

**PUBLIC EMPLOYEES RETIREMENT ASSOCIATION
FINANCIAL AND COMPLIANCE AUDIT
FOR THE YEAR ENDED JUNE 30, 1985**

JANUARY 1986

**Financial Audit Division
Office of the Legislative Auditor
State of Minnesota**



STATE OF MINNESOTA

OFFICE OF THE LEGISLATIVE AUDITOR

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JAMES R. NOBLES, LEGISLATIVE AUDITOR

Senator Randolph W. Peterson, Chairman
Legislative Audit Commission

Members of the Legislative Audit Commission

and

Mr. James Hacking, Executive Director
Public Employees Retirement Association

Audit Scope

We have completed a financial and compliance audit of the Public Employees Retirement Association for the year ended June 30, 1985. The audit included a review of certain administrative procedures and expenditures during the period December 1, 1984 to June 30, 1985. The administrative procedures and expenditures from July to November 1984 were reviewed during our fiscal year 1984 audit. Our audit was made in accordance with generally accepted auditing standards, and the standards for financial and compliance audits contained in the U.S. General Accounting Office Standards for Audit of Governmental Organizations, Programs, Activities, and Functions, and accordingly, included such audit procedures as we considered necessary in the circumstances. Field work was completed on November 22, 1985.

The objectives of the audit were to:

- express an opinion on the financial statements of the Public Employees Retirement Association (PERA) for the year ended June 30, 1985;
- study and evaluate major PERA internal control systems, including a review of annuity payments and other withdrawals, receipts including contributions, payroll, and administrative disbursements; and
- verify that financial transactions were made in accordance with applicable laws, regulations, and policies, including Minnesota Statute Chapters 353 and 356, and other finance-related laws and regulations.

The management of PERA is responsible for establishing and maintaining a system of internal accounting control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly.

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Because of inherent limitations in any system of internal accounting control, errors or irregularities may occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions, or that the degree of compliance with the procedures may deteriorate.

The management of PERA is also responsible for the agency's compliance with laws and regulations. In connection with our audit, we selected and tested transactions and records from the programs administered by PERA. The purpose of our testing of transactions was to obtain reasonable assurance that PERA had, in all material respects, administered their programs in compliance with applicable laws and regulations.

Conclusions

We have issued an unqualified opinion on the PERA financial statements for the year ended June 30, 1985. Our audit opinion, dated November 1, 1985, is included within the 1985 PERA Comprehensive Annual Report.

In our opinion, the PERA system of internal accounting control in effect on June 30, 1985, taken as a whole, was sufficient to provide management with reasonable, but not absolute assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly.

In our opinion, except for the issue raised in Section I, for the year ended June 30, 1985, PERA administered its' programs in compliance, in all material respects, with applicable finance-related laws and regulations.

Section I of this Audit Report contains the recommendation we developed during this audit. It is presented to assist you in improving accounting procedures and controls. Recommendation 1 resulted from our review of administrative procedures and expenditures for the period December 1, 1984 to April 11, 1985 when PERA was administered by the previous Board. Although the finding occurred during the administration of the prior Board, it is the responsibility of the current Board to see it is resolved. Progress on implementing the recommendation will be reviewed during our audit next year.

Section II of this report includes a summary of the progress on all recommendations developed during our fiscal year 1984 audit. Many of the prior year's findings recommended that PERA seek reimbursement for certain

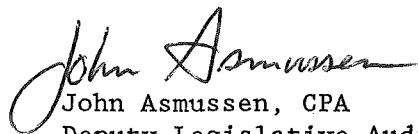
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unallowable expenditures. Although all amounts questioned have not yet been recovered, the findings are not repeated in this audit report because the issues have been referred to the Attorney General's Office for appropriate action.

We would like to thank the Public Employees Retirement Association staff for the cooperation extended to us during this audit.



James R. Nobles
Legislative Auditor



John Asmussen, CPA
Deputy Legislative Auditor

January 17, 1986

PUBLIC EMPLOYEES RETIREMENT ASSOCIATION

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AUDIT PARTICIPATION

The following members of the Office of the Legislative Auditor participated in this audit:

John Asmussen, CPA	Deputy Legislative Auditor
Claudia Gudvangen	Audit Manager
Michael Hassing	Auditor-in-Charge
Lori Pellicci	Staff Auditor
Scott Trobec	Staff Auditor

An exit conference was held with the following PERA staff on January 8, 1986:

James Hacking, Executive Director
Allen Eldridge, Manager of Benefits and Administration
Mike Hovde, Assistant Manager of Finance
Diane Rognrud, Manager of Data Processing

PUBLIC EMPLOYEES RETIREMENT ASSOCIATION

I. CURRENT AUDIT FINDING AND RECOMMENDATION

A member's retirement annuity was incorrectly calculated by PERA staff.

Upon separation from public service, a PERA member, meeting established age and service requirements, is entitled to a retirement annuity upon application to PERA. Based on documentation contained in a member's file, a PERA employee manually calculates the retirement annuity according to the provisions of Minn. Stat. Chapter 353. As a control to ensure the accuracy of the calculation, another employee is supposed to independently calculate the annuity and check the accuracy of the first amount.

Our testing found an erroneous annuity calculation for one member who retired effective July 1984. PERA staff incorrectly computed the member's "high five average salary." As a result, the member was overpaid approximately \$2,900 over a sixteen-month period. The second calculation performed by PERA staff did not identify the error. This occurred during a time period when PERA had a large backlog in annuity calculations to process. It appears that in attempting to complete the work there was a temporary lapse in controls. When we detected the problem, we expanded our testing of annuities for this time period. Our testing did not identify other errors. Since the independent second verification is an essential control, a careful review of documentation must be exercised to ensure the accuracy of annuity calculations.

RECOMMENDATION:

1. *PERA should correct the member's monthly annuity amount and collect the overpayment.*

PUBLIC EMPLOYEES RETIREMENT ASSOCIATION

II. STATUS OF PRIOR AUDIT RECOMMENDATIONS
AND

PROGRESS TOWARD IMPLEMENTATION

PERA did not adequately monitor the expense reimbursements and out-of-state travel of board members.

1. PERA should establish formal policies and procedures for the reimbursement of board member expenses, including:
 - a definition of the types of activities and types of expenses which qualify for reimbursement;
 - formal authorization in board minutes for all out-of-state travel;
 - an identification of the individual participants when meals are paid for on a group basis; and
 - a procedure for independent verification of expense reimbursements.

Recommendation Implemented.

2. PERA should seek legislative authority for any committees of the association which are composed of non-board members. Any travel by these committee members should be specifically authorized by the board.

Recommendation Implemented. Laws of 1985, Chapter 11, eliminated the authority for reimbursement of committee expenses.

3. PERA should institute procedures to monitor travel advances to ensure that final expense reports are submitted in a timely manner in all cases where advances were made.

Recommendation Implemented.

4. PERA should seek reimbursement of the amounts overpaid to board members for out-of-state travel.

Recommendation Implemented. Recommendation has been referred to the Attorney General's Office for further investigation and final disposition. See current recommendation #1 for additional amount questioned.

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The PERA BOARD inappropriately authorized reimbursement of moving expenses for the Executive Director.

5. PERA should request reimbursement of \$9,671.25 from Mr. McLaren for the inappropriate relocation expense payments.

Recommendation has been referred to the Attorney General's Office for further investigation and final disposition.

PERA did not follow established policies in the reimbursement of educational expenses for the Executive Director.

6. PERA should seek reimbursement from Mr. McLaren for the portion of the \$6,000 payment made to him which did not relate to completed educational coursework.

Recommendation has been referred to the Attorney General's Office for further investigation and final disposition.

Various questions exist regarding the payment of Mr. McLaren's severance pay.

7. PERA should seek reimbursement from Mr. McLaren for the week he was in California on personal business and did not take vacation.

Recommendation has been referred to the Attorney General's Office for further investigation and final disposition.

8. PERA should request an opinion from the Attorney General whether the waiver of notice requirements in the Codified Terms of Employment were satisfied by the board, so that the payment of severance pay based on sick leave balances would be proper.

Recommendation has been referred to the Attorney General's Office for further investigation and final disposition.

9. PERA should consult with the Attorney General prior to any amendments to the Codified Terms of Employment to ensure that all benefits granted employees are appropriate in accordance with statutory requirements.

Recommendation Implemented. Laws of 1985, Chapter 11, established PERA as a state agency subject to state personnel rules and regulations.

PERA did not have adequate procedures for authorization of out-of-state travel by the Executive Director.

10. PERA should establish formal procedures for authorization and approval of out-of-state travel by the Executive Director.

Recommendation Implemented.

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11. PERA should adopt the state policy on disposition of airline benefits for all employees traveling at association expense, and seek reimbursement for any inappropriate use of such benefits.

Recommendation Implemented. Laws of 1985, Chapter 11 established PERA as a state agency subject to applicable travel rules and regulations.

12. PERA should request reimbursement from the former Executive Director for the \$104.58 in travel reimbursement overpayments.

Recommendation has been referred to the Attorney General's Office for further investigation and final disposition.

PERA improperly expended pension funds on a fishing trip for certain staff and legislators.

13. PERA should continue to seek reimbursement of \$878.22 from Mr. McLaren and \$206.00 from Mr. Fleming for costs associated with the fishing trip.

Recommendation has been referred to the Attorney General's Office for further investigation and final disposition.

PERA did not follow proper procedures in the purchase of picture frames for selected staff, board members, and legislators.

14. PERA should seek reimbursement for the cost or request return of pictures given to individual staff, board members, and legislators.

Recommendation has been referred to the Attorney General's Office for further investigation and final disposition.

15. In all future purchases, PERA should comply with established bidding and requisition procedures.

Recommendation Implemented. Laws of 1985, Chapter 11 established PERA as a state agency subject to applicable controls.

PERA did not have specific statutory authority for the group term life insurance plan established in 1984.

16. PERA should consult with the Attorney General regarding the legal status of this plan and any restrictions on the use of fees collected under the program.

Recommendation Implemented. Laws of 1985, Chapter 11 specifically authorized the insurance plan.

PUBLIC EMPLOYEES RETIREMENT ASSOCIATION

17. In the future when seeking legal advice regarding their duties and responsibilities in administering the association, PERA should request the opinion of the Attorney General.

Recommendation Implemented.

PERA had questionable authority to mail campaign literature for selected candidates in the 1984 board election.

18. PERA should work with the Attorney General and Secretary of State to determine their proper role in the board election process. Candidate information provided to members should be uniform and equitable.

Recommendation Implemented. Laws of 1985, Chapter 11 establishes specific procedures for board elections.

PERA personnel policies require revision and strengthening.

19. PERA should develop standard policies and procedures for hiring, promoting, and providing educational opportunities to employees. All documentation supporting these personnel decisions should be retained on file.

Recommendation Implemented.

PERA does not maintain a positive time reporting system.

20. PERA should implement a positive time reporting system. The system should require each employee to prepare and sign a time report which is then approved by their supervisor.

Recommendation Implemented.

PERA's controls over contracts require strengthening.

21. PERA should institute procedures to ensure that formal contracts are entered into and approved by the Attorney General's Office prior to the acceptance of goods or provision of services.

Recommendation Implemented. Laws of 1985, Chapter 11 established PERA as a state agency subject to applicable controls over contractual services.

22. When making payments for any contractual services, PERA should review all contract provisions to ensure compliance. If contract revisions or price adjustments are necessary, formal amendments to the contract should be made.

Recommendation Implemented.

PUBLIC EMPLOYEES RETIREMENT ASSOCIATION

23. If travel expenditures are allowed as a part of a contract, expense documentation should be obtained prior to reimbursement. The contracts should specify allowable travel amounts with limitations as provided for staff employees.

Recommendation Implemented.

24. PERA should adopt a policy whereby consultants who develop contract specifications are precluded from bidding on the contract.

Recommendation Implemented.

25. PERA should consult with the Attorney General to determine if they should seek reimbursement for any of the questionable contractual payments.

Recommendation has been referred to the Attorney General's Office for further investigation and final disposition.

Inadequate controls exist for certain administrative expenditure areas.

26. PERA should implement procedures to ensure an employee's workers' compensation benefits plus sick, annual, and overtime pay, if any, do not exceed the employee's normal weekly wage.

Recommendation Implemented. PERA is now subject to the policies and procedures of the Department of Finance relating to this area.

27. PERA should establish procedures to review long distance telephone calls made by the Executive Division to ensure they pertain to official PERA business.

Recommendation Implemented.

28. PERA should ensure that documentation supporting completion of educational courses is submitted before employees are reimbursed for any expenses. PERA should review the questioned amounts, and if evidence of successful course completion is not provided, they should request reimbursement of the improper payments.

Recommendation Implemented. Documentation of successful course completion was obtained by PERA to support the educational expenses.

29. PERA should develop specific policies and guidelines relating to reimbursement of courses necessary for completion of a college degree. They should address such issues as number and types of courses eligible, time frame for completion, and whether an employee is required to remain employed with PERA for a certain time period to be eligible for reimbursement.

Recommendation Implemented.

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30. PERA should monitor expenditures from the Department Head Expense Account to ensure budgetary limitations are not exceeded.

Recommendation Implemented.

31. PERA should discontinue reimbursing employees for parking violations.

Recommendation Implemented.

In two instances, standard procedures used to calculate annuities were revised by the Executive Director.

32. PERA should refer the questionable calculations to the Attorney General's Office to determine if benefit adjustments are necessary.

Recommendation Implemented. PERA requested and received an interpretation from an Attorney General's representative on September 19, 1985 concluding that PERA acted within the intent of the law.

33. In the future, if questions arise relating to the intent of statutory provisions, an Attorney General's Opinion regarding the proper interpretation should be requested. If necessary, PERA should request legislative clarification of questionable statutory sections.

Recommendation Implemented.

Due to a lack of proper internal controls and noncompliance with established procedures in prior years, PERA has made benefit overpayments to various disabilitants.

34. PERA should work with the Department of Labor and Industry to develop more accurate procedures to ensure disabilitants do not receive benefits from both PERA and Workers' Compensation.

Recommendation Implemented.

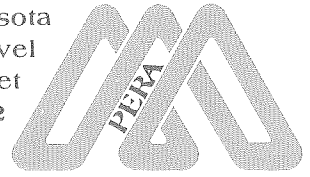
35. PERA should assign responsibilities relating to disability benefits so that there is an independent verification of the documentation used in the calculation of benefits.

Recommendation Implemented.

The PERA Board approved a policy relating to repayment of refunds, which at the time was not in compliance with Minnesota statutes.

36. PERA should consult with the Attorney General regarding appropriate action relating to the retirees who were improperly allowed to repay refunds.

Recommendation Implemented. PERA requested and received an interpretation from an Attorney General's representative on September 19, 1985 concluding that PERA acted within the intent of the law.



January 17, 1986

Mr. James R. Nobles, Legislative Auditor
Office of the Legislative Auditor
First Floor Veterans Service Building
20 West 12th Street
St. Paul, MN 55155

Dear Mr. Nobles:

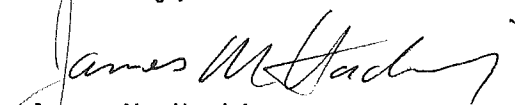
As requested in Claudia Gudvangen's letter dated January 7, 1986, I am submitting this response to the comments and recommendations contained in the draft copy of the 1985 PERA audit report.

In your testing, you found an erroneous annuity calculation for one member who retired effective July 1, 1984. This erroneous calculation resulted in an overpayment to the member of \$2,916.32. The recommendation is that PERA correct the member's monthly annuity amount and collect the overpayment. As of this date, the following steps have already been taken to resolve this situation:

1. The member's monthly annuity amount was corrected, effective for the November 1, 1985, payment.
2. At their meeting on November 26, 1985, the PERA Trustees authorized collection of the overpayment.
3. PERA's counsel from the Attorney General's office is working with the member's legal counsel to arrive at an agreeable repayment schedule. We anticipate that this matter will be resolved in the near future.

The audit report emphasized the necessity of having an independent second verification of final annuity calculations as an essential control. With this point we at PERA completely agree. Although it appears that the failure of our independent verification process to "catch" the erroneous calculation was the result of an unusual set of circumstances existing at the time (and not likely to reoccur), we are looking into the possibility of automating certain steps in the benefit final calculation process. We hope that automation will further reduce the possibility of error in the future.

Sincerely,


James M. Hacking
Executive Director

JMH/sk