REPORT TO THE BOARD OF SUPERVISORS
FAIRFAX COUNTY, VIRGINIA

REPORT ON:
FAIRFAX COUNTY'S
RETIREMENT ADMINISTRATION AGENCY'S (RAA'S)
ADMINISTRATION OF THE POLICE OFFICERS,
SUPPLEMENTAL, AND UNIFORMED RETIREMENT SYSTEMS

RAA'S ACTIONS WILL FURTHER IMPROVE ADMINISTRATION OF RETIREMENT FUNDS

OFFICE OF FINANCIAL AND PROGRAMS AUDITOR

DEC 29 1998

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EXECUTIVE SUMMARY

Fairfax County contributes to five retirement systems for County and school employees. Three of the retirement systems – Supplemental, Police Officers, and Uniformed Retirement Systems – are overseen by their respective Boards of Trustees and are administered daily by Fairfax County's Retirement Administration Agency (RAA). The Virginia Retirement System and the Educational Employees Supplemental Retirement System of Fairfax County are operated by the Commonwealth of Virginia and the Fairfax County Public Schools (FCPS), respectively, and were not included in our review.

This is the second and final report of our review of the three retirement systems, which was undertaken at the request of the Board of Supervisors. Our first report concerned the financial condition of these retirement systems and whether Fairfax County was contributing an appropriate amount to each of the three systems. That report, entitled, "Retirement Systems: Excellent Financial Condition; County Contribution Rates Appropriate; And Fiscal Year 1999 Contributions Projected To Be Significantly Lower," was issued on February 27, 1998.

This report focuses on the results of the second part of our review that concerns the effectiveness of the Retirement Administration Agency's day-to-day administration of the three retirement systems. Overall, we believe that RAA's staff of 21 is administering the three retirement systems, which have over 18,000 active and retired members and investments valued at over $2.7 billion, very well. The actions it has taken on issues identified during our review will further improve the administration of retirement funds. Actions taken include:

- Meeting with FCPS officials in April 1998, to expedite the transfer of their employee and employer contributions (approximately $1 million per month) to the Supplemental Retirement System. These contributions help fund monthly System expenses and permit more of the System's assets to remain invested.

- Refining cash management practices to ensure that minimum cash balances are maintained in the three systems' cash accounts that are pooled with County funds thereby maximizing their investment strategies and avoiding negative balances in their cash accounts.

- Adjusting 54 FCPS retirees' annuities who retired between April 1, 1997 and October 31, 1998. Thirty-three retirees will receive upward adjustments and twenty-one retirees will receive downward adjustments. RAA has taken corrective action so this situation will not recur.

With this correction made to the retirement benefit computations for FCPS retirees, we have concluded that the methodology followed for the retirement benefit computations for all three retirement systems results in the calculation of retirement benefits as intended by governing Fairfax County Ordinances.

In his response to our report (which is included in its entirety in Appendix VI), the RAA's Executive Director concurred with our report and pointed out that our review helped RAA to focus on opportunities to improve operations. Examples of these improvements included the more timely transfer of the Public Schools System's contributions to the Supplemental Retirement System, better reporting of the status of retiree health premium payments, and a better process for acting on any overdue amounts from retirees.

Additionally, RAA's Executive Director stated that RAA has rectified the one inconsistency we found in RAA's use of a computer program for calculating an adjustment factor to offset the impact of deferred merit increases in Fiscal Years 1992 and 1993. RAA has clarified instructions for staff and now the correct adjustment factor is being produced by the computer program for use in computing Supplemental Retirement System retirement annuities. Also, RAA has taken action to adjust payments to those retirees whose benefit amounts were incorrect.

Lastly, RAA's Executive Director pointed out that RAA has strengthened its cash forecasting process and improved the monitoring of cash balances to ensure that future negative balances are avoided. This will eliminate any future negative impacts on the allocation of interest earnings to other County funds. He added that RAA is continuing to review its process for projecting and monitoring the timing of major disbursements to strike the right balance between the cost of frequent transfers from investment accounts and maintaining the minimum possible balance in the County's pooled cash account.

We concur with the actions taken by the RAA and believe that these actions will further improve the administration of the three retirement systems. Because RAA already has taken these actions, we are making no recommendations for remedial action.

INTRODUCTION

Fairfax County provides funding for employees in five separate public employee retirement systems. Three of the systems, the Supplemental, Police Officers, and Uniformed Retirement Systems, are overseen by three Boards of Trustees and the County's Retirement Administration Agency (RAA), and are the subject of this review. The County also contributes to the Virginia Retirement System (VRS) and the Educational Employees Supplemental Retirement System of Fairfax County, which is a component of the Public Schools. These two systems were not included in our review.

This is our second and final report on the Supplemental, Police Officers, and Uniformed Retirement Systems. This report concerns RAA's day-to-day administration of these retirement systems. Our earlier report dealt with the overall financial condition of each of the retirement systems. That report, entitled, "Retirement Systems: Excellent Financial Condition; County Contribution Rates Appropriate; And Fiscal Year 1999 Contributions Projected To Be Significantly Lower," was issued on February 27, 1998.

BACKGROUND ON RAA

The RAA processes benefit payments to eligible Fairfax County retirees and their survivors from the three retirement systems and refunds of retirement contributions to terminated County employees. The RAA management counsels and provides active and retired County employees with complete information pertaining to their benefits. In addition, the RAA oversees the management and investment of retirement trust funds. The RAA is responsible for maintaining internal accounting controls to provide reasonable assurance that transactions are properly authorized and recorded. RAA's budget for Fiscal Year 1999 was approved for over $108 million which funds 21 personnel, banking and investment manager services, and payments to retirees, beneficiaries, and refunds to those withdrawing contributions. (See Appendix I for RAA's Organization Chart.) RAA is located at 10680 Main Street, Suite 280 in the City of Fairfax.

Benefits Paid to Retirees and Survivors

Benefit provisions for the three pension systems are established and may be amended by County Ordinances. All benefits vest at five years of service. To be eligible for normal retirement, employees generally must reach a certain combination of age and years of service. The normal retirement benefit is calculated using average final compensation and years of service at the date of termination. Annual cost-of-living adjustments are provided to retirees and beneficiaries equal to the lesser of 4 percent or the percentage increase in the Consumer Price Index for the Washington Standard Metropolitan Statistical Area.

Retirement benefits and refunds of contributions made to those who left the systems, paid during the Fiscal Year ended June 30, 1998, totaled $78.2 million. About $49.9 million was paid from the Supplemental, $15.2 million from the Police Officers and $13.1 million from the Uniformed System.

Member and Employer Contributions

The contribution requirements for employees who are members of the three retirement systems are established, and may be amended by County Ordinances. The three systems require different percentage rates of contributions depending on the system to which the member belongs, and the plan chosen within that system. When the plan has been chosen, the rate of contribution remains fixed at that level by Ordinance. Employee contributions to the three systems for the year ended June 30, 1998, totaled $29.3 million, consisting of $18.0 million from Supplemental members, $6.2 million from Police Officer members, and $5.1 million from Uniformed members.

The contribution requirements for Fairfax County are set from year to year at an actuarially determined rate. Fairfax County's pension costs for the three systems for the Fiscal Year ended June 30, 1998, totaled $58.9 million, consisting of $31.0 million for the Supplemental, $11.3 million for the Police Officer, and $16.6 million for the Uniformed Retirement Systems.

The Three Boards of Trustees

The RAA staff work for the Board of Trustees of each of the three retirement systems. Members of each of the three Boards of Trustees are listed in Appendixes II, III, and IV of this report.

The Supplemental Board has 10 trustees. Three of them, the Director of the County's Department of Finance, who serves as the Treasurer of the Board, the Director of the County's Department of Human Resources, and the Fairfax County Public Schools' Benefits Insurance Coordinator, are ex officio members of the Board. Four of the trustees are appointed by the Board of Supervisors, two are elected by the County employees who are members of the retirement system (one is elected by School Board employees and one is elected by general County employees), and one is a retired member elected by the retired members of the system.

The Police Officers Retirement Board of Trustees consists of five trustees. Two trustees are appointed by the Board of Supervisors, two trustees are elected by the members of the retirement system, and one trustee is Director of the County's Department of Finance, who is an ex officio member of the Board.

The Uniformed Retirement Board of Trustees has eight trustees. Three trustees are appointed by the Board of Supervisors; two trustees are elected by the uniformed employees of the Fire and Rescue Department; one trustee is elected by the uniformed employees of the Sheriff's Department and the Division of Animal Control and Park Police and Helicopter Pilot members of the system; and the other two trustees are ex officio members, the Director of the Department of Finance and the Director of the Department of Human Resources for Fairfax County.

All of the members of the Boards of Trustees, except the ex officio members, have four-year terms of office, and may be re-appointed.

Functions of the Three Boards

The three Boards of Trustees have similar functions. They each establish rules and regulations for the administration of their respective retirement systems and for the transaction of their business. They each are required to keep in convenient form such data as shall be necessary for an annual, actuarial valuation of their systems and for checking the experience of the system.

The Boards are the trustees of the systems' funds and have full power to invest and re-invest them. Such investments are to be conducted with discretion and in accordance with the laws of the Commonwealth of Virginia as may apply to fiduciaries investing such funds. They are permitted to employ investment counsel to assist them in their investment efforts.

The Boards have Investment Objectives and Policies that establish investment goals, guidelines, constraints and performance standards the trustees use when exercising their fiduciary duties to manage the investment assets of the retirement systems. The Boards operate in conformity with the standard of care required in making investments as stated in the Code of Virginia.

The Boards of Trustees are required by County Ordinance to have actuarial evaluations made of the systems. The firm of Milliman & Robertson, Inc., has been retained to provide actuarial services for all three systems.

The Role of the Actuary

The actuary provides annual reviews of the three retirement systems and submits reports which include, among other things, an analysis of funding, a determination of plan cost, participant and financial data, funding method, factors and assumptions used in determining cost estimates and other factors deemed appropriate. Reports containing this information are submitted to each of the three Boards of Trustees. The actuary meets with the respective Boards of Trustees for comments and discussions before and after completion of the studies and submission of each report.

In addition, the actuary appears before the Board of Supervisors as requested; provides cost estimates for proposed plan changes; meets with the various Boards of Trustees as requested concerning suggested plan changes, administration of the plan, and any other pertinent questions posed by the trustees; and apprises and reminds the trustees of changes in the law which may affect the plans and assesses the impact of these changes on the plans.

The actuary also is required to provide an actuarial experience study that includes studies of the systems' experience with respect to both economic and demographic assumptions and recommended actions. The last such study covered the period from July 1, 1990, through July 1, 1995. Future studies are to be done every five years thereafter.

IMPROVEMENTS MADE IN MANAGING RETIREMENT FUNDS

To optimize returns on retirement systems' funds, RAA must collect employee and employer contributions and other amounts owed to the systems promptly, and maintain in pooled cash accounts (similar to checking accounts for each retirement system) only the amounts of cash needed to pay retirement benefits, refunds, and other expenditures. The balance should be invested promptly in accordance with Boards of Trustees' guidance. During our review we noted that improvements were needed in the collection of amounts owed and that further refinements could be made in the process of determining the amount to keep on hand for payments. These practices, in effect, resulted in less money being available to be invested, and some money invested at lower rates of return than it could have been.

On other occasions, RAA had too little money in its pooled cash accounts. RAA officials overdrew the Supplemental Retirement System's pooled cash account with the County for several months. In essence, the Supplemental Retirement System obtained an interest-free loan for several months from the County's pooled cash program that included the General Fund and other County agencies. Since the County invests the pooled cash and it didn't have the use of the funds borrowed by RAA, the General Fund lost the opportunity to earn $36,000 in interest income. RAA also overdrew the Police Officers Retirement Systems pooled cash account, but only for a few days. RAA promptly corrected the problem after the County's Department of Finance notified RAA that it overdrew its account.

After we brought these matters to the attention of RAA officials, they immediately took corrective actions to strengthen cash management procedures that will benefit all retirement systems under RAA's management. Further, they took action to repay the General Fund for the interest lost from the Supplemental Retirement System being overdrawn.

SCHOOLS PROVIDING REQUIRED CONTRIBUTIONS MORE TIMELY

Both the employee and the employers -- Fairfax County and Fairfax County Public Schools (FCPS) -- contribute to the retirement systems. Employees' contributions generally are made through payroll deductions when Fairfax County and FCPS process their payrolls. RAA records the employees' contributions in their respective retirement accounts maintained at RAA.

RAA staff computes Fairfax County contributions to each retirement system. Since Police Officers and Uniformed employees (such as firefighters) are employed by the County, Fairfax County is responsible for making the employer's contribution to the Police Officers and Uniformed Retirement Systems. Fairfax County also is responsible for providing the employer's contribution to the Supplemental Retirement System for all of the other employees working for the County. This calculation is performed on or just before the pay date which enables accounting transactions to be made that transfer amounts from the County's General Fund to the retirement systems. RAA's prompt computations and recording of the accounting transactions in the Financial Accounting and Management Information System (FAMIS) results in making funds available in a timely fashion for investment at higher rates of return, if not needed in the immediate future to pay retirement benefits, refunds, and other expenditures.

FCPS also is responsible for providing employees' and employer's contributions to the retirement systems to which its employees belong. Some of its employees (such as custodians and part time employees), belong to the Supplemental Retirement System. FCPS staff computes the employees' and employer's contributions and records in FAMIS the transfer of these contributions to the Supplemental Retirement System. During our review of the contributions to the retirement systems, we noted that both the employees' and FCPS's contributions were frequently late (not transferred to the Supplemental Retirement System in FAMIS on or near the pay date) between July 1997 through March 1998.

FCPS was late in making the transfer in 17 of the 19 biweekly payrolls and in 5 of the 9 monthly payrolls. FCPS's tardiness ranged from 3 to 73 days late. The employee and employer contributions during this period totaled approximately $1 million per month. These contributions should have been made to the Supplemental Retirement System on time (within two days of the employees' pay date). Since FCPS staff did not transfer the contributions to the Supplemental Retirement System promptly, RAA staff was unable to use these funds to pay Supplemental Retirement System expenses or to invest them.

As soon as we completed this analysis, we discussed our concerns with RAA officials and suggested that they take immediate corrective action since the Supplemental Retirement System was losing use of these funds. They agreed and promptly met in April 1998 with FCPS officials to discuss the issue. Shortly after that meeting, FCPS began making their contributions to the Supplemental Retirement System on time. RAA officials' prompt action had an immediate positive dollar impact on operations.

ACTION TAKEN TO COLLECT RECEIVABLES

Because a small number of retiree's monthly retirement checks are not sufficient to cover the cost of health or other benefits still available to them through the County or FCPS, some retirees must remit personal checks to pay for those benefits. For those who retired from a FCPS position, they remit their checks directly to FCPS. Since this review was focused on the administrative operations of the RAA, we did not review FCPS's collection system.

During our review of RAA's collection system, however, we noted that RAA had 71 retirees that had to remit personal checks to cover their health and other benefits. The monthly amounts due ranged from $77 to over $500 per month. We also noted that several retirees were behind in making payments by about a month; some others were behind for several months. Further, little effort had been made at the time of our review to provide notices to those who were behind. Subsequent inquiries, after bringing this to RAA's attention, resulted in learning that one retiree had died, two others said that they would remit payment, and another retiree's health insurance had to be terminated for nonpayment of over $3,000, which was over 18 months in arrears.

It is important to collect these amounts timely because the retirement systems are not to pay premiums for retiree's health or other benefits beyond the amount specified in County Ordinances. If a retiree's retirement check is too small to cover the cost of benefits they wish to continue in retirement, RAA's procedure is to ask the retiree to always pay for these benefits one month in advance. RAA has this procedure so it can reimburse the County for health and other benefit premium payments it makes on behalf of retirees with the retirees money, not funds from the retirement systems.

When we discussed this matter with RAA officials, they began immediate corrective action to bring the accounts current. They also requested periodic reports to ensure the proper handling of this area. In addition, they met with Department of Human Resources personnel to discuss the problem of nonpayment of over $3,000. Because this expense is not a permissible expense to the retirement system, the County has agreed to make a one-time reimbursement to the retirement system. However, the Department of Human Resources has requested and RAA has agreed to provide more specific reporting that shows whether retirees are current on their benefit payments in an attempt to prevent this type of situation from recurring.

ADDITIONAL EMPHASIS NEEDED ON MAXIMIZING DOLLARS INVESTED BY REFINING CASH MANAGEMENT PRACTICES

Sound cash management policies are important to every organization, including RAA. These policies include ensuring that amounts due the retirement systems are collected on time and that the amounts owed by the retirement systems are paid when due, and not before unless discounts offered by vendors make early payment worthwhile. In the case of RAA, these policies also should include maintaining minimum positive balances in Fairfax County's pooled cash management program. Fairfax County's pooled cash investment program generally earns a lower return because its investment objectives give higher priority to safety and liquidity rather than rate of return. For example, Fairfax County's pooled cash investments earned about 5% while the retirement systems earned more than twice that amount during Fiscal Year 1998.

In order to ensure that cash management policies are implemented effectively, it is important that cash flow forecasts be routinely performed. During our review we were informed that RAA staff used to perform cash forecasts some time ago, but had stopped the practice because RAA could not depend on schools' contributions to the Supplemental Retirement System being made timely.

Instead of formal cash flow forecasts, RAA would informally review the "Equity in Pooled Cash" accounts for each of the retirement systems about twice a month and compare expected employee and employer contributions with known major expenses, like annuity checks to retirees and beneficiaries. This generally resulted in maintaining a positive balance in the pooled cash accounts. However, this technique resulted in the Supplemental Retirement System's pooled cash account balance going negative in August 1997. While it stayed negative until December 1997, it was not because of informal cash forecasting as explained further on the next page. This informal technique also resulted in the Police Officers' pooled cash account balance going negative for one day in a more recent month. In our opinion, the estimating technique was too informal for such a significant amount of money.

We discussed our concerns for the need to refine cash management with RAA officials who agreed that RAA needed to do a better job of managing pooled cash balances. They pointed out that RAA has been entering payments into FAMIS without keeping track of when the payments are scheduled out of "Equity in Pooled Cash" accounts. They acknowledged that the account balances needed to be kept positive, but not too high because they can earn a higher rate of return with their other investments. They said that they plan to institute a more refined method of forecasting cash needs in order to ensure that appropriate balances are maintained in the pooled cash accounts.

NEGATIVE CASH BALANCES
TO BE AVOIDED

While reviewing each retirement systems' "Equity in Pooled Cash" account balances, we discovered that the Supplemental Retirement System's balances were negative from August through most of December 1997. The negative balances ranged from several hundred thousand dollars to over $4 million.

In effect, RAA was using cash belonging to other funds, including the General Fund, to pay Supplemental Retirement System expenses rather than transferring some of its $1.4 billion in Supplemental Retirement System assets from other investments to its pooled cash account. This occurred because the County's Department of Finance did not have a procedure to deal with negative balances. RAA's use of others' funds reduced the amount available for Department of Finance's staff to invest. (Each day, this staff consolidates all the money in agencies' pooled cash accounts with money in the General fund, which includes tax collections and other revenue, and invests the amount not immediately needed to pay bills.) As a result, $36,000 of interest was not earned by the County's investments and therefore, not distributed to the County's General Fund and other agencies' accounts that had a share in the total pooled cash invested.

After we pointed out the impact of its actions, RAA subsequently notified the Department of Finance on June 2, 1998, that an adjustment should be made to reduce the interest earned by the Supplemental Retirement System. While a number of funds were affected, the Department of Finance, for administrative ease, made an adjusting entry that resulted in the interest lost being repaid to the General Fund in conjunction with the County's annual audit.

Since the absence of a Department of Finance policy permitted RAA to overdraw its pooled cash account, we plan to continue our work at other agencies to determine the extent of negative balances in their pooled cash accounts. However, as a result of our discussing the negative cash balance problem with the Departments of Finance and Management and Budget, officials of these two Departments agreed on a new policy for monitoring negative balances in agencies' pooled cash funds. The new goal is to identify unacceptable negative balances, such as RAA's, as soon as they occur so that immediate corrective action can be taken. To meet this goal, the Department of Finance has already changed its system of monitoring negative balances in pooled cash funds to daily rather than weekly. The fact that this monitoring is working is evidenced by the Finance staff's identifying a negative balance in the Police Officers Retirement System's "Equity in Pooled Cash" account which was described on page 8 of this report.

METHODOLOGY USED FOR DETERMINING RETIREMENT BENEFITS IS SOUND

During our review of benefit calculations under the three retirement systems, we found that the methodology used for the Police Officers' and the Uniformed Retirement Systems results in the calculation of retirement benefits as intended by Fairfax County's Ordinances. We also found that the methodology used for the Supplemental Retirement System resulted in the proper calculation of retirement benefits, with one exception we noted. Because this exception could affect the retirement benefits of some former FCPS employees who retired after April 1, 1997, we brought this matter to RAA officials' attention.

RAA officials agreed with our concern and corrected the problem as of October 31, 1998. In addition RAA undertook a study to determine the impact on retirement benefits of those affected. As a result of this study, RAA found that 54 (20%) of the 273 FCPS personnel that retired between April 1, 1997 and October 31, 1998 were receiving incorrect retirement benefits. Twenty-one were being overpaid and 33 were being underpaid. Overpayments ranged from $2.62 to $74.90 per month and underpayments ranged from $.14 to $62.87 per month. For those who were underpaid, RAA plans to issue retroactive checks for the amount of the past underpayments and adjust the monthly benefits to the correct amount. For those that were overpaid, RAA plans to adjust the monthly benefits and ask for the overpayment to be returned to the Supplemental Retirement System. Retirees can provide a "Statement of Financial Condition" for the Board of Trustees' review and consideration if repayment poses a financial hardship.

REVIEW OF COMPUTER PROGRAM USED TO CALCULATE MISSED INCREMENT FACTOR FOR SUPPLEMENTAL RETIREMENT SYSTEM RETIREES

During its budget approval process, the Fairfax County Board of Supervisors deferred the merit increments (step increases) for active employees for Fiscal Years 1992 and 1993. The Board of Supervisors' decision was not intended to impact members' annuities at retirement. Therefore, the Boards of Trustees of the Fairfax County Police Officers, Supplemental, and Uniformed Retirement Systems recommended Ordinance changes which would adjust a member's final average compensation as if merit increments had not been deferred. The Board of Supervisors approved these Ordinance changes in March 1993. As part of these Ordinance changes, the Boards of Trustees were authorized and directed to make any necessary retroactive adjustments to allowances and benefits back to July 13, 1991.

At the request of RAA, the Supplemental Retirement Systems' consulting actuary, Milliman and Robertson, Inc., recommended, developed, and delivered in September 1993 a computer program that was intended to assist in the computation of retirement benefits. This program computes a factor to be used to adjust a member's final average pay if the member worked during Fiscal Years 1992 and/or 1993 and was not at the longevity step for three years or more before the pay freeze became effective. The computer program is used for Supplemental Retirement System members but not members of the Police Officers or the Uniformed Retirement Systems.

According to an RAA official, the sheer volume of members retiring in the Supplemental Retirement System necessitated the use of the computer program to assist RAA personnel with the computation of the effect of deferred merit increments on average final pay.

In September 1995, the Board of Supervisor's included clarifying language in the Ordinance of the Supplemental Retirement System. This amendment stated, among other things, that "the Board shall calculate the member's average final compensation in a manner which approximates the average final compensation the member would have if the member had received the merit increment at the time he or she would have been entitled to receive such merit increment but for the aforesaid amendments to Section 4.3-2 of the Personnel Regulations." This amendment also codified the use of a "factor" to calculate the increase, if any, in a member's average final compensation.

Between September 1993 and April 1997, RAA refined its Supplemental Retirement System computer program three times. Refinements were made when they discovered incidents of people retiring with a somewhat rare set of circumstances. These refinements were made so the computer program would be able to compute a factor that when used for any others retiring after the modification, with these same, rare circumstances, would more closely approximate an individual's average final compensation.

We tested the population of those who retired under the Supplemental Retirement System between September 1993 and April 1997. Our purpose was to determine whether others had the same circumstances that led to the computer program changes and if so, determine the impact, if any, on their retirement benefit computations.

For our test, we randomly selected 87 or 10% of the 868 who retired during the period. Only one person in our sample had circumstances similar to those for which the computer program was changed and had retired before the computer program was changed. However, we concluded, after recalculating the retiree's missed increment factor using the latest, refined computer program, that the difference in the factors was negligible. We therefore believe that the computer program being used to compute missed increment factors is in compliance with the Ordinance governing the Supplemental Retirement System. The computer program produces factors that allow RAA staff to approximate the average final compensation a member would have received if he or she would have received a merit increment for which he or she was eligible during Fiscal Years 1992 and 1993.

MISINTERPRETATION OF COMPUTER PROGRAM INSTRUCTIONS AFFECTED SOME SCHOOL RETIREES' BENEFIT PAYMENTS

During our review of the methodology used for retiree benefit calculations, we discovered that the two Supplemental Retirement System retirement counselors (one for County employees and one for FCPS employees) were interpreting the instructions differently for entering data into the computer program. The difference in interpretation, which happened between April 1, 1997 and October 31,1998, can affect the amount of the retiree's retirement benefit. Because of this, we met with RAA officials to discuss this matter. RAA officials determined that the instructions were being properly interpreted for County employees and misinterpreted for FCPS employees. Because of the potential impact on retirement benefits, RAA recalculated the records of 273 FCPS retirees who retired between April 1, 1997 and October 31,1998. Of these retirees, approximately 20% or 54 retirees had different retirement benefit calculations using the correct program interpretation of when a member would have received a merit increment adjustment.

As a result of this review, RAA discovered that 21 retirees were being overpaid and 33 retirees were being underpaid. Overpayments ranged from $2.62 to $74.90 per month. Underpayments ranged from $.14 to $62.87 per month.

Based on this analysis, RAA plans to issue retroactive checks for the amount of the past underpayments and adjust the monthly retirement benefits to the correct amount. For those who were overpaid, RAA plans to adjust the monthly benefits and ask for the overpayment to be returned to the Supplemental Retirement System. Retirees can provide a "Statement of Financial Condition" for the Board of Trustees' review and consideration if repayment poses a financial hardship.

CONCLUSIONS

RAA's staff of 21 has a sizable responsibility. It has over 18,000 active and retired members to handle and $2.7 billion in investments to administer for its members and their Boards of Trustees. Overall, we believe that RAA is administering the three retirement systems very well. Further, where we pointed out areas in which RAA could refine operations to make them more effective, RAA officials quickly acted to make operational improvements. It is readily apparent that the staff is dedicated to quality service to retirement systems' members and effective operations.

Since RAA either has corrected or is in the process of correcting matters that we have brought to their attention during our review, we are not making any recommendations. We would like to commend RAA officials and staff for their prompt actions to matters arising during our review. Their prompt actions evidence their unanimous desire for quality operations.

COMMENTS AND OUR EVALUATION

In his response to our report (which is included in its entirety in Appendix VI), the RAA's Executive Director concurred with our report and pointed out that our review helped RAA to focus on opportunities to improve operations. Examples of these improvements included the more timely transfer of the Public Schools System's contributions to the Supplemental Retirement System, better reporting of the status of retiree health premium payments, and a better process for acting on any overdue amounts from retirees.

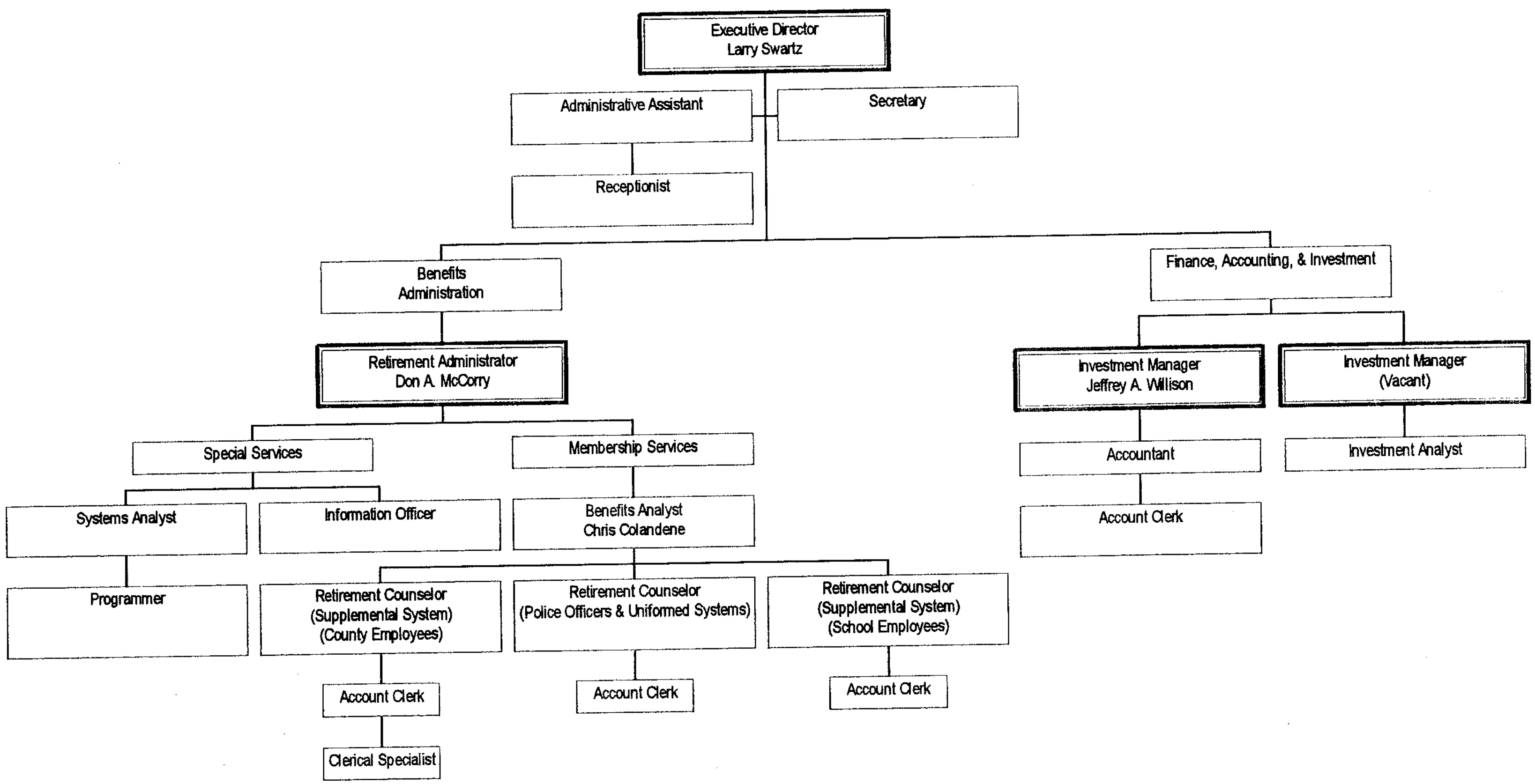
Additionally, RAA's Executive Director stated that RAA has rectified the one inconsistency we found in RAA's use of a computer program for calculating an adjustment factor to offset the impact of deferred merit increases in Fiscal Years 1992 and 1993. RAA has clarified instructions for staff and now the correct adjustment factor is being produced by the computer program for use in computing Supplemental Retirement System retirement annuities. Also, RAA has taken action to adjust payments to those retirees whose benefit amounts were incorrect.

Lastly, RAA's Executive Director pointed out that RAA has strengthened its cash forecasting process and improved the monitoring of cash balances to ensure that future negative balances are avoided. This will eliminate any future negative impacts on the allocation of interest earnings to other County funds. He added that RAA is continuing to review its process for projecting and monitoring the timing of major disbursements to strike the right balance between the cost of frequent transfers from investment accounts and maintaining the minimum possible balance in the County's pooled cash account.

We concur with the actions taken by the RAA and believe that these actions will further improve the administration of the three retirement systems. Because RAA already has taken these actions, we are making no recommendations for remedial action.

APPENDIX I

Fairfax County Retirement Administration Agency
Organization Chart



FAIRFAX COUNTY SUPPLEMENTAL RETIREMENT SYSTEM

BOARD OF TRUSTEES

FAIRFAX COUNTY POLICE OFFICERS RETIREMENT SYSTEM

BOARD OF TRUSTEES

APPENDIX IV

FAIRFAX COUNTY UNIFORMED RETIREMENT SYSTEM

BOARD OF TRUSTEES

SCOPE OF OUR REVIEW

This review is part of the Board of Supervisors' work plan for our Office. The work plan was approved by the Audit Committee and was presented to and approved by the Board of Supervisors.

Our review of Fairfax County's Supplemental, Police Officers, and Uniformed Retirement Systems had two objectives: (1) to review the financial condition of the systems, and determine whether the county was contributing an appropriate amount to each system and (2) to determine whether the retirement systems were being administered effectively. Our first report, entitled "Retirement Systems: Excellent Financial Condition; County Contribution Rates Appropriate; and Fiscal Year 1999 Contribution Rates Projected To Be Significantly Lower," dated February 27, 1998, addressed the first objective.

This report focuses on the second objective. To accomplish that objective, we reviewed sections of the Fairfax County Code, brochures prepared for system members, and operational policies and procedures in RAA's Manual pertaining to the three retirement systems. We also interviewed RAA staff and management to ascertain procedures they followed in performing their duties. Further, we reviewed pertinent documents related to the performance of day-to-day functions of RAA.

With this information, we developed and performed key tests of operational controls over procedures and methodologies followed by staff that can affect cash inflow to RAA and cash outflow from RAA. Cash inflow to RAA includes employee contributions, employer contributions, investment income, security litigation income, employees buying back or buying into retirement systems, and retirees' payments for health benefits and life insurance premiums when annuities are insufficient to take them out of retirees' checks. Cash outflow from RAA includes benefit payments to retirees or beneficiaries, refunds of contributions to former retirement system members, costs of investment services, and administrative expenses.

Controls were in place and working at the time of our review for most of the above areas. Where we found problems with the controls, we discussed them with the new Executive Director who took prompt corrective action. We discuss in the body of the report the control problems found and the corrective action taken or to be taken. Controls require constant vigilance in order to ensure that staff is performing tasks and duties correctly, as desired by management. We have every confidence that the new Executive Director and his staff are committed to that end.

We would like to express our appreciation to the Boards of Trustees and RAA personnel for their cooperation and assistance during this last phase of our review. We also commend the new Executive Director for promptly taking corrective action when we brought operational concerns to his attention. His actions have resulted in very timely improvements and his planned actions will further strengthen RAA's operations.

FAIRFAX COUNTY, VIRGINIA

APPENDIX VI

MEMORANDUM

TO: John J. Adair
Auditor to the Board of Supervisors

FROM: Laurnz A. Swartz, Executive Director *LAS*
Retirement Administration Agency

DATE: December 22, 1998

SUBJECT: Audit Report - Phase II

This memorandum is in response to your report on the second and final phase of your review of the Supplemental, Police Officers, and Uniformed Retirement Systems.

As the new Executive Director to the Retirement Boards, your audit review was timely in that it assisted me in meeting my personal objective of reviewing the existing controls in Retirement Administration and the accuracy of our benefit calculations. I was pleased that no serious shortcomings were identified and that you confirmed that benefits are being calculated according to the ordinances governing the retirement systems.

The issues identified in your review and noted in your report have helped us to focus on opportunities to improve our operations and our controls. We have improved our coordination with the Public Schools System and contributions continue to be transferred on a timely basis. We have also improved our reporting of the status of retiree health premium payments and strengthened our process for acting on any overdue amounts.

Your thorough review of the process used to adjust average final compensation to offset the impact of deferred merit increases in fiscal years 1992 and 1993 was particularly helpful in that you confirmed that our procedures and program continue to accomplish the intent of the March 1993 Ordinance changes. We have rectified the one inconsistency in the use of our calculation program by clarifying instructions for staff and by adjusting payments for the retirees whose benefit amounts were incorrect.

Finally, now that we are aware that negative balances in the County's Pooled Cash Account adversely affect the allocation of interest earnings to other funds, we have strengthened our cash forecasting process and improved the monitoring of our cash balances to ensure that we avoid future negative balance situations. We are continuing to review our process for projecting and monitoring the timing of our major disbursements to strike the right balance between the cost of frequent transfers from investment accounts and maintaining the minimum possible balance in the County's pooled cash account.

The manner in which your office conducted the audit has benefitted the County and the retirement systems. We were able to approach your independent review of the Retirement Administration Agency with the common objectives of assessing our effectiveness and identifying opportunities for improvement. I appreciate the time you and your staff devoted to Retirement Administration and your recognition that RAA staff is dedicated to the quality of our work and service to members. I can assure you that we will continue to search for and be alert to opportunities to build on that strong foundation.

cc: Members, Boards of Trustees
Police Officers Retirement System
Supplemental Retirement System
Uniformed Retirement System