

MINNESOTA STATE RETIREMENT SYSTEM
FINANCIAL AUDIT
FOR THE YEAR ENDED JUNE 30, 1989

JANUARY 1990

Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

90-6

MINNESOTA STATE RETIREMENT SYSTEM

FINANCIAL AUDIT FOR THE YEAR ENDED JUNE 30, 1989

Public Release Date: January 31, 1990

No. 90-6

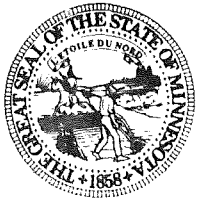
OBJECTIVES:

- EXAMINE THE SYSTEM'S FINANCIAL STATEMENTS.
- TEST COMPLIANCE WITH CERTAIN FINANCE-RELATED LEGAL PROVISIONS.
- EVALUATE INTERNAL CONTROL STRUCTURE: Employee and employer contributions, receipts, annuity payments, plan withdrawals, refunds of contributions, payroll, administrative disbursements, and staff payroll.

CONCLUSIONS:

- We will issue our opinion on the financial statements in the system's annual report.
- We found two departures from finance-related legal requirements.
 - The system did not calculate annuity payments correctly for 11 judges.
 - The system does not make timely transfers for annuities to the Post Retirement Fund.
- We found the internal control structure to be effective. However, we noted two matters involving the internal control structure:
 - Separation of duties over contributions need to be improved.
 - The system does not have a written agreement with the Department of Health for disability reviews.

Contact the Financial Audit Division for additional information.
(612) 296-1730



STATE OF MINNESOTA

OFFICE OF THE LEGISLATIVE AUDITOR

VETERANS SERVICE BUILDING, ST. PAUL, MN 55155 • 612/296-4708

JAMES R. NOBLES, LEGISLATIVE AUDITOR

Senator John E. Brandl, Chair
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Minnesota State Retirement System

Members of the Board of Directors
Minnesota State Retirement System

Paul Groschen, Executive Director
Minnesota State Retirement System

Audit Scope

We have audited the financial statements of the Minnesota State Retirement System as of and for the year ended June 30, 1989 and issued our report thereon dated November 15, 1989. We have also made a study and evaluation of the internal control structure of the Minnesota State Retirement System in effect at June 30, 1989.

We conducted our audit in accordance with generally accepted government auditing standards, including Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements.

As part of our examination of the financial statements and our study and evaluation of the internal control structure, we performed tests of the Minnesota State Retirement System's compliance with certain provisions of laws, regulations, contracts, and grants. However, our objective was not to provide an opinion on overall compliance with such provisions.

Management Responsibilities

The management of the Minnesota State Retirement System is responsible for establishing and maintaining an internal control structure. This responsibility includes compliance with applicable laws, regulations, contracts, and grants. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that:

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- assets are safeguarded against loss from unauthorized use or disposition;
- transactions are executed in accordance with applicable legal and regulatory provisions, as well as management's authorization; and
- transactions are recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles.

Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

Internal Control Structure

For purposes of this report, we have classified the significant internal control structure policies and procedures in the following categories:

- employee and employer contribution receipts,
- annuity payments,
- plan withdrawals,
- refunds of contributions,
- payroll, and
- administrative disbursements.

For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk.

Conclusions

In our opinion, the internal control structure of the Minnesota State Retirement System in effect at June 30, 1989, taken as a whole, was sufficient to meet the objectives stated above insofar as those objectives pertain to the prevention or detection of errors or irregularities in amounts that would be material in relation to the financial transactions of the Minnesota State Retirement System.

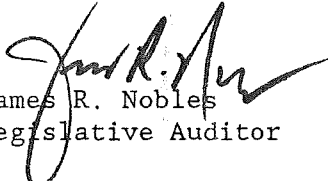
However, we noted certain matters involving the internal control structure and its operation that we reported to the management of the Minnesota State Retirement System in findings 3 and 4.

Except for the issues discussed in findings 1 and 2, the results of our tests indicate that, with respect to the items tested, the Minnesota State Retirement System complied, in all material respects, with the provisions


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referred to in the audit scope paragraphs. With respect to items not tested, nothing came to our attention that caused us to believe that the Minnesota State Retirement System had not complied, in all material respects, with those provisions.

This report is intended for the information of the Legislative Audit Commission and management of the Minnesota State Retirement System. This restriction is not intended to limit the distribution of this report, which was released as a public document on



James R. Nobles
Legislative Auditor



John Asmussen, CPA
Deputy Legislative Auditor

END OF FIELDWORK: December 6, 1989

REPORT SIGNED ON: January 19, 1990

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AUDIT PARTICIPATION

The following members of the Office of the Legislative Auditor prepared this report:

John Asmussen, CPA	Deputy Legislative Auditor
Jeanine Leifeld, CPA	Audit Manager
Kari Irber, CPA	Auditor-in-Charge
Connie O'Brien, CPA	Senior Auditor
Amy Vanderziel	Intern

EXIT CONFERENCE

An exit conference was held with the following MSRS staff on January 11, 1990:

Paul Groschen	Executive Director
Arvin Herman	Assistant Director for Finance
Dennis Jensen	Accounting Manager

MINNESOTA STATE RETIREMENT SYSTEM

I. INTRODUCTION

The Minnesota State Retirement System (MSRS) administers retirement programs for state employees, correctional employees, unclassified employees, state troopers, legislators, elective state officers, and judges. The system also administers a deferred compensation plan available to all Minnesota public employees and officials.

The Minnesota State Retirement System is governed generally by Minn. Stat. Chapter 352, which establishes the Minnesota State Retirement Fund and the Correctional Employees Retirement Fund. Minn. Stat. Chapter 352 also gives the MSRS executive director the authority to establish rules and procedures to govern the Deferred Compensation Fund. Other retirement plans administered by MSRS include the Legislators Retirement Fund governed by Minn. Stat. Chapter 3A, the Highway Patrol Fund governed by Minn. Stat. Chapter 352B, the Elective State Officers Fund governed by Minn. Stat. Chapter 352C, the Unclassified Fund governed by Minn. Stat. Chapter 352D, and the Judges Retirement Fund governed by Minn. Stat. Chapter 490. In addition, Minn. Stat. Chapter 356 provides general guidance on the operation of all publicly funded pension plans pursuant to the laws of the State of Minnesota. The Minnesota State Retirement System is also subject to certain general legal provisions which affect the financial management of most state agencies.

The policy-making function for MSRS is vested in a board of directors, consisting of 11 members. The board consists of three members appointed by the governor, four state employees elected by state employees covered by the system, one employee of the Metropolitan Transit Commission, one member of the state patrol retirement plan, one employee covered by the correctional employees plan, and one retired employee. Paul Groschen serves as the executive director, appointed by the board.

MINNESOTA STATE RETIREMENT SYSTEM

II. CURRENT FINDINGS AND RECOMMENDATIONS

1. The Minnesota State Retirement System did not calculate annuity payments correctly for 11 judges.

MSRS staff used incorrect annual salary amounts to calculate the annuities for most judges who retired since June 30, 1988. The annuity calculation for all retiring judges is based on the judge's five highest years' salaries. MSRS used published salary amounts for their annuity calculations. However, the published salaries were estimates based on a projected 4 percent increase in the statutory salary amounts. The estimate had failed to take into consideration a law limiting judges' salary increases found in Laws of 1985, First Special Session, Chapter 13, Sec. 52. This law limited judges' annual salary increases to not more than the lowest comparable rate of increase in a labor settlement involving state employees. The lowest increase for 1988 was 2.9999 percent rather than the 4 percent increase projected when developing the salary rate.

As a result of the error, we estimate that annuity payments were overstated for each of the 11 judges. Although the total error is not material, MSRS should correct the annuity amounts. Also, in the future, MSRS should verify directly any judges' salary increases.

RECOMMENDATION:

- MSRS should correct the overstated annuities and should, in the future, recalculate any salary changes directly.
2. MSRS does not use the estimate process to make transfers for annuities to the Post Retirement Fund.

The amount needed to pay annuities for all retired employees is separately invested and accounted for in the Post Retirement Fund. Once an employee retires, MSRS must determine the amount of money needed to pay all of the person's monthly annuities. According to Minn. Stat. 11A.18 Subd. 6a, MSRS must transfer the annuity amount "no later than the last business day of the month in which the benefit payment . . . begins." Subd. 6b goes on to state that, if the exact amount of the initial transfer is not readily calculable, an initial transfer based on the best estimate of the executive director must be made on a timely basis.

MSRS does not transfer to the Post Retirement Fund based on estimated annuity amounts. Rather, they only make the transfer after they have calculated the annuity amount based on actual, final information. MSRS does reimburse the Post Retirement Fund for any interest lost as a result of the late transfers. However, MSRS is not complying with the statute governing the Post Retirement Fund.

MINNESOTA STATE RETIREMENT SYSTEM

RECOMMENDATION:

- MSRS should either develop procedures to estimate and transfer annuity amounts in accordance with Minn. Stat. Section 11A.18, Subd 6b or, if necessary, should propose changes to the statutory requirements.

3. Separation of duties over contributions need to be improved.

MSRS needs to improve separation of duties over depositing and recording employee and employer contribution receipts. These receipts come to MSRS in the form of checks from approximately 225 payroll units. The MSRS subsidiary account clerk is responsible for the entire contribution receipts process. She receives the incoming checks, prepares the deposits, verifies the accuracy of the related payroll abstracts, posts to the general ledger accounts, and reconciles the general ledger totals to those in the data base contributions file.

With the present system of controls, the employee could potentially conceal errors or irregularities. To provide adequate controls over contribution receipts, another person should either reconcile the data base to the general ledger or perform a formal review of the reconciliations on a monthly basis.

RECOMMENDATION:

- An independent employee should either reconcile the data base contributions file to the general ledger or review and approve the reconciliations on a monthly basis.

4. MSRS does not have a written agreement with the Department of Health for disability eligibility reviews.

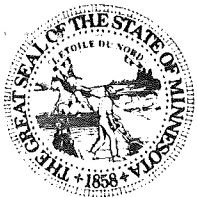
The Department of Health serves as the medical advisor for the retirement funds pursuant to Minn. Stat. 352.03 Subd. 8. The Department of Health, as medical advisor, is responsible for designating a physician to examine each disability applicant and reviewing the resultant physician's report. The statute does not specify a fee for this service. During fiscal year 1989, the Department of Health billed MSRS \$45 per applicant.

MSRS should develop a written agreement with the Department of Health that specifies the billing rate for each disability certification and clarifies any other responsibilities. A written agreement would help the parties to avoid any misunderstandings or disputes.

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RECOMMENDATION:

- MSRS should develop a written agreement with the Department of Health that specifies the billing rate for each disability certification.



MINNESOTA STATE RETIREMENT SYSTEM

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ST. PAUL, MINNESOTA 55101
(612) 296-2761

OFFICERS
Executive Director
Paul L. Groschen
Assistant Directors
Douglas Mewhorter
Arvin Herman

No. January 17, 1990

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

Dear Mr. Nobles:

This is in response to your management letter on the results of our fiscal year 1989 audit.

RECOMMENDATION 1:

The annuities were corrected for 8 judges after we discovered the incorrect salary. The remaining annuities were not significantly affected by the incorrect salary. In the future, different published salaries should not happen because the limitation of the lowest labor settlement was removed.

RECOMMENDATION 2:

The Minnesota State Retirement System has not used estimates to transfer required reserves to MPRIF because:

- The estimate process was intended for the Teachers Retirement Fund where the majority of retirements occur in June. Our retirements are more evenly distributed with no one month's transfer having a significant impact on MPRIF.
- The estimates on a detailed level would be inaccurate and difficult since we have annuity startings possible every day for 5 funds, including the last day of the month when transfers are due.
- There is no dollar impact between MPRIF and our funds. Interest is paid as required when the actual transfer is known, usually 1 to 2 months after employment termination and the annuity begins to accrue.

BOARD OF DIRECTORS

Elected Members

Abigail Robles, Chair
General Plan
Department of Revenue
10 River Park Plaza
St. Paul, MN 55146

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MTC Representative
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Kenneth Yozamp
Correctional Plan
Minnesota Correctional Facility
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State Treasurer
303 Administration Building
St. Paul, MN 55155

Otto Bang
American Agency, Inc.
5851 Cedar Lake Road
St. Louis Park, MN 55416

Mr. James Nobles
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Transfers based on actual retirements are always accurate, administratively simple and timely. MSRS will attempt to clarify the legal requirements.

RECOMMENDATION 3:

Our Accounting Director will continue to review the monthly reconciliation process. To formalize this process, he will sign and date that documentation.

RECOMMENDATION 4:

MSRS did have a written 'Memorandum of Understanding' with the Department of Health in 1983. We will update that agreement to reflect any possible changes since that time.

We appreciate the audit guidance in maintaining and improving our administrative processes.

Sincerely,



Paul L. Groschen
Executive Director

PLG:kf