Public Employees Retirement Association

Financial Audit
For the Fiscal Year Ended June 30, 1996

January 1997

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Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

97-3

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

STATE OF MINNESOTA
OFFICE OF THE LEGISLATIVE AUDITOR
CENTENNIAL BUILDING, 658 CEDAR STREET • ST. PAUL, MN 55155 • 612/296-4708 • TDD RELAY 612/297-5353
JAMES R. NOBLES, LEGISLATIVE AUDITOR

Representative Ann H. Rest, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Lyle R. Olson, President, Board of Trustees
Public Employees Retirement Association

Mary Most Vanek, Acting Executive Director
Public Employees Retirement Association

We have audited the financial statements of the Public Employees Retirement Association (PERA) as of and for the fiscal year ended June 30, 1996, as further explained in the Background section of this report. The work conducted in the department is part of our Statewide Audit of the state of Minnesota's fiscal year 1996 financial statements. PERA's Comprehensive Annual Financial Report for the year ended June 30, 1996, includes our unqualified audit opinion thereon, dated December 2, 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* 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 also require that we design the audit to provide reasonable assurance that PERA complied with provisions of laws, regulations, contracts, and grants that are significant to the audit. The management of PERA 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 PERA. 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: December 2, 1996

Report Signed On: January 10, 1997

SUMMARY

State of Minnesota
Office of the Legislative Auditor
1st Floor Centennial Building
658 Cedar Street • St. Paul, MN 55155
(612)296-1727 • FAX (612)296-4712
TDD Relay: 1-800-627-3529
email: auditor@state.mn.us
URL: http://www.auditor.leg.state.mn.us

Public Employees Retirement Association

Financial Audit
For the Fiscal Year Ended June 30, 1996

Public Release Date: January 17, 1997 No. 97-3

Agency Background

The Public Employees Retirement Association (PERA) administers pension funds that serve approximately 200,000 county, school, and local public employees, their survivors and dependents. Approximately 2,000 separate Minnesota government units participate in the retirement funds administered by PERA. These units include counties, cities, townships, and school districts.

The association administers three defined benefit funds. These funds provide retirement annuities and survivor and disability benefits to members. The PERA Board of Trustees is responsible for administering these funds in accordance with state statutes and has a fiduciary obligation to PERA's members, the employers, and the state. PERA also administers a defined contribution plan. PERA assets at June 30, 1996, totaled approximately $8 billion for all of its retirement plans.

Audit Objectives and Scope

The primary objective of our audit was to render an opinion on PERA's financial statements. These financial statements are included both in PERA's and in the state of Minnesota's Comprehensive Annual Financial Report for fiscal year 1996. Our objective included determining whether PERA's 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 gained an understanding of the internal control structure and ascertained whether PERA complied with laws and regulations that may have a material effect on its financial statements. During our audit, we gained an understanding of the contributions, annuities, refunds, Police and Fire Consolidation Fund mergers, and the financial statement preparation cycles.

Conclusions

PERA's Comprehensive Annual Financial Report for the year ended June 30, 1996, includes our unqualified audit opinion thereon, dated December 2, 1996. The PERA financial statements are also included in 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. PERA designed and implemented management controls for material financial activities, and for the items tested, complied with material legal provisions.

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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
Jim Riebe, CPA	Audit Manager
Carl Otto, CPA	Auditor-in-Charge
Marina Mirman	Auditor

Exit Conference

We discussed the results of the audit at an exit conference with the following PERA staff on January 6, 1997:

Mary Most Vanek	Acting Executive Director
David DeJonge	Manager of Finance
Gary Hovland	Senior Accounting Supervisor

Chapter 1. Background

The Public Employees Retirement Association (PERA) administers pension funds that serve approximately 200,000 county, school, and local public employees, their survivors and dependents. Approximately 2,000 separate Minnesota government units participate in the retirement funds administered by PERA. These units include counties, cities, townships, and school districts.

The association administers the following defined benefit funds. These funds provide retirement annuities and survivor and disability benefits to members.

Basic Plan:	Participants in this plan are public employees hired prior to January 1, 1968, who did not elect to be covered by social security benefits. This plan is closed to new members.
Coordinated Plan:	Members in this plan include public employees, other than police officers and firefighters, who earn over $425 per month. Coordinated members are covered by social security benefits.
Police and Fire Fund:	Membership in this plan consists of police officers and firefighters.
Police and Fire Consolidated Fund:	Legislation passed in 1987 allows local police and salaried firefighters' relief associations to consolidate retirement programs with PERA. The law requires the local relief associations to transfer all assets to PERA as of the effective date of each merger. Two mergers took place during the fiscal year ending June 30, 1996. As of June 30, 1996, 37 local relief associations had consolidated with PERA.

PERA also administers a defined contribution plan. This plan is a tax-deferred retirement savings program for elected public officials and public ambulance service personnel.

The PERA Board of Trustees is responsible for administering these funds in accordance with state statutes and has a fiduciary obligation to PERA's members, the employers, and the state. The board consists of ten members and the State Auditor. The Governor appoints five of the members who serve four-year terms. These members represent cities, counties, school boards, retired annuitants, and the general public. 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 member must be a former member of PERA or a member who receives a disability benefit.

The board appoints the Executive Director of PERA. Laurie Fiori Hacking was the Executive Director from January 1991 through October 1996. The board has since named Mary Most Vanek the Acting Executive Director. With the 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 is a member of the State Investment Advisory Council. The council advises the State Board of Investment on the management and investment of pension funds and other assets.

For the three defined benefit pension funds administered by PERA, Table 1-1 shows fund assets at June 30, 1996, and Table 1-2 shows fiscal year 1996 operating revenues and expenses.

Table 1-1
Public Employees Retirement Association
Defined Benefit Funds
Balance Sheet (in thousands)
as of June 30, 1996

	Public Employees Retirement Fund	Police and Fire Fund	Police and Fire Consolidation Fund
Assets:			
Cash	$ 1,428	$ 274	$ 69
Accounts Receivable	889	145	2,807
Investments	2,559,298	1,202,720	368,130
Equity in Minnesota Post Retirement investment Fund	3,152,736	391,369	381,589
Other Assets, Net of Accumulated Depreciation	551	0	0
Total Assets	$5,714,902	$1,594,508	$752,595
Total Liabilities	$ 12,655	$ 1,837	$ 5,924
Total Fund Balance	5,702,247	1,592,671	746,671
Total Liabilities and Fund Balance	$5,714,902	$1,594,508	$752,595

Source: Condensed information from PERA's Comprehensive Annual Financial Report for the year ended June 30, 1996.

Table 1-2
Public Employees Retirement Association
Defined Benefit Funds
Revenues and Expenses (in thousands)
for the Year Ended June 30, 1996

	Public Employees Retirement Fund	Police and Fire Fund	Police and Fire Consolidation Fund
Operating Revenues:			
Member Contribution	$121,525	$ 24,065	$ 4,061
Employer Contribution	129,738	36,066	15,091
Investment Income	712,790	216,491	90,528
Other	1,202	159	2
Total Operating Revenues	$965,255	$276,781	$109,682
Operating Expenses:			
Benefits Paid	$312,511	$ 37,132	$ 41,841
Refunds	14,683	846	79
Other	10,171	2,311	849
Total Operating Expenses	$337,365	$ 40,289	$ 42,769
Change in Reserves New P & F Consolidations	N/A	N/A	$ 7,929
Net Fund Balance Additions	$ 627,890	$ 236,492	$74,842
Fund Balance, July 1, 1995	$5,074,357	$1,356,179	$671,829
Fund Balance, June 30, 1996	$5,702,247	$1,592,671	$746,671

Source: Condensed information from PERA's Comprehensive Annual Financial Report for the year ended June 30, 1996.

Total assets of the defined contribution plan increased approximately $1.7 million during fiscal year 1996 to a total of $7 million as of June 30, 1996. The plan is reported as an Agency Fund.

During our audit, we gained an understanding of the cash and investments, contributions, annuities, refunds, and investment income cycles. The State Board of Investment (SBI) performs a significant portion of the controls over PERA investments. We review the controls over state investments as part of our annual audit of SBI.

The primary objective of our audit was to render an opinion on PERA's financial statements. These financial statements are included both in PERA's and in the state of Minnesota's Comprehensive Annual Financial Report for fiscal year 1996. Our objective included determining whether PERA's 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 gained an understanding of the internal control structure and ascertained whether PERA complied with laws and regulations that have a material effect on its financial statements.

To address our audit objectives, we interviewed key department employees, reviewed applicable policies and procedures, and reviewed PERA's process for preparing the financial statements. We tested representative samples of financial transactions and performed analytical procedures as we considered appropriate. We relied on the annual actuarial valuation performed by the Legislative Commission on Pension and Retirement's actuary. The purpose of the actuarial valuation is to test how the retirement system is achieving its fundamental financing objectives and to determine the actuarial status of PERA's defined benefit funds. Table 1-3 below highlights the funding ratios of the three defined benefit funds at June 30, 1996.

Table 1-3
Public Employees Retirement Association
Defined Benefit Funds
Funding Ratios
June 30, 1996

Retirement Fund Name	Funding Date	Funding Ratio
Public Employees	2020	79.59%
Police and Fire	2020	122.40%
Police and Fire Consolidated	2010	95.26%

Source: Condensed information from PERA's Comprehensive Annual Financial Report, Actuarial Section, for the year ended June 30, 1996. This funding ratio, based on the entry age normal actuarial cost method, is the Ratio of Assets to Actuarial Accrued Liabilities. According to statute, assets for this computation are valued at cost plus one-third of the difference between cost and market values.

PERA's Comprehensive Annual Financial Report for the year ended June 30, 1996, includes our unqualified audit opinion thereon, dated December 2, 1996. The PERA financial statements are also included in 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

PERA's financial statements fairly presented employee and employer contributions. PERA designed and implemented 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. PERA complied with material financial legal provisions for contributions tested.

PERA collects and processes employee contributions, employer contributions, and additional employer contributions from participating counties, cities, townships, school districts, and other public agencies. Table 1-2 shows contributions received during fiscal year 1996. PERA members and participating employers contribute matching amounts to the Pension Fund. For the basic and coordinated plans, employers make additional contributions to cover unfunded liabilities. As stated in Minnesota Statutes 353A.09 Subd. 5(b), cities where relief associations have consolidated with PERA also must make an additional municipal contribution to amortize the unfunded liability of the relief association at the time of consolidation.

Table 2-1 shows contribution rates for employees and employers and additional employer contributions.

Table 2-1
Retirement Plan Contribution Rates

Retirement Plan	Employee	Employer	Additional Employer
Public Employees Retirement Fund:			
Basic Plan	8.23%	8.23%	2.50%
Coordinated Plan	4.23%	4.23%	0.25%
Public Employees Police and Fire Fund	7.60%	11.40%	0.00%
Police and Fire Consolidation Fund	7.60%	11.40%	(1)

(1) Additional lump sum municipal contribution as required by MS 353A.09.

Source: Minnesota Statutes 353.27, 353.65, and 353A.09.

Audit Objectives and Methodology

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

- Were employee and employer contributions presented fairly in PERA's financial statements?
- Did PERA 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 PERA comply with material financial legal provisions in administering contributions?

To answer these questions, we gained an understanding of the management controls over contributions by interviewing PERA staff, reviewing policies and procedures, and determining if the controls were implemented. We recalculated employee and employer contributions and additional employer contributions as specified in statute. We also performed analytical procedures on contribution amounts.

Conclusions

Contributions were fairly presented in PERA's financial statements. PERA also designed and implemented management controls to provide reasonable assurance that employee and employer contributions were adequately safeguarded. Contribution transactions were authorized and properly posted to the appropriate units and member accounts and recorded in the proper funds. For the contributions tested, we concluded that PERA complied with material financial legal provisions.

Chapter 3. Annuities

Chapter Conclusions

PERA's financial statements fairly presented annuity benefit payments. PERA designed and implemented management controls to provide 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. We concluded that, for the items tested, PERA complied with applicable legal requirements in calculating annuity benefits.

PERA provides retirement and disability benefits to members and survivor benefits upon the death of eligible members. Retirement benefits are based on a member's highest average salary for any five successive years of allowable service, age, and years of credit at termination. Table 1-2 shows annuities paid during fiscal year 1996.

A retiring member receives the higher of a step-rate benefit accrual formula or a level accrual formula. Normal retirement age for Public Employees Retirement Fund (PERF) members is age 65 if the member was employed prior to July 1, 1989. For a person who becomes a public employee after June 30, 1989, normal retirement age is the higher of age 65 or retirement age as defined in United State Code, title 42, section 416(l), as amended. If the member has reached normal retirement age, the level accrual formula is 2.5 percent for each year of service for basic members and 1.5 percent for each year of service for coordinated members.

Public Employees Police and Fire Fund (PEPFF) members, who have attained the age of 55 and received credit for not less than three years of service, qualify for the normal retirement annuity upon separation from public service. PEPFF members receive 2.65 percent for each year of service.

Members of the Police and Fire Consolidated Fund (PFCF) have the option to choose benefits identical to those of the PEPFF or the local relief association of which they were members at the time of consolidation. Certain benefit qualifications apply depending on the effective date of the consolidation.

Members of the various defined benefit funds administered by PERA may select from several different types of retirement annuities. The normal annuity is a lifetime annuity that ceases upon the death of the retiree. Another type of annuity is the joint and survivor annuity, which provides a designated joint annuitant payments upon the members death. For all defined benefit plans, a reduced retirement annuity is available to eligible members seeking early retirement.

At the time of retirement, actuarially determined reserves required to pay the cost of the member's annuity are transferred from the member's retirement fund to the Minnesota Post Retirement Investment Fund (MPRIF). Table 1-1 shows each retirement fund's equity in the MPRIF. Annuitants receive an annual increase in their benefits based on an inflation adjustment and the investment activity of the MPRIF. The benefit increase on January 1, 1996, was 6.395 percent. Either a full or partial increase is granted depending on the member's retirement date.

Audit Objectives and Methodology

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

- Were annuity benefits fairly presented in PERA's financial statements?

- Did PERA 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 PERA calculate annuity payments and properly transfer funds to the MPRIF in compliance with Minnesota Statutes?

To answer these questions, we interviewed key department personnel to gain an understanding of the management controls over annuity calculations and reviewed applicable policies, procedures, and legal provisions. We also tested a representative sample of annuity calculations and MPRIF transfers and performed comparisons of changes in members' annuity benefits from prior years.

Conclusions

Annuity benefits were fairly presented in PERA's financial statements. PERA designed and implemented management controls to provide reasonable assurance that assets for annuity benefits were adequately safeguarded and that annuity transactions were authorized and properly recorded in appropriate units, members' accounts and funds, and in the financial statements. For the items tested, PERA complied with applicable legal requirements in calculating annuity benefits.

Chapter 4. Refunds

Chapter Conclusions

PERA fairly presented refunds of contributions in the financial statements. PERA designed and placed in operation management controls to provide reasonable assurance that assets for refund payments were adequately safeguarded, and that refund transactions were authorized and properly recorded in the accounting records and financial statements. PERA also complied with applicable legal requirements in calculating member refunds for those transactions we tested.

Upon terminating public employment, members can elect to either withdraw funds and receive a lump sum payment or transfer funds into another qualified pension plan. Defined benefit fund refunds for fiscal year 1996 were over $15 million as shown in Table 1-2.

In addition, PERA administers a defined contribution plan (DCP). This plan is a tax-deferred retirement savings program for elected public officials and public ambulance service personnel. Participants determine how employee and employer contributions are to be invested through the purchase of shares in the Minnesota Supplemental Investment Fund administered by the State Board of Investment. Total contributions plus investment performance determines the ultimate benefit to the member, which is paid as a lump sum upon withdrawal. As stated in Minnesota Statute 353D.03, elected public officials contribute five percent of their salary and their employers contribute an identical amount. Since DCP is a qualified tax-deferred program, any time funds are withdrawn they are subject to taxation. If funds are withdrawn before reaching age 59 1/2, and not rolled into another qualified plan, withdrawals are subject to an additional ten percent tax surcharge. For the year ended June 30, 1996, approximately $339,000 was refunded to DCP members.

Audit Objectives and Methodology

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

- Were refunds properly recorded and fairly presented in the financial statements?
- Did PERA design and implement management controls to provide reasonable assurance that assets to pay refunds were adequately safeguarded and that refund transactions were authorized and properly reported in the accounting records and financial statements? Our objective in reviewing management controls over refunds was not to provide an opinion on the effectiveness of the controls.
- Were refunds paid in accordance with applicable legal requirements?

Our audit methodology included interviewing key department personnel to gain an understanding of the procedures PERA follows in calculating, recording, and processing refunds. We also reviewed applicable policies, procedures, and legal provisions and tested samples of refund transactions.

Conclusions

PERA fairly presented refund amounts in the financial statements. PERA designed and implemented management controls to provide reasonable assurance that assets to pay refunds were adequately safeguarded, and that refund transactions were authorized and properly reported in the accounting records and financial statements. For the transactions tested, PERA complied with applicable legal requirements in calculating member refunds.

Chapter 5. Police and Fire Consolidation Fund Mergers

Chapter Conclusions

PERA fairly presented Police and Fire Consolidation Fund merger financial activity in the financial statements. PERA also designed and implemented management controls to provide reasonable assurance that assets were adequately safeguarded, and that merger transactions were authorized and properly recorded in the accounting records and financial statements. In addition, for the merger transactions tested, PERA complied with material financial legal provisions.

In accordance with Minnesota Statutes 353A, local police or fire relief associations can consolidate with the Police and Fire Consolidated Fund administered by PERA. At the time of consolidation, the local relief association transfers all assets to the consolidation fund. These assets are valued at market value as of the date of consolidation. It is at this value that the local relief association participation in the consolidation fund is recorded.

Upon consolidation, PERA takes responsibility for administering the association's benefit plan, but bears no responsibility for financing it. The city continues to retain sole responsibility for financing the relief association plan.

Minnesota Statutes Section 353A.09, Subd. 5, requires municipalities to make an additional municipal contribution to the consolidation account. The additional payments are required in order to amortize, by the year 2010, the unfunded actuarial accrued liability of the former relief association at the date of consolidation. Additional employer contributions are also required in order to amortize subsequent actuarial gains or losses over 15 years. Approximately $9 million of additional municipal contributions were made to the consolidation account in fiscal year 1996.

Prior to 1987, 50 local relief associations administrated independent pension plans for their employees. From December 1987 to June 30, 1996, 37 police and fire associations had consolidated with PERA. Two consolidation mergers took place during fiscal year 1996, with assets totaling approximately $8 million being added to the Police and Fire Consolidation Fund.

Audit Objectives and Methodology

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

- Did PERA fairly present local relief association merger activities in the financial statements?

- Did PERA design and implement management controls to provide reasonable assurance that assets were adequately safeguarded, and that merger transactions were authorized and properly recorded in the accounting records and financial statements? Our objective in reviewing management controls over police and fire consolidations was not to provide an opinion on the effectiveness of the controls.

- Were actuarial calculations completed prior to the local relief association consolidations, and were the assets transferred to PERA after consolidation?

To satisfy our audit objectives, we reviewed the procedures PERA followed to complete consolidation fund mergers. We determined that actuarial calculations were done prior to the consolidation for each local relief association. We verified assets transferred to the state during the consolidation process and traced the individual and total amount of assets to the financial statements.

Conclusions

We found that PERA fairly presented Police and Fire Consolidation Fund merger financial activity in the financial statements. PERA also designed and implemented management controls to provide reasonable assurance that assets were adequately safeguarded, and that merger transactions were authorized and properly recorded in the accounting records and financial statements. In addition, for the merger transactions tested, PERA complied with material financial legal provisions.