COUNTY OF WINNEBAGO

WINNEBAGO COUNTY AUDITOR

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IMRF (Illinois Municipal Retirement Fund) Pension Spiking Audit

Total Findings: 4
March 1st, 2017

The mission of the Winnebago County Auditor's Office is to safeguard Winnebago County assets and provide objective, accurate and meaningful information about County operations so that the County Board can make informed decisions to better serve County citizens.

AUDIT TEAM MEMBER(S):

Bryan M. Cutler, Chief Deputy Auditor

Copies of County Auditor's reports are available by request.
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March 1, 2017

Members of the County Board
Frank Haney, County Board Chairman
Amanda Hamaker, County Administrator
Carla Paschal, Chief Financial and Budget Officer

On August 26, 2011, Public Act 97-0609 was signed into law. One of the key elements of the act was to address pension spiking that occurs when earnings subject to IMRF withholding are increased in the years nearing retirement. To address this issue, the Act requires employers to accelerate pension contributions for retirees whose compensation in the final years of employment is greater than 6% from the prior year's compensation.

The goal of the accelerated payment is to fund the incremental cost of an individual's pension due to IMRF earnings increases over the 6% threshold immediately rather than adding them to the employer's unfunded actuarial accrued liability which is currently collected over 30 years and contains an assumption of 7.5% investment returns.

Winnebago County has received $537,165.99 in accelerated payment invoices over the last 14 months. This represents a significant increase relative to historical activity.

The County Auditor's Office recently performed an audit of the accelerated payments and other IMRF financial issues. The primary objective of our audit is to identify the underlying cause of the accelerated payment requests and to identify any potential policy changes that will lessen future financial exposure related to pension costs.

Audit Findings & Recommendations

Finding 1:

The Auditor's Office noted two cases which employees were paid out vacation time in a manner that circumvented the IMRF 125% rule. The 125% rule limits includable IMRF pension wages received in the final 3 months of employment to a maximum of 125% of the highest month wages received in the previous 45 months. The 125% rule was circumvented by a department paying out vacation balances during the 45 months immediately preceding retirement and then spreading out large final vacation payouts in the final three months of employment. **This resulted in the County receiving accelerated payment requests in the amounts of $97,202.77 and 74,719.51 after both individuals retired.**

The underlying causes of accelerated payment invoices **other than those described above** and received in the last 14 months are as follows:

- 8 instances of increases in wages from overtime
- 4 instances of increases in wages from promotions
- 5 instances of increases in wages from retro-pay payments from settlement of a collective bargaining agreement.
- 10 instances of increases in wages from vacation payouts at the end of employment

These accelerated payments resulted from payroll activity that we would describe to be in the ordinary course of business. Winnebago County has recently experienced an increase in retirements which has contributed to an increase in accelerated payment invoices. We anticipate that the volume and dollar amount of these invoices will decrease going forward.

Recommendation 1:

IMRF rules are complex. There are multiple plans with multiple tiers. We recommend that the County Chief Financial and Budget Officer consider distributing to all appointed and elected officials a brief description of common IMRF pension spiking scenario's along with precautions on how to avoid them. We recommend using IMRF's Pension Spiking and AP Webinar PowerPoint presentation for this purpose.

Recommendation 1-1:

Winnebago County IMRF expenses are charged to a separate fund which funded by property taxes and replacement taxes. Departmental budgets are generally not impacted by IMRF expenses. We recommend County Administration develop a pension spiking policy that would prohibit certain payments that spike pensions. We recommend this policy include a provision to charge the individual departments rather than the IMRF fund for the additional IMRF expenses associated with spiked pensions.

Finding 2:

Finding 1 addressed retirees for which the County has already received accelerated payment requests. In Finding 2, we have noted through examination of payroll records that active employees exist that have been paid out vacation time and are currently eligible to retire with an IMRF pension. This type of payout effectively sets the stage to circumvent the IMRF 125% rule, particularly if the future retiree has a large vacation balance at retirement.

Recommendation 2:

See recommendation 1 and 1-1. Additionally, we recommend Administration consider working with the County Board to pass an ordinance change that would prohibit all vacation payouts for active employees and require all final vacation payouts to be paid in one installment along with the employees final paycheck.

Finding 3:

The Auditor's Office recently was presented for payment a signed severance agreement for $100,000 which hadn't been reviewed by someone with an intimate knowledge of IMRF rules. We determined through our research that this payment would circumvent IMRF's pension spiking controls, significantly spike the employee's pension and generate an accelerated payment invoice of nearly $300,000. We referred the issue to the States Attorney's Office.

Additionally, the County has paid several severance payments over the last 5 years that may have contributed to a pension increase since they were paid immediately after termination of the employee. Generally, these payments have a somewhat limited impact due to the IMRF 125% rule limiting the portion to be includable as IMRF earnings.

Recommendation 3:

We recommend that all contracts for separation of employment that include compensation be reviewed and **approved** by the Chief Financial and Budget Officer.

Recommendation 3-1:

Severance payments made after the first calendar month after termination of employment do not constitute IMRF earnings regardless of what they are or when they were earned or when the agreement was made to make payments. We recommend County Administration develop a policy that requires all severance agreements to include language indicating payments will be made only after the first calendar month after termination of employment.

Finding 4:

IMRF gives local governments the option appeal accelerated payment invoices. We believe that Winnebago County could file a successful appeal for most of the accelerated payment invoices received in the future. The result of a successful appeal would be that cost of the associated pension increase would be added to employer's unfunded actuarial accrued liability and charged interest. The advantage would be improved cash flow in the IMRF fund. The disadvantage would be increased interest costs embedded in future IMRF employer rates.

<u>Recommendation 4</u>:

We recommend County Administration develop a policy to address accelerated payment appeals. This policy would ideally provide guidance to payroll and finance staff on whether to appeal accelerated payments or to initiate payment of the full balance requested by IMRF.