
Teachers Retirement Association

Financial Audit

Fiscal Year Ended June 30, 1998

February 1999

**Financial Audit Division
Office of the Legislative Auditor
State of Minnesota**

99-9

SUMMARY

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Teachers Retirement Association

Financial Audit Fiscal Year Ended June 30, 1998

Public Release Date: February 11, 1999

No. 99-9

Agency Background

The Teachers Retirement Association (TRA) is the administrator of a multi-employer, cost sharing defined benefit 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 assets as of June 30, 1998, were approximately \$15.3 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 1998. This objective included 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 refund control cycles, and the financial statement preparation process.

Conclusions

TRA's Comprehensive Annual Financial Report for the year ended June 30, 1998, includes our qualified audit opinion dated December 1, 1998. TRA's financial statements were fairly presented; however, we qualified our report because sufficient audit evidence did not exist to verify TRA's disclosures with respect to the year 2000. We do not provide assurance that TRA is or will be year 2000 ready, that its year 2000 remediation efforts will be successful in whole or in part, or that parties with which TRA does business will be year 2000 ready. TRA designed and implemented management controls to provide reasonable assurance that it properly administered its material financial activities, except that it did not adequately safeguard certain benefit checks. TRA complied with material financial legal provisions for the items tested.

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



STATE OF MINNESOTA
OFFICE OF THE LEGISLATIVE AUDITOR
JAMES R. NOBLES, LEGISLATIVE AUDITOR

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Legislative Audit Commission

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Mr. Vernell R. Jackels, President

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Teachers Retirement Association

Mr. Gary Austin, Executive Director
Teachers Retirement Association

We have audited the financial statements of the Teachers Retirement Association (TRA) as of and for the fiscal year ended June 30, 1998, as further explained in Chapter 1. The work conducted at TRA is part of our Statewide Audit of the State of Minnesota's fiscal year 1998 financial statements. We qualified our audit opinion, dated December 1, 1998, on TRA's Comprehensive Annual Financial Report for the year ended June 30, 1998. The financial statements were fairly presented. Our report was qualified, however, because of uncertainties about the potentially adverse affect the year 2000 computer issue may have on TRA's operations. Information technology experts believe that many computer applications in private businesses and government may fail as a result of data integrity problems and erroneous calculations beyond December 31, 1999. Sufficient audit evidence did not exist to verify TRA's disclosures with respect to the year 2000 issue. Because of the unprecedented nature of the year 2000 issue, its effects and the success of related remediation efforts will not be fully determinable until the year 2000 and thereafter. The following Summary highlights the audit objectives and conclusions. We discuss our conclusions more fully in the individual chapters of this report.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we obtain an understanding of internal controls over financial reporting to plan the audit and to determine the nature, timing, and extent of audit tests to be performed. The standards also require that we design the audit to provide reasonable assurance of detecting noncompliance with provisions of laws, regulations, contracts, and grants that have a direct and material effect on the financial statements. The management of TRA is responsible for establishing and maintaining the internal control structure and complying with applicable laws, regulations, contracts, and grants.

As part of obtaining reasonable assurance about whether TRA's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws,

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regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determinations of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

In planning and performing our audit, we considered TRA's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce, to a relatively low level, the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted another matter involving internal control over certain benefit checks that is presented in Chapter 3.

This report is intended for the information of the Legislative Audit Commission and the management of TRA. However, this report, which was released as a public document on February 11, 1999, is a matter of public record and its distribution is not limited.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: December 1, 1998

Report Signed On: February 8, 1999

Teachers Retirement Association

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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
Charlie Gill	Auditor-in-Charge
Neal Dawson	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 28, 1999:

Gary Austin	Executive Director
John Wicklund	Assistant Executive Director
John Gardner	Assistant Executive Director
Frank Merry	Accounting Services Manager
Connie Gunderson	Processing Center Manager

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Teachers Retirement Association

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 defined benefit 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 first employed by MnSCU may elect TRA coverage within 90 days of first employment.

TRA's net assets reported at market value on June 30, 1998, totaled \$15,289,822,531. Table 1-1 shows TRA's statement of changes in plan net assets at June 30, 1998.

Table 1-1
Teachers Retirement Fund
Statement of Changes in Plan Net Assets
June 30, 1998

Additions:

Employee and Employer Contributions	\$ 275,418,403
Net Investment Income	2,637,948,298
Other Income	1,329,869
Total Additions	<u>\$ 2,914,696,570</u>

Deductions:

Annuities	\$ 533,851,113
Refunds	5,689,067
Administrative Expenses	5,417,370
Other	1,226,838
Total Deductions	<u>\$ 546,184,388</u>

Net Increase	\$ 2,368,512,182
Net Assets Held in Trust:	
Beginning of year	<u>12,921,310,349</u>
End of Year	<u>\$15,289,822,531</u>

Source: 1998 audited TRA Statement of Changes in Plan Net Assets.

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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 1998. 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.

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 also 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, 1998, the actuary reported that TRA's actuarial accrued liability was \$12,046,312,000.

TRA's Comprehensive Annual Financial Report for the year ended June 30, 1998, includes our qualified audit opinion dated December 1, 1998. TRA's financial statements were fairly presented; however, we qualified our report because sufficient audit evidence did not exist to verify TRA's disclosures with respect to the year 2000 computer issue. TRA's financial statements are also included in the State of Minnesota's Comprehensive Annual Financial Report for the year ended June 30, 1998, which includes our audit opinion dated December 1, 1998.

Chapter 2. Contributions

Chapter Conclusions

TRA fairly presented contribution revenue on its fiscal year 1998 financial statements. TRA designed and implemented management controls to provide reasonable assurance that contributions were adequately safeguarded, and transactions were properly recorded in the accounting records and financial statements. In addition, for the items tested, TRA complied with material financial legal provisions.

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 nine percent of their annual salary to the fund. Coordinated members, those with Social Security coverage, contribute five percent of their annual salary to the fund. Contributions from members totaled approximately \$124 million during fiscal year 1998.

The employers of TRA eligible members contribute nine percent of total salaries for basic members and five percent of total salaries for coordinated members. Contributions from employers totaled approximately \$151 million during fiscal year 1998. Effective July 1, 1997, the additional employer contribution rate for fiscal year 1998 was reduced from 3.64 percent to 1.64 percent. The purpose of this additional contribution was to amortize the unfunded liability of the fund by June 30, 2020. However, as of July 1, 1997, TRA's unfunded actuarial accrued liability was extinguished. As a result, the additional employer contribution rate of 1.64 percent was eliminated according to statute effective with 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 1998 financial statements?
- Did TRA design and implement management controls to provide reasonable assurance that contributions were adequately safeguarded, and 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?

Teachers Retirement Association

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 1998 financial statements. TRA designed and implemented management controls to provide reasonable assurance that contributions were adequately safeguarded, and transactions were properly recorded in the accounting records and financial statements. In addition, for the items tested, TRA complied with material financial related legal provisions for contributions.

Chapter 3. Annuities

Chapter Conclusions

TRA fairly presented annuity benefits on its fiscal year 1998 financial statements. Generally, TRA designed and implemented management controls to provide reasonable assurance that assets for annuity benefits were adequately safeguarded, and the annuity payments were authorized and properly recorded in the accounting records and financial statements. However, TRA did not adequately safeguard certain benefit checks. In addition, for the items tested, TRA complied with applicable legal requirements in calculating annuity benefits.

TRA's largest expense is annuity benefits as noted on Table 1-1. During fiscal year 1998, TRA paid approximately \$533.8 million in benefits. Annuities comprised 97 percent of all TRA expenses. Minn. Stat. Chapter 354 identifies three primary factors that determine a member's benefit: the member's age, the average of the member's highest five successive annual salaries, and an accumulated percentage factor based on the member's 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. Annuitants and other individuals receiving benefits at May 31, 1996, were eligible to receive the January 1, 1998, benefit increase of 10.0876 percent. Members whose effective date of retirement is after June 1, 1996, receive a prorated portion of the increase.

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 1998 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

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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 1998 financial statements. Generally, TRA designed and implemented management controls to provide reasonable assurance that assets for annuity benefits were adequately safeguarded, and 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. In addition, for the items tested, TRA complied with applicable legal requirements in calculating annuity benefits.

1. Prior Finding Not Resolved: TRA did not adequately safeguard certain benefit checks.

TRA did not maintain an adequate inventory listing of returned or withheld warrants for periodic comparison with the actual warrants held in the safe.

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, 1998, we found 153 benefit warrants totaling \$213,492 in the safe.

TRA has improved its safeguarding of benefit checks from the last audit. Specifically, TRA purchased a safe to properly secure its benefit checks and also now restrictively endorses all personal checks upon receipt from an annuitant's estate.

TRA maintains two logs. However, neither log was complete. One member had 10 months worth of warrants totaling \$7,528. One warrant for \$592 was not recorded on either log. TRA can reduce the risk of either lost or stolen warrants by adequately maintaining the logs and resolving the disposition of returned warrants in a timely manner.

Recommendation

- *TRA should maintain a current listing of returned and withheld benefit warrants and develop guidelines for the timely disposition of these warrants.*

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 refund transactions were authorized and properly recorded in the accounting records and financial statements. In addition, for the items tested, TRA complied with applicable legal requirements in calculating member refunds.

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 \$5.7 million in refunds during fiscal year 1998.

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 1998, 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.

Audit Objectives and Methodology

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

- Did TRA fairly present refunds on its fiscal year 1998 financial statements?
- Did TRA design and implement management controls to provide reasonable assurance that assets to pay refunds were adequately safeguarded, and refund transactions were authorized and properly recorded in the accounting records and financial statements?
- Did TRA pay refunds in accordance with applicable legal requirements?

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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 refund transactions were authorized and properly recorded in the accounting records and financial statements. In addition, for the items tested, TRA complied with applicable legal requirements in calculating member refunds.

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Status of Prior Audit Issues As of June 30, 1998

Most Recent Audit

Legislative Audit Report 98-1, issued in January 1998, covered fiscal year ended June 30, 1997. The primary objective of our audit was to render an opinion on TRA's financial statements. Our objective included determining whether TRA's financial statements presented fairly its financial position and results of operations in conformity with generally accepted accounting principles. We issued an unqualified opinion on the TRA financial statements. Our report had one finding concerning the safeguarding of certain benefit checks. Although TRA made some progress in implementing our recommendation, the finding is repeated in the current audit.

State of Minnesota Audit Follow-Up Process

The Department of Finance, on behalf of the Governor, maintains a quarterly process for following up on issues cited in financial audit reports issued by the Legislative Auditor. The process consists of an exchange of written correspondence that documents the status of audit findings. The follow-up process continues until Finance is satisfied that the issues have been resolved. It covers entities headed by gubernatorial appointees, including most state agencies, boards, commissions, and Minnesota state colleges and universities. It is not applied to audits of the University of Minnesota and quasi-state organizations, such as the metropolitan agencies or the State Agricultural Society, the state constitutional officers, or the judicial branch.

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Teachers Retirement Association



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February 2, 1999

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, 1998. TRA values 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 your recommendation:

TRA should maintain a current listing of returned and withheld benefit warrants and develop guidelines for the timely disposition of these warrants.

The return of benefit warrants to TRA is a necessary business function to prevent disbursing TRA benefits to deceased recipients or unauthorized survivors. Since warrants are generated in batch monthly, TRA also prints some benefit warrants under the assumption that any outstanding documentation expected from the recipient will be shortly received. Once the necessary documentation is received and accepted, TRA will immediately mail the withheld warrant to the benefit recipient. This customer service practice avoids the problem of a recipient waiting up to a month before the warrants are printed again.

The TRA Processing Center has limited the number of individuals with access to the safe. Employees have been instructed to consistently record access to and from the safe and note the warrant numbers moved. Most warrants are not held for extensive periods of time and are resolved timely. The Processing Center will assign specific employees to investigate why particular member checks were held as indicated in your report. The Processing Services Manager will develop guidelines and suggested timeframes on the disposition of returned benefit amounts.


Mr. James Nobles
February 2, 1999
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As verification of this work, the TRA Accounting Services will periodically conduct an independent, random spot-check of the warrant log to the contents of the safe. Any benefit warrants held beyond a reasonable time will be reported to the Processing Services Manager.

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

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

Sincerely,



Gary Austin
Executive Director

GAA:cs