MINNESOTA STATE RETIREMENT SYSTEM
FINANCIAL AUDIT
FOR THE YEAR ENDED JUNE 30, 1990

FEBRUARY 1991

Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

91-9

Veterans Service Building, Saint Paul, Minnesota 55155 • 612/296-4708

MINNESOTA STATE RETIREMENT SYSTEM

FINANCIAL AUDIT
FOR THE YEAR ENDED JUNE 30, 1990

Public Release Date: February 15, 1991 No. 91-9

OBJECTIVES:

- EXAMINE THE SYSTEM'S FINANCIAL STATEMENTS.
- EVALUATE INTERNAL CONTROL STRUCTURE: Employer and employee contributions and buybacks, defined benefit annuities, defined contribution refunds and withdrawals, and defined benefit refunds.
- TEST COMPLIANCE WITH CERTAIN FINANCE-RELATED LEGAL PROVISIONS.

CONCLUSIONS:

We will issue our opinion on the financial statements in the system's annual report.

We found one area where the internal control structure needed improvement:

- MSRS needs to limit computer access to the statewide accounting system and the central payroll system.

We reported on one area where the system had not complied with finance-related legal provisions:

- MSRS does not always determine interest amounts for refunds consistently.

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

Representative Dee Long, Acting Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Francis Marshall, Board Chairman
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 (MSRS) as of and for the year ended June 30, 1990, and issued our report thereon dated November 13, 1990. We have also made a study and evaluation of the internal control structure of MSRS in effect during June 1990.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial activities attributable to the transactions of MSRS 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 MSRS 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:

- 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 on the statewide accounting system in accordance with Department of Finance policies and procedures.

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:

- employer and employee contributions and buybacks,
- defined benefit annuities,
- defined contribution refunds and withdrawals, and
- defined benefit refunds.

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

Our study and evaluation disclosed the condition discussed in finding 1 involving the internal control structure of MSRS. We consider this condition to be a reportable condition under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the entity's ability to record, process, summarize, and report financial data consistent with the assertions of management in financial statements.

A material weakness is a reportable condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We believe that the reportable condition described above is not a material weakness.

We also noted other matters involving the internal control structure and its operation that we reported to the management of MSRS at the exit conference held on January 31, 1991.

The results of our tests indicate that, except for the issue discussed in finding 2, with respect to the items tested, MSRS complied, in all material respects, with the provisions referred to in the audit scope paragraphs. With respect to items not tested, nothing came to our attention that caused us to believe that MSRS 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 February 15, 1991.

We would like to thank the MSRS staff for their cooperation during this audit.

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

END OF FIELDWORK: November 13, 1990

REPORT SIGNED ON: February 8, 1991

MINNESOTA STATE RETIREMENT SYSTEM

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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
Susan Rumpca	Senior Auditor
Mark Johnson	Staff Auditor

EXIT CONFERENCE

An exit conference was held with the following MSRS staff on January 31, 1991:

Arvin Herman, Assistant Director
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 provides income for covered employees or their beneficiaries upon retirement, disability, or death. MSRS also administers a deferred compensation plan available to all Minnesota public employees and officials.

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.

II. CURRENT FINDINGS AND RECOMMENDATIONS

1. MSRS needs to further limit computer access to the statewide accounting system and the central payroll system.

MSRS needs to improve computer access controls in two areas. First, the employee in charge of purchasing at MSRS has the authority to enter payment transactions into the statewide accounting (SWA) system. Even though the executive director generally authorizes all payments, the person in charge of purchasing could potentially enter unauthorized payments into the system. The person in charge of purchasing should only have access to the purchasing transactions.

In addition, the employee who is responsible for personnel functions at MSRS also has access to the payroll transactions on the payroll system. Although she does not normally enter transactions into the payroll system, one person should not have the authority to both enter employees onto the payroll system and enter payroll payment transactions.

RECOMMENDATION

- **The MSRS accounting division manager, who is responsible for determining who receives computer access, should insure that:**
  - **the person who is in charge of purchasing does not have access to enter payment transactions, and**
  - **the person responsible for personnel does not have access to enter payroll transactions.**

2. MSRS does not always determine interest amounts for refunds consistently.

MSRS does not calculate interest on refunds consistently. MSRS processes refunds differently for employees who contributed to MSRS for less than one fiscal year than for employees who worked for more than one fiscal year. When employees contribute for more than one fiscal year, MSRS does not pay interest on that portion of contributions the person made within the current fiscal year. Conversely, MSRS calculates interest differently if an employee started work, resigned, and submitted a refund application all within a single fiscal year. MSRS will pay the person interest on the refund, even though it had not held the money for a complete year.

Minn. Stat. Section 352.22 Subd. 2 provides the formula for MSRS to calculate contribution refunds:

> ...an amount equal to employee accumulated contributions plus interest at the rate of six percent per year compounded annually. Interest must be computed to the first day of the month in which the refund is processed and must be based on fiscal year balances (emphasis added).

The refund statute is unclear and open to interpretation. In 1984, the MSRS executive director decided that MSRS should give interest to all persons requesting a refund, including those persons only working in the current year. However, the MSRS method is not equitable to everyone. MSRS must decide whether or not to pay refund interest on first year contributions and must apply the policy consistently.

RECOMMENDATION

- MSRS should pay interest on contribution refunds consistently. If necessary, the MSRS Board of Directors should develop a formal refund policy relating to Minn. Stat. Section 352.22.

MINNESOTA STATE RETIREMENT SYSTEM

529 JACKSON STREET AT 10TH
ST. PAUL, MINNESOTA 55101
(612) 296-2761
FAX (612) 297-5238

February 4, 1991

Mr. James Nobles, Legislative Auditor
Veterans Service Building, 1st 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 1990 audit.

Recommendation 1:

The computer clearances for payment and payroll transactions were changed to achieve a better division of responsibilities as recommended.

Recommendation 2:

We are in the process of reprogramming the interest calculation to eliminate interest on nonfiscal year balance refunds. Individuals who start and are refunded in the same fiscal year will not receive interest. This is consistent with longer term refunds as recommended.

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

Sincerely,

Paul L. Groschen
Executive Director

PLG:jb