Teachers Retirement Association

Financial Audit
Fiscal Year Ended June 30, 1997

January 1998

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Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

98-1

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STATE OF MINNESOTA
OFFICE OF THE LEGISLATIVE AUDITOR
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Legislative Audit Commission

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Mr. Vernell R. Jackels, President

Members of the Board of Trustees
Teachers Retirement Association

Mr. Gary Austin, Executive Director
Teachers Retirement Association

We have audited the financial statements of the Teachers Retirement Association (TRA) for the fiscal year ended June 30, 1997. The work conducted at TRA is part of our Statewide Audit of the state of Minnesota's financial statements for the fiscal year ended June 30, 1997. TRA's Comprehensive Annual Financial Report for the year ended June 30, 1997, includes our unqualified audit opinion, dated December 8, 1997. 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 also require that we design the audit to provide reasonable assurance that the Teachers Retirement Association complied with provisions of laws, regulations, contracts, and grants that are significant to the audit. Management of the Teachers Retirement Association 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 Teachers Retirement Association. This restriction is not intended to limit the distribution of this report, which was released as a public document on January 15, 1998.

James R. Nobles
Legislative Auditor

Claudia Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: November 21, 1997

Report Signed On: January 9, 1998

SUMMARY

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Teachers Retirement Association
Financial Audit
Fiscal Year Ended June 30, 1997

Public Release Date: January 15, 1998 No. 98-1

Agency Background

The Teachers Retirement Association (TRA) is the administrator of a multi-employer, cost sharing Teachers Retirement Fund. Its function is to provide a secure and dependable source of retirement income for its members or beneficiaries as a result of retirement, disability, or death. TRA's net assets as of June 30, 1997, were approximately $12.9 billion.

Audit Objectives and Scope

The primary objective of our audit was to render an opinion on the Teachers Retirement Association's financial statements. These statements are included in both TRA's and the state of Minnesota's Comprehensive Annual Financial Reports for fiscal year 1997. This objective included determining whether TRA's financial statements present fairly its financial position and results of operations in conformity with generally accepted accounting principles.

As part of our work, we are required to gain an understanding of the internal control structure and ascertain whether TRA 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 and refunds control cycles, and the financial statement preparation cycle.

Conclusions

The TRA's Comprehensive Annual Financial Report for the year ended June 30, 1997, includes our unqualified audit opinion dated December 8, 1997. The TRA financial statements are also included in the state of Minnesota's Comprehensive Annual Financial Report for the year ended June 30, 1997. TRA designed and implemented management controls for material financial activities, and, for the items tested, TRA complied with material legal provisions. However, we found that TRA did not adequately safeguard certain benefit checks.

TRA agreed with our finding and has taken action to resolve the issue.

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Audit Participation

The following members of the Office of the Legislative Auditor prepared this report:

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Tom Donahue, CPA	Audit Manager
Sonya Hill, CPA	Auditor-in-Charge
Laura Peterson, CPA	Auditor
Mike Byzewski	Auditor

Exit Conference

We discussed the results of the audit at an exit conference with the following staff of the Teachers Retirement Association on January 8, 1998:

Gary Austin	Executive Director
John Wicklund	Assistant Executive Director
John Gardner	Assistant Executive Director
Judith Strobel	Assistant Executive Director
Frank Merry	Accounting Services Manager

Chapter 1. Introduction

The Minnesota Legislature established the Teachers Retirement Association (TRA) on July 1, 1931. TRA serves as the administrator of a multi-employer, cost sharing Teachers Retirement Fund. TRA's mission is to provide a secure and dependable source of retirement income for its members. It administers two types of plans: Basic (without social security coverage) and Coordinated (with social security coverage) in accordance with Minn. Stat. Chapters 354 and 356. An eight member board of trustees is responsible for the management of the Teachers Retirement Fund. The board appointed Gary Austin as the Executive Director of TRA to manage day-to-day operations.

TRA members include teachers employed in Minnesota's public elementary and secondary schools, charter schools, the Minnesota State Colleges and Universities (MnSCU) system, and all other state educational institutions, with the exception of teachers employed by the cities of Minneapolis, St. Paul, Duluth, and the University of Minnesota. Teachers employed by MnSCU have a one-time election to join TRA.

TRA's net assets reported at market value on June 30, 1997, totaled $12,921,310,348. Table 1-1 shows TRA's statement of changes in plan net assets at June 30, 1997.

Table 1-1
Teachers Retirement Fund
Statement of Changes in Plan Net Assets
June 30, 1997

Additions:	
Employee and Employer Contributions	$ 345,830,596
Net Investment Income	2,296,019,494
Other Income	704,736
Total Additions	$ 2,642,554,826
Deductions:	
Annuities	$ 427,588,141
Refunds	10,898,914
Administrative Expenses	4,552,373
Other	638,751
Total Deductions	$ 443,678,179
Net Increase	$ 2,198,876,647
Net Assets Held in Trust:	
Beginning of year	10,722,433,701
End of Year	$12,921,310,348

Source: 1997 audited TRA Statement of Changes In Plan Net Assets.

Teachers Retirement Association

During our audit, we gained an understanding of the contributions, benefits, and refunds control cycles. The State Board of Investment performs a significant portion of the controls over TRA investments. We reviewed the controls over state investments as part of our annual audit of the State Board of Investment.

The primary objective of our audit was to render an opinion on TRA's financial statements. These statements are included in both TRA's and the state of Minnesota's Comprehensive Annual Financial Reports for fiscal year 1997. This objective included determining whether TRA's financial statements present fairly its financial position and results of operations in conformity with generally accepted accounting principles. For fiscal year 1997, TRA implemented Governmental Accounting Standards Board Statements Number 25 and 28, which are "Financial Reporting for Defined Benefit Pension Plans" and "Accounting and Financial Reporting for Securities Lending Activities," respectively. As part of our work, we are required to gain an understanding of the internal control structure and ascertain whether TRA complied with laws and regulations that may have a material effect on its financial statements.

To address our audit objectives, we interviewed key TRA employees, reviewed applicable policies and procedures, reviewed TRA's preparation of the financial statements through its general ledger, tested representative samples of financial transactions, and performed analytical procedures, as appropriate. We relied on the annual actuarial valuation performed by the Legislative Commission on Pension and Retirement's consulting actuary. The purpose of the actuarial valuation is to determine the financial status of TRA's defined benefit plan. As of June 30, 1997, the actuary reported that TRA's actuarial accrued liability was $10,963,637.

The TRA's Comprehensive Annual Financial Report for the year ended June 30, 1997, includes our unqualified audit opinion thereon, dated December 8, 1997. The TRA financial statements are also included in the state of Minnesota's Comprehensive Annual Financial Report for the year ended June 30, 1997.

Chapter 2. Contributions

Chapter Conclusions

TRA fairly presented contribution revenue on its fiscal year 1997 financial statements. TRA designed and implemented management controls to provide reasonable assurance that contributions were adequately safeguarded, and that transactions were properly recorded in the accounting records and financial statements. TRA complied with material financial legal provisions for contributions tested.

Local school district teachers and other TRA eligible members pay a percentage of their annual salary to the Teachers Retirement Fund. Employers also pay a percentage of their employees' salaries into the fund as well. These contributions are used to pay benefits to members upon their retirement. Minn. Stat. Section 354.42 specifies the employee and employer contribution rates to be used for basic and coordinated members as a percentage of salaries paid. Basic members, those without Social Security coverage, contribute 10.5 percent of their annual salary to the fund. Coordinated members, those with Social Security coverage, contribute 6.5 percent of their annual salary to the fund. Contributions from members totaled approximately $154 million during fiscal year 1997.

The employers of TRA eligible members contribute 8.5 percent of total salaries for basic members and 4.5 percent of total salaries for coordinated members. In addition, Minn. Stat. Section 354.42, subdivision 5, required an additional employer contribution of 3.64 percent of the member's salary. The purpose of this additional contribution was to amortize the unfunded liability of the fund and to meet the full funding date of June 30, 2020. Effective July 1, 1997, the additional employer contribution was reduced to 1.64 percent pursuant to Laws of 1997, Chapter 233, Article I, Section 50. However, as of July 1, 1997, TRA's unfunded actuarial accrued liability was extinguished. As a result, Laws of 1997, Chapter 233, Article I, Section 50 further provided that Minn. Stat. Section 354.42, subdivision 5 "is repealed once the actuarial value of the assets of the plan equal or exceed the actuarial accrued liability of the plan." This change is effective the first day of the first full pay period after March 31, 1998.

Audit Objectives and Methodology

We focused on the following objectives during our review of contributions:

- Did TRA fairly present employee and employer contributions on its fiscal year 1997 financial statements?
- Did TRA design and implement management controls to provide reasonable assurance that contributions were adequately safeguarded, and that transactions were authorized and properly recorded in the accounting records and financial statements?
- Did TRA comply with material financial related legal provisions in administering contributions?

To answer these questions, we interviewed TRA staff, observed how incoming contributions were processed and recorded, reviewed Minn. Stat. Section 354.42, and performed detailed tests of employer and employee transactions.

Conclusions

TRA fairly presented contribution revenue on its fiscal year 1997 financial statements. TRA designed and implemented management controls to provide reasonable assurance that contributions were adequately safeguarded, and that transactions were properly recorded in the accounting records and financial statements. TRA complied with material financial related legal provisions for contributions tested.

Chapter 3. Annuities

Chapter Conclusions

TRA fairly presented annuity benefits on its fiscal year 1997 financial statements. TRA complied with applicable legal requirements in calculating annuity benefits for the items tested. Generally, TRA designed and implemented management controls to provide reasonable assurance that assets for annuity benefits were adequately safeguarded, and that the annuity payments were authorized and properly recorded in the accounting records and financial statements. However, TRA did not adequately safeguard certain benefit checks.

TRA's largest expense is annuity benefits as noted on Table 1-1. During fiscal year 1997, TRA paid over $427 million in benefits. Annuities comprised 96 percent of all TRA expenses. Minn. Stat. Chapter 354 identifies three primary factors that determine a members benefit: the member's age, the average of the member's highest five successive annual salaries, and an accumulated percentage factor based on the members total years of service credit. Members choose from six different annuity plans. Each plan offers different payment options to members and their beneficiaries.

Annuitants receive an annual increase in their benefits based on the Consumer Price Index and the investment results of the Minnesota Post Retirement Investment Fund. On January 1, 1997, TRA annuitants with an effective retirement date prior to July 1, 1995, received a 8.04 percent cost of living adjustment. Members retiring after July 1, 1995, but before June 2, 1996, received a prorated adjustment.

Audit Objectives and Methodology

We focused on the following objectives during our review of annuities:

- Did TRA fairly present annuity benefits on its fiscal year 1997 financial statements?
- Did TRA calculate and disburse annuity benefits in accordance with applicable laws and regulations?
- Did TRA design and implement management controls over annuity payments that provided reasonable 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?

To answer these questions, we interviewed TRA employees to gain an understanding of the annuity process, recalculated benefits based on applicable statutes, reviewed member files and actuarial tables, and analyzed the increases and prorated cost of living increases paid to annuitants.

Conclusions

TRA fairly presented annuity benefits on its fiscal year 1997 financial statements. TRA complied with applicable legal requirements in calculating annuity benefits for the items tested. Generally, TRA designed and implemented management controls to provide reasonable assurance that assets for annuity benefits were adequately safeguarded, and that the annuity payments were authorized and properly recorded in the accounting records and financial statements. However, TRA did not adequately safeguard certain benefit checks as explained further in Finding 1.

1. TRA did not adequately safeguard certain benefit checks.

TRA kept returned benefit warrants and benefit warrants withheld from retirees in an unlocked metal box in a desk drawer. TRA did not maintain an inventory listing of returned or withheld warrants for periodic comparison with the actual warrants held in the box.

TRA receives returned benefit warrants from the post office when an annuitant fails to inform TRA of changes in address or from estates or family members when annuitants die. In addition, TRA withholds benefit warrants until the necessary paperwork or documents are received from the annuitant. On October 2, 1997, we found 127 benefit warrants totaling $289,536 in the unlocked box. Not keeping the warrants secured and accounted for increases the risk of theft or loss.

In addition, we noted that TRA did not restrictively endorse personal checks immediately upon receipt from an annuitant's estate. TRA's processing division received the unendorsed checks, recorded the repayments in the master annuity accounting records, completed the deposit slips, and sent the checks and paperwork to accounting. During this process, a minimum of four employees handled the unendorsed checks increasing the chance of someone losing or stealing the checks. Restrictive endorsement of checks limits the ability to cash lost or stolen checks.

Recommendations

- *TRA should maintain a listing of returned and withheld benefit warrants and periodically compare it to the actual benefit warrants on hand.*
- *TRA should keep benefit warrants in a secure place with limited access.*
- *TRA should restrictively endorse personal checks upon receipt.*

Chapter 4. Refunds

Chapter Conclusions

TRA fairly presented refunds on its financial statements. TRA 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. TRA also complied with applicable legal requirements in calculating member refunds for those transactions tested. For those individuals who elected to have their coverage transferred to the correctional plan at the Minnesota State Retirement System, TRA transferred the correct amounts.

TRA members who stop teaching have the option of taking a refund of their contributions upon submitting an application to TRA. The application for a refund may be submitted anytime after 30 days from the termination of service. TRA pays interest on the member's accumulated contributions at the rate of five percent compounded annually if the person terminated service before May 16, 1989. If the person terminated service on or after May 16, 1989, the accumulated contributions receive interest at six percent compounded annually. TRA issued approximately $5.5 million in refunds during fiscal year 1997.

There are two types of refund calculations. If the refund is due to a death, interest is paid to the date of death. For a regular refund, interest is computed on fiscal year end balances to the first day of the month that the refund is issued. The member has several refund options. For example, the member can request that the entire amount be directly rolled over or transferred to a specific institution, or sent directly to the individual less any applicable taxes, or a combination of the two.

In addition, during fiscal year 1997, certain human services or corrections employees had the one time election to have their service transferred to the correctional plan of the Minnesota State Retirement System (MSRS). TRA's actuaries determined the present value of accumulated contributions to be transferred. These refunds totaled S5.3 million during fiscal year 1997.

Audit Objectives and Methodology

We focused on the following objectives during our review of refunds:

- Did TRA fairly present refunds on its fiscal year 1997 financial statements?

- Did TRA 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 recorded in the accounting records and financial statements?

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- Did TRA pay refunds in accordance with applicable legal requirements?
- Did TRA transfer the correct amount of contributions to the correctional plan at MSRS?

To answer these questions, we interviewed TRA staff, observed how member refunds were processed and recorded, and performed detailed tests of refund transactions.

Conclusions

TRA fairly presented refunds on its financial statements. TRA 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. TRA also complied with applicable legal requirements in calculating member refunds for those transactions tested. TRA also transferred the correct contributions to the correctional plan at MSRS.

Teachers Retirement Association

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January 8, 1998

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

Dear Mr. Nobles:

Thank you for your draft report summarizing the results of your financial audit for the fiscal year ended June 30, 1997. As in prior years, TRA continues to value the opinions and observations of your auditors in strengthening our internal control structure over key administrative processes.

We have taken immediate action to improve the safeguarding of benefit checks in response to each of your three recommendations:

1. *TRA should maintain a listing of returned and withheld benefit warrants and periodically compare it to the actual benefit warrants on hand.*

We have implemented a new procedure to maintain a log of benefit warrants arriving and leaving the safe. A representative of the TRA Accounting Services Division will conduct random monthly spot-checks to verify the log and provide for a separation of duties.

Persons Responsible: Connie Gunderson, Processing Center Manager
Frank Merry, Accounting Services Manager

2. *TRA should keep benefit warrants in a secure place with limited access.*

TRA purchased and received a large safe in December 1997 to properly secure benefit checks. TRA management has decided to limit access to a small number of employees in the Processing Center. Warrants and personal checks are presently secured in the safe.

Persons Responsible: John Gardner, Assistant Executive Director
Connie Gunderson, Processing Center Manager

3. *TRA should restrictively endorse personal checks upon receipt.*

We have changed procedures so that a TRA Processing Center employee restrictively endorses all personal checks upon receipt from an annuitant's estate. The checks will be recorded in the log per your first recommendation. In some instances, the checks are returned to the representative of the annuitant's estate. If the Processing Center determines that the check should be deposited in TRA's account, the check will be immediately routed to the Accounting Services for depositing. The Accounting Services employees will then make copies of the check for the subsequent administrative needs of the Processing Center.

Persons Responsible: Frank Merry, Accounting Services Manager
Connie Gunderson, Processing Center Manager

We believe we have satisfactorily responded to your findings and will keep you apprised of progress made on each of these issues. If you have any further questions or comments, please feel free to contact me.

Sincerely,

Gary Austin
Executive Director

GA:cs