

**MINNESOTA STATE RETIREMENT SYSTEM
FINANCIAL AUDIT
FOR THE YEAR ENDED JUNE 30, 1991**

APRIL 1992

Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

92-22

SUMMARY

State of Minnesota
Office of the Legislative Auditor
Centennial Office Building • St. Paul, MN 55155
612/296-4708

MINNESOTA STATE RETIREMENT SYSTEM

FINANCIAL AUDIT FOR THE YEAR ENDED JUNE 30, 1991

Public Release Date: April 3, 1992

No. 92-22

OBJECTIVES:

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

CONCLUSIONS:

We issued an unqualified opinion on the financial statements which are published in the system's annual report.

We found the internal control structure to be effective.

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

- The Minnesota State Retirement System overclaimed about \$250,000 from the Judges Plan appropriation during the 1990-1991 biennium. The system has agreed to repay the General Fund.

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

FINANCIAL AUDIT DIVISION



STATE OF MINNESOTA

OFFICE OF THE LEGISLATIVE AUDITOR

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

JAMES R. NOBLES, LEGISLATIVE AUDITOR

Representative Ann Rest, 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

David Bergstrom, 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, 1991, and issued our report thereon dated November 27, 1991. We have also made a study and evaluation of the internal control structure of MSRS in effect during June 1991.

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:

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Members of the Board of Directors
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Page 2

- 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,
- defined benefit annuities,
- defined benefit refunds, and
- defined contribution and deferred compensation refunds and withdrawals.

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 as of June 1991, 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 the 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 at the exit conference held on February 5, 1992.

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Page 3

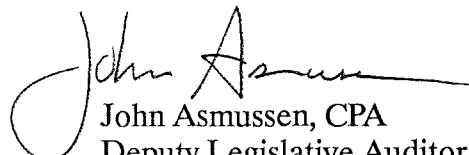
The results of our tests indicate that, except for the issue discussed in finding 1, with respect to the items tested, the Minnesota State Retirement System complied, in all material respects, with the provisions referred to in the audit scope paragraphs. With respect to items not tested, nothing came to our attention that caused us to believe that 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 April 3, 1992.

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 27, 1991

Report Signed On: March 30, 1992

Minnesota State Retirement System

Table of Contents

	Page
Introduction	1
Current Finding and Recommendation	2
Agency Response	4

Audit Participation

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

John Asmussen, CPA	Deputy Legislative Auditor
Jeanine Leifeld, CPA	Audit Manager
Carl Otto, CPA	Auditor-in-Charge
Pat Ryan	Senior Auditor
Kevin Schimnich	Staff Auditor

Exit Conference

An exit conference was held with the following MSRS staff on February 5, 1992:

Douglas Mewhorter	Acting Executive Director
Arvin Herman	Assistant Director of Finance and Systems
Dennis Jensen	Accounting Director

Minnesota State Retirement System

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, who retired in September 1991, served as the executive director during the period under audit. The board recently appointed David Bergstrom as the new executive director.

Minnesota State Retirement System

Current Finding and Recommendation

1. The Minnesota State Retirement System claimed more of the Judges Plan appropriation than it needed during the 1990-1991 biennium.

We believe that MSRS may have overclaimed about \$245,000 from a General Fund appropriation provided for the Judges Retirement Plan. For the two fiscal years in the 1990-1991 biennium, the Legislature appropriated a total of \$11,400,000 to MSRS for the Judges Retirement Plan. The appropriation law indicates that it is an estimate of the amount needed. As a result, we believe that MSRS was entitled to claim funds from the appropriation as it realized a direct need for the funds. We define "need" as employer shares of new annuitant transfers, annuities for non-Post Retirement Fund participants, actuarial mortality losses, and certain administrative costs. However, MSRS contends that "need" also includes shortages in appropriation amounts from the prior biennium. Therefore, MSRS simply claimed the appropriation amounts as lump sums early in each fiscal year. Also, we believe that MSRS claimed the funds sooner in each fiscal year than it was able to substantiate a need. Thus, MSRS was able to further increase the funds available to the Judges Plan through investment earnings.

Minnesota Laws 1989, Chapter 335, Article I, Section 45 provides that the appropriations are for "the amounts estimated to be needed for each program". Subpart (b) of the section designates \$5,500,000 for fiscal year 1990 and \$5,900,000 for fiscal year 1991 as the estimates for the Judges Plan. The law further provides that if the amount is insufficient for either year, the appropriation for the other year is available for it. MSRS originally derived the appropriation request based on the number of judges expected to retire during the biennium. However, MSRS claimed the appropriation in total each year, rather than claiming amounts based on individual judicial retirements.

Actuarial estimates show that the Judges Plan has a significant unfunded liability. During fiscal year 1991, the Judges Retirement Fund received retirement contributions deducted from the payroll of active judges. It also was credited with investment earnings. The state retains the financial obligation for the remaining unfunded liability. Thus, it is not a question of whether the state will provide funds to the Judges Retirement Fund. The issue involves the timing of the state's payments. Through the 1990-1991 biennium, state law satisfied the state's obligation when judges retired. Other retirement plans commonly provide for the state to satisfy its financial obligation when active employees earn retirement benefits. These employer contributions are based on various assumptions and actuarial estimates so that the fund will accumulate a sufficient amount to finance the employees' benefits upon retirement. Beginning in fiscal year 1992, the state has initiated a similar funding mechanism for the Judges Plan. The law now provides that the state must pay an employer contribution each pay period, similar to the employee contribution. However, for the 1990-

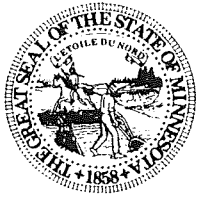
Minnesota State Retirement System

1991 biennium, we believe the law provides that the state's only financial obligation should be provided at the time of a judge's retirement.

MSRS claimed the entire Judges Plan appropriations in lump sum amounts. In fiscal year 1990, it claimed \$2,800,000 on July 6, 1989 and \$2,700,000 on October 31, 1989. In fiscal year 1991, it claimed the entire \$5,900,000 on July 30, 1990. According to our calculations, MSRS should have claimed \$245,000 less over the course of the biennium. Also, we believe that the claims should have been made on a monthly basis to coincide with the timing of judges' retirements. As a result, MSRS drew the funds earlier than needed and was able to earn excess investment earnings which otherwise would have accrued to the state's General Fund.

Recommendation

- *The Minnesota State Retirement System should work with the Department of Finance to determine whether it should return part of the 1990-91 Judges Plan appropriation to the General Fund.*



MINNESOTA STATE RETIREMENT SYSTEM

175 WEST LAFAYETTE FRONTAGE ROAD
ST. PAUL, MINNESOTA 55107-1425
(612) 296-2761
FAX (612) 297-5238

March 25, 1992

Ms. Jeanine Liefeld, Audit Manager
Office of the Legislative Auditor
Centennial Building
St. Paul, MN 55155

Dear Ms. Liefeld:

Thank you for sending me a draft of your financial and compliance audit report of the Minnesota State Retirement System (MSRS) for the year ending June 30, 1991. Your report concludes that we should have claimed \$245,000 less of the Judges Plan appropriation during fiscal year 1991, and that we should work with the Department of Finance to resolve the issue. In response to your report, we will transfer \$245,588.86 from the Judges Plan to the State General Fund.

The annual appropriation to the Judges Plan was necessary to pay the monthly retirement and survivor benefits for judges. For the past ten years, we have transferred most of the appropriation from the State General Fund to the Judges Plan at the beginning of each fiscal year and then made monthly payments from this account. Excess amounts, if any were carried into the next biennial request, thus reducing the amount that otherwise would have been requested. This practical approach worked well until 1991 when a law was enacted to properly fund the Judges Plan, reducing the need for annual appropriations.

We have contacted the Department of Finance to initiate the transfer. The issue of transferring the necessary appropriation on a monthly basis rather than yearly is no longer a concern since the funding of the plan has changed.

OFFICERS

Executive Director
David Bergstrom
Assistant Directors
Douglas Mewhorter
Arvin Herman

BOARD OF DIRECTORS

Elected Members

Francis C. Marshall, Chair
General Plan
Department of Transportation
419 Transportation Building
St. Paul, MN 55155

Richard K. Hull
State Patrol Plan
MN State Patrol, Dist. 2400
3489 Hadley Avenue No.
Oakdale, MN 55128

John Johnson
MTC Representative
312 Central Avenue, Room 438
Minneapolis, MN 55414

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

Luther Thompson
General Plan
Department of Public Service
American Center Building
160 E. Kellogg Blvd.
St. Paul, MN 55101

Robert A. Whitaker
Retiree Representative
1303 Watson Avenue
St. Paul, MN 55116

Allen D. Willie
General Plan
University of Minnesota
1919 University Ave., Room 290
St. Paul, MN 55104

Kenneth Yozamp
Correctional Plan
Minnesota Correctional Facility
Box B
St. Cloud, MN 56302

Appointed Members

Commissioner Dana Badgerow
Department of Administration
2nd Floor, Administration Bldg.
St. Paul, MN 55155

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

Mei Hansen
4505 - 28th Avenue So.
Minneapolis, MN 55406

I am pleased that this issue has been resolved and look forward to working with you in the future. If you have any questions, please let me know.

Sincerely,

A handwritten signature in cursive script that reads "David Bergstrom".

David Bergstrom
Executive Director

DKB:jb
cc: Mr. James Nobles