Teachers Retirement Association

Financial Audit

For the Year Ended June 30, 1994

February 1995

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Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

95-04

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

SUMMARY

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

Teachers Retirement Association

Financial Audit
For The Year Ended June 30, 1994

Public Release Date: February 17 1995 — No. 95-04

Objectives:

- Examine the system's financial statements.

- Review internal control structure: Employer and employee contributions, annuity payments and refunds of contributions.

- Test compliance with certain finance-related legal provisions.

Conclusions:

We issued an unqualified opinion on the financial statements which were published in the association's annual report for fiscal year 1994.

We noted two weaknesses in the internal control structure over inactive member accounts:

- TRA does not maintain contact with its inactive members.

- TRA does not adequately separate refund duties.

We found one possible departure from finance-related legal provisions:

- We noted that the interest rate to be paid on certain refunds is unclear and that an Attorney General's opinion should be sought.

Contact the Financial Audit Division for additional information.
296-1235

STATE OF MINNESOTA
OFFICE OF THE LEGISLATIVE AUDITOR
CENTENNIAL BUILDING, ST. PAUL, MN 55155 • 612/296-4708
JAMES R. NOBLES, LEGISLATIVE AUDITOR

Senator Phil Riveness, Chair
Legislative Audit Commission

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Mr. Vernell R. Jackels, President
Teachers Retirement Association Board of Trustees

Members of the Board of Trustees
Teachers Retirement Association

Mr. Gary Austin, Executive Director
Teachers Retirement Association

Audit Scope

We have audited the financial statements of the Teachers Retirement Association (TRA) as of and for the year ended June 30, 1994, and issued our report thereon dated November 18, 1994. We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we consider the internal control structure in order to plan our audit, and that we perform tests of TRA's compliance with certain material provisions of laws, regulations, contracts and grants. However, our objective was not to provide an opinion on the internal control structure or on overall compliance with finance-related legal provisions.

Internal Control Structure

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

- employee and employer contributions;
- annuity payments; and
- refunds.

For 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.

Management Responsibilities

The management of TRA is responsible for establishing and maintaining the 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 internal control 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.

Conclusions

Our audit disclosed the condition discussed in finding 2 involving the internal control structure of the Teachers Retirement Association. We consider this condition to be 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.

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. However, we believe the reportable condition described above is not a material weakness.

The results of our tests of compliance indicate that, except for the issue discussed in finding 1, with respect to the items tested, the Teachers Retirement Association complied, in all material respects, with the provisions referred to in the audit scope paragraphs. With respect to the items not tested, nothing else came to our attention that caused us to believe that the Teachers Retirement Association had not complied, in all material respects, with those provisions.

We also noted other matters involving the internal control structure and its operation, that we reported to the management of the Teachers Retirement Association at the exit conference held on December 28, 1994.

This report is intended for the information of the Legislative Audit Commission and management of the Teachers Retirement Association. This restriction is not intended to limit the distribution of this report, which was released as a public document on February 17, 1995.

We thank the staff of the Teachers Retirement Association for their cooperation during this audit.

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

End of Fieldwork: November 18, 1994

Report Signed On: February 13, 1995

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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
Tom Donahue, CPA	Audit Manager
Jean Mellett, CPA	Auditor-in Charge
Mark Johnson	Auditor

Exit Conference

The findings and recommendations in this report were discussed with the following staff of the Teachers Retirement Association on December 28, 1994:

Gary Austin	Executive Director
John Wicklund, CPA	Assistant Executive Director
John Gardner	Assistant Executive Director
Judith Strobel	Assistant Executive Director
Frank Merry	Accounting Director

Introduction

The Teachers Retirement Association (TRA) was established on July 1, 1931, by the Minnesota State Legislature. It is governed by a board of trustees which manages the Teachers Retirement Fund. The board consists of eight trustees: the commissioners of education and finance, a representative of the Minnesota school boards association, four members elected by members of the fund, and a retiree elected by retirees of the fund. The board elects an executive director to serve at its pleasure and manage the association. Mr. Gary Austin is the current executive director.

All teachers employed in Minnesota's public elementary and secondary schools (except those teachers employed by the cities of Minneapolis, St. Paul, and Duluth and by the University of Minnesota) are required to be TRA members.

Pension costs of the Teachers Retirement Fund are funded by member and employer contributions collected by TRA and by earnings on investments. In fiscal year 1994, each coordinated or basic member contributed 4.5 percent or 8.5 percent of their salary, respectively. Basic members are not covered by social security. All new members of the fund are automatically considered coordinated members and are covered by social security. In fiscal year 1994, employers matched employee contributions and also paid an additional 3.64 percent of members' salaries for the purpose of amortizing the unfunded liability of the fund. The projected date of full funding for the Teachers Retirement Fund is 2020. Beginning July 1, 1994, the employee contribution increased by two percent. The employer contribution did not increase.

The following schedule shows fiscal year 1994 financial activity for the Teachers Retirement Fund administered by TRA:

Teachers Retirement Fund
Financial Activity
Year Ended June 30, 1994

Operating Revenues:	
Employer Contributions	$171,854,594
Member Contributions	100,803,239
Investment Income	710,189,034
Other	8,752,052
Total Operating Revenue	$991,598,919
Operating Expenses:	
Benefits	$309,036,770
Refunds	3,583,342
Other	10,176,758
Total Operating Expenses	$322,796,870

Source: 1994 audited TRA Statement of Revenues, Expenditures, and Changes in Fund Balance.

Current Findings and Recommendations

1. The interest rate to be paid on certain refunds is unclear.

TRA may be applying an incorrect interest rate on refunds to inactive members who terminated teaching prior to May 16, 1989, but subsequently applied for refunds after that date. Effective May 16, 1989, state law increased interest rates on refunded member contributions from five percent to six percent. Members currently applying for refunds receive six percent interest on their contributions if they ceased teaching on or after May 16, 1989, but only five percent interest if they ceased teaching before May 16, 1989. Currently, members who terminated teaching prior to May 16, 1989, receive the six percent interest rate if they return to teaching for one day. Effective July 1, 1995, TRA has increased the one day teaching requirement to 85 days.

Minn. Stat. 354.49 provides that, "Any person who ceases to be a member by reason of termination of teaching service shall receive a refund...with interest at the rate of six percent per annum compounded annually."

Prior to May 16, 1989 the statutory interest rate to be paid on refunded contributions was five percent. TRA applies the statutory interest rate in effect on the date the member terminated teaching. TRA has based its interpretation of refund interest rates on legal opinions that indicate that member retirement benefits are based on the law in effect on the date the member terminated teaching. We question, however, whether these legal opinions apply to refunds.

TRA currently does not have an attorney general opinion regarding the application of refund interest rates.

Recommendation

- *TRA should request an attorney general's opinion to determine the interest rate to be paid on refunds of member contributions made subsequent to May 16, 1989.*

2. TRA needs to strengthen controls over inactive member accounts.

TRA does not maintain contact with inactive members. An inactive member is a person who has ceased teaching but maintains a contributions balance in the TRA fund. Inactive members may apply for a refund of contributions or may keep their money in the fund. TRA writes off member balances of $500 or less if the member does not apply for a refund within five years after the end of the fiscal year in which the member last contributed to the fund. Inactive members do not receive annual statements. TRA does not update addresses for inactive members. Also, some TRA members are not properly classified on TRA inactive member computer files. TRA needs to contact inactive members to confirm that actuarial data is correct. Inactive members should receive statements showing their account balances.

TRA does not adequately separate refund duties. One staff person is authorized to handle every aspect of processing refunds, including taking calls from members, making information changes to members' files, calculating refunds, verifying information on tapes used to print warrants, initiating changes to the refund tapes, maintaining change documentation, preparing batch sheet totals, and picking up refund warrants at the Department of Finance. Although TRA has instituted certain mitigating controls, such as verification of refund calculations by a second person, one person should not have authorization to perform all refund processing duties. The potential for errors and irregularities to occur without being detected in a timely manner increases when duties are not adequately separated.

Recommendation

- *TRA should strengthen its control procedures over inactive member accounts by:*
  - *Updating to the extent possible, inactive member information, including current addresses.*
  - *TRA should send annual statements to inactive members.*
  - *The duties involved in providing refunds to members should be separated.*

STATE OF MINNESOTA
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February 9, 1995

Mr. James R. Nobles, Legislative Auditor
Office of the Legislative Auditor
Centennial Building, First Floor S.
658 Cedar Street
St. Paul, MN 55155

Dear Mr. Nobles:

The State of Minnesota Teachers Retirement Association (TRA) is committed to maintaining effective internal controls, and appreciates the thorough and valuable review of current administrative policies and procedures by the audit team.

In response to the individual recommendations,

1. *TRA should request an attorney general's opinion to determine the interest rate to be paid on refunds of member contributions made subsequent to May 16, 1989.*

   TRA has already discussed this matter with its Attorney General representative who has opined that the statutory refund provision is not clear and arguments could support either the past or current rate of interest. TRA will seek a written confirmation of that opinion. If statutory clarification is necessary, we will contact the other statewide public retirement systems because they currently follow a similar practice and the Legislative Commission on Pensions and Retirement has put significant emphasis on uniformity.

2. *TRA should strengthen its control procedures over inactive member accounts.*

   A major challenge for both public and private pension retirement systems is to maintain contact with inactive members who have left contributions in their retirement fund. TRA is aware of its obligations to "inactive members" and plans several steps to meet this challenge as part of our customer service initiative and strategic planning process.

First, we will send a first-class mailing this spring to those for whom we have current addresses to restore our avenues of communication. Second, we will contract with a national database service bureau to obtain current addresses where needed and crosscheck our records with those of the Social Security Administration to determine if deaths have occurred. Third, we will prepare to distribute statements of account balances on an annual basis. Finally, TRA will continue to develop ongoing strategies to maintain more frequent communication with inactive members.

Although the number of refunds taken during the past 10 years has declined significantly due to federal tax law changes, TRA will further separate the duties involved in providing refunds to members. We will do this by increasing the responsibilities of other accounting employees who currently participate in only a few aspects of the refund process. Effective immediately, an employee whose work responsibilities are independent of the refund process will pick up warrants at the Department of Finance. The implementation of the new statewide accounting system in July, 1995, may also provide additional opportunities to improve controls over this process.

Sincerely,

Gary Austin

Gary Austin
Executive Director

GA/sw