MINNESOTA STATE RETIREMENT SYSTEM

FINANCIAL AUDIT

FOR THE YEAR ENDED JUNE 30, 1993

MARCH 1994

Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

94-05

Centennial Office Building, Saint Paul, MN 55155 ● 612/296-4708

MINNESOTA STATE RETIREMENT SYSTEM

FINANCIAL AUDIT
FOR THE YEAR ENDED JUNE 30, 1993

Public Release Date: March 9, 1994 No. 94-05

OBJECTIVES:

- EXAMINE THE SYSTEM'S FINANCIAL STATEMENTS.
- EVALUATE INTERNAL CONTROL STRUCTURE: Employer and employee contributions, defined benefit annuities, 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 were published in the system's annual report for fiscal year 1993.

We found the internal control structure to be effective.

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

- Some deferred compensation recipients began receiving their annuities after the required distribution date.

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

FINANCIAL AUDIT DIVISION

STATE OF MINNESOTA
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JAMES R. NOBLES, LEGISLATIVE AUDITOR

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Members of the Legislative Audit Commission

Kenneth Yozamp, Board Chair
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, 1993, and issued our report thereon dated November 24, 1993. We have also made a study and evaluation of the internal control structure of MSRS in effect during June 1993.

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,

- defined benefit annuities, 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 1993, taken as a whole, was sufficient to meet the objectives stated above insofar as those objectives pertain to the prevention or detection or 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 December 21, 1993.

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 March 9, 1994.

We thank the Minnesota State Retirement System staff for their cooperation during this audit.

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

End of Fieldwork: November 24, 1993

Report Signed On: March 3, 1994

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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
Carl Otto, CPA	Auditor-in-Charge
Pat Ryan	Senior Auditor
Amy Walvatne	Staff Auditor

Exit Conference

An exit conference was held with the following MSRS staff on December 21, 1993:

Dave Bergstrom	Executive Director
Arvin Herman	Asst. Director for Finance and Systems
Doug Mewhorter	Asst. Director for Employee Service and Records
Dennis Jensen	Accounting Director

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. David Bergstrom serves as the executive director of MSRS.

The Unclassified Retirement Fund, a Defined Contribution Plan, had a net fund balance addition of $11,506,000 during fiscal year 1993, increasing to $104,123,000 as of June 30, 1993.

The Deferred Compensation Fund is reported as an Agency Fund pursuant to generally accepted governmental accounting principles. Total assets of the Deferred Compensation Fund increased $134,964,000 during fiscal year 1993. Total assets of the plan as of June 30, 1993 were $843,787,000.

The following schedule shows fiscal year 1993 financial activity for the defined benefit fund type administered by MSRS.

Operating Revenues:	Defined Benefit Plans
Member Contributions	$ 66,840,000
Employer Contributions	72,331,000
Investment Income	309,507,000
Other	13,000
Total Operating Revenue	$452,496,000
Operating Expenses:	
Annuities	$125,748,000
Other	14,444,000
Total Operating Expenses	$140,192,000

Source: Financial information included within the 1993 audited MSRS Annual Financial Report.

Current Finding and Recommendations

1. Some deferred compensation recipients began receiving their annuities after the required distribution date.

Several participants began receiving ongoing annuities from deferred compensation in April 1992, even though their required distribution dates ranged from 1988 to 1991. MSRS and IRS rules require that, upon termination, participants must begin receiving deferred compensation distributions no later than April 1 after the close of the taxable year in which the participant attains age 70 1/2. Eight of the sample items we tested for ongoing deferred compensation payments did not meet this requirement. MSRS identified these participants when it revised the deferred compensation process in 1991.

It is unclear what effect, if any, these late payments has directly on MSRS. According to the IRS, if payment does not start by the required distribution date, the deferred compensation participant may be subject to a penalty on the required amount not paid. Also, the IRS regulations expect the administrators of qualified plans to distribute deferred compensation payments to participants by the required beginning date.

Recommendations

- *MSRS should take necessary steps to ensure that participants are notified timely concerning mandatory distribution dates.*

- *MSRS should seek legal advice from the Attorney General and/or the IRS to determine its responsibilities and potential consequences of late deferred compensation distributions.*

MINNESOTA STATE RETIREMENT SYSTEM

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February 18, 1994

Ms. Jeanine Leifeld, Audit Manager
Office of the Legislative Auditor
1st Floor, Centennial Bldg.
St. Paul, MN 55155

Dear Ms. Leifeld:

Thank you for giving us the opportunity to respond to the written findings and recommendations in the draft audit report.

Your first recommendation states,

> *"MSRS should take steps to ensure that participants are notified timely concerning mandatory distribution dates."*

As you indicate in the text of your findings, MSRS identified participants who did not begin receiving deferred compensation distribution when it revised the deferred compensation process in 1991. In essence, your first recommendation was implemented in 1991. We plan to strengthen our current notification procedure by further automating the process to enhance our follow-up capabilities.

Your second recommendation states,

> *"MSRS should seek legal advice from the Attorney General and/or the IRS to determine its responsibilities and potential consequences of late deferred compensation distributions."*

We certainly can seek further assistance from the Attorney General and the IRS. We have already done some research into the required distribution requirements. We do not feel we have violated the mandatory distribution requirements based on the following narrative from the IRS regulations published in July 1987.

> "A-5. Q. To what extent will a plan be treated as failing to satisfy the qualification requirements of Section 401(a) if the plan in operation fails to make distributions in accordance with Section 401(a)(9)?

A. A plan will not satisfy the qualification requirements of Section 401(a) with respect to a plan year unless all distributions required under Section 401(a)(9) are made for the calendar year ending with or within such plan year. Notwithstanding the preceding sentence, for plan years beginning after December 31, 1988, a plan will not fail to satisfy the qualification requirements of Section 401(a) because there are isolated instances when the minimum distribution requirements of Section 401(a)(9) are not satisfied in operation. However, a pattern or regular practice of failing to meet the minimum distribution requirements of Section 401(a)(9) with respect to one or more employees will not be considered an isolated instance even if each instance is de minimis."

This specifically references Section 401(a) which initially applied to qualified pension plans. The Tax Reform Act of 1986 extended this requirement to deferred compensation plans by adding Section 457(b)(5) [copy enclosed]. Your staff identified eight participants who started drawing after the required age. Upon further review, we identified 22 other participants who were required to start distribution as part of our cleanup in 1991. We feel that these incidents were isolated and not a pattern or regular practice of failing to meet the distribution requirements. The procedure implemented in 1991 limited our exposure to future late distributions and, with further automation and better data, we will all but eliminate additional incidents.

The Unclassified/Deferred Compensation Manager is the person responsible for mandatory minimal distribution requirements. This same individual will coordinate our future enhancements.

We would be happy to respond to any questions you have and will continue to implement your recommendations.

Sincerely,

David Bergstrom
Executive Director

DKB:jb