PUBLIC EMPLOYEES RETIREMENT ASSOCIATION

FINANCIAL AUDIT

FOR THE YEAR ENDED JUNE 30, 1993

MAY 1994

Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

94-21

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

STATE OF MINNESOTA
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JAMES R. NOBLES, LEGISLATIVE AUDITOR

Senator Phil Riveness, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Robert D. McCubbin, President, Board of Trustees
Public Employees Retirement Association

Members of the Board of Trustees
Public Employees Retirement Association

Ms. Laurie Fiori Hacking, Executive Director
Public Employees Retirement Association

Audit Scope

We have audited the financial statements of the Public Employees Retirement Association for the year ended June 30, 1993, and issued our report thereon dated November 30, 1993. We have also made a study and evaluation of the internal control structure of the Public Employees Retirement Association in effect at June 30, 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 the Public Employees Retirement Association 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 Public Employee Retirement Association's compliance with certain provisions of laws, regulations, and contracts. However, our objective was not to provide an opinion on overall compliance with such provisions.

Management Responsibilities

The management of the Public Employees Retirement Association is responsible for establishing and maintaining an internal control structure. This responsibility includes compliance with applicable laws, regulations, and contracts. 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 Public Employees Retirement Association's records.

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 contributions;
- annuity payments; and
- Police and Fire Fund consolidations.

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 the Public Employees Retirement Association. 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.

Senator Phil Riveness, Chair,
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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 activities being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We do not believe the reportable condition described above is a material weakness.

The results of our tests indicate that, with respect to the items tested, the Public Employees Retirement Association 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 Public Employees Retirement Association has 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 Public Employees Retirement Association. This restriction is not intended to limit the distribution of this report, which was released as a public document on May 13, 1994.

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

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

End of Fieldwork: December 1, 1993

Report Signed On: May 9, 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
Claudia Gudvangen, CPA	Audit Manager
David Poliseno, CPA	Auditor-In-Charge
Rhonda Regnier, CPA	Auditor
Jenny Lee	Auditor

Exit Conference

The findings and recommendations in this report were discussed with the following staff of the Public Employees Retirement Association on April 4, 1994:

Laurie Fiori Hacking	Executive Director
Judith Hunt	Manager of Finance
Gary Hovland	Senior Accounting Supervisor
Susan Movrich	Accounting Officer

Introduction

In 1931, the Minnesota Legislature established the Minnesota Public Employees Retirement Association (PERA). PERA administers pension funds that serve approximately 175,000 public employees, their survivors and dependents. Approximately 2,000 separate units of government in Minnesota participate in the PERA-administered retirement system. These units include counties, cities, townships and school districts.

The association administers funds to provide a variety of retirement annuities, and survivor and disability benefits. In the case of coordinated members, these annuities and benefits are in addition to those provided by Social Security. The PERA board of trustees is responsible for administering these funds in accordance with Minnesota statutes and has a fiduciary obligation to PERA's members, the governmental employer units, the state and its taxpayers.

The PERA Board of Trustees is composed of ten members. The State Auditor is a member by statute. Five members who are appointed by the governor serve four-year terms and represent cities, counties, school boards, Police and Fire Fund members, retired annuitants and the general public, respectively. The remaining three board members are elected by the PERA active membership for four-year terms.

The board appoints an executive director to serve as chief administrative officer of PERA. With approval of the board, the director develops the annual administrative budget, determine staffing requirements, contracts for actuarial and other services, and directs the day-to-day operations of the association. The director also serves as a member of the state investment advisory council, which advises the State Board of Investment on the management and investment of pension funds and other assets. During our audit period Laurie Fiori Hacking was the executive director.

The following schedule shows the fiscal year 1993 operating revenues and expenses (in thousands) for the three defined benefit pension funds administered by PERA.

	Public Employees Retirement Fund	Police and Fire Fund	Police and Fire Consolidation Fund
Operating Revenues:			
Member Contribution	$106,358	$ 20,406	$ 1,619
Employer Contribution	113,184	30,434	7,679
Investment Income	404,548	103,409	26,709
Other	2,431	128	97
Total Operating Revenue	$626,521	$154,377	$36,104
Operating Expenses:			
Benefits Paid	$236,420	$ 24,619	$15,004
Other	19,061	2,467	1,561
Total Operating Expenses	$255,481	$ 27,086	$16,565

Source: 1993 PERA audited financial statements.

Current Finding and Recommendations

1. PERA's system for monitoring funds transferred to the Minnesota Post Retirement Investment Fund needs improvement.

PERA's procedures for verifying required reserve transfers did not detect two erroneous transfers in a timely manner. Currently, PERA runs a monthly post retirement reserve report from information recorded in its computer system. The report identifies the amount to be transferred to the State Board of Investment (SBI). An employee reviews the report and transfers the calculated amount. Subsequently, PERA runs various edit and reconciliation reports to detect potential errors. However, PERA's control system did not identify certain unusual circumstances which resulted in erroneous transfers.

The first error involved a transfer for a Police and Fire Consolidation Fund member's annuity. PERA transferred $269,724 to the Post Retirement Investment Fund, administered by the State Board of Investment (SBI), rather than retaining the funds. The member elected to receive benefits based on the local relief association formula rather than through the state fund. In such cases, PERA retains control of the monies. The transfer of funds to the Post Retirement Investment Fund resulted in lost investment income to the Consolidation Fund. PERA transferred the funds to SBI in June, 1992, and did not request the funds back until July, 1993. This delay resulted in lost investment income of approximately $20,000.

The second error occurred in the Public Employees Retirement Fund when PERA transferred excessive required reserve and interest amounts to SBI. A member retired effective July 1, 1987. Subsequently, the member and his spouse divorced. Effective April 1, 1993 the member's annuity was split in half with his former spouse. However, PERA staff entered the original retirement date of July 1, 1987 as the effective date for the change. As a result of this error, PERA paid the Post Retirement Investment Fund $95,446 in interest charges for a late transfer, when actually there was no late transfer. Additionally, PERA calculated a separate reserve amount for the spouse and transferred $154,948 to the Post Retirement Investment Fund in error. The additional transfer was not required because PERA had already transferred the funds for the member's annuity. As a result, the Post Retirement Investment Fund earned additional investment income on the extra transfer and PERA's active fund lost income.

PERA needs to develop procedures to better monitor transfers to ensure that funds are adequately controlled and properly invested for the benefit of its membership. This could include a second review of the transfer calculation. In addition, staff should review the interest calculation for late transfers for reasonableness and investigate unusually large amounts.

Recommendations

- *PERA should review its procedures and improve its monitoring system to detect and correct errors in transfers to the Post Retirement Investment Fund.*

- *PERA should review the two situations addressed above and request the return of any monies due them from the Post Retirement Investment Fund. PERA should reinstate returned funds to the proper accounts.*

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April 29, 1994

Mr. James R. Nobles, Legislative Auditor
Office of the Legislative Auditor
1st Floor South, Centennial Office Building
St. Paul, MN 55155

Dear Mr. Nobles:

Thank you for your draft report summarizing the results of the fiscal year 1993 (FY93) statewide financial audit. We share your beliefs that our internal control structure is important to ensure that pension funds are controlled and properly invested for our membership's benefit. As in prior years, we continue to value your staff's fieldwork and appreciate this opportunity to formally respond to their comments and recommendations for improvements.

Your report indicates our system for monitoring funds transferred to the Minnesota Post Retirement Investment Fund (MPRIF) needs improvement. Specifically, you cited two instances where our controls did not detect unusual circumstances that resulted in two erroneous transfers during the year. Considering we processed in excess of 3,900 transfers to the MPRIF in FY93 totalling $116 million from the Public Employees Retirement Fund and $193 million from the Public Employees Police and Fire Consolidation Fund, we believe your finding is not sufficiently significant to warrant classification as a reportable condition. We feel these are isolated instances; historical data indicates these types of transfers are not of a recurring nature to be considered a significant deficiency in the design of our internal control structure.

Nevertheless, we concur with the facts presented and the principle of the finding. Accordingly, we have made some minor changes to improve our monitoring system. Our data processing staff have recently enhanced computer edits to identify unusual circumstances that could result in possible erroneous transfers similar to those referenced in your report. We also have developed new procedures for accounting staff to analyze whether these transfers of required reserves should occur and to take any timely and corrective actions for determining the proper amounts to transfer. These procedures also include reviewing the calculation of the amounts (including interest) to be transferred to the MPRIF each month.

Staff implemented these new procedures in late March as they reviewed the amounts of required reserves and interest expense to be transferred for April 1994. We will send, under separate cover, a copy of these procedures to Ms. Claudia Gudvangen, Audit Manager.

Regarding the first error mentioned in your report, we also met with staff from the State Board of Investments on April 18, 1994 and made arrangements to recover the lost investment income of $21,600 to the Public Employees Police and Fire Consolidation Fund.

Concerning the second error, your report states that the MPRIF earned additional investment income on the extra transfer and PERA's active fund lost income. Since the MPRIF was operating with a mortality loss in excess of $7.4 million for FY93, this additional investment income helped to minimize this loss. One might argue that the funds belonged to the MPRIF in the first place.

If you have any additional questions or concerns, please feel free to contact Finance Manager Judy Hunt at 297-3573 or Senior Accounting Supervisor Gary Hovland at 296-9170.

Sincerely,

Laurie Fiori Hacking

Laurie Fiori Hacking
Executive Director

cc: Claudia Gudvangen, OLA
Judy Hunt, PERA
Gary Hovland