monitors payroll and contributions through its pay-period reporting process). However, KPERS officials acknowledged that without the field audits, there is substantive risk that retirement contributions and other service information could be inaccurate.

Beginning July 2015, KPERS officials developed an audit plan and restarted its audit function. At that time, KPERS resumed work on five of the nine original audits begun in late 2013 and also started 14 additional audits of various employers, including school districts, cities, and counties.

**Pay-period reporting and new governmental accounting standards provide KPERS with additional controls, but are not a substitute for field audits.** As of January 2015, all KPERS-covered employers were required to remit payroll and other information related to retirement contributions by payroll period, rather than annually. For example, if an employer pays employees every two weeks, then the employer must also remit payroll information as well as retirement contributions to KPERS every two weeks. KPERS officials told us this helps ensure some mistakes are caught but acknowledged it is not a sufficient substitute for routine field audits of employers' contribution and payroll records.

Beginning fiscal year 2015, the Government Accounting Standards Board (GASB) required state and local government employers to show their proportionate share of pension plan costs and obligations on their financial statements. We asked both KPERS officials and the CPA firm contracted to perform these audits (referred to as GASB 68 employer audits) whether the audits could help mitigate the lack of KPERS' field audits. Although both

agreed that both audits validate membership and contribution data, the GASB 68 audits serve a different purpose and are narrower than KPERS field audits. KPERS audits, in addition to validating membership and contribution data, also review service purchases, leaves of absence, salary certifications, and compliance with requirements for working after retirement.

---

***KPERS Could Strengthen its Efforts to Identify Recipients of Disability Benefits Who Are Not Eligible for Those Benefits***

In addition to retirement and death benefits, KPERS also provides disability benefits to eligible members. Members who become disabled are eligible to receive a monthly payment equal to 60% of their monthly salary.

As a condition to receiving disability benefits, a member must be unable to perform their job duties either because of sickness or injury, and they must apply for federal social security disability benefits. Our test work involved determining whether disability recipients had earned any income while also receiving disability benefits.

**KPERS relies on a third-party contractor to monitor the ongoing eligibility of KPERS disability recipients.** Once KPERS certifies that an employee is eligible for disability benefits, United Health Care, a third-party contractor, administers disability benefits on behalf of KPERS. KPERS officials told us United Health Care continually monitors whether disability recipients are eligible for such benefits. For example, members are required to submit to medical or vocational examinations as requested. In addition, if the member becomes eligible for social security benefits, their KPERS disability payments would be reduced and KPERS' would be reimbursed for disability payments already paid to the member. Finally, disability recipients are required to report any income earned.

**We identified at least 16 KPERS disability recipients who earned substantial income while also receiving disability benefits.** In total about 3,300 members receive KPERS disability benefits each year. We used data from the Kansas Department of Revenue (KDOR) and the Kansas Department of Labor (KDOL) to identify any income earned by these disability recipients during calendar years 2013 and 2014. To receive benefits, a member must be unable to perform their job duties either because of sickness or injury and unable to earn 60 to 80% of the income they earned at the time they became disabled. There are some exceptions, including that recipients who are working in rehabilitative employment are allowed to earn income and still receive a reduced KPERS disability benefit for up to 24 months. In addition, KPERS officials told us that some recipients also are

allowed to earn income while receiving disability benefits if the income is minimal and not earned on a regular basis.

We asked KPERS to evaluate 38 cases that we targeted for further test work because the disability recipients had earned income and collected KPERS disability benefits at the same time. Of those, KPERS preliminarily determined that at least 16 may be ineligible for disability benefits. KPERS officials told us they are conducting further investigation into each of these instances. In nearly all of the 22 other cases, KPERS records showed the disability recipients had been approved for rehabilitative employment or their income was minimal and would not cause them to be ineligible for disability benefits.

**Information from the Kansas Department of Revenue (KDOR) and the Kansas Department of Labor (KDOL) could help KPERS identify disability recipients who earned substantial income while also receiving disability benefits.** Since 2005, state law has allowed KDOR to provide certain tax information (W-2's) to KPERS but to date, that information has not been shared. (At the time, officials from both agencies attempted to draft a memorandum that detailed how the data sharing would happen, but technical issues made it difficult for KDOR to transfer the data to KPERS.) In addition, quarterly wage information from KDOL could help pinpoint when income was received—an important factor when determining eligibility for KPERS disability benefits.

**KDOR and KDOL officials told us they foresee few if any problems in sharing income-related data with KPERS in the future.** Officials from both KDOR and KDOL agreed that such information could help ensure KPERS disability benefits were administered appropriately. As we were ending our audit work, KPERS and KDOR were working together to finalize a memorandum that will detail how KDOR will provide the tax information to KPERS. Lastly, KDOL officials agreed to begin sharing quarterly wage information and other employer-reported information with KPERS.

---

***We Found Seven Teachers Who Were Incorrectly Awarded KPERS Service Credits While Working for Education Associations***

For each year worked in a KPERS-covered position, an employee earns one service credit. Service credits are used to help determine when an employee is eligible to retire and are awarded in one-quarter increments to members who work any length of time during a quarter.

To test KPERS' controls related to awarding service credits, we checked the employment status and service credit records for a sample of members. We chose 34 teachers in a targeted sample

and randomly selected an additional 21 state employees. We placed additional emphasis on school employees for two reasons. First, legislators had expressed specific concerns regarding teachers working for education associations and earning years of KPERS service credit. Second, if that were happening, the state (rather than the schools) would bear the cost of the additional employer contributions. That is because the state has historically paid the school districts' share of the KPERS obligation.

**The seven teachers were no longer teaching in their district and were officers in their education association.** We reviewed information from the Kansas National Education Association (KNEA), local education associations, school districts, and KPERS. In all instances, we confirmed that while they worked for the education associations, the teachers did not work for the school districts. The seven teachers were from larger school districts. We did not include smaller districts in our test work because, although many also have local education associations, their officers tend to be volunteers and are not paid. Kansas Department of Education (KSDE) officials also confirmed they were not aware of smaller districts having such arrangements.

**In reporting payroll information to KPERS, each school district continued to show the teachers as working for the school district.** Like other KPERS-covered employers, school districts regularly report their employees' work status and salary information to KPERS. During the time they worked for the education associations, these teachers did not work for the districts, yet remained "district employees" according to school district officials. For six of the seven teachers, the districts were reimbursed all or part of the teacher's salary by the education associations. Because each of the former teachers remained on the districts' payroll, the teachers continued to accumulate retirement benefits.

**Because education associations are not KPERS-covered employers, the seven former teachers should not have been awarded KPERS service credits while working for them.** Public school district employees are KPERS-covered members. On the other hand, KNEA and its local affiliates are advocacy organizations for educators and are not KPERS-covered employers. However, because these teachers continued to be reported as school district employees, KPERS continued to award them service credits.

For the remaining teachers included in our test work we found that although they were officers in the local education associations, they were serving in a voluntary capacity and continued to work

for the school districts. Therefore, any years of service credits awarded by KPERS were appropriate.

**It is likely that service credits have been incorrectly awarded this way for many years.** In general, our interviews with a few school districts confirmed that at least in recent years the local education associations have reimbursed these school districts for some teachers' salaries. Because the former teachers remained on the districts' payroll, the teachers continued to accumulate retirement benefits.

**KPERS plans to investigate and correct any errors.** KPERS officials told us state law requires KPERS to correct any records in error and to retroactively collect any benefit overpayments that may be resulted in the past five years. Officials told us they plan to investigate the issues that we found and collect any overpayments as necessary. In addition, they plan to implement procedures that will help them identify any other like errors.

KPERS is estimating the employer portion of contributions for each of these teachers. Because the state pays the employer portion of contributions for public school employees, districts do not incur these costs. Instead, the employer contribution is paid by the Kansas Department of Education (KSDE). For these seven cases, KPERS will likely refund the employer contribution to KSDE, since the contributions were paid in error.

---

## **OTHER FINDINGS RELATED TO RETIREMENT BENEFIT INCREASES**

---

***When Calculating  
Members' Retirement  
Benefits, KPERS  
Handled Final Average  
Salary Calculations  
Appropriately***

Retirement benefits for some retirees may be higher if significant amounts of accumulated leave or late-in-career salary increases are included when calculating their benefits. This is commonly referred to as retirement benefit inflation. A member's monthly KPERS retirement benefit depends on several factors, including requirements in state law, their employer group, years of service and final salary calculation.

**Current state law includes provisions intended to limit the impact of accumulated leave and late-in-career salary increases on member's retirement benefits.** Specifically, the law only allows KPERS to include accumulated leave, longevity pay, and compensatory time in the final average salary calculations for members who joined on or before July 1, 1993. If these "add-ons" cause the member's final average salary to increase by more than 15%, then the employer must reimburse KPERS for the actuarial cost of any retirement benefits that resulted above that. In addition, if a member's salary increases from year-to-year by more than 7.5% to 15% (depending on their group), any amount above

that is not counted when calculating the employee's retirement benefit.

**Our test work showed that retirement benefit inflation rarely happens, but when it did KPERS made the required adjustments.** We reviewed final average salary calculations and related information for all 11,000 members retiring in calendar year 2013 or 2014 and selected a sample to determine whether KPERS made the necessary adjustments. Our test work showed that:

- **Significant increases in the final average salaries used to calculate members' monthly retirement benefits have been rare—5% of retirees in the past two years had significant increases and those instances were calculated as required by law.** Of the members retiring in the past two years, 73% did not have salary increases that raised their retirement benefits. Another 22% of members had minimal increases from \$1 to \$2999 in the two salary quarters used to calculate their final average salary, which may have slightly increased their retirement benefit. Finally, the remaining 5% of members increased their salary by an average of \$14,000 during the last two salary quarters. Within that group, the smallest salary increase was about \$3,000 and the largest was slightly more than \$281,000.
- **For the 61 retirees included in our sample, KPERS appropriately identified increases in their final average salaries and then made the necessary adjustments.** In the past two years, 540 or 5% of all retirees had significant salary increases (caused by including accumulated unused leave or late-in career salary increases) that raised their monthly retirement benefits. We randomly selected 61 retirees and found that for all, KPERS appropriately billed the employer for any benefit amounts above the 15% threshold.

---

***Legislation Considered  
During the 2015  
Legislative Session  
Would Have  
Substantially Limited  
the Opportunity for  
Retirees to Include  
Unused Leave When  
Calculating Retirement  
Benefits***

**Currently, two KPERS retirement plans call for unused leave to be included when calculating retirement benefits.** Of the five retirement plans managed by KPERS, two plans require KPERS to consider unused leave and other compensation when calculating monthly retirement benefits. In both instances, the employees must have been hired on or before July 1, 1993.

- **For members of the KPERS 1 retirement plan who were hired on or before July 1, 1993, KPERS must consider unused leave when calculating retirement benefits.** For these members, KPERS staff calculate retirement benefits in two ways: an average of the three highest years of salary excluding unused leave, or an average of the four highest years of salary including unused leave and other compensation. The higher result is used in determining the member's benefit. Over the past five years, the four-year average salary calculation was higher for about 24% (6,300) of all KPERS 1 and was the basis for calculating their retirement benefits.



- **For members of the Kansas Police and Firemen's (KP&F) retirement system who were hired on or before July 1, 1993, KPERS must include unused leave when calculating retirement benefits.** KPERS staff calculate the benefit by averaging the three highest years within the last five years of salary including unused leave.

For all other retirement plans, benefits are calculated excluding unused leave. These plans include members of the KPERS 1 and KP&F retirement plans who were hired after July 1, 1993.

**Although rare, the monthly retirement benefit for some retirees was substantially increased when large amounts of unused leave were included in their final salary calculation, as provided for by state law.** In the past two years, 5% of retirees had significant increases in their final average salary caused by either late-in-career salary increases or by including unused leave when calculating their retirement benefits. (Unused leave payments are called “add-ons” because they are added onto the member’s compensation at retirement, which is then used as part of the final average salary calculation.) However, a few individuals in that group increased their monthly retirement benefit substantially.

For example, without add-ons, one individual’s final average salary was about \$103,000 and would have resulted in about \$6,900 per month in retirement benefits. With add-ons included, the final average salary was \$139,000 and monthly retirement benefits increased to about \$9,300 per month, a 36% increase. In another example, an individual’s final average salary was about \$93,000 without add-ons and would have resulted in about \$6,000 per month in retirement benefits. With add-ons, the final average salary was about \$121,000 and monthly retirement benefits increased to about \$7,800 per month, a 31% increase.

According to KPERS, retirement benefit increases caused by including unused leave or late-in-career salary increases have little effect on the funding status of KPERS. Officials told us these have already been factored in by KPERS’ actuaries and for any increase that exceeds 15%, KPERS bills the employer for the actuarial cost of the increase above 15%. However, it is unclear whether employers have factored this cost increase into their budgets.

**In reaction to such instances, the 2015 Legislature considered two bills which would have limited employees’ ability to include unused leave when calculating retirement benefits.** Both House Bill 2416 and House Bill 2426 would limit the amount of vacation leave employees could accumulate to 240 hours. In addition, House Bill 2426 likely would have limited how and whether employees hired on or before July 1, 1993 could include

unused leave when calculating their retirement benefits. Currently, state law requires KPERS to consider unused leave and other compensation when calculating their retirement benefits for these members.

---

***Restricting or  
Eliminating the  
Inclusion of Unused  
Leave Could Reduce  
KPERS' Unfunded  
Liability Up to \$80  
Million, But the Actual  
Impact Likely Will be  
Far Less***

As mentioned in the Overview on page 6, the current actuarial estimate of KPERS' unfunded liability is about \$9.5 billion. An unfunded liability happens when the value of benefits earned by public employees (what is owed) is greater than the value of the plan's assets (what can be used to pay). Restricting or eliminating retirees' ability to include unused leave when calculating retirement benefits would reduce KPERS' unfunded actuarial liability.

**KPERS' actuaries estimated eliminating the inclusion of unused leave in the benefits calculation would save the plan up to \$80 million.** The estimate assumes that future retirees would not be able to include any unused leave when calculating retirement benefits. Using KPERS' current valuation as of December 2013, the actuaries estimated that eliminating the inclusion of unused leave would reduce the unfunded liability by about \$49 million for the KPERS employees and \$31 million for Kansas Police and Firemen's system employees. These are the only members who are currently allowed to include unused leave when calculating retirement benefits.

KPERS officials told us neither they nor their contracted actuary were able to project the actuarial impact of limiting unused leave to 240 hours (or any amount other than zero). Officials said that is because it is difficult to know how much unused vacation and sick leave that non-retirees have accumulated and could potentially add in once they retire.

**We estimated that setting a 240-hour limit on the amount of unused leave that can be included would save the plan up to \$62 million.** Setting the limit at 240 hours (as proposed in the recent bills) has less effect on reducing the unfunded liability than completely eliminating the option because members would still be allowed to add to their retirement benefit, but to a lesser extent. We estimated that the 240-hour limit could reduce the unfunded liability by up to \$62 million (about \$34 million for KPERS employees hired on or before July 1, 1993 by and about \$28 million for the Kansas Police and Firemen's system).

In preparing our estimate, we acknowledge that it is more simple than and not as reliable as one prepared by an actuary. In addition, our estimate includes a number of assumptions, several of which would tend to overstate the effect on how much KPERS' unfunded

actuarial liability would be reduced. For more information about the method behind our estimates, see *Appendix B*.

**Neither estimate is likely to be fully realized because many members would retire before either potential policy change took effect.** Only the 24,000 members hired on or before July 1, 1993 can include unused leave in their retirement benefit calculations. Each year about 1,300 of these members retire. If the law was changed and these members were no longer allowed to include a significant share of their unused leave when calculating retirement benefits, it is likely that many would retire to avoid a decrease in their retirement benefit. For example, if state law were changed to allow only 240 hours to be included when calculating retirement benefits and 50% of members retired before such a limit was implemented, then the unfunded liability would be reduced by only about \$30 million, not \$60 million. In comparison to KPERS' current unfunded actuarial liability, which was \$9.5 billion as of December 2014, an estimated \$30 million reduction is very small—only about .30%. Further, because additional retirement benefits would be paid to the members who retired earlier than expected, the cost of those additional benefits would further reduce how much the unfunded liability would be affected.

Finally, it is important to note that if changes are made to a retirement plan after members have vested such a change likely would be litigated.



---

## Conclusion and Recommendations

---

### ***Conclusion***

Overall, we found KPERS had most of the controls needed to help ensure it collects accurate retirement contributions and distributes appropriate benefits amounts, and we did not identify large gaps in its controls to detect and prevent fraud and abuse. We did identify one significant control weakness—the suspension of field audits for almost two years. KPERS reports that it has since resumed that function, which helps ensure KPERS receives accurate employer contributions. Though not as significant an issue, we also identified options that would help KPERS verify the ongoing eligibility of disability recipients. The other issues we identified appear to be isolated errors which have since been corrected.

---

### ***Recommendations for Executive Action***

1. To address the issues with the field audits not being conducted, KPERS' fiscal services division should follow through with its current plan to reinstitute those audits (pages 12 to 14).
  2. To address the concern with individuals' eligibility for disability benefits, KPERS should work to establish inter-agency data-sharing agreements with the Kansas Department of Revenue and the Kansas Department of Labor for the purpose of identifying members who are no longer eligible (pages 14 to 15).
  3. To address issues related to inaccurate service credit records described on pages 15 to 17, KPERS should:
    - a. incorporate a check of members' service records into its field audit function and then correct any inaccuracies as they are discovered.
    - b. for the seven teachers we identified, make any corrections to records and contributions as required by law.
-



## **APPENDIX A**

### **Scope Statement**

This appendix contains the scope statement approved by the Legislative Post Audit Committee for this audit on March 5, 2014. The audit was requested by Representative Highland. At the request of the Legislative Post Audit Committee, the start date for the audit was moved back to accommodate an audit of school districts. Subsequently, this audit was begun in March 2015.

The Kansas Public Employees Retirement System (KPERS) administers three statewide defined-benefit retirement plans for state and local public employees. As of January 2015, about 120 KPERS employees helped serve more than 291,000 active, inactive, and retired members. KPERS employers include the state, all 105 Kansas counties, more than 400 cities and townships, and all 286 school districts. KPERS manages approximately \$16.4 billion in assets for members' benefits.

Those employers are required to report the employer's portion of pension contribution amounts to KPERS on an annual basis. KPERS uses that information to help verify increases to an employee's years of service (an important factor in determining employees' benefit amounts at retirement) and to help reconcile employer and KPERS contribution records.

Legislators have expressed concern that some individuals might be finding ways to circumvent KPERS' current controls in order to continue receiving years of service credit or credit for employer contributions even when not working for a member employer. Additionally, legislators are interested in knowing what steps KPERS staff take to prevent fraud and abuse in other areas of its pension system.

A performance audit in this area would address the following question:

- 1. Does the Kansas Public Employees Retirement System have sufficient controls to detect and prevent fraud and abuse?** To answer this question, we would review professional literature to identify best practices related to detecting and preventing fraud and abuse for state pension systems. We would work with KPERS officials to determine what controls they currently have in place to detect and prevent fraud and abuse including verification of member's existence, the accuracy of member transactions and data, and identify theft. We would compare those actions to best practices to identify any missing or weak KPERS controls. Further, we would work with our contracted audit firm to identify any relevant control tests they might have done during the course of the KPERS financial audit. On a sample basis, we would determine if existing controls were working correctly through interviews with KPERS staff, direct tests of system controls and edits, and a review of relevant documentation. We would perform additional work in this area as necessary.

**Estimated Resources:** 3 LPA staff

**Estimated Time:** 3 months (a)

*(a) From the audit start date to our best estimate of when it would be ready for the committee.*





**APPENDIX B**  
**A Summary of the Methodology We Used for Estimating How a 240-hour Limit  
On Unused Leave Would Affect KPERS' Unfunded Actuarial Liability**

To estimate the effect of setting a 240-hour limit on the amount of unused leave that certain KPERS members can use when calculating retirement benefit, we did the following:

1. We estimated the amount of unused leave included in retirement benefit calculations for members retiring from 2009 to 2013, who had been hired before 1993.
2. We projected those trends to the remaining 24,000 KPERS and Kansas Police and Firemen's (KP&F) system members hired before 1993 who, once they retire, will be allowed to include unused leave when calculating their final average salaries for retirement benefit purposes.
3. Finally, we used that information to calculate how much of KPERS' estimated \$80 unfunded actuarial liability would be reduced if the remaining 24,000 retirees were allowed to include only 240-hours of unused leave when calculating their retirement benefits.

Key assumptions made as part of our estimate:

1. We assumed that final average salary increases for members retiring from 2009 to 2013, was due solely to including unused leave and that it was not caused by late-in-career salary increases.
2. We assumed that future retirees will have accumulated similar amounts of unused leave as compared to members retiring from 2009 to 2013.



## **APPENDIX C**

### **Agency Response**

On August 3<sup>rd</sup>, we provided copies of the draft audit report to the Kansas Public Employees Retirement System (KPERS). Its response is included as this Appendix. Following the agency's written response is a table listing KPERS' specific implementation plan for each recommendation.

KPERS officials agreed to implement our recommendations and had no comments in their formal response that required us to change the report.



## 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

Mr. Scott Frank  
August 26, 2015  
Page 2

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.

Mr. Scott Frank  
August 26, 2015  
Page 4

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](mailto: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** Attachment A  
**Completed Audits of CY 2013 Employer Data for 2014 GASB 68 Report\***

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.

August 26, 2015

Page 2 of 3



**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.

August 26, 2015

Page 3 of 3



**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:

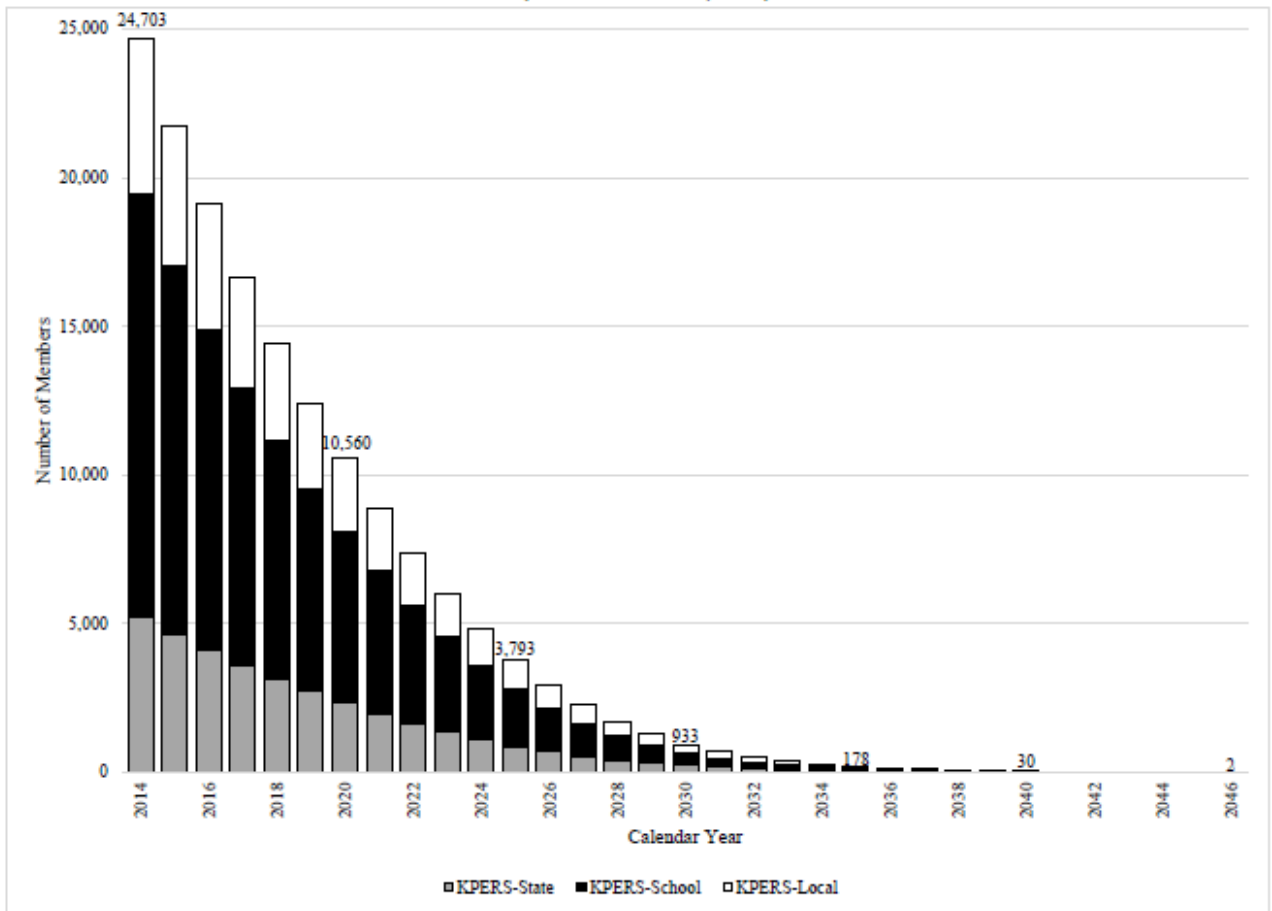
- Six cities;
- One county;
- Two hospitals;
- One instrumentality;
- One mental health center;
- One township; and
- 14 unified school districts.

August 26, 2015



**Projected Counts of KPERS Members Hired Before July 1, 1993**  
(as of December 31, 2013)

Attachment C



August 26, 2015



### Itemized Response to LPA Recommendations

#### Kansas Public Employees Retirement System (KPERS): Evaluating Controls to Detect and Prevent Fraud and Abuse

LPA Recommendation		Agency Action Plan
Question		
1.	To address the issues with the field audits not being conducted, KPERS' fiscal services division should follow through with its current plan to reinstitute those audits.	Field audits have already been reinstituted, and KPERS Fiscal Services Employer Auditing has developed a 2016 Annual Employer Audit Plan. The GASB 68 Employer Payroll and Membership Audit of supporting 2013 census data was completed in the course of preparing the 2014 GASB 68 report, and the GASB 68 audit of supporting 2014 census data will soon begin.
		KPERS continued applying other on-going monitoring procedures to employer payroll data during the time employer field auditors were assisting with the implementation of Payroll Period Reporting
		1. Fiscal Services staff continued monitoring employer payments and other transactions, reconciling employer fund balances and correcting member records using benefit administration IT system edits as guidance.
		2. Though no field audit reports were completed during this time, desk auditing procedures were often applied.
		3. In addition, the 61 GASB 68 audits of 2013 payroll and membership data performed by the field auditors during the period of March through May of 2015 showed very few errors in the employer payroll data.
		4. Benefits and Member Services staff continued reviewing all payroll records for members who applied for retirement to ensure service credit, contributions and final average salary calculations were accurate before calculating benefits.
		5. KPERS will maintain each of these monitoring procedures in the future.
2.	To address the concern with individuals' eligibility for disability benefits, KPERS should work to establish inter-agency data-sharing agreements with the Kansas Department of Revenue and the Kansas Department of Labor for the purpose of identifying members who are no longer eligible.	KPERS appreciates Legislative Post Audit's assistance with obtaining wage and income information from the Departments of Revenue and Labor to assist with detecting non-reported income of disability benefit recipients. We are currently working directly with both agencies to finalize memoranda of understanding for the data exchange and will begin routinely evaluating the available information in the near future.
3.	To address the issues related to inaccurate service credit records, KPERS should:	
a.	incorporate a check of members' service records into its field audit function and then correct any inaccuracies as they are discovered.	Field audit procedures have been amended to include a step to verify member eligibility on a sampling basis. With 1,500 employers and over 154,000 active members, employer field auditing procedures applied to detect whether a member is working at the employer's place of business has not been a cost-effective audit procedure. Consultation with other state pension plan auditors yielded the same answer.
		KPERS will continue to use employer training via Designated Agent (DA) seminars and webinars, DA manuals and other communications to keep employers informed of KPERS eligibility rules. To find potentially ineligible members, KPERS is also using our benefit administration information system edits to identify member compensation below certain thresholds. Based on the results of this audit, KPERS will more clearly define member eligibility rules in future communications to employers, providing examples of what employment is and is not allowed in order to receive KPERS service credits.
		KPERS is also exploring adding additional fields and system edits to employer pay period reporting that will help to identify member eligibility issues.
b.	for the seven teachers we identified, make any corrections to records and contributions as required by law.	All ineligible service credit identified in the audit will be reviewed and removed from the members' service records, as appropriate.

