OLA **OFFICE OF THE LEGISLATIVE AUDITOR**
**STATE OF MINNESOTA**

**FINANCIAL AUDIT DIVISION REPORT**

# Public Employees Retirement Association

## Financial Statement Audit

## Year Ended June 30, 2009

**March 9, 2010** **Report 10-06**

FINANCIAL AUDIT DIVISION
Centennial Building – Suite 140
658 Cedar Street – Saint Paul, MN 55155
Telephone: 651-296-4708 • Fax: 651-296-4712
E-mail: auditor@state.mn.us • Web site: http://www.auditor.leg.state.mn.us
Through Minnesota Relay: 1-800-627-3529 or 7-1-1

## Financial Audit Division

The Financial Audit Division annually audits the state's financial statements and, on a rotating schedule, audits agencies in the executive and judicial branches of state government, three metropolitan agencies, and several "semi-state" organizations. The division has a staff of forty auditors, most of whom are CPAs. The division conducts audits in accordance with standards established by the American Institute of Certified Public Accountants and the Comptroller General of the United States.

The Office of the Legislative Auditor (OLA) also has a Program Evaluation Division, which evaluates topics periodically selected by the Legislative Audit Commission.

Reports issued by both OLA divisions are solely the responsibility of OLA and may not reflect the views of the Legislative Audit Commission, its individual members, or other members of the Minnesota Legislature. For more information about OLA reports, go to:

**http://www.auditor.leg.state.mn.us**

To obtain reports in electronic ASCII text, Braille, large print, or audio, call 651-296-4708. People with hearing or speech disabilities may call through Minnesota Relay by dialing 7-1-1 or 1-800-627-3529.

To offer comments about our work or suggest an audit, investigation, or evaluation, call 651-296-4708 or e-mail auditor@state.mn.us.

Senator Ann H. Rest, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Members of the Public Employees Retirement Association Board of Trustees

Ms. Mary Most Vanek, Executive Director
Public Employees Retirement Association of Minnesota

In auditing the Public Employees Retirement Association's basic financial statements for the year ended June 30, 2009, we considered internal controls over financial reporting. We also tested compliance with significant legal provisions impacting the basic financial statements and did not identify any noncompliance to report. This report contains our findings and recommendations on internal control and compliance over financial reporting. However, given the limited nature of our audit work, we do not express an overall opinion on the effectiveness of the Public Employees Retirement Association's internal controls or compliance. In addition, our work may not have identified all significant control deficiencies or instances of noncompliance with legal requirements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. This report meets the audit standard requirements of the American Institute of Certified Public Accountants and the Government Accountability Office to communicate internal control matters identified in a financial statement audit. The audit was conducted by Jim Riebe, CPA, (Audit Manager) and Carl Otto, CPA, (Auditor-in-Charge), assisted by auditors Mark Allan, CPA, Xin Wang, CPA, Adam Spooner, and Alex Weber.

We consider the deficiencies described in Findings 1 and 2 to be material weaknesses. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis. We consider the deficiency describe in Finding 3 to be a significant deficiency. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

We discussed the results of the audit with the Public Employees Retirement Association on March 2, 2010. Management's response to our findings and recommendations is presented in the accompanying section of this report titled, *Agency Response.* We did not audit the response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Public Employees Retirement Association's management and the Legislative Audit Commission and is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit the distribution of this report, which was released as a public document on March 9, 2010.

| | |
|---|---|
| */s/ James R. Nobles* | */s/ Cecile M. Ferkul* |
| James R. Nobles<br>Legislative Auditor | Cecile M. Ferkul, CPA, CISA<br>Deputy Legislative Auditor |

End of Fieldwork: January 6, 2010

Report Signed On: March 5, 2010

# Table of Contents

# Report Summary

## Conclusion

The Public Employees Retirement Association's (PERA) financial statements were fairly presented in all material respects. However, PERA had some weaknesses in internal control over financial reporting as noted below.

## Findings

- Prior Finding Not Resolved: PERA did not have adequate controls to ensure that employers reported and remitted the correct amount of salaries and retirement contributions. (Finding 1, page 3)

- PERA did not accurately report foreign currency risks in its financial statement footnote disclosures. (Finding 2, page 3)

- PERA did not adequately segregate incompatible receipt duties for members' voluntary contributions. (Finding 3, page 4)

## Audit Scope

We audited PERA's basic financial statements for the fiscal year ended June 30, 2009.

# Findings and Recommendations

## Finding 1

**Prior Finding Not Resolved: PERA did not have adequate controls to ensure that employers reported and remitted the correct amount of salaries and retirement contributions.**

PERA did not have control procedures in place to ensure employers reported amounts based on statutory requirements. This internal control weakness increased the risk of pension contributions and retirement benefits being overstated or understated.

In our prior audit report for the year ended June 30, 2008, we noted that the City of Duluth had erroneously reported employee salaries to PERA dating back to January 1997.[1] The city had incorrectly included some employer-paid benefits in its calculation of employees' base salaries. The city used this overstated salary amount to determine both its employee and employer retirement contributions and also reported these incorrect base salaries to PERA. PERA used the incorrect base salaries to determine employees' pension benefits.

Employers are responsible to report members' eligible salaries in accordance with *Minnesota Statutes.*[2] According to statute, employer-paid fringe benefits, including employer contributions to flexible spending accounts, deferred compensation plans, and insurance coverage, are excluded from the definition of salary. Although PERA provided extensive training to employers on how to calculate and report salary information and pension contributions, it did not verify that employers reported the correct base salaries and pension contributions.

*Recommendation*

- *PERA should verify that participating employers properly calculate and report eligible salaries and contributions.*

## Finding 2

**PERA did not accurately report foreign currency risks in its financial statement footnote disclosures.**

PERA did not accurately disclose $32.8 million of cash and $10.6 million of fixed income investments as investments held in foreign currencies in its foreign currency risk footnote. Instead, PERA erroneously reported that the funds were invested in other types of foreign currencies not specified in the disclosure. PERA relied on the State Board of Investment to provide the information included in the foreign currency investment disclosure since the board invests the pension's

[1] Office of the Legislative Auditor's Financial Audit Division Report 09-04, *Public Employees Retirement Association*, issued February 13, 2009.
[2] *Minnesota Statutes* 2009*,* 353.01, subd. 10.

funds. Ultimately, however, PERA is responsible for the accuracy of its financial statements and footnote disclosures.

Government accounting principles require that if a government's deposits or investments are exposed to foreign currency risk, the government should disclose the U.S. dollar balances of such deposits or investments, organized by currency denomination and, if applicable, investment type.[3] The State Board of Investment provided the foreign currency schedule to PERA that incorrectly summarized cash and fixed income balances into a "other" denomination classification without allocating the amounts to their respective foreign currencies. However, PERA did not question the accuracy of the information received. Uncorrected, the inaccuracies in the foreign currency disclosure may have been misleading to users of PERA's financial statements.

*Recommendation*

- *PERA should work with the State Board of Investment to ensure the accuracy of the foreign currency risk disclosures reported in PERA's footnotes to the financial statements.*

## Finding 3

**PERA did not adequately segregate incompatible receipt duties for members' voluntary contributions.**

One employee received member voluntary contributions, posted the payments to PERA's accounting system, and prepared the checks for deposit. This concentration of responsibilities resulted in incompatible duties, because the same employee had access to the checks and updated the accounting records. Member voluntary contributions are nonroutine payments by members to buy back service credits.

In fiscal year 2009, PERA received over 500 checks totaling about $4.7 million for voluntary member contributions. The Department of Management and Budget's policy states that the same employee should not complete the following duties: open mail and receive cash or checks, prepare deposits for the bank, or enter receipts into the accounting system.[4] PERA performs daily reconciliations among the department's business system, the state accounting system, and bank report; however, this is not an effective mitigating control as lost or stolen receipts would not be part of the reconciliation.

*Recommendation*

- *PERA should adequately segregate receipt duties for members' voluntary contributions.*

---

[3]Government Accounting Standards Board Statement 40: *Deposit and Investment Risk Disclosures,* paragraph. 17.
[4]Department of Management and Budget Policy 0602-03: *Recording and Depositing Receipts.*

**Public Employees Retirement Association of Minnesota**
60 Empire Drive, Suite 200
Saint Paul, Minnesota 55103-2088
Member Information Services: 651-296-7460 or 1-800-652-9026
Employer Response Lines: 651-296-3636 or 1-888-892-73
PERA Fax Number: 651-297-2547 ◆ PERA Website: www.mnpera.org

March 3, 2010

James R. Nobles, Legislative Auditor
Office of the Legislative Auditor
Room 140, Centennial Office Building
658 Cedar Street
St. Paul, MN 55155-1603

Dear Mr. Nobles:

Thank you for the opportunity to review and respond to the audit your office conducted for fiscal year 2009. We take audit findings very seriously, and are either in the process of implementing your recommendations or have already implemented them. Our responses to your findings and recommendations are provided below.

1. ***Finding: PERA did not have adequate controls to ensure that employers reported and remitted the correct amount of wages and retirement contributions.***

   **Recommendation: PERA should verify that participating employers properly calculate and report eligible salaries and contributions.**

   Response: We have system controls in place that ensure the contributions we receive are calculated correctly based on the salary provided, but have not had authority in statute to conduct compliance audits. We have an extensive training program that includes online information, employer handbooks, quarterly newsletters and training sessions conducted throughout the state, and have introduced legislation that would give us authority to "establish reporting procedures and methods as required to review compliance by employers with the salary and contribution reporting requirements…." Should the legislation pass, we will be allowed to review payroll records of participating employers.

   We have been working with the Teachers Retirement Association to jointly plan compliance audits of schools once we have authority in statute to do so. We will work with them for the next couple of years on schools, then will broaden our scope to include other employers. During this past year we also restructured the work done by staff so that we could free up the time of two employees to handle compliance audits.

   Resolution Date: We will begin auditing schools during the summer of 2010, assuming legislation passes during the 2010 legislative session giving us that authority.

   Person Responsible: Cheryl Keating

2. ***Finding: PERA did not accurately report foreign currency risks in its financial statement footnote disclosures.***

   **Recommendation: PERA should work with the State Board of Investment to ensure the accuracy of the foreign currency risk disclosures reported in PERA's footnotes to the financial statements.**

   Response: In August 2005 we met with the Legislative Auditor's Office, the Minnesota Department of Finance, the State Board of Investment, the Teachers Retirement Association and the Minnesota State Retirement System to determine how we would implement GASB Statement No. 40 on deposit and investment risk disclosures. At that meeting we agreed that amounts less than 1% of the outstanding foreign currency risk at year end would be put in an "other" category because they were insignificant and immaterial. Since that date, the State Board of Investment has provided PERA with the foreign currency risk disclosures in accordance with those guidelines. Those disclosures were audited and approved by the Legislative Auditor in fiscal years 2005, 2006, 2007 and 2008. They were once again approved this year, and we received a certification letter dated December 18 stating "the financial statements referred to above present fairly, in all material respects, the financial position of the Public Employees Retirement Association as of June 30, 2009…." We published our CAFR on December 30, 2009 once we received their certification letter. On January 6, 2010, however, the Legislative Auditor's Office determined that the guidelines that were established in 2005 were no longer valid, and required the State Board of Investment to eliminate the "other" category and break out the small amounts from the "other" category into their proper categories. We were never told why this change was required or why amounts less than 1% of the outstanding foreign currency risk are now considered material, but we complied with the Legislative Auditor's request to re-publish our CAFR in January with the additional breakout in our footnotes as provided by the State Board of Investment.

   Our investments are co-mingled with the investments of other entities in a pool managed by the State Board of Investment. We rely on the State Board of Investment for the foreign currency disclosure figures we put in our CAFR. Assuming the State Board of Investment is able to continue to break out currency risk according to the new guidelines in the future, this issue is resolved.

   Resolution Date: RESOLVED

   Person Responsible: Dave DeJonge

3. ***Finding: PERA did not adequately segregate incompatible receipt duties for members' voluntary contributions.***

   **Recommendation: PERA should adequately segregate receipt duties for members' voluntary contributions.**

   Response: We will segregate incompatible receipt duties for members' voluntary contributions.

   Resolution Date: June 30, 2010

   Person Responsible: Dave DeJonge

Sincerely,

Mary Most Vanek

Mary Most Vanek
Executive Director