
Minnesota State Retirement Association

Financial Audit

Fiscal Year Ended June 30, 1998

February 1999

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

99-10

SUMMARY

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Minnesota State Retirement System

Financial Audit Fiscal Year Ended June 30, 1998

Public Release Date: February 18, 1999

No. 99-10

Agency Background

The Minnesota State Retirement System (MSRS) administers retirement programs for state employees, correctional employees, unclassified employees, state troopers, legislators, elected 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's assets at June 30, 1998, totaled nearly \$9 billion.

Audit Objectives and Scope

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 1998. 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 MSRS's internal control structure over contributions, benefits, refunds, and the financial statement preparation cycle. We also determined whether MSRS complied with laws and regulations that may have a material effect on its financial statements.

Conclusions

MSRS's Comprehensive Annual Financial Report for the year ended June 30, 1998, includes our audit opinion dated December 1, 1998. We qualified our report because sufficient audit evidence did not exist to verify MSRS's disclosures about the year 2000. Auditing MSRS's year 2000 compliance efforts was not an objective of this audit. As a result, we do not provide assurance that MSRS 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 MSRS does business will be year 2000 ready. MSRS designed internal controls to provide reasonable assurance that it properly administered its material financial activities, except, as noted in the following findings. Finding 1 explains that MSRS did not meet the Department of Finance's reporting deadline and submitted draft financial statements that required significant adjustments. Finding 2 discusses reconciliations that MSRS did not perform to ensure the integrity of data on its general ledger, its subsystems, and the state's accounting system.

MSRS agreed with our recommendations and will take the necessary corrective action.



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

Senator Deanna Wiener, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Kenneth Yozamp, Chair
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, 1998, as further explained in Chapter 1. The work conducted in the department was 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 MSRS's Comprehensive Annual Financial Report for the year ended June 30, 1998. Our report was qualified because of uncertainties about the potentially adverse affect the year 2000 computer issue may have on MSRS's operation. Information technology experts believe that many computer applications in private business and government may fail as a result of data integrity problems and erroneous calculations beyond December 31, 1999. MSRS is currently addressing year 2000 issues, and believes that all of their financial systems are year 2000 compliant. Auditing MSRS's year 2000 compliance efforts was not an objective of this audit. As a result, we do not provide assurance that MSRS 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 MSRS does business will be year 2000 ready.

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 over financial reporting to plan the audit and to determine the nature, timing, and extent of our audit tests. 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 MSRS 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 MSRS's financial statements are free of material misstatement, we performed tests of its compliance with certain provision of laws,

Senator Deanna Wiener, Chair
Members of the Legislative Audit Commission
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Mr. David Bergstrom, Executive Director
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regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination 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 MSRS'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 financial reporting matters 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.

We prepared this report for the information of the Legislative Audit Commission and the management of the Minnesota State Retirement System. We do not, however, limit the distribution of this report, which was released as a public document on February 18, 1999.

/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 11, 1999

Minnesota State Retirement System

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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
Cecile Ferkul, CPA, CISA	Audit Manager
Eric Wion, CPA, CISA	Auditor-in-Charge
Mike Byzewski	Staff Auditor
April Snyder	Intern
Uyen Nuyen	Intern

Exit Conference

We discussed the results of the audit at an exit conference with the following Minnesota State Retirement System staff on February 3, 1999:

David Bergstrom	Executive Director
Arvin Herman	Assistant Director, Finance and Systems
Dennis Jensen	Accounting Manager

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Chapter 1. Introduction

The Minnesota Legislature established the Minnesota State Retirement System (MSRS) in 1929 to provide retirement benefits to state employees. During fiscal year 1998, MSRS administered six defined benefit plans and one defined contribution plan. (Defined benefit pension plans determine the participant's annuity based on a statutory formula using such factors as age, average salary, and length of service. Defined contribution plans determine the participant's annuity by the amount of the employer and employee contributions and the plan's investment earnings.) MSRS's defined benefit plans were the State Employees, State Patrol, Correctional Employees, Judicial, Legislative, and Elected State Officers plans. MSRS's defined contribution plan was the Unclassified Employees Retirement Fund.

MSRS also administered a deferred compensation plan, available to all Minnesota public employees and officials. This plan, governed by the Internal Revenue Service (IRS) regulations Section 457, allowed eligible employees to contribute up to 25 percent of their income, to a maximum of \$8,000. IRS regulations defer participants' income taxes on the contributions and earnings until they withdraw the funds. The funds, however, are not available to employees until termination of employment, retirement, death, or an unforeseeable emergency. Participants could choose several different investment options administered by three investment providers: the Minnesota State Board of Investment, Minnesota Mutual Life Insurance Company, and Great West Life Assurance Company. MSRS processed contributions designated for investment with the Minnesota State Board of Investment. The two insurance companies were responsible for processing all other deferred compensation contributions.

An 11-member board of directors governed MSRS's administration. The board included four elected State Employees Plan members, one elected State Patrol Plan member, one elected Correctional Plan member, one elected retired member, one designated Metropolitan Council Transit Operations representative, and three members appointed by the Governor. Mr. David Bergstrom serves as the executive director of MSRS.

MSRS's assets at June 30, 1998, totaled nearly \$9 billion for all of its retirement plans. The total assets of the defined benefit plans increased more than \$1 billion during fiscal year 1998 to approximately \$8 billion as of June 30, 1998. The total assets of the defined contribution plan increased approximately \$52 million to a total of \$259 million. At June 30, 1998, assets in the deferred compensation plan approached \$600 million.

Table 1-1 highlights the funding ratios of the retirement plans at June 30, 1998, as reported by the consulting actuary for the Legislative Commission on Pensions and Retirement. The funding ratio shows how well each plan's assets can meet obligations to its beneficiaries. It is the ratio of the plan's assets to its 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.

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Table 1-1
MSRS Funding Ratios – Defined Benefit Plans
As of June 30, 1998

<u>Plan Name</u>	<u>Funding Date</u>	<u>Funding Ratio</u>
State Employees	2020	108%
State Patrol	2020	116%
Correctional Employees	2020	113%
Judges	2020	66%
Legislators (Note 1)	N/A	50%
Elected State Officers (Note 1)	N/A	15%

Note 1: The Legislature annually appropriates funds sufficient to meet the pension liabilities of these plans.

Source: Condensed information from the Actuarial Section of MSRS's Comprehensive Annual Financial Report for the year ended June 30, 1998.

Audit Scope, Objectives, and Conclusions

The primary objective of our audit was to render an opinion on MSRS's financial statements. Our audit determined whether MSRS's financial statements fairly presented its financial position and results of operations in conformity with generally accepted accounting principles. As part of our work, we gained an understanding of the internal control structure over financial reporting and determined whether MSRS complied with laws and regulations that had a material effect on its financial statements.

Our audit focused on contributions, retirement benefits, and refunds. We also reviewed investments and investment activity as reported on the financial statements. The State Board of Investment (SBI) performs a significant portion of the controls over MSRS's investments. We reviewed the controls over state investments as part of our annual audit of SBI.

To address our audit objectives, we interviewed key department employees, reviewed applicable policies and procedures, and reviewed MSRS's process for preparing its financial statements. We tested representative samples of financial transactions and performed analytical procedures, as we considered appropriate. We also relied on the annual actuarial valuation performed by the Legislative Commission on Pension and Retirement's actuary.

MSRS's Comprehensive Annual Financial Report for the year ended June 30, 1998, includes our qualified audit opinion dated December 1, 1998. We qualified our report because sufficient audit evidence did not exist to verify MSRS's disclosures with respect to the year 2000 computer issue. Except for the year 2000 issue, the Minnesota State Retirement System (MSRS) fairly presented its financial activities in accordance with generally accepted accounting principles. However, MSRS did not meet the Department of Finance's reporting deadline and submitted draft financial statements that required significant adjustments. MSRS also did not perform timely reconciliations of its general ledger and subsystems to the state's accounting system to ensure the

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integrity of its data. In Chapter 2 we discuss our concerns about MSRS's financial reporting process.

MSRS fairly presented contribution revenue, retirement benefits, and other withdrawals in its fiscal year 1998 financial statements. The results of our tests disclosed no instances of legal noncompliance that are required to be reported under *Government Auditing Standards*. In Chapter 3 we describe the contributions that employees and employers made to the retirement plans. Chapter 4 recaps the annuity process.

MSRS'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.

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Chapter 2. Accounting and Financial Reporting

Chapter Conclusions

The Minnesota State Retirement System (MSRS) fairly presented its financial activities in accordance with generally accepted accounting principles. MSRS did not meet the Department of Finance's reporting deadline and submitted draft financial statements that required significant adjustments. MSRS also did not perform timely reconciliations of its general ledger and subsystems to the state's accounting system to ensure the integrity of its data.

MSRS's financial activity consists of contributions to the retirement plans by employers and employees, the investment of the contributions, and the payment of annuities or refunds to the plan participants. The plans pay MSRS's administrative costs from accumulated assets. MSRS holds the plans' net assets in trust to provide pension benefits to the plan participants. Table 2-1 shows the fiscal year 1998 Statement of Plan Net Assets, and Table 2-2 shows the Statement of Changes in Plan Net Assets for the defined benefit, defined contribution, and deferred compensation plans.

Table 2-1
MSRS Statement of Plan Net Assets at June 30, 1998
(In Thousands)

	Defined Benefit Plan	Defined Contribution Plan	Deferred Compensation Plan
Assets:			
Cash	\$ 39	\$ 118	\$ 122
Accounts Receivable	9,930	365	2,707
Due From Other Funds	2,790	0	0
Due From Other Plans	13,662	787	0
Investments	4,463,514	234,780	550,056
Equity in Post Retirement Fund	2,894,780	0	0
Security Lending Collateral	708,210	23,408	47,076
Nondedicated Member Deposits	7,254	0	0
Fixed Assets	115	0	0
Total Assets	<u>\$8,100,294</u>	<u>\$ 259,458</u>	<u>\$ 599,961</u>
Liabilities:			
Accounts Payable	\$ 2,054	\$ 0	\$ 568
Security Lending Collateral	708,210	23,408	47,075
Due to Other Funds	5,143	0	0
Due to Other Plans	8,722	5,138	589
Total Liabilities	<u>\$ 724,129</u>	<u>\$ 28,546</u>	<u>\$ 48,232</u>
Net Assets Held in Trust	<u>\$7,376,165</u>	<u>\$230,912</u>	<u>\$551,729</u>

Source: Condensed information from MSRS's Comprehensive Annual Financial Report for the year ended June 30, 1998.

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Table 2-2
MSRS Statement of Changes in Plan Net Assets (In Thousands)
For the Year Ended June 30, 1998

	Defined Benefit Plan	Defined Contribution Plan	Deferred Compensation Plan
Additions:			
Member Contributions	\$ 74,714	\$ 3,490	\$ 38,835
Employer Contributions	81,382	5,029	0
General Fund Revenues	7,057	0	0
Transfers From Other Plans	9,862	721	0
Transfers From Other Providers	0	0	13,939
Net Investment Income	1,280,068	41,836	92,302
Net Income From Security - Lending Activity	2,567	71	152
Other Additions	23	824	3,027
Total Additions	\$1,455,673	\$ 51,971	\$ 148,255
Deductions:			
Retirement Benefits	221,671	0	9,307
Refunds	12,168	5,333	3,669
Transfers To Other Plans	7,108	3,474	0
Transfers To Other Providers	0	0	11,689
Other Deductions	4,183	881	3,193
Total Deductions	\$ 245,130	\$ 9,688	\$ 27,858
Net Increase	\$1,210,543	\$ 42,283	\$ 120,397
Net Assets Held in Trust July 1, 1997	\$6,165,622	\$ 188,629	\$ 0
Change In Accounting Principles (Note 1)	\$ 0	\$ 0	\$ 431,332
Net Assets Held in Trust July 1, 1998	\$7,376,165	\$ 230,912	\$ 551,729

Note 1: MSRS implemented the provisions of the Government Accounting Standards Board's Statement No. 32. To do so, MSRS excluded assets held in trust by two contract vendors and reported only those assets reported by the State Board of Investment. This portion, previously reported as an agency fund, is now reported as an expendable trust fund.

Source: Information condensed from MSRS's Comprehensive Annual Financial Report for the year ended June 30, 1998.

Minnesota Statutes require MSRS to annually prepare and submit a Comprehensive Annual Financial Report (CAFR) to the Legislative Commission on Pensions and Retirement. The statutes require that the annual financial report contain audited financial statements and disclosures that indicate the financial operations and position of the retirement plans.

Audit Scope, Objectives, and Methodology

Our audit scope included MSRS's financial statements for the fiscal year ending June 30, 1998, and MSRS's financial information included in the State of Minnesota's financial statements for that period. The primary objective of our audit was to determine whether the financial statements were fairly presented in accordance with generally accepted government accounting principles.

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As a part of our audit, we gained an understanding of the internal control structure over financial reporting and determined compliance with legal provisions that may have a material effect on the financial statements.

To meet our objectives, we performed analytical procedures and verified financial statement amounts. We obtained external confirmations for cash and supporting documentation for investment balances.

Conclusions

Except for the year 2000 issue discussed in Chapter 1, MSRS's financial statements fairly presented its financial position and results of operations in conformity with generally accepted accounting principles for fiscal year 1998. In Finding 1 we discuss deficiencies in the completeness and accuracy of MSRS's draft financial statements and MSRS's inability to meet the Department of Finance's financial reporting deadline. In Finding 2 we discuss MSRS's lack of timely reconciliations to ensure that the financial information posted to MAPS agreed with MSRS's general ledger data.

1. MSRS did not meet the Department of Finance's reporting deadline and submitted draft financial statements that required significant adjustments.

MSRS submitted draft financial statements to the Department of Finance on November 12, four weeks after the Department of Finance's deadline. More significantly, the statements submitted were not complete and did not conform to generally accepted governmental accounting principles. MSRS is a pension trust fund of the State of Minnesota. The state included MSRS's financial information in its Comprehensive Annual Financial Report. The Department of Finance relied upon MSRS's staff for financial information since the information came from MSRS's general ledger and its subsystems.

The Department of Finance adjusted MSRS's draft statements by over \$2 billion. We made additional adjustments totaling approximately \$818 million. For example, MSRS used the wrong beginning net asset balances for all of its defined benefit plans. MSRS also reported all its defined benefit fund investments at cost, even though accounting standards require that it report investments at market value and recognize any unrealized gains. MSRS's draft statements also did not include the required securities lending information. (Although some actuarial data is not available until after the Department of Finance's deadline, this should not prevent MSRS from submitting financial statements that are otherwise complete and accurate.)

The Department of Finance had established October 13, 1998, as the deadline by which it needed MSRS's financial information. The Department of Finance set this deadline to allow sufficient time for review and revision of the draft statements by its financial reporting staff, formatting of the data for inclusion in the state's financial statements, and review by the auditors to obtain an audit opinion. By not meeting this deadline, MSRS gave the Department of Finance and our auditors little time to react to the submitted data and jeopardized the Department of Finance's ability to meet its financial reporting obligations.

MSRS had similar problems meeting deadlines and submitting complete and accurate data for the fiscal year 1997 financial statements.

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Recommendation

- *MSRS needs to submit complete and accurate draft financial statements to the Department of Finance by the agreed upon deadline.*

2. MSRS did not perform timely reconciliations of its general ledger and subsystems to the state's accounting system to ensure the integrity of its data.

MSRS did not perform periodic reconciliations to ensure that its financial activity was properly recorded on MAPS and in its general ledger and subsystems. Periodic reconciliations detect errors and allow for their correction in a timely manner. For MSRS, these reconciliations were even more critical since it implemented a new general ledger system in July 1997.

The general ledger is MSRS's main source of information for the financial statements. Transactions are typically initiated on one of MSRS's subsystems. These subsystems interface with the general ledger and with the state's accounting system, MAPS. MSRS can also enter transactions directly on MAPS, bypassing the subsystems and the general ledger.

MSRS did not verify that the subsystems properly interfaced with the general ledger. For example, a batch of refund payments totaling over \$200,000 posted to the incorrect retirement plan on the general ledger, although it did post to the proper plan on the state's accounting system.

MSRS also did not adequately reconcile its general ledger to MAPS. We found two contribution transactions, totaling approximately \$1,250,000, that were not recorded in the general ledger. Also, contributions to the Deferred Compensation Plan were approximately \$470,000 less in MSRS's general ledger than the actual contribution deposits recorded on MAPS.

According to MSRS staff, their control to ensure the general ledger is complete and accurate is to reconcile the cash balance recorded in MAPS, for each fund, to the cash balance recorded in its general ledger. Our audit revealed, however, MSRS was delinquent in performing these cash reconciliations. As of October 30, 1998, MSRS's June 30, 1998, cash balance reported in its general ledger exceeded MAPS by approximately \$591,000. MSRS reported these unreconciled cash balances in the draft financial statements it submitted to the Department of Finance in early November 1998. Furthermore, since non-cash transactions affect the amount recorded as revenue or expenditures, a reconciliation of only the cash balance will not adequately ensure the integrity of the general ledger's financial activity.

MSRS's use of multiple accounting systems, and especially the implementation of a new system, heightens the risk that errors may occur. Therefore, it is critical that MSRS implement effective controls to identify and correct errors in a timely manner. In order to ensure that the financial activity recorded on the subsystems properly posts to the general ledger and to MAPS, and to ensure that all activity posted to MAPS is recorded on the general ledger, MSRS needs to regularly reconcile these systems. Without these reconciliations, errors and irregularities will not be detected in a timely manner.

Recommendation

- *MSRS should perform periodic reconciliations of its subsystems, its general ledger, and MAPS.*

Chapter 3. Contributions

Chapter Conclusions

MSRS fairly presented contribution revenue in its fiscal year 1998 financial statements. The results of our tests disclosed no instances of legal noncompliance that are required to be reported under Government Auditing Standards.

During fiscal year 1998, MSRS administered six defined benefit plans and one defined contribution plan. Minnesota statutes establish the contribution rates for both employees and employers. MSRS credits the employee and employer contributions to each participant's account. The State Board of Investment (SBI) invests the contributions. Unlike the other plans, the state does not prospectively fund the Legislative and Elected State Officer plans. Instead, the Legislature biennially appropriates the amount needed to pay current benefits. Table 3-1 shows the statutory employee and employer contribution rates in effect during fiscal year 1998.

Table 3-1
Contribution Rates
Fiscal Year 1998

<u>Plan Name</u>	<u>Employee</u>	<u>Employer</u>	<u>Total</u>
Defined Benefit Plans			
State Employees	4.00%	4.00%	8.00%
State Patrol	8.40%	12.60%	21.00%
Correctional Employees	5.50%	7.70%	13.20%
Judges	6.27%	22.00%	28.27%
Legislators	9.00%	NA	NA
Elective State Officers	9.00%	NA	NA
Defined Contribution Plan			
Unclassified Employees	4.00%	6.00%	10.00%

Source: Minnesota statutes.

Table 3-2 shows the dollar value of employer and employee contributions to the various retirement plans and the amount of employee contributions to the Deferred Compensation Plan administered through the Minnesota State Board of Investment.

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Table 3-2
Employee and Employer Contributions (In Thousands)
Fiscal Year 1998

<u>Plan Name</u>	<u>Employee</u>	<u>Employer</u>	<u>Total</u>
State Employees	\$ 62,901	\$62,315	\$125,216
State Patrol	3,634	5,475	9,109
Correctional Employees	5,954	8,146	14,100
Judges (1)	1,571	5,446	7,017
Legislators (2)	612	NA	612
Elected State Officers (3)	42	NA	42
Unclassified Employees	3,490	5,029	8,519
Deferred Compensation	<u>38,835</u>	<u>NA</u>	<u>38,835</u>
Total	<u>\$117,039</u>	<u>\$86,411</u>	<u>\$203,450</u>

- (1) In addition, \$1,683,076 was appropriated from the General Fund for annuity benefits of judges and survivors not participating in the Post Retirement Fund.
- (2) In addition, \$5,199,339 was appropriated from the General Fund for annuity benefits.
- (3) In addition, \$175,003 was appropriated from the General Fund for annuity benefits.

Source: MSRS Comprehensive Annual Financial Report for the year ended June 30, 1998.

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 1998 financial statements?
- Did MSRS design and implement management controls to provide reasonable assurance that contributions were properly reported in the accounting records and financial statements?
- 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 processing and recording contribution revenue. We also performed analytical reviews and substantive testing for each the plans.

Conclusions

MSRS fairly presented contribution revenue in its fiscal year 1998 financial statements. The results of our tests disclosed no instances of legal noncompliance that are required to be reported under *Government Auditing Standards*.

Chapter 4. Retirement Benefits and Other Withdrawals

Chapter Conclusions

Retirement benefits and other withdrawals were properly presented in the fiscal year 1998 financial statements. The results of our tests disclosed no instances of legal noncompliance that are required to be reported under Government Auditing Standards.

MSRS provides retirement and disability benefits to members and survivor benefits upon the death of eligible members. The system's plans have varying provisions establishing the normal retirement age and the annuity calculation formulas. Generally, members may select from different types of retirement annuities. A single-life annuity ceases upon the death of the retiree, while a joint-and-survivor annuity provides a lifetime annuity for the named survivor after the member's death. Vested employees who terminate employment prior to the normal retirement age may elect to receive an annuity sometime in the future or receive a refund.

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, which is administered by the Minnesota State Board of Investment. (Table 2-1 shows each retirement fund's equity in the Minnesota Post Retirement Investment Fund.) Annuitants receive an annual increase in their benefits based on an inflation adjustment and the investment performance of the Minnesota Post Retirement Investment Fund.

MSRS also provides retirement payments to public employees and officials who participated in the Deferred Compensation Plan. The amount the participant receives is a result of their contributions and the performance of their chosen investment option. Withdrawal prior to retirement is only allowed when employment is terminated, at death, or because of an unforeseeable financial emergency. Participants may elect to receive a lump sum payment, use the lump sum amount to purchase an annuity, or receive the amount in monthly installments over a specific period.

Table 4-1 shows each plan's retirement benefits and refunds for fiscal year 1998.

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Table 4-1
Retirement Benefits and Refunds
Fiscal Year 1998
(In thousands)

Plan Name:	Retirement Benefits	Refunded Contributions
State Employees	\$182,562	\$11,659
State Patrol	18,354	23
Correctional Employees	8,226	378
Judges	9,082	0
Legislators	3,276	108
Elected State Officers	171	0
Unclassified Employees (Note 1)	0	5,333
Deferred Compensation	9,307	3,669
Total	<u>\$230,978</u>	<u>\$21,170</u>

Note 1: Unclassified annuity expenditures are included with the State Employees Plan since unclassified employees receive that plan's annuity.

Source: MSRS Comprehensive Annual Financial Report for the year ended June 30, 1998.

Audit Objectives and Methodology

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

- Did MSRS fairly present annuity expenditures and other withdrawals in its fiscal year 1998 financial statements?
- Did MSRS design and implement controls to provide reasonable assurance that retirement benefits and other withdrawals were properly reported in the accounting records and financial statements?
- Did MSRS comply with material financial legal provisions in administering retirement benefits?

To achieve these objectives, we interviewed MSRS staff to gain an understanding of the controls in place over the processing and recording of retirement benefits and other withdrawals. We also performed analytical reviews and substantive testing for each of the plans.

Conclusions

MSRS fairly presented retirement benefits and other withdrawals in its fiscal year 1998 financial statements. The results of our tests disclosed no instances of legal noncompliance that are required to be reported under *Government Auditing Standards*.

Minnesota State Retirement System

Status of Prior Audit Issues As of December 1, 1998

Most Recent Audit

An audit of the Minnesota State Retirement System (MSRS) is performed annually by the Office of the Legislative Auditor. **Legislative Audit Report 98-6**, dated February 20, 1998, covered fiscal year ended June 30, 1997. The audit scope included those areas material to the MSRS financial statements. No audit issues were noted in this report.

State of Minnesota Audit Follow-Up Process
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<p>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, any quasi-state organizations, such as the metropolitan agencies or the State Agricultural Society, the state constitutional officers, or the judicial branch.</p>
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Minnesota State Retirement System

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Minnesota State Retirement System

February 8, 1999

Ms. Cecile Ferkul, Audit Manager
Office of the Legislative Auditor
1st Floor, Centennial Bldg.
St. Paul, MN 55155

Dear Ms. Ferkul:

I am writing in response to the written findings and recommendations in the draft audit report.

Your first recommendation states,

"MSRS needs to submit complete and accurate draft financial statements to the Department of Finance by the agreed upon deadline."

MSRS agrees to meet all deadlines agreed to by the Legislative Auditor and the Department of Finance. Please include them in future engagement letters so we can meet all necessary deadlines.

Your second recommendation states,

"MSRS should perform periodic reconciliations of its subsystems, its general ledger, and MAPS."

MSRS now prepares monthly reconciliations for its general ledger, MAPS, and subsystems. The omissions and delays of these reconciliations in F.Y. 98 were the result of one-time system enhancement that is now fully operational.

We are very proud of our many years of "clean" audits, and will continue to work to improve our accounting systems.

Sincerely,

David Bergstrom
Executive Director

DKB:jb