Minnesota State Retirement System

Financial Audit
Fiscal Year Ended June 30, 1996

January 1997

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Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

97-2

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Members of the Legislative Audit Commission

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Minnesota State Retirement System

Members of the Board of Directors
Minnesota State Retirement System

Mr. David Bergstrom, Executive Director
Minnesota State Retirement System

We have audited the financial statements of the Minnesota State Retirement System (MSRS) as of and for the fiscal year ended June 30, 1996. The work conducted at MSRS is part of our Statewide Audit of the State of Minnesota's fiscal year 1996 financial statements. The MSRS Comprehensive Annual Financial Report for the year ended June 30, 1996, includes our unqualified audit opinion thereon, dated November 20, 1996. The following Summary highlights the audit objectives and conclusions.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, as issued by the Comptroller General of the United States. Those standards require that we obtain an understanding of management controls relevant to the audit. The standards require that we design the audit to provide reasonable assurance that the MSRS complied with provisions of laws, regulations, contracts, and grants that are significant to the audit. The management of the MSRS is responsible for establishing and maintaining the internal control structure and complying with applicable laws, regulations, contracts, and grants.

This report is intended for the information of the Legislative Audit Commission and the 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 January 17, 1997.

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

End of Fieldwork: November 8, 1996

Report Signed On: January 10, 1997

SUMMARY

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Minnesota State Retirement System

Financial Audit
Fiscal Year Ended June 30, 1996

Public Release Date: January 10, 1997 No. 97-2

Agency Background

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. MSRS assets at June 30, 1996, totaled $5,988,341,000 for all of its retirement plans.

Audit Scope and Conclusions

The primary objective of our audit was to render an opinion on the Minnesota State Retirement System's financial statements. These statements are included both in MSRS's and in the state of Minnesota's Comprehensive Annual Financial Reports for fiscal year 1996. This objective included whether the financial statements presented fairly its financial position, results of operations, and changes in cash flows in conformity with generally accepted accounting principles.

As part of our work, we were required to gain an understanding of the internal control structure and ascertain whether MSRS complied with laws and regulations that may have a material effect on its financial statements. During our audit, we gained an understanding of the cash and investments, contributions, annuities, General Fund appropriations, deferred compensation plan, investment income, and financial statement preparation control cycles.

The MSRS Comprehensive Annual Financial Report for the year ended June 30, 1996, includes our unqualified audit opinion thereon, dated November 20, 1996. The MSRS financial statements are also a part of the state of Minnesota's Comprehensive Annual Financial Report for the year ended June 30, 1996, which includes our audit opinion dated December 2, 1996.

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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
Warren Bartz, CPA	Audit Manager
Pat Ryan	Auditor-in-Charge
Chege Ngigi	Auditor
Susan O'Connell	Auditor

Chapter 1. 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.

A board of directors provides the policy-making function for MSRS. The board consists of 11 members, including three members appointed by the governor (one of whom must be a constitutional officer or appointed state official), four state employees elected by state employees covered by the system, one employee of the transit operating division of the Metropolitan Council, 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.

MSRS assets at June 30, 1996, totaled $5,988,341,000 for all of its retirement plans, including $1,337,498,000 for the deferred compensation plan. Table 1-1 shows the fiscal year 1996 balance sheet for the defined benefit and defined contribution plans MSRS administers.

Table 1-1
MSRS Balance Sheet
June 30, 1996

	Defined Benefit Plans	Defined Contribution Plan
Assets:		
Cash	$ 38,000	$ 13,000
Accounts Receivable	8,850,000	358,000
Investments	2,786,224,000	153,123,000
Equity in Post Retirement Fund	1,695,387,000	0
Nondedicated Member Deposits	6,678,000	0
Fixed Assets	172,000	0
Total Assets	$4,497,349,000	$153,494,000
Liabilities:		
Accounts Payable	$ 1,406,000	$ 275,000
Deferred Revenue	10,000	0
Due to Other Funds	4,429,000	0
Due to Other Plans	211,000	131,000
Total Liabilities	$ 6,056,000	$ 406,000
Net Assets	$4,491,293,000	$153,088,000

Source: MSRS Comprehensive Annual Financial Report for the year ended June 30, 1996.

MSRS also administers the deferred compensation plan for public employees and officials. MSRS reports the deferred compensation plan as an Agency Fund pursuant to generally accepted government accounting principles. Total assets of the deferred compensation plan increased $202,454,000 during fiscal year 1996 to a total of $1,337,498,000 as of June 30, 1996.

During our audit we gained an understanding of cash and investments, contributions, annuities, General Fund appropriations, deferred compensation plan withdrawals, and investment income control cycles. The State Board of Investment performs a significant portion of the controls over MSRS investments. We reviewed the controls over state investments as part of our annual audit of the State Board of Investment. We relied on the annual actuarial valuation performed by the Legislative Commission on Pensions and Retirement's actuary. The purpose of the actuarial valuation was to test how MSRS was achieving its fundamental financing objectives and to determine the actuarial status of its retirement funds.

As calculated by the actuary, the accrued funding ratio is a measure of funding status. The ratio is based on the actuarial cost method that has been historically used by the state. MSRS has a goal of reaching full funding for all advance funded defined benefit plans by the year 2020. Table 1-2 shows the funding ratios at June 30, 1996.

Table 1-2
Defined Benefit Plans
MSRS Funding Ratios
June 30, 1996

Plan Name	Funding Ratio
Advance Funded Plans:	
State Employees	97.27%
State Patrol	106.56%
Correctional Employees	113.38%
Judges	59.96%
Unfunded Plans:	
Legislators	41.55%
Elective State Officers	13.81%

Source: MSRS Comprehensive Annual Financial Report for the year ended June 30, 1996.

The primary objective of our audit was to render an opinion on the MSRS financial statements. These statements are included in both MSRS's and in the State of Minnesota's Comprehensive Annual Financial Reports for fiscal year 1996. Our objectives included whether the MSRS financial statements fairly presented its financial position, results of operations, and changes in cash flows in conformity with generally accepted accounting principles. As part of our work, we were required to gain an understanding of the internal control structure and ascertain whether MSRS complied with laws and regulations that may have a material effect on its financial statements.

The MSRS Comprehensive Annual Financial Report for the year ended June 30, 1996, includes our unqualified audit opinion thereon, dated November 20, 1996. The MSRS financial statements are also part of the State of Minnesota's Comprehensive Annual Financial Report for the year ended June 30, 1996, which includes our audit opinion dated December 2, 1996.

Chapter 2. Contributions

Chapter Conclusions

MSRS fairly presented contribution revenue on its fiscal year 1996 financial statements. MSRS designed and implemented management controls to provide reasonable assurance that contributions were adequately safeguarded and that transactions were properly reported in the accounting records and financial statements. MSRS complied with material financial legal provisions for contributions tested.

MSRS is responsible for administering six defined benefit plans and one defined contribution plan. The contribution rates for these plans are set forth in Minnesota statutes. Employee contributions are credited to each participant's account and invested by the State Board of Investment. Employer contributions are based on each employee's earnings and are also invested. The Legislative and Elected State Officer Plans employer share is not funded until the member begins receiving an annuity payment. At that time, the state must contribute an amount equal to the full annuity value less the accumulated employee contributions. Table 2-1 shows the statutory employee and employer contribution rates in effect during fiscal year 1996. Table 2-2 shows the dollar value of contributions.

MSRS also administers a Deferred Compensation Plan. This is an optional plan for all state employees and employees of political subdivisions. These contributions are tax deferred to the employee. The minimum contribution to the plan is $10 per pay period up to a maximum of 25 percent of gross taxable compensation or $7,500. This plan is further discussed in Chapter 4.

Table 2-1
Contribution Rates
Fiscal Year 1996

Plan Name	Employee	Employer	Total
State Employees	4.07%	4.20%	8.27%
State Patrol	8.92%	14.88%	23.80%
Correctional Employees	4.90%	6.27%	11.17%
Judges	8.15%	22.00%	30.15%
Legislators	9.00%	NA	NA
Elective State Officers	9.00%	NA	NA
Unclassified Employees	4.07%	6.00%	10.07%

Source: Minnesota statutes.

Table 2-2
Employee and Employer Contributions
Fiscal Year 1996

Plan Name	Employee	Employer	Total
State Employees	$ 63,507,000	$65,556,000	$ 129,063,000
State Patrol	3,484,000	5,742,000	9,226,000
Correctional Employees	3,575,000	4,559,000	8,134,000
Judges (1)	1,427,000	4,972,000	6,399,000
Legislators (2)	563,000	0	563,000
Elected State Officers (3)	41,000	0	41,000
Unclassified Employees	2,991,000	4,356,000	7,347,000
Deferred Compensation	29,549,000	NA	29,549,000
Total	$105,137,000	$85,185,000	$190,322,000

(1) In addition, $1,472,711 was appropriated from the General Fund for annuity benefits of judges and survivors not participating in the Post Retirement Fund.

(2) In addition, $2,135,353 was appropriated from the General Fund for annuity benefits.

(3) In addition, $155,512 was appropriated from the General Fund for annuity benefits.

Source: MSRS Comprehensive Annual Financial Report for the year ended June 30, 1996, and MSRS accounting records for deferred compensation.

Audit Objectives and Methodology

The primary objectives of our audit were to answer the following questions:

- Did MSRS properly present contribution revenue in the fiscal year 1996 financial statements?
- Did MSRS design and implement management controls to provide reasonable assurance that contributions were adequately safeguarded and that transactions were authorized and properly reported in the accounting records and financial statements? Our objective in reviewing management controls over contributions was not to provide an opinion on the effectiveness of the controls.
- Did MSRS comply with material financial legal provisions in administering contributions?

To achieve these objectives, we interviewed MSRS staff to gain an understanding of the controls in place over the processing of contribution revenue. We also performed analytical reviews and selected samples of transactions from each of the plans and conducted detailed audit tests.

Conclusion

MSRS fairly presented contribution revenue on its fiscal year 1996 financial statements. MSRS designed and implemented management controls to provide reasonable assurance that contributions were adequately safeguarded and that transactions were properly reported in the accounting records and financial statements. MSRS complied with material financial legal provisions for contributions tested.

Chapter 3. Annuities

Chapter Conclusions

Retirement benefits were properly presented on the fiscal year 1996 financial statements. MSRS designed and implemented management controls to provide reasonable and assurance that assets for annuity benefits were adequately safeguarded, and that annuity payments were authorized and properly recorded in the accounting records and financial statements. We concluded that MSRS complied with applicable legal requirements in calculating annuity benefits for the items tested.

MSRS administers annuity, disability, and survivor benefit payments to state employees. The plans include six defined benefit plans and one defined contribution plan. Each of the plans vary as to normal retirement age and the formulas used to calculate annuity amounts. When an employee retires, the present value of the annuity calculated is transferred into the Post Retirement Fund, which is administered by the State Board of Investment. An annuitant's benefits may be increased each January 1 depending on the investment results of the fund. The following provides a general overview of each of the retirement plans.

Defined Benefit Plans

State Employees Retirement Plan:
Participants of this plan are state employees, nonacademic staff of the University of Minnesota, and some metropolitan agency employees. The normal retirement age for this plan is 65 for employees hired before July 1, 1989. For employees hired after that date normal retirement age is the greater of 65 or the age eligible for full social security retirement benefits. The plan also has provisions for early retirement. Disability benefits are available for employees experiencing total and permanent disability before normal retirement age. The amount of an annuitant's benefit is based on the number of years of allowable service and an average of the five highest successive years of salary.

State Patrol Retirement Plan:
Participants of this plan are state troopers, conservation officers, and some employees of the Bureau of Criminal Apprehension. The normal retirement age is 55 with three years of allowable service. The retirement annuity is based on 2.65 percent of average salary for each year of allowable service. The plan also has provisions for disability annuities and early retirement options.

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Correctional Employees Retirement Plan:
Participants of this plan are state employees who have direct contact with inmates at Minnesota correctional facilities. The normal retirement age is 55 with three years of service. The retirement annuity is based on 2.5 percent of average salary for each year of allowable service up to a maximum of 75 percent of average salary. The plan also has provisions for disability annuities and early retirement options.

Judicial Retirement Plan:
Participants of this plan are Minnesota district, appellate, and supreme court judges. The normal retirement age is 65 with five years of service. The retirement annuity is based on 2.5 percent of average salary for each year of allowable service prior to July 1, 1980, and 3 percent of average salary for each year of allowable service after June 30, 1980. The maximum benefit is 65 percent of salary for the 12 months preceding retirement. The plan also has provisions for disability annuities and early retirement options.

Legislative Retirement Plan:
Participants of this plan are members of the state Legislature. The normal retirement age is 62 with either six full years of service or service during all or part of four regular legislative sessions. The retirement annuity is 5 percent of average salary for the first eight years of service prior to January 1, 1979, and 2.5 percent for subsequent years. For allowable service after December 31, 1978, the annuity is based on 2.5 percent of salary. This plan also offers provisions for early retirement. The plan does not offer disability benefits.

Elective State Officers Plan:
Participants of this plan are elected constitutional officers. The normal retirement age is 62 with eight years of allowable service. The retirement annuity is based on 2.5 percent of average salary for the highest five successive years. This plan also offers provisions for early retirement. The plan does not offer disability benefits.

Defined Contribution Plan

Unclassified Employees Plan:
Participants of this plan include employees of the state of Minnesota in unclassified positions. Employees in this plan choose from among the investment options offered by the Minnesota Supplemental Investment Fund. After leaving state service, participants are allowed to withdraw the market value of the investments purchased with employee and employer contributions. Participants may choose to receive a lifetime annuity at age 55 with any length of service. This plan also has provisions for disability benefits.

Table 3-1
Annuity Expenditures
Fiscal Year 1996

Plan Name	Retirement Annuities	Disability Payments	Total
State Employees	$131,424,000	$ 5,097,000	$ 136,521,000
State Patrol	12,914,000	364,000	13,279,000
Correctional Employees	5,050,000	409,000	5,460,000
Judges	6,506,000	253,000	6,761,000
Legislators	2,318,000	NA	2,318,000
Elected State Officers	155,000	NA	155,000
Total	$158,367,000	$6,123,000	$164,494,000

Note: Unclassified annuity expenditures are presented as part of the State Employees Plan.

Source: MSRS Comprehensive Annual Financial Report for the year ended June 30, 1996.

Audit Objectives and Methodology

The primary objectives of our audit were to answer the following questions:

- Did MSRS properly present annuity expenditures on its fiscal year 1996 financial statements?
- Did MSRS design and implement controls over annuity payments that provided reasonable assurance that assets for annuity benefits were adequately safeguarded and that annuity payments were authorized and properly reported in the accounting records and financial statements? Our objective in reviewing management controls over annuity payments was not to provide an opinion on the effectiveness of the controls.
- Did MSRS calculate and disburse annuity benefits in accordance with applicable laws and regulations?

To answer these questions, we interviewed MSRS staff to gain an understanding of the management controls in place over the processing of annuity benefits. We also performed analytical reviews, selected samples of transactions from each of the funds, and conducted detailed audit tests of a representative sample.

Conclusion

Retirement benefits were properly presented on the fiscal year 1996 financial statements. MSRS designed and implemented management controls to provide reasonable and assurance that assets for annuity benefits were adequately safeguarded, and that annuity payments were authorized and properly recorded in the accounting records and financial statements. We concluded that MSRS complied with applicable legal requirements in calculating annuity benefits for the items tested.

Chapter 4. Deferred Compensation Plan

Chapter Conclusions

MSRS properly presented participant account balances on the fiscal year 1996 financial statements. MSRS designed and placed in operation management controls to provide reasonable assurance that assets for withdrawals were adequately safeguarded and that transactions were authorized and properly recorded in the accounting records. MSRS also complied with applicable legal requirements in calculating withdrawals for the transactions we tested.

MSRS administers a deferred compensation plan for state and other public employees in the state of Minnesota. The plan is governed by the Internal Revenue Service (IRS) regulations, section 457. Eligible employees can contribute up to 25 percent of their gross taxable compensation to a maximum of $7,500 each year. Participants can choose several different investment options administered by three different investment providers. Employees can chose investments offered by the Minnesota Supplemental Investment Fund (administered by the State Board of Investment) and by two private insurance companies (Minnesota Mutual Life Insurance Company and Great West Life Assurance Company). Each provider offers investments in various stock, bond, money market, and fixed income investments. MSRS is responsible for processing contributions designated for investment in the Supplemental Investment Fund. The two insurance companies are responsible for safeguarding contributions submitted to them. During fiscal year 1996, MSRS processed $29.5 million of employee contributions applicable to the Supplemental Investment Fund. Table 4-1 shows the market value of investments held by each of the investment providers at June 30, 1996.

Table 4-1
Participant Account Balances
Fiscal Year 1996

Investment Provider	Participant Account Balances
Great West Life Assurance Co.	$ 673,994,811
Minnesota Supplemental Investment Fund	339,861,092
Minnesota Mutual Life Insurance Co.	314,359,085
Total	$1,328,214,988

Source: MSRS and insurance company accounting records.

The plan allows employees portability options which allows them to reallocate invested funds among investment providers as well as among investment options. MSRS is responsible for the processing of investment reallocations within the Supplemental Investment Fund as well as transfers to and from the insurance companies.

The plan has specific rules regarding the withdrawal of deferred compensation deposits. Withdrawal is allowed when employment is terminated, at death, or because of unforeseeable financial emergency. The amount an employee withdraws is based on the month-end market value of the investments held in the employee's account. Month-end market values are determined by the State Board of Investment. The Minnesota Supplemental Investment Fund offers three different withdrawal options:

- lump sum,
- lump sum purchase of a fixed or variable annuity from the insurance company, or
- monthly installment payments over period specified by the participant.

Table 4-2 shows deferred compensation withdrawal amounts by type.

Table 4-2
Deferred Compensation Withdrawals
Fiscal Year 1996

Refund Type	Amount
Transfers To Insurance Companies	$12,374,057
Lump Sum Withdrawals	1,525,807
Partial Withdrawals	517,697
Financial Emergency Withdrawals	381,466
Employee Death Withdrawals	209,675
Other	71,903
Total Withdrawals	$15,080,605

Source: MSRS withdrawal subsystem database.

Audit Objectives and Methodology

The primary objectives of our audit were to answer the following questions:

- Did MSRS properly present deferred compensation participant account balances on the fiscal year 1996 financial statements?
- Did MSRS calculate and disburse deferred compensation withdrawals in accordance with applicable laws and regulations?
- Did MSRS properly record deferred compensation withdrawals in its financial records and on the state's accounting system?
- Did MSRS design and implement management controls to provide reasonable assurance that assets to pay withdrawals were adequately safeguarded and that withdrawal transactions were authorized and properly reported in the accounting records? Our objective in reviewing management controls over withdrawals was not to provide an opinion on the effectiveness of the controls.

To answer these questions, we interviewed MSRS staff to gain an understanding of the controls in place over the processing of deferred compensation withdrawals and contributions, and the presentation participant account balances. We also performed analytical reviews, selected samples of transactions, and conducted detailed audit tests.

Conclusion

MSRS properly presented participant account balances on the fiscal year 1996 financial statements. MSRS designed and placed in operation management controls to provide reasonable assurance that assets for withdrawals were adequately safeguarded and that transactions were authorized and properly recorded in the accounting records. MSRS also complied with applicable legal requirements in calculating withdrawals for the transactions we tested.