

Public Employees 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

95-06

SUMMARY

State of Minnesota
Office of the Legislative Auditor
Centennial Office Building • St. Paul, MN 55155
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Public Employees Retirement Association

Financial Audit For The Year Ended June 30, 1994

Public Release Date: February 24, 1995

No. 95-06

Objectives:

- Examine the association's financial statements.
- Review internal control structure: Employee and employer contributions, annuity payments, Police and Fire Fund consolidations.
- Test compliance with certain finance-related legal provisions.

Conclusions:

We issued an unqualified opinion on the association's financial statements for fiscal year 1994.

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

- PERA does not have an adequate separation of duties over the annuity payment process.

We found no departures from finance-related legal provisions.



STATE OF MINNESOTA

OFFICE OF THE LEGISLATIVE AUDITOR

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

JAMES R. NOBLES, LEGISLATIVE AUDITOR

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Legislative Audit Commission

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Public Employees Retirement Association

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Public Employees Retirement Association

Laurie Fiori Hacking, Executive Director
Public Employees Retirement Association

Audit Scope

We have audited the financial statements of the Public Employees Retirement Association as of and for the year ended June 30, 1994, and issued our report thereon dated December 1, 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 the department'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:

- employer and employee contributions,
- annuity payments, and
- Police and Fire Consolidations

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.

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Management Responsibilities

The management of Public Employees Retirement Association 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 study and evaluation disclosed the issue discussed in finding 1 involving the internal control structure of the Public Employees Retirement Association. We consider this issue 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.

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

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may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we do not believe the reportable condition described above is a material weakness.

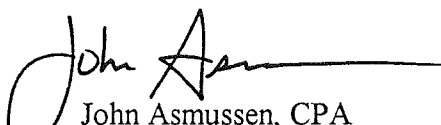
The results of our tests of compliance indicate that, with respect to the items tested, the Public Employees Retirement Association complied, in all material respects, with the provisions referred to in the audit scope paragraphs. With respect to the items not tested, nothing else came to our attention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

We also noted other matters that we reported to the management of the Public Employees Retirement Association at the exit conference held on February 9, 1995.

This report is intended for the information of the Legislative Audit Commission and management of Public Employees Retirement Association. This restriction is not intended to limit the distribution of this report, which was released as a public document on February 24, 1995.

We 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 9, 1994

Report Signed On: February 17, 1995

Public Employees Retirement Association

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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
Beth Hammer, CPA	Auditor-in-Charge
Jenny Lee	Auditor

Exit Conference

An exit conference was held with the following Public Employees Retirement Association staff on February 9, 1995:

Laurie Fiori Hacking	Executive Director
Mary Vanek	Manager of Member Services
Judith Hunt	Manager of Finance
Gary Hovland	Senior Accounting Supervisor

Public Employees Retirement Association

Introduction

The Minnesota Legislature established the Public Employees Retirement Association (PERA) in 1931. PERA administers pension funds that serve approximately 185,000 county, school, and local 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 three defined benefit funds. These funds provide a variety of retirement annuities, and survivor and disability benefits. The PERA board of trustees is responsible for administering these funds in accordance with statutes passed by the Minnesota Legislature and has a fiduciary obligation to PERA's members, the governmental employer units, the state and its taxpayers.

During fiscal year 1994, the PERA board of trustees included the State Auditor, six members appointed by the governor, and three trustees elected by the active membership. Legislation passed during the 1994 session changed the board composition, as of January 1, 1995, to include ten members and the State Auditor. The governor appoints five of these members who serve four-year terms. These members represent cities, counties, school boards, retired annuitants and the general public, respectively. The PERA active membership elects the remaining five trustees. One of these trustees must be a member of the police and fire fund and one must be a former member of PERA or a member who receives a disability benefit.

The board appoints an executive director to serve as administrative head of PERA. With approval of the board, the director develops the annual administrative budget, determines 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. Laurie Fiori Hacking has been the Executive Director since January 1991.

Legislation passed in 1987, allows local police and salaried firefighter's relief associations to consolidate with PERA. As of the effective date of each merger, the law states that the local relief association shall transfer all assets to PERA. At June 30, 1993, 25 local relief associations had consolidated with PERA. During fiscal year 1994, 10 additional local police and fire relief associations elected to consolidate with PERA and transferred assets valued at \$256,556,000.

The following schedule shows the fiscal year 1994 operating revenues and expenses (in thousands) for the three defined benefit pension plans administered by PERA.

Public Employees Retirement Association

Public Employees Retirement Association 1994 Revenues and Expenses (in thousands)

	Public Employees Retirement Fund	Police and Fire Fund	Police and Fire Consolidation Fund
<u>Operating Revenues:</u>			
Member Contribution	\$112,940	\$ 21,806	\$ 3,030
Employer Contribution	119,390	32,536	15,195
Investment Income	477,779	114,925	37,142
Other	<u>3,567</u>	<u>271</u>	<u>28</u>
Total Operating Revenues	<u>\$713,676</u>	<u>\$169,538</u>	<u>\$ 55,395</u>
<u>Operating Expenses:</u>			
Benefits Paid	264,233	28,126	\$ 27,305
Other	<u>19,761</u>	<u>2,500</u>	<u>935</u>
Total Operating Expenses	<u>\$283,994</u>	<u>\$ 30,626</u>	<u>\$ 28,240</u>

Source: 1994 PERA audited financial statements.

Current Finding and Recommendation

1. The Public Employees Retirement Association does not have an adequate separation of duties over the annuity payment process.

PERA concentrates the duties of the annuity payment process with two employees in the disbursement division. These employees have control over all aspects of the annuity disbursement process including creating certain annuity records, entering manual payment adjustments, entering deduction information, entering direct deposit information, initiating check printing, and mailing payments to annuitants. In addition, their duties include initiating edit reports and correcting errors detected in the reports. The employees have position descriptions which define their specific duties. However, PERA has not defined these duties to ensure a proper separation of responsibility. Therefore, errors and irregularities could occur and remain undetected.

The inadequate separation of duties occurred, in part, because the disbursing division has operated without a supervisor for approximately one year. PERA did not restructure duties after the former supervisor left. PERA could improve controls by specifically defining roles of the two disbursing division employees. This would include reviewing and authorizing access to the annuity system based on specific job responsibilities. Also, a supervisor or another employee without access to the annuity system could review edit reports for unauthorized changes.

Recommendation

- *Public Employees Retirement Association should ensure that a proper separation of duties exist over the annuity payment process.*



February 14, 1995

James R. Nobles, Legislative Auditor
Office of the Legislative Auditor
Centennial Building
658 Cedar Street
Saint Paul, Minnesota 55155

Dear Mr. Nobles:

Thank you very much for your draft report summarizing the results of the fiscal year 1994 financial audit of Public Employees Retirement Association (PERA). This year, in particular, we commend your staff for an exceptionally thorough examination of our significant financial activities. The auditors identified PERA as needing to separate duties in the annuity payment process. At this time, we appreciate the opportunity to formally respond to their finding and recommendation for improvement.

We concur with the audit finding and intend to step up activities to strengthen our internal control structure. In past years, the disbursing division has operated with both a supervisor and an additional employee. We will focus our priorities toward hiring new staff who can assume some of the duties currently performed by the two disbursing division employees. This will require our rewriting position descriptions and submitting them to the Department of Employee Relations for reclassification before posting any vacancies. In the interim, we will improve controls by redefining responsibilities of each of the disbursing division employees to ensure a proper separation of duties exists.

Judy Hunt, Finance Manager, will be responsible for resolution of this audit finding. She projects June 1, 1995 as the date for hiring the needed staff.

Again, thank you for your staff's contributions. We extend a special thank you to Ms. Claudia Gudvangen. For several years, we've admired her extensive knowledge of state operations and pension trust funds and we've trusted her as our agency's confidant and advisor. We will miss her direct association as PERA's audit manager on future engagements. Most importantly, we wish her all the best in her new role as Senior Audit Manager.

Sincerely,

A handwritten signature in cursive script that reads "Laurie Fiori Hacking".

Laurie Fiori Hacking
Executive Director