

STATE OF CONNECTICUT



***AUDITORS' REPORT
STATE COMPTROLLER – STATE RETIREMENT FUNDS
FOR THE FISCAL YEARS ENDED JUNE 30, 2004, 2005 AND 2006***

AUDITORS OF PUBLIC ACCOUNTS

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October 1, 2008

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We have made an examination of the financial records of the State Retirement Funds including the State Employees' Retirement Fund, the Alternate Retirement Program Fund, the State's Attorneys' Retirement Fund, the General Assembly Pension Fund, the Judges' and Compensation Commissioners' Retirement Fund, the Public Defenders' Retirement Fund, the Probate Judges' and Employees' Retirement Fund, the Municipal Employees' Retirement Funds and the Policemen and Firemen Survivors' Benefit Fund, maintained by the Retirement and Benefit Services Division of the State Comptroller's Office for the fiscal years ended June 30, 2004, 2005, and 2006. We have included in that examination the records pertaining to the State's Deferred Compensation Plan as well as those pertaining to the appropriations for the Alternate Retirement System, the Judges' and Compensation Commissioners' Retirement Fund, the various miscellaneous statutory pensions and the State's share of retirement salaries and health insurance costs for retirees. This audit did not include the Teachers' Retirement Fund, as a separate Teachers' Retirement Board administers that fund.

Financial statements pertaining to the operations and activities of the State Retirement Funds for the fiscal years ended June 30, 2004, 2005, and 2006, are presented on a Statewide Single Audit basis to include all State agencies and funds. This audit has been limited to assessing the State Comptroller's Retirement and Benefit Services Division's compliance with certain provisions of financial and/or retirement related laws, regulations and contracts, and evaluating the State Comptroller's Retirement and Benefit Services Division's internal control structure policies and procedures established to ensure such compliance.

This report on that examination consists of the Comments, Recommendations and Certification, which follow.

COMMENTS

Foreword:

The Office of the State Comptroller operates primarily under the provisions of Article Fourth, Section 24, of the State Constitution and Title 3, Chapter 34 of the General Statutes. The Retirement and Benefit Services Division of the Office of the State Comptroller is responsible for processing the required actions and maintaining the records and accounts of the various retirement plans administered by the Connecticut State Employees' Retirement Commission. It provides counseling services to members, administers State employee deferred compensation, dependent care assistance, group life and health insurance programs, and manages the State unemployment compensation accounts.

Officers:

During the audited period the officers of the Office of the Comptroller were as follows:

State Comptroller	Nancy S. Wyman
Deputy Comptroller	Mark E. Ojakian

Steven Weinberger served as Director of the Retirement and Benefit Services Division (Retirement Division) until April 13, 2004. Dr. Thomas Woodruff was appointed Director of the Retirement Division on June 18, 2004, and continued to serve in that position throughout the audited period.

Significant Legislation:

Notable legislative changes which took effect during the audited period, are presented below:

- **Public Act 04-98** - Effective July 1, 2004, it requires the State Comptroller to maintain a flexible health care spending account program for State employees.
- **Public Act 04-2, May Special Session** - Retroactive to November 1, 1989, it amended Section 5-200 of the General Statutes to establish in statute the existing administrative practice of giving elected legislators and legislative branch employees the same retirement and health insurance rights and benefits granted State employees under the union coalition contract.
- **Public Act 05-284** - Effective October 1, 2005, it establishes a higher level of disability retirement benefit for corrections officers permanently disabled as a result of the special hazard inherent in their duties and unable to engage in other suitable employment. This provision was codified under Section 18-101e of the General Statutes.

Boards and Commissions:

Connecticut State Employees' Retirement Commission:

The Connecticut State Employees' Retirement Commission, established under Section 5-155a of the General Statutes, is responsible for the administration of the retirement programs mentioned in this report. In accordance with Section 5-155a, the membership of the Retirement Commission is composed of fifteen trustees, including six trustees representing State employees, six trustees representing State management, two trustees who are professional actuaries, and one neutral trustee who serves as chairman. In addition the State Comptroller, ex officio, serves as nonvoting secretary. All trustees serve for a three-year term, except for the chairman who serves a two-year term. The Governor makes all appointments except for the employee trustees who are selected by employee bargaining agents. The management and employee trustees make the appointments of the chairman and the actuarial trustee positions.

Members of the Retirement Commission serve without compensation, except that the chairman and the two actuarial trustees are compensated at their normal per diem rate plus travel expenses. All other Retirement Commission members are entitled to reimbursement for necessary expenses incurred in the performance of their official duties. Members of the Retirement Commission as of June 30, 2006, were:

Peter R. Blum, Chairman	
Robert D. Baus, Actuarial Trustee	Charles W. Casella, Employee Trustee*
Claude Poulin, Actuarial Trustee	Thomas P. Culley, Employee Trustee*
Stephen Caliendo, Management Trustee	Paul Fortier, Employee Trustee*
Robert D. Coffey, Management Trustee	Stephen Greatorex, Employee Trustee*
Richard Cosgrove, Management Trustee	Salvatore Luciano, Employee Trustee*
Mary M. Marcial, Management Trustee	Steven Perruccio, Employee Trustee*
Linda J. Yelmini, Management Trustee	

There was one vacant Management Trustee position as of June 30, 2006.

* State Employees' Bargaining Agent Coalition (SEBAC)

Medical Examining Board for State Employee Disability Retirement:

Under Section 5-169 of the General Statutes the Governor shall appoint a board of seven State employee physicians to determine entitlement to disability retirement for members of the State Employees' Retirement System. The members of the Board as of June 30, 2006, were:

Cynthia D. Conrad, M.D, Ph.D.
Dr. Marc S. Croteau
Anne H. Flitcraft, M.D.
Virginia E. Hofmann, M.D.
Catherine F. Lewis, M.D.
John D. Meyer, M.D, MPH
Timothy Silvis, M.D.

There was one vacant position as of June 30, 2006.

RÉSUMÉ OF OPERATIONS:

State Employees' Retirement Fund:

Title 5, Chapter 66, of the General Statutes, defined as the "State Employees Retirement Act," provided for a retirement system for State employees to be administered by a board of trustees known as the Connecticut State Employees Retirement Commission. The Retirement and Benefit Services Division of the State Comptroller's Office maintains the accounting records pertaining to the operations of the retirement system. In addition, the State Treasurer serves as custodian and investment manager of the funds of the retirement system.

On June 30, 1982, the required legislative action was completed approving the first "Pension Agreement," a collective bargaining agreement to be effective for the period July 1, 1982, through June 30, 1988, concerning changes to the retirement system for State employees. These changes, most of which took place on October 1, 1982, applied to those collective bargaining units party to the agreement or subsequently accepting it and to those employees excluded from collective bargaining to which the provisions were extended by the Joint Committee on Legislative Management and the Commissioner of Administrative Services. The "Pension Agreement" along with a supplemental agreement, which took effect March 1, 1983, was incorporated into the General Statutes.

Since the enactment of the "Pension Agreement" there has been one arbitration award and various negotiated agreements that have changed the terms of the initial "Pension Agreement". The State of Connecticut and the State Employees' Bargaining Agent Coalition have negotiated five separate agreements, known as SEBAC agreements, which have modified the terms of the "Pension Agreement". The SEBAC I, II, III and IV agreements were enacted and effective prior to the 1996-1997 fiscal year. During the 1996-1997 fiscal year, the SEBAC V pension agreement was enacted, which further modified the "Pension Agreement" and created a new tier entitled Tier IIA, effective July 1, 1997. The SEBAC V pension agreement provides that the State Employees Retirement System shall not be changed through June 30, 2017, unless mutually agreed to by the parties.

As of July 1, 1997, the State Employees' Retirement System consisted of a three-tier system. Membership in each tier, for the most part, depends upon the employee's hire date. Membership in the Tier I and Tier II retirement plans is closed to those employees hired after June 30, 1997.

The Tier I plan, effective October 1, 1982, was based on the then existing retirement system provided for in Chapter 66 of the General Statutes. Under Tier I, however, certain provisions of chapter 66 were modified by the pension agreement. Employees working in positions covered by the pension agreement, or who were exempt from the collective bargaining process, were automatically covered under Tier I if they were contributing to the State Employees' Retirement Fund as of October 1, 1982, or the effective date of the Tier II plan stated in the respective collective bargaining unit agreement, whichever was later. Tier I is a contributory pension plan. As provided for in Section 5-158f of the General Statutes, there are two benefit plans within Tier I, referred to as Plan B and Plan C, to which eligible members could elect to belong. Plan B is integrated with Social Security and pays a lower benefit at age 65 or once Social Security disability benefits are received. Plan C benefits are in addition to those provided by Social Security. Approximately 14 percent of the total work force is covered under the Tier I plan.

The retirement benefit for which a Tier I member is eligible is determined by their years of service, age at retirement, average final compensation, plan participation, and the benefit payment option selected. The benefit percentage used for normal retirement (age 55 with at least 25 years of service or age 65 with at least 10 years of service) is two percent multiplied times years of service, times an average salary. Members that have completed at least ten years of service and are between age 55 and 65 may elect to receive an early retirement benefit that is provided at a reduced amount. The benefit percentage used for early retirement ranges from 1.0 to 1.99 percent, based on age and years of service or a reduction of .01 to 1.0 percent times years of service. Age 70 retirement is allowed with at least five years of service and uses 2.5 percent times years of service to a maximum of 50 percent or two percent per year if over 25 years.

Tier II is a noncontributory plan that provides a single level of benefits to all members, with the exception of hazardous duty members, who must make contributions to the system. Tier IIA is a contributory plan that provides benefits similar to Tier II, but requires contributions. Approximately 45 and 41 percent of the total work force is covered under the Tier II and Tier IIA plans, respectively.

The retirement benefits for Tier II and IIA members are determined by their years of service, age at retirement, average final compensation, a breakpoint calculation and the benefit payment option selected. The benefit percentages and calculation of normal retirement for Tier II and IIA members (age 60 with at least 25 years of vesting service; age 62 with at least 10 but less than 25 years of vesting service; or, age 62 with at least 5 years of actual State service) are the sum of 1.33 percent times average salary plus .5 percent times average salary in excess of the year's breakpoint (\$36,400 for 2006 and increasing by six percent annually) times years of credited service to a maximum of 35 years; plus 1.625 percent times average salary times years of credited service over 35 years. Members that have completed at least ten years of service and have attained age 55 may elect to receive an early retirement benefit that is provided at a reduced amount. The benefit is reduced by .25 percent for each month you receive a retirement benefit prior to your normal retirement or 3 percent per year up to 21 percent.

Retirements effective June 1, 1997 or earlier were eligible for an annual three percent cost-of-living (COLA) increase on their anniversary date. The anniversary date is January 1 or July 1, whichever first follows at least nine full months of retirement. The SEBAC V pension agreement impacted the cost-of-living adjustment. For retirements effective July 1, 1999 and later, the COLA will range from a minimum of two and a half percent to a maximum of six percent based on a formula which utilizes the increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) for the twelve months immediately preceding the retiree's anniversary date. Retirements between July 1, 1997 and June 1, 1999 were eligible to select, irrevocably, either of the two COLA provisions.

Members who work in positions designated as hazardous duty may receive normal retirement benefits with 20 years of service regardless of age. There is no early retirement benefit provided to hazardous duty employees, regardless of tier membership.

Survivor benefits for members of the State Police Division within the Department of Public Safety are provided for in Section 5-146 through 5-150 of the General Statutes. Section 5-146, subsection (a) as amended by the 1989 Pension Agreement, provides surviving spouses of deceased State police officers with a monthly allowance of \$670 payable for life or until

remarriage, with payments to commence upon the death of such State police officer. Provision is also made for a surviving spouse to receive an additional monthly benefit for any unmarried dependent children under the age of 18. Such payments range from \$300 to \$700 per month, depending on the number of children.

The State Employees' Retirement System provides for the retirement coverage of most employees of the State of Connecticut, members of the General Assembly, operators of vending stands in public buildings, certain teachers employed at the E.O. Smith School, employees of Connecticut Institute for Municipal Studies, and in certain cases, employees of the United States Property and Fiscal Office. Effective January 1, 1993, new employees or reemployed employees of The Newington Childrens' Hospital, The American School for the Deaf and The Connecticut Institute for the Blind are no longer eligible to become members of the System.

Those State employees not participating in the State Employees' Retirement System include Judges, Compensation Commissioners, certain State's Attorneys and Public Defenders, teachers in the Teachers' Retirement System and higher education employees in the Alternate Retirement Program.

Under the provisions of Section 5-156a of the General Statutes, the State Employees' Retirement System is to be funded on an actuarial reserve basis. The General Assembly appropriates annually the amounts necessary to meet this funding plan and such amounts are paid over to the Retirement Fund in equal monthly installments. These payments are not supposed to be reduced or diverted for any purpose until the unfunded liability has been amortized. However, various agreements reached with SEBAC and ratified by the General Assembly have provided for reductions and deferrals in the appropriations needed to meet the funding plan.

The Retirement Commission is required to prepare a valuation of the assets and liabilities of the system at least once every two years. The Retirement Commission is authorized to employ the services of actuaries at least once every two years to prepare such valuations and to determine the annual appropriation of State funds necessary to meet the funding plan outlined in Section 5-156a of the General Statutes. Actuarial valuations of the system were prepared as of June 30, 2004, and 2006, with an interim valuation prepared at June 30, 2005. As a result of these valuations, the unfunded actuarial accrued liability from the most recent valuations follows:

As of June 30,	<u>2004</u>	<u>2005</u>	<u>2006</u>
Unfunded actuarial accrued liability	\$6,890,251,830	\$7,469,869,214	\$7,878,956,254

All assets were valued using the "Actuarial Value of Assets" method, which spreads any gains and losses over a five-year period and makes adjustments, as necessary, so that the final actuarial value is within 20 percent (plus or minus) of the market value.

A comparison of membership information for the State Employees' Retirement System as of June 30, has been presented below:

As of June 30,	<u>2004</u>	<u>2005</u>	<u>2006</u>
Active Members	47,926	48,919	50,605
Retired Members	36,749	36,705	36,964
Inactive Members (Terminated Vested)	<u>1,744</u>	<u>1,750</u>	<u>1,732</u>
Totals	<u>86,419</u>	<u>87,374</u>	<u>89,301</u>

The four major recurring revenue sources for the State Employees' Retirement Fund are State funding contributions, Federal funding contributions, member contributions and investment income. A comparison of these revenue sources for three fiscal years, along with a non-recurring revenue for the gain on the sale of investments has been provided below:

	<u>2003-2004</u>	<u>2004-2005</u>	<u>2005-2006</u>
State Contributions	\$366,730,112	\$403,316,568	\$ 507,264,748
Federal Contributions	103,602,832	115,452,253	115,797,984
Employee Contributions	47,632,219	51,718,794	55,234,913
Investment Income	312,755,044	329,827,411	310,758,041
Gain on Sale of Investments	<u>63,728,775</u>	<u>45,272,673</u>	<u>26,543,361</u>
Totals	<u>\$894,448,982</u>	<u>\$945,587,699</u>	<u>\$1,015,599,047</u>

A summary of the Fund's expenditures for three fiscal years has been presented below. The totals include a comparison of the three major recurring expenditures along with a non-recurring expenditure for the loss on sale of investments.

	<u>2003-2004</u>	<u>2004-2005</u>	<u>2005-2006</u>
Benefit Payments	\$862,208,447	\$882,375,233	\$913,030,578
Employer Refunds	5,956,693	5,186,816	5,882,788
Other Expenses	338,592	460,441	403,382
Loss on Sale of Investments	<u>14,225,185</u>	<u>43,324,455</u>	<u>12,506,759</u>
Totals	<u>\$882,728,917</u>	<u>\$931,346,945</u>	<u>\$931,823,507</u>

The State Treasurer is the custodian of the Fund's investments. A summary of the market value, the "Actuarial Value of Assets", and rate of return as of June 30, has been presented below. Investments in the State of Connecticut Combined Investment Funds are verified as part of our audit of the State Treasurer. This summary is based on information from actuarial reports on file with the Retirement and Benefit Services Division.

As of June 30	<u>2004</u>	<u>2005</u>	<u>2006</u>
Market Value of Assets	\$7,677,233,815	\$8,146,304,073	\$8,789,643,845
Rate of Return	15.22%	10.45%	11.01%
Actuarial Value of Assets*	\$8,238,250,287	\$8,517,679,204	\$8,951,392,914
Rate of Return	6.74%	7.37%	8.03%

*Note: This method spreads the recognition of gains and losses over a five-year period. The resulting value is called the Actuarial Value of Assets and is further adjusted as necessary so that the final actuarial value is within 20 percent (plus or minus) of the market value of assets.

Alternate Retirement Program Fund:

Section 5-155a of the General Statutes empowers the Connecticut State Employees' Retirement Commission to authorize participation in an alternate retirement program for eligible unclassified employees of the constituent units of the State system of higher education. Such program may be underwritten by a licensed life insurance company.

An arbitration award provided that all employees who elect to become members of the Alternate Retirement Program after July 13, 1990, will also be covered by Social Security. Those employees who were members before that date had the option of choosing whether or not they wanted to participate in Social Security. For those employees who chose to be covered by Social Security, their coverage began July 13, 1990.

For part of the audited period, the Alternate Retirement Program was operated on the continuation of an agreement made between the Board of Higher Education and a Third-Party Administrator (TPA) for the plan, the Teachers' Insurance and Annuity Association - College Retirement Equities Fund (TIAA-CREF). Under the terms of the agreement with TIAA-CREF, the employee and the State contributions were forwarded monthly to the insurer who would issue annuity contracts to individual participants. TIAA-CREF performed the function of the TPA for the plan until being replaced by ING, effective January 1, 2006. Under the terms of the new contract with ING, the employee and the State contributions are forwarded on a biweekly basis to the TPA for transfer to the participant directed investment options offered by the Plan. Retirement benefits are based on contributions, distribution of contributions, length of participation, age and the payment option selected. Payment options include partial or lump-sum withdrawals, systematic withdrawal option, rollover to another eligible retirement plan or IRA, or a combination of various payment and annuity options.

The retirement contribution rate for participants is five percent of salary while the State's share is determined from a schedule in Section 5-156 of the General Statutes. All participant and State contributions are held in a separate retirement fund in the custody of the State Treasurer and are forwarded to the insuring company upon certification from the State Comptroller. Effective July 1, 1985, and thereafter, the State share is fixed at eight percent of salary.

It should be noted, that Section 5-156 of the General Statutes provides that expenditures from the Alternate Retirement Program Fund account, to be forwarded to the insuring company, may exceed the appropriation to such account if such deficiency is due to anticipated reimbursements to the account and if such reimbursements are anticipated to be made within six months of such expenditures. The transfers of the State share from the General Fund appropriation for that purpose must be made in the month following the employee contribution.

Contributions from participant employees, the State's share from the General Fund and the amounts remitted to the insuring company follows:

	<u>2003-2004</u>	<u>2004-2005</u>	<u>2005-2006</u>
Contributions - Participants	\$23,982,932	\$26,279,054	\$28,668,413
Contributions - State's Share	37,890,663	41,370,570	22,029,270
Remitted to insuring company	61,805,643	67,490,751	52,833,095

A cash balance of \$1,994,349, \$2,153,222 and \$40,508, as of June 30 2004, 2005 and 2006, respectively, represented participant contributions collected, but not yet forwarded to the insuring company.

The General Fund share of the aforementioned contributions was met from appropriations administered by the State Comptroller for the purposes of the Alternate Retirement System. Refunds of contributions from the insuring company and fringe benefit recoveries to the General Fund were credited against this share resulting in net charges against the General Fund appropriation account totaling \$17,454,276, \$17,447,948 and \$27,204,058 for the 2003-2004, 2004-2005 and 2005-2006 fiscal years, respectively.

State’s Attorneys’ Retirement Fund:

Sections 51-49, 51-287, and 51-288 of the General Statutes provide a separate retirement plan for State’s Attorneys. Eligibility for membership in this plan is limited under Section 51-287 to, “Each chief state’s attorney, deputy chief state’s attorney and state’s attorney who elected under the provisions of section 51-278 to be included in the provisions of this section...” In accordance with an opinion of the Attorney General, eligibility for participation in the retirement plan is limited to the Chief State’s Attorney, two deputies and to those who were State’s Attorneys and participants in the plan on June 30, 1973, or who were incumbent State’s Attorneys on July 1, 1978, and who were, on June 30, 1973, either Assistant State’s Attorneys, chief prosecuting attorneys or deputy chief prosecuting attorneys. All appointees to these offices who do not meet the eligibility requirements must be members of the State Employees’ Retirement System.

Section 51-278 requires the State Comptroller to deduct five percent of the salaries of member State’s Attorneys as contributions for retirement purposes. These contributions are deposited in a separate trust fund in the custody of the State Treasurer. Contributions can be refunded if any such attorney leaves office before retirement.

The retirement salary for which a member State’s Attorney is eligible is determined by age at retirement, years of service and the salary of the office held at the time of retirement, as such salary may be changed from time to time. The retirement salary, however, cannot exceed two-thirds of the salary of the office. Since the retirement salary is based on six and two-thirds percent of salary for each year of service, the maximum retirement credit is accrued after ten years of service. In the event of disability, a member State’s Attorney may be retired at the maximum retirement salary. In the event of death, the widow of a member State’s Attorney is entitled to one-third of the salary of the office that he held at the time of retirement; as such salary may be changed from time to time.

The aforementioned sections of the General Statutes do not specifically outline the method of financing retirement salary payments to each retired State’s Attorney. Most pension payments have been charged to the General Fund appropriation for “Pensions and Retirements – Other Statutory.” The State’s Attorneys’ Retirement Fund assets were used, if necessary. Charges to the General Fund appropriation account amounted to \$1,052,140, \$944,988 and \$99,382 for the 2003-2004, 2004-2005 and 2005-2006 fiscal years, respectively. The State’s Attorneys’ Retirement Fund was charged \$86,123 for pensions paid to retired members during the 2004-2005 fiscal year.

The investments of the State's Attorneys' Retirement Fund, which made up most of the assets of the fund, the receipts of the fund, and pensions paid to retired members from the General Fund appropriation account and the Retirement Fund are shown below:

	<u>2003-2004</u>	<u>2004-2005</u>	<u>2005-2006</u>
Market Value of Investments, June 30	\$ 716,011	\$ 718,213	\$ 771,462
Receipts	233,786	59,198	55,730
Pensions Paid to Retired Members	1,052,140	1,031,111	999,382

Investments in the State of Connecticut Combined Investment Funds are verified as part of our audit of the State Treasurer. Receipts consisted mainly of employee contributions and investment income. Pensions paid to retired members were mainly financed by the General Fund appropriation for, "Pensions and Retirements – Other Statutory" and, as noted above, the State's Attorneys' Retirement Fund.

General Assembly Pension Fund:

Sections 2-8b to 2-8p of the General Statutes had provided for a voluntary retirement plan for members of the General Assembly. Under Public Act 85-502, effective July 1, 1985, this pension system was abolished and all assets of the Fund were transferred to the State Employees' Retirement Fund, except for those actuarially determined reserves needed to fund those already retired from the General Assembly Pension System. As provided for in Section 2-8r, members of the General Assembly were to be covered under Tier II of the State Employees' Retirement System, unless by December 31, 1990, an election was made by the member to participate in the Tier I plan.

The investments of the General Assembly Pension Fund, which made up most of the assets of the fund and consisted primarily of investments in the State Treasurer's Short Term Investment Fund, the receipts of the fund and pensions paid to retired members were as follows:

	<u>2003-2004</u>	<u>2004-2005</u>	<u>2005-2006</u>
Market Value of Investments, June 30	\$ 26,989	\$ 24,671	\$ 23,172
Receipts	334	597	1,037
Pensions Paid to Retired Members	3,436	2,914	2,536

Investment balances were verified as a part of our audit of the State Treasurer. Receipts consisted mainly of investment income. The General Assembly Pension Fund financed pensions paid to retired members.

Judges' and Compensation Commissioners' Retirement Fund:

Sections 51-49 through 51-50b, inclusive and Section 51-51 of the General Statutes provide a retirement system for judges, compensation commissioners and family support magistrates. All monies received in connection with the system are to be deposited to the Judges' and Compensation Commissioners' Retirement Fund. Funding for the system is to be provided by contributions from the General Fund and payroll deductions from members' salaries, at a rate of five percent. The Retirement Commission is the administrator of the system while the State Treasurer serves as custodian and investment manager of the fund.

Participation in this system is automatic for all commissioners and judges, except that judges, with ten years of credited service in the State Employees' Retirement System at the time of their initial appointment, may elect to remain in that system, as provided for in Section 5-166a.

Section 51-49d of the General Statutes provides that the Judges' Retirement System be funded on an actuarial reserve basis with actuarial surveys of the system performed at least once every two years and with annual certifications to the General Assembly of funding requirements. Actuarial valuations of the system were prepared as of June 30 2004, June 30, 2005 (interim) and June 30, 2006. As a result of these valuations, the unfunded actuarial accrued liability as of June 30, 2004, 2005 and 2006, was determined to be \$68,974,850, \$74,685,056 and \$77,205,261, respectively.

The retirement salary for which a member is eligible is determined by age at retirement, years of service and the salary of the office held at retirement. Members become eligible for the normal retirement benefit at age 65, or after 20 years of service. This benefit is equal to two-thirds of the salary of the office, as such salary, including longevity pay, may be changed from time to time or, where applicable, to two-thirds of the member's final compensation.

A reduced retirement benefit is available to those members with ten years of service who do not meet the eligibility requirements for a normal retirement benefit. In the event of disability, members receive the normal retirement benefit. In the event of death, the surviving spouse is entitled to one-third of the salary of the office held at the time of retirement, or, where applicable, one-third of the deceased spouse's final compensation.

The following shows the actuarial value of assets. This value is based on information from actuarial reports on file with the Retirement and Benefit Services Division. It also shows the investments of the Judges' and Compensation Commissioners' Retirement Fund, the receipts of the fund, and pensions paid to retired members, which were derived from the Retirement Division's financial statements that were based on State Treasurer data.

	<u>2003-2004</u>	<u>2004-2005</u>	<u>2005-2006</u>
Actuarial Value of Assets, June 30	\$150,873,834	\$160,322,228	\$169,666,234
Market Value of Investments, June 30	140,387,092	152,715,298	163,758,464
Receipts	18,894,752	19,733,281	19,328,809
Pensions Paid to Retired Members	14,322,519	15,084,905	15,893,207

Investments in the State of Connecticut Combined Investment Funds are verified as part of our audit of the State Treasurer. The asset balances are valued using the Actuarial Valuation of Assets method. This method spreads the recognition of gains and losses over a five-year period and is further adjusted, as necessary, so that the final actuarial value is within 20 percent of the market value of assets. Receipts consisted mainly of General Fund appropriation transfers, investment income, including gain on sale of investments, and employee contributions. Pensions paid to retired members were financed by the Judges' and Compensation Commissioners' Retirement Fund, mainly from transfers from a General Fund appropriation for Judges' and Compensation Commissioners' Retirement Contributions. Charges to the General Fund appropriation account amounted to \$11,597,773, \$12,235,665 and \$11,730,025 for the 2003-2004, 2004-2005 and 2005-2006 fiscal years, respectively.

Public Defenders' Retirement Fund:

Sections 51-49, 51-295 and 51-295a of the General Statutes provide a separate retirement program for each Public Defender incumbent on July 1, 1978, similar to the program for State's Attorneys. In addition, effective July 1, 1986, the Chief Public Defender and the deputy could elect membership in this retirement program. A retirement fund was established to receive contributions from participants at the rate of five percent of salary, including transfers from the State Employees' Retirement Fund for transferred service credit. Retirement salary determination, eligibility, death benefits and funding arrangements are similar to those previously explained for the State's Attorneys' Retirement Fund.

Public Defenders' Retirement Fund investments in the Treasurer's Short Term Investment Fund, receipts and pensions paid to retired members are shown below:

	<u>2003-2004</u>	<u>2004-2005</u>	<u>2005-2006</u>
Market Value of Investments, June 30	\$ 51,885	\$ 58,765	\$ 68,312
Receipts	6,914	7,880	9,547
Pensions Paid to Retired Members	366,250	380,272	391,508

The investment balance was verified as part of our audit of the State Treasurer. Receipts were mainly employee contributions. Pensions paid to retired members were for five retirees/beneficiaries and were mainly financed by the General Fund appropriation for "Pensions and Retirements – Other Statutory."

Probate Judges' and Employees' Retirement Fund:

Sections 45a-34 through 45a-56 of the General Statutes provide for a retirement system for Probate Court judges and employees to be administered by the Retirement Commission. Section 45a-35 established a Probate Judges' and Employees' Retirement Fund to account for retirement contributions from members of the system as well as the amounts transferred from the Probate Court Administration Fund and to finance the benefits, allowances and other payments required under the system.

As provided in Section 45a-49 all contributions required under the system are to be transmitted by the Retirement Commission to the State Treasurer who shall be Custodian of the Retirement Fund with power to invest as much of the Fund as is not required for current disbursements. Sections 45a-44 and 45a-45 require members of the retirement system to make contributions equal to one percent of their earnings on which Social Security taxes are paid through the Retirement Commission and three and three-quarters percent of earnings in excess of that, while for those not under such Social Security coverage, retirement contributions are three and three-quarters percent of earnings.

Section 45a-82 of the General Statutes requires that on or before July first annually the Retirement Commission shall certify to the State Treasurer, on the basis of an actuarial determination, the amount to be transferred to the Retirement Fund to maintain the actuarial plan adopted by the Retirement Commission. Payments of these actuarially determined funding amounts are made from the Probate Court Administration Fund. Actuarial valuations of the system were prepared as of December 31, 2004, 2005, and 2006. As a result of these valuations,

it was determined that there was no unfunded actuarial accrued liability as of December 31, 2004, 2005 and 2006.

The retirement salary for which a member is eligible is determined from Social Security coverage, if any, the retirement date, the years of service, and the average final compensation, in accordance with the provisions of the aforementioned sections of the General Statutes. No retirement salary, however, including Social Security benefits, can exceed 80 percent of the member's average final compensation for judges or 100 percent for employees, and no retirement salary can be less than \$360 annually.

The following shows the actuarial value of assets. This value is based on information from actuarial reports on file with the Retirement and Benefit Services Division. It also shows the investments of the Probate Judges' and Employees' Retirement Fund, which made up most of the assets of the fund, the receipts of the fund, and pensions paid to retired members, which were derived from the Retirement Division's financial statements that were based on State Treasurer data.

	<u>2003-2004</u>	<u>2004-2005</u>	<u>2005-2006</u>
Actuarial Value of Assets, Dec. 31	\$72,633,571	\$77,628,198	\$82,006,897
Market Value of Investments, June 30	67,072,384	72,081,636	77,321,233
Receipts	4,752,369	5,676,605	5,231,615
Pensions Paid to Retired Members	2,226,599	2,563,180	2,613,472
Health Services Costs Paid Through Fund	1,966,908	2,078,528	2,227,629

The asset balances are valued using the Actuarial Valuation of Assets method. This method spreads the recognition of gains and losses over a three-year period and is further adjusted, as necessary, so that the final actuarial value is within 20 percent of the market value of assets. Investments in the State of Connecticut Combined Investment Funds are verified as part of our audit of the State Treasurer. Receipts consisted mainly of investment income, including gain on sale of investments, General Fund appropriation transfers, mainly for health service costs, and employee contributions. Pensions paid to retired members were financed by the Probate Judges' and Employees' Retirement Fund.

Municipal Employees' Retirement Fund:

The Connecticut Municipal Employees' Retirement System, which is administered by the Connecticut State Employees' Retirement Commission, operates generally, under the provisions of Sections 7-425 through 7-450a of the General Statutes.

The Municipal Employees' Retirement System is composed of a Retirement Fund and an Administration Fund. As of June 30, 2006, municipalities and housing authorities with 8,505 enrolled active employees were participants. As of that date, benefits were being paid to 5,112 retired employees or to their survivors. This represented net increases of 85 active participants and 369 benefit recipients during the audited period.

Any municipality may, by resolution passed by its legislative body and subject to referendum, participate in the System. The effective date of participation shall be the first day of July at least 90 days subsequent to the receipt by the Retirement Commission of a certified copy

of the resolution. Participation may also be effected through an agreement between a municipality and an employee bargaining organization. If so, Section 7-474, subsection (f), of the General Statutes, provides that the effective date of participation shall be the first day of the third month following the month in which a certified copy of the agreement is received by the Retirement Commission, or such later date as may be specified in the agreement. Under Section 7-427, eligible employees of housing authorities who were not already enrolled in Fund B were required to become members thereof on July 1, 1972, unless the board of commissioners of the authority voted against such participation.

Section 7-441 of the General Statutes, which prescribes the various contributions required of participating municipalities, provides that each municipality must pay to the Retirement Commission an annual proportionate share of the Fund's administrative costs, as determined by the Retirement Commission on the basis of the number of members employed by each municipality. During the audited period the participating municipalities were required to contribute \$75 per member per year for such administrative expenses. These moneys were deposited to the Administrative Fund, which was established to account for all administrative contributions and expenditures.

The retirement salary for which a member is eligible is determined by the years of service and average final compensation over the three highest paid years of service. Members become eligible for retirement after completing 25 years of aggregate service in a participating municipality. Or by attaining the age of 55 and completing 5 years of continuous service, or 15 years of active aggregate service in a participating municipality. Provisions exist for disability retirements and death benefits.

Employee contribution rates are set by Section 7-440 of the General Statutes. Each employee contributes two and one quarter percent of the portion of salary for which Social Security contributions are to be deducted and five percent of the portion for which such contributions are not to be deducted. Municipal contribution rates are set by the Retirement Commission based on actuarial valuations, which, under the provisions of Section 7-443, are required at least every five years. Actuarial valuations have been performed on an annual basis starting with the July 1, 1992, report. Actuarial valuations of the system were prepared as of June 30 of each year and were as follows:

As of June 30,	<u>2004</u>	<u>2005</u>	<u>2006</u>
Unfunded actuarial accrued liability	\$(40,860,605)	\$(47,381,146)	\$(38,170,164)

Despite the negative unfunded actuarial accrued liability, contribution rates to the Municipal Employees' Retirement System have been increased to compensate for the expected impact of asset losses on future valuations that will result from the normal application of the smoothing method used to develop the actuarial value of assets.

The rates shown below, effective July 1, were based on the results of the actuarial valuations performed for the preceding periods. These rates represent the percentage of salaries that municipalities must contribute and are presented in the chart below:

Effective Date July 1,	<u>2004</u>	<u>2005</u>	<u>2006</u>
Policemen and firefighters with Social Security	5.25%	7.75%	8.00%
General employees with Social Security	4.75%	6.25%	6.75%
Policemen and firefighters without Social Security	5.25%	7.50%	7.75%
General employees without Social Security	4.75%	6.50%	7.00%

Section 7-439b of the General Statutes provides for annual cost-of-living increases for each retired member or surviving annuitant of a retired member receiving regular benefit payments. Cost of living increases are determined by the member's date of retirement and age at retirement.

The following shows the actuarial value of assets. This value is based on information from actuarial reports on file with the Retirement and Benefit Services Division. It also shows the investments of the Municipal Employees' Retirement System, which made up most of the assets of the fund, the receipts of the fund, and pensions paid to retired members, which were derived from the Retirement Division's financial statements that were based on State Treasurer data.

	<u>2003-2004</u>	<u>2004-2005</u>	<u>2005-2006</u>
Actuarial Value of Assets, June 30	\$1,434,305,515	\$1,512,473,272	\$1,587,659,815
Market Value of Investments, June 30	1,303,832,971	1,394,837,426	1,501,120,450
Receipts	89,847,385	96,427,945	99,169,879
Pensions Paid to Retired Members	64,711,908	69,747,511	73,994,846

Investments in the State of Connecticut Combined Investment Funds are verified as part of our audit of the State Treasurer. The actuarial value of assets was determined on a market related basis. The asset valuation method recognizes assumed investment income fully each year. Differences between actual and assumed investment income were phased in over a closed five-year period. Receipts consisted mainly of investment income and employee and municipal contributions. Pensions paid to retired members were financed by the Municipal Employees' Retirement Fund.

Policemen and Firemen Survivors' Benefit Fund:

The Policemen and Firemen Survivors' Benefit Fund operates, generally, under the provisions of Sections 7-323a through 7-323i of the General Statutes. The primary objective of the Fund is to provide benefits for surviving dependents of deceased municipal policemen and firefighters. Any municipality may, by ordinance or collective bargaining agreement approved by its legislative body, participate in the plan. Employee contribution rates are fixed by statute at one percent of the employee's compensation. Municipal contributions, however, are made in amounts determined by the Retirement Commission to be necessary to maintain the Fund on a sound actuarial basis.

Section 7-323c, subsection (d), of the General Statutes requires that municipalities annually pay a proportionate share of the costs of the administration of the Fund as determined by the Commission. The administrative fee remained at \$30 per member per year for the audited period. Revenues collected through this assessment have been deposited to the Administration Fund of the Municipal Employees' Retirement System as its employees have the responsibility of overseeing the operations of the Policemen and Firemen Survivors' Benefit Fund.

As of June 30, 2006, the date of the last available actuarial valuation, nine municipalities, with 548 active employees, were participating in the plan.

The following shows the actuarial value of assets, assets in excess of net actuarial liabilities, contributions, interest income and benefit payments. These values are based on information from available actuarial reports on file with the Retirement and Benefit Services Division. Also shown are the investments of the Police and Firemen Survivors' Benefit Fund, which made up most of the assets of the Fund, the receipts of the Fund, and disbursements for pensions paid to surviving dependents, which were derived from the Retirement Division's financial statements that were based on State Treasurer data.

	<u>2003-2004</u>	<u>2004-2005</u>	<u>2005-2006</u>
Actuarial Value of Assets, June 30	\$20,077,105	\$21,456,097	\$22,260,223
Market Value of Investments, June 30	18,083,143	19,045,044	19,634,650
Receipts	825,975	927,292	1,071,714
Pensions Paid to Surviving Dependents	730,483	742,716	756,947

Investments in the State of Connecticut Combined Investment Funds are verified as part of our audit of the State Treasurer. Contributions are transferred to the State Treasurer for investment. Disbursements for benefit payments are processed in the Policemen and Firemen Survivors' Benefit Fund through the Municipal Employees' Retirement Fund system. The actuarial valuations prepared for June 30, 2004, 2005 and 2006 resulted in municipal contribution rates of zero percent of each municipality's active covered payroll, with the exception of the New Britain Police Department, which was assessed .67 percent and .57 percent as of July 1, 2005, and 2006, respectively. As previously mentioned in this report, employee contribution rates are fixed by statute at one percent of the employee's compensation. Administrative assessments are collected from the participating municipalities and are deposited to the Administrative Fund of the Municipal Employees' Retirement System.

Pensions and Retirements – Other Statutory:

Sections 3-2a, 6-2b and 11-10a of the General Statutes and various special acts authorize pensions and retirements to former governors and their spouses, certain former county employees and law librarians, and various individuals. These pensions and retirements are paid from a special appropriation of the General Fund entitled "Pensions and Retirements – Other Statutory." In addition, this account is used to fund that portion of the retirement benefits paid to retired members of the State's Attorneys' and Public Defenders' Retirement Funds that is not funded by those Retirement Funds. Expenditures for State's Attorneys' and Public Defenders' Retirement Funds were disclosed previously. The remaining expenditures for other statutory charges during the 2003-2004, 2004-2005 and 2005-2006 fiscal years, from the above special appropriation account, amounted to \$185,257, \$185,418 and \$183,966, respectively, and were made for that portion related to the above statutes.

Deferred Compensation:

In addition to the retirement programs already noted in this report, Section 5-264a of the General Statutes authorizes the Office of the Comptroller, through a third party administrator, to offer to the State of Connecticut employees a deferred compensation plan created in accordance

with Section 457 of the Internal Revenue Service Code. This plan permits all permanent employees, including elected and appointed officials and members of the General Assembly, to defer a portion of their salary until future years. Effective January 1, 2006, a political subdivision of the State may participate in the plan in accordance with Section 5-264a (g) of the General Statutes. This deferred compensation is not available to employees until retirement, termination of employment, disability, unforeseeable emergency or death.

During the audited period the Office of the Comptroller revised the deferred compensation program by contracting with a single administrator selected by a competitive process. This was intended to reduce fees and provide an improved level of services to participants. In February 2005, ING Financial Advisors, LLC was selected as the third party administrator of the State's deferred compensation program. Companies participating in this program and the market value of these accounts at June 30 are listed below:

Market Values at June 30,	<u>2004</u>	<u>2005</u>	<u>2006</u>
ING	\$611,088,857	\$ 669,976,647	\$1,281,025,285
Hartford	347,398,662	394,480,255	0
Phoenix	34,504,846	41,260,342	0
Total	<u>\$992,992,365</u>	<u>\$1,105,717,244</u>	<u>\$1,281,025,285</u>

General and Special Transportation Funds Appropriations:

The General and Special Transportation Funds also include appropriations and expenditures for the pension and retirement programs of the State. A summary of the net expenditures of the General and Special Transportation Funds follows:

	<u>2003-2004</u>	<u>2004-2005</u>	<u>2005-2006</u>
General Fund:	\$	\$	\$
Alternate Retirement System:			
State share of contributions	17,454,276	17,447,948	27,204,058
State Employees' Retirement System:			
State share of retirement funding	321,866,112	354,400,568	447,209,748
Pensions and Retirements-Other Statutory:			
State share of costs:			
State's Attorneys' Retirement System	1,052,140	944,988	999,382
Public Defenders' Retirement System	366,250	379,272	391,508
Pension payments – miscellaneous (A)	185,257	185,418	183,966
Judges' and Compensation			
Commissioners' Retirement Fund:			
State share of retirement funding	11,597,773	12,235,665	11,730,025
Retired State Employees'			
Health Service Costs:			
State share of costs	317,825,568	374,171,219	390,383,106
Special Transportation Fund:			
State Employees' Retirement System:			
State share of retirement funding	44,864,000	48,916,000	60,055,000
Total Expenditures	<u>\$715,211,376</u>	<u>\$808,681,078</u>	<u>\$938,156,793</u>

- (A) Includes payments to former governors or widows, county employees, law librarians and individuals whose pensions are authorized by special act.

Retired State Employees' Health Service Costs:

For retirements before July 1, 1997, the State pays 100 percent of the health insurance premiums for each retired employee receiving benefits from a State-sponsored retirement system except those retirees under the Municipal Employees' Retirement System and the Teachers' Retirement System. This coverage includes the payment of 100 percent of health coverage provided through the State Comptroller or in conjunction with Federal medical benefits provided under the Medicare Part B Program. Members retiring on or after July 1, 1997, may be required to assume a share of the premium cost depending on the plan selected. As of June 30, 2006, there were 36,911 retired State employees receiving health care benefits.

During the 2003-2004, 2004-2005 and 2005-2006 fiscal years appropriations and transfers of \$320,811,000, \$375,021,900 and \$399,265,000, respectively, were made to cover the State's share of health insurance costs for those eligible retirees mentioned previously. A summary of the total expended for this purpose follows:

	<u>2003-2004</u>	<u>2004-2005</u>	<u>2005-2006</u>
Anthem Blue Cross/Blue Shield	\$260,676,897	\$312,360,792	\$181,159,548
Health Net	32,450,394	31,471,223	31,569,599
Medicare Part B	20,423,076	24,264,139	28,301,734
Connecticare	2,004,801	3,045,345	-
UnitedHealthcare Oxford	-	-	2,380,410
PharmaCare Management Services	-	-	144,542,813
Anthem Blue Cross/Blue Shield Dental	2,128,056	2,867,298	-
CIGNA Dental	142,344	162,422	-
UnitedHealthcare Dental	-	-	2,278,018
Aetna Dental	-	-	159,984
Total	<u>\$317,825,568</u>	<u>\$374,171,219</u>	<u>\$390,383,106</u>

The increases in expenditures during the audited period were mainly due to increases in negotiated premiums. Other changes were the result of changes in the providers offered. Effective with the 2005-2006 fiscal year, prescription drug coverage under all medical plans was provided by PharmaCare Management Services.

The State funds the health insurance benefits for retired employees as those costs are incurred; the State has not established any reserve to provide support for future years. The implementation of Governmental Accounting Standards Board Statement No. 45 in the 2008 fiscal year will require the State to calculate and record an actuarial accrued liability for the future health care benefits of retired employees. At the time of our review (April 2008) the State Comptroller has estimated that, dependent upon various actuarial assumptions, the potential liability for future health care benefits would range from \$11.4 to \$21.7 billion dollars. The annual cost to fund this liability, dependent upon the discount rate used and other assumptions, would range from \$1.0 to \$1.6 billion dollars, this estimate includes the cost of current employees eligible to receive future benefits and retirees.

CONDITION OF RECORDS

During our review of the financial records of the State Retirement Funds, as kept by the Retirement and Benefit Services Division of the State Comptroller's Office, we found several areas warranting comment. These areas are described below:

State Employees' Retirement Fund

Finalizing Retirement Payrolls:

Criteria: The process of finalizing retirement applications should be done in a timely manner. Section 5-156e of the Connecticut General Statutes requires that the Retirement and Benefit Services Division must pay five percent interest per year on any lump sum amount owed to the retiree at the time of finalization that has not been paid within six months. Interest does not start accruing until after the first six months.

Condition: As a result of the Early Retirement Incentive Program (ERIP) granted in 2003, a significant backlog of retirement applications not yet finalized was created. At June 30, 2003, a backlog of approximately 5,900 applications were on file. This amount was reduced to approximately 5,600 as of June 2004, but has shown no further improvement with approximately 5,540, 5,670 and 6,340 applications listed on file as of June 30, 2005, 2006 and 2007, respectively. At the time of our review (April 2008) there were approximately 6,500 applications on file waiting finalization. Of these, approximately 1,500 dated from the 2003 ERIP. Prior to the 2003 ERIP, a backlog averaging approximately 1,200 applications existed.

Effect: Retirees are not receiving their finalized benefit in a timely manner. The retirement fund must pay interest on the difference between estimated benefit amounts and the actual amount owed at the time of finalization for any period of time after the first six months.

Cause: The 2003 ERIP placed the Retirement and Benefit Services Division in a significant backlog position, which it has not been able to eliminate with the continual addition of new retirements.

Our previous audit also noted a number of causes that made it more difficult for Division staff to promptly complete retirement finalizations. Among them were the various complexities arising from the pension agreement and other collective bargaining agreements, particularly the retroactive provisions of such agreements, and verifying compliance with the "130 percent cap" provision governing an employee's retirement base salary.

The Retirement Division has made certain efforts to address the condition. It established an ad-hoc labor and management subcommittee to review the final audit process seeking efficiencies. In March 2007, the Division retained contract consultants to assist in the automation of retirement benefits calculations. A spreadsheet has been designed and implemented to facilitate that automation and its use has significantly improved productivity. In February 2008, the Commission authorized the use of \$80,000 from the State Employees Retirement Fund for Division staff overtime costs. However, we note that the number of new retirement applications has continued to increase, outpacing the improvements.

Recommendation: The Retirement and Benefit Services Division should continue its effort to reduce the backlog of retirement applications waiting to be finalized. (See Recommendation 1.)

Agency Response: “The auditor’s finding explains the condition, cause and effect of the retirement application audit backlog in concise detail. Prior to the onslaught of retirement applications due to the 2003 ERIP, the Division finalized a retirement application in approximately six months - today the same audit could take more than four times as long. Also, as noted in the finding, the Division has taken steps to reduce the backlog. For example, in preparation of the biennial budget, the Director requested additional clerical positions, and two Retirement Benefits Officer positions for the Audit Unit. Additionally, the Director hired a consultant to aid in the automation of retirement benefits calculations, engaged summer interns to “populate” the data (the interns populated over 3,000 spreadsheets) and sought overtime for the Audit staff for the express purpose of reducing the backlog. However, all of these measures have been palliative and resembled the placing of a band aid on a gaping wound. Significant progress will not be made in reducing the backlog unless and until the State makes an equally significant commitment in terms of additional personnel and resources to enable full automation of the retirement calculation and benefit audit process.”

Unreconciled Cash, Receipts and Disbursements Account Balances:

Criteria: The State Comptroller’s *State of Connecticut Accounting Manual (State Accounting Manual)* states “The Comptroller’s records are the official accounting records of the State of Connecticut; it follows, therefore, that the Comptroller’s Annual Report is the official statement of the State’s revenue, expenditures and surplus....It is the responsibility of the Chief Financial Officer of each State Agency to reconcile the Agency’s records with those of the Comptroller. Any errors discovered in this reconciliation

(other than one which affects only the agency records) should be reported to Accounting Services.”

The Retirement Division’s *Accounting Procedures Manual* sets forth that monthly postings be done to appropriate general ledgers and subsidiary accounts, reconciling with the Comptroller’s available cash and appropriation ledgers. In addition, with respect to the preparation of the monthly Balance Sheet and Cash Statement for each of the Retirement Funds, the *Accounting Procedures Manual* states that each of these statements are prepared when the figures are balanced with the Comptroller’s available cash and appropriation ledgers.

Condition:

The account balances reported for cash, receipts (revenues) and disbursements (expenditures) on the fiscal-year-end financial statements for the various retirement funds prepared by the Accounting Unit were not always in agreement with, and were not reconciled to, the corresponding account balances as recorded on the State’s general ledger and as reported in the Comptroller’s annual budgetary basis financial reports. Although some of the differences in the reported account balances between the Retirement Division’s accounting records and the Comptroller’s general ledger records were not always significant in nature, in one instance, the differences were material. In this particular instance, the Retirement Division’s fiscal-year-end cash statement as of June 30, 2006, for the Higher Education Alternate Retirement System reported receipts and disbursements totals that were approximately \$26,845,000 greater than the totals recorded in the State Comptroller’s General Ledger.

We also found that, during the audited period, the Retirement Division’s Accounting Unit did not perform monthly or fiscal-year-end reconciliations of its cash, receipts and disbursements account balances between its internal records and the Comptroller’s automated general ledger accounting records, including such records as the general ledger trial balance and available cash trial balance reports.

Effect:

The failure to reconcile the Retirement Funds’ account balances with the Comptroller’s accounting records, on either a monthly or fiscal-year-end basis, can lead to undetected errors in account balances and inaccuracies in the Retirement Funds’ fiscal-year-end financial statements.

The identified control weakness resulted in the failure to comply with the requirements of the State Comptroller’s *State Accounting Manual* and the Retirement Division’s *Accounting Procedures Manual*.

Cause: Subsequent to the implementation of the Core-CT system, the Retirement Division did not implement the procedures necessary to ensure that all cash, receipts and disbursements activities and related account balances as recorded in the Retirement Funds' accounting records were reconciled on a monthly and fiscal-year-end basis with the Comptroller's General Ledger records.

It appears that a lack of adequate administrative control led to the Accounting Unit's failure to prepare the required monthly and fiscal-year-end reconciliations.

Recommendation: The Retirement Division should implement the internal control procedures necessary to ensure that monthly and fiscal-year-end reconciliations are performed between the Retirement Funds' accounting records and the State's official record in the form of the Comptroller's General Ledger in accordance with the requirements of the State Comptroller's *State Accounting Manual* and the Retirement Division's *Accounting Procedures Manual*. (See Recommendation 2.)

Agency Response: "It is first important to note that many of the findings involved balances prior to 2007. By way of background, the Division's senior Accountant retired during the 2003 ERIP. Prior to her retirement, many of the accounting functions were done on a manual basis. The position was finally filled in November 2006 and the Division took that opportunity to reorganize the Division's Accounting Unit and staff it with two full-time employees. The Division also made efforts to automate and properly document the Division's accounting functions. Since that date the Accounting Unit staff members have moved the Division's retirement fund bookkeeping from manual paper ledgers to PC based automated spreadsheets and begun the task of documenting, and in some cases, updating and adjusting Division accounting functions. In that connection, the cash, receipts and disbursements are reconciled and documented using newly created reconciliation reports on a monthly and fiscal year end basis. In addition, the reconciliation processes have been incorporated in retirement fund "check list" procedural documentation."

General Fund Appropriation Accounts – Incomplete Accounting Records:

Background: The State Comptroller's State Employees Retirement and Benefit Services Division is responsible for maintaining the accounting records for the following five General Fund appropriation accounts: the State Employees Retirement Contributions account, the Higher Education Alternate Retirement Program account, the Pensions and Retirement – Other Statutory account, the Judges and

Compensation Commissioners Retirement Fund account and the Retired Employees Health Services Costs account.

Criteria: Accounting and financial reporting standards and proper internal control requires the maintenance of current, complete and accurate financial records. The *State Accounting Manual* requires that each agency reconcile its records with those of the State Comptroller.

Condition: The Accounting Unit of the Retirement and Benefit Services Division did not properly maintain its internal accounting records to account for the activities related to the General Fund appropriation accounts for the Higher Education Alternate Retirement Plan, the Pension and Retirements – Other Statutory plan and the Retired Employees Health Services Costs during the audited period. Consequently, the Retirement Division Accounting Unit’s records were not maintained in a manner that would allow for the reconciliation of the expenditure transactions charged to these General Fund appropriation accounts on a monthly, a cumulative year-to-date, or an annual basis to the Comptroller’s General Ledger, as maintained on the Core-CT system.

We found the internal accounting records for the Higher Education Alternate Retirement Plan were not completed for the fiscal years 2004, 2005 and 2006. In addition, the Accounting Unit did not prepare, or otherwise, maintain an internal accounting record for the General Fund appropriation account for the Pension and Retirements – Other Statutory plan for the fiscal year 2006. Lastly, we found that the Accounting Unit did not prepare the internal accounting records related to the General Fund appropriation account for the Retired Employees Health Services Cost for the fiscal years 2005 and 2006.

Effect: The Division’s failure to maintain adequate accounting records prohibits the reconciliation of these General Fund appropriation accounts with the Comptroller’s accounting records, which could result in undetected errors and inaccuracies in reported account balances.

The identified control weakness resulted in the failure to comply with the requirements of the *State Accounting Manual*.

Cause: The implementation of the Core-CT system’s Financial Module and the assignment of new, inexperienced staff to the Accounting Unit during the audited period affected the Division’s ability to maintain its accounting records.

Recommendation: The Retirement Division should implement the procedures necessary to ensure that the Division's internal accounting records for General Fund appropriation accounts are prepared, properly maintained and reconciled with the State Comptroller's records in accordance with the requirements of the *State Accounting Manual*. (See Recommendation 3.)

Agency Response: "Once again, it is important to note that many of the findings involved records that were incomplete from 2004, 2005 and 2006. Beginning in November 2006, the Division's Accounting Unit was reorganized and staffed with two full-time employees in an effort to automate and properly document the Division's accounting functions. The Retirement & Benefit Services Division's Accounting Unit is in the process of researching, preparing and documenting internal accounting records for the activities related to the General Fund appropriation accounts for the Higher Education Alternate Retirement Plan, the Pension and Retirements - Other Statutory Plan and the Retired Employees Health Services Costs."

Codification of Pension Agreement Changes to the State Employees' Retirement System:

Criteria: Section 5-155a of the General Statutes states that, the general administration and the responsibility for the proper operation of the State Employees' Retirement System is vested with the Retirement Commission and the Commission shall act in accordance with the provisions of the General Statutes and applicable collective bargaining agreements. Our prior audit recommended that action be taken to codify subsequent agreements and administrative amendments that impact an original pension agreement.

Condition: The existing State Employees' Retirement Act is an accumulation of various General Statutes which reflect a collective bargaining Pension Agreement that took effect July 1, 1982 and which was codified in the Statutes in 1983. The Pension Agreement was subsequently modified by an arbitration award and five separately negotiated pension agreements through 1997 (SEBAC I, II, III, IV and V). Neither these amendments nor the administrative amendments resulting from changes in Internal Revenue Services regulations have ever been codified in the Statutes.

In the most recent memorandum of agreement between the State of Connecticut and State Employees' Bargaining Agent Coalition, known as SEBAC V, the parties agreed to submit the language of the Pension Agreement in statutory form to the Legislative Commissioner's Office for codification in the General Statutes. Although this agreement was signed February 4, 1997, the OPM Office of Labor Relations and SEBAC never prepared or submitted

the revised Pension Agreement. Our Office has repeated a prior recommendation, regarding the failure to comply with this agreement, in our audit report on the Office of Policy and Management, issued on February 28, 2008.

Although there was no formal agreement between the parties to have the Retirement Commission prepare proposed statutory language for codification, the parties did have an informal understanding that the process would necessitate the State Comptroller's Retirement and Benefit Services Division's review. In order for the process to go forward the State Comptroller's Retirement and Benefit Services Division, as administrator for the Commission, prepared a draft document. This draft was submitted to OPM and SEBAC in March 2008, and following their review it is to be submitted to the Legislative Commissioner's Office of the General Assembly.

Effect: The Retirement Commission's responsibility for the proper administration of the retirement system and to act in accordance with the provisions of the General Statutes and applicable collective bargaining agreements becomes more difficult to maintain with each modification to the Pension Agreement that has not been codified.

Cause: There were inconsistencies within the agreements and only a verbal agreement between the Office of Policy and Management and SEBAC providing for an independent review of the proposed language. The need for the involvement of the State Comptroller's Retirement and Benefit Services Division is evident by the State Employees' Bargaining Agent Coalition and the Office of Policy and Management's Office of Labor Relations' failure to comply with their agreement and prior discussions by the above parties that produced no concluding codifying results.

Conclusion: We consider the prior audit recommendation implemented. The State Comptroller should remind the State Employees' Bargaining Agent Coalition and the Office of Policy and Management of the necessity to promptly complete the codification of all SEBAC agreements, arbitration awards and administrative actions of the Retirement Commission.

Per Diem and Travel Expenditures:

Criteria: Section 5-155a of the Connecticut General Statutes established the Connecticut State Employees Retirement Commission. The Statute states in part... "The trustees, with the exception of the chairman and the actuarial trustees, shall serve without compensation but shall be reimbursed in accordance with the standard travel

regulations for all necessary expenses that they may incur through service on the commission. The chairman and the actuarial trustees shall be compensated at their normal and usual per diem fee, plus travel expenses, from the funds of the retirement system for each day of service to the commission.”

Condition: The chairman and the actuarial trustees of the Retirement Commission have billed the State Employees’ Retirement Fund with two per diem payments for the same day, as well as air travel and hotel costs in excess of what is customary and reasonable for travel on State business.

Some excessive charges noted by our audit were:

- The payment of two separate per diem payments of \$2,900 each, applicable to morning and afternoon Retirement Commission meetings held on the same day.
- The payment of \$944 for round trip airfare that customarily costs \$350 to \$400 for State employees.
- The payment for two round-trip airfares to attend a single meeting, one to cover the travel from Orlando, Florida to the member’s hometown area in New Jersey, then a second from New Jersey to Connecticut to attend the Commission’s meeting. The total cost of airfare was \$1,043. In addition, reimbursement was made for \$284 for the cost for a single night of airport lodging prior to the trustee’s departure from New Jersey to Connecticut.
- Incurring of \$2,198 in travel-related costs relative to two special meetings, each of which lasted less than two hours in duration, rather than choosing to attend via teleconference.

Total per diem and travel costs paid from the State Employees’ Retirement Fund, which was approved by the Commission, totaled \$229,187 for the 2006-2007 fiscal year.

Effect: The State Employees’ Retirement Fund is charged with administrative costs in excess of what is generally considered reasonable for governmental service.

Cause: State travel regulations controlling travel expenditures were not made applicable to the Retirement Commission. The definition of “normal and usual per diem fee, plus travel expenses” was never established at the time the chairman and actuarial trustees were originally appointed. The Commission as a body approves the per diem and travel expenditures of its own members. The Commission does not routinely employ teleconferencing as a method to save the time and travel costs of Commission members.

Recommendation: The Connecticut State Employees Retirement Commission should adopt, or otherwise implement, regulations to effect the limitation of costs related to trustees' overnight lodging and travel that are commensurate with the reimbursement amounts set forth in the State Travel Regulations. (See Recommendation 4.)

Agency Response: "With regard to this finding there is an important distinction between the State Retirement Commission proper (the "Commission") and the Retirement and Benefit Services Division ("Division"). The Division is responding to this finding as the Agency; however, the Division has limited, if any, authority over the Commission with regard to its approval of travel expenses for Commission members or, in the alternative, implementation of regulations governing such travel and expenses. Pursuant to Conn. Gen. Stat. Sec. 5-155a, any such authority is placed squarely on the Commission. Saying that, the Director has met with the Chair of the Commission and the two actuaries to discuss the concerns expressed in this finding and to recommend to the actuaries to use the government established rate for their hotel stays and airfare. Additionally, the Division will recommend to the Regulation Subcommittee of the Commission that it meet and promulgate criteria for the reimbursement of "per diems" and travel expenses for Commission members since there appears to be no State guidelines that apply to non-employee Commission members."

Municipal Employees' Retirement System

Retirement Benefit Calculations:

Criteria: The General Statutes and other information available to retirement plan participants identify various methodologies to determine retirement benefits mainly based on length of service, age, average annual pay based on three distinct years of the highest annual pay and the form of pension chosen, such as contingent annuitant options. Calculations should be accurate, with appropriate documented reviews.

Condition: Prior audits have cited the Comptroller's Office for inaccurate calculations of retirement benefits owed to eligible beneficiaries. Our current review again found that errors continue to occur due to inadequate internal controls. We reviewed three months of new retirement benefit recipients, some of which were contingent annuitants of the retiree. We reviewed the months of November 2003, January 2005 and April 2006; in those months, we found errors for 5 of 15, or 33 percent, 3 of 20, or 15 percent, and 6 of 21, or 29 percent, of the tested recipients (a total of 14 of 56), respectively. Nine of the errors involved the determination of the highest average salary, which were caused by the inaccurate identification of the three highest years of salary to be used to determine the highest average salary. The five remaining errors were caused by data entry errors related to such factors as the use of incorrect service time and an incorrect option factor. Due to the above errors, both underpayments and overpayments to recipients occurred. Total underpayments were approximately \$16,575, and individual underpayments ranged up to \$9,455, with current underpayments ranging up to \$38.93 per month. Total overpayments were approximately \$7,965 and individual overpayments ranged up to \$3,310.80, with current overpayments ranging up to \$103.42 per month.

Effect: Participants received understated and overstated monthly retirement benefits. The underpayments created a liability for each month the miscalculation was unidentified; the overpayments ultimately created a receivable to the State for each month it was unidentified and not waived.

Cause: It appeared that, due to the sometimes complex nature of the average annual pay calculations, the manual nature of the reviews and re-reviews, the old methodology could still lead to inaccurate average annual pay determinations. Situations in which pay amounts varied significantly, due to such things as overtime, made determining the highest three-year total of twelve consecutive

monthly segments of salary very difficult. Other errors occurred and were not identified within the review process.

Recommendation: The Retirement and Benefit Services Division should take greater care in the review of the retirement benefit calculations for the Municipal Employees' Retirement System; internal controls relating to the finalization process should be strengthened and reviews should be documented. (See Recommendation 5.)

Agency Response: "By way of explanation, it is first important to note that the majority of the auditors' findings of errors relate to the benefits owed to the contingent annuitant (beneficiary) after the death of the member rather than the member itself. The benefit owed to the contingent annuitant is derived from the calculation done for the member usually many years earlier utilizing outdated procedures. In sum, an incorrect calculation discovered for a contingent annuitant in 2006 was most likely based upon the member's original benefit calculation done sometime in the 1980s and 1990s without the benefit of Connecticut Municipal Employees' Retirement System's (CMERS) current automated benefit worksheet.

Prior to 2003, errors occurred primarily because the calculation process was manual. In 2002, CMERS implemented an automated program that accurately calculates the member's benefit including the calculation of the three highest years. CMERS believe that the use of this program to calculate the member's benefit (including the three highest years of salary) will alleviate the majority of the errors found by the auditors.

With regard to resolving the present situation, CMERS' procedure is to automatically recalculate the benefit for the contingent annuitant once it receives word of the member's passing. If there is an amount due and owing the member because of an incorrect calculation, the amount is calculated and payment is made to the member's estate. If there is an amount due and owing CMERS, it is treated as an overpayment and, pursuant to C.G.S. Sec. 7-439h, CMERS collects repayment from the member's beneficiary, spouse or contingent annuitant through a set amount subtracted from their monthly benefit entitlement."

RECOMMENDATIONS

Status of Prior Audit Recommendations:

- The Retirement and Benefit Services Division should submit statutory language to the General Assembly to codify the changes to the State Employees' Retirement System that have been administratively enacted by the Retirement Commission - our current review found that a draft codification that addressed the administrative changes enacted by the Retirement Commission has been prepared by the Division and in March 2008 was forwarded to the Office of Policy and Management's Office of Labor Relations and State Employees' Bargaining Agent Coalition for their review. We consider the recommendation implemented.
- The State Comptroller, through the Retirement Commission and its Retirement and Benefit Services Division, should establish a formal process to complete the codification of all SEBAC agreements, arbitration awards and any administrative actions of the Retirement Commission - our current review found that the Division has prepared a draft codification. In March 2008 the Division submitted that draft to the Office of Policy and Management's Office of Labor Relations and the State Employees' Bargaining Agent Coalition for their review. It is the responsibility of the Office of Policy and Management to request the necessary legislative changes. Accordingly, we consider the recommendation implemented.
- The Retirement and Benefit Services Division should promulgate waiver regulations for the Municipal Employees' Retirement System so that the Retirement Commission may act upon any waiver requests - our current review found the Division has been processing any such refunds using the procedures established for the State Employees' Retirement System. The Division has drafted regulations for the waiver of repayments for the Municipal Employees' Retirement System as part of a set of revised and updated regulations for the State Employees' Retirement System. These new regulations are to be put into place after the codification of the changes in the retirement statutes. We are not repeating the recommendation at this time.
- The Retirement and Benefit Services Division should take greater care in the review of the retirement benefit calculations for the Municipal Employees' Retirement System; internal controls relating to the finalization process should be strengthened and reviews should be documented - our current review found the status of this recommendation was unchanged; we found no improvement in the calculation accuracy of retirement benefits. We are repeating the recommendation (see Recommendation 5).

Current Audit Recommendations:

- 1. The Retirement and Benefit Services Division should continue its effort to reduce the backlog of retirement applications waiting to be finalized.**

Comment:

Our review of the retirement finalization process has found that some improvements in procedures has been made; however at the time of our review (April 2008) there were 6,525 applications on file waiting finalization. Of these, approximately 1,500 dated from the 2003 Early Retirement Incentive Program.

- 2. The Retirement Division should implement the internal control procedures necessary to ensure that monthly and fiscal-year-end reconciliations are performed between the Retirement Funds' accounting records and the State's official record in the form of the Comptroller's General Ledger in accordance with the requirements of the State Comptroller's *State Accounting Manual* and the Retirement Division's *Accounting Procedures Manual*.**

Comment:

Our review of the financial statements for the various retirement funds prepared by the Division found account balances that were not reconciled to the corresponding account balances on the State's general ledger accounting system.

- 3. The Retirement Division should implement the procedures necessary to ensure that the Division's internal accounting records for General Fund appropriation accounts are prepared, properly maintained and reconciled with the State Comptroller's records in accordance with the requirements of the *State Accounting Manual*.**

Comment:

Our review of the financial statements for the various funds and accounts prepared by the Division found the expenditure transactions were not reconciled to the corresponding General Fund appropriation on the State's general ledger accounting system.

- 4. The Connecticut State Employees Retirement Commission should adopt, or otherwise implement, regulations to effect the limitation of costs related to trustees' overnight lodging and travel that are commensurate with the reimbursement amounts set forth in the State Travel Regulations.**

Comment:

Our review of the per diem, airfare and hotel expenditures noted spending significantly in excess of what is customary and reasonable for travel on State business. Per diem and

travel costs for the Commission chairman and two actuarial trustees totaled \$229,187 for the 2007 fiscal year.

5. **The Retirement and Benefit Services Division should take greater care in the review of the retirement benefit calculations for the Municipal Employees' Retirement System; internal controls relating to the finalization process should be strengthened and reviews should be documented.**

Comment:

Our review of the calculations of retirement benefits for accuracy found errors for 14 of the 56 calculations reviewed. Nine of the errors were caused by the inaccurate identification of the three years of salary to be used to determine the highest average salary. The five remaining errors were caused by data entry errors. We noted both underpayments and overpayments in our sample. From the sample reviewed the identified underpayments totaled \$16,575 and the overpayments totaled \$7,965.

INDEPENDENT AUDITORS' CERTIFICATION

As required by Section 2-90 of the General Statutes we have audited the books and accounts of the State Comptroller's State Retirement Funds for the fiscal years ended June 30, 2004, 2005 and 2006. This audit was primarily limited to performing tests of the State Comptroller's Retirement and Benefit Services Division's compliance with certain provisions of laws, regulations, contracts and grants, and to understanding and evaluating the effectiveness of the Division's internal control policies and procedures for ensuring that (1) the provisions of certain laws, regulations, contracts and grants applicable to the Division are complied with, (2) the financial transactions of the Division are properly recorded, processed, summarized and reported on consistent with management's authorization, and (3) the assets of the Division are safeguarded against loss or unauthorized use. The financial statement audits of the State Retirement Funds for the fiscal years ended June 30, 2004, 2005 and 2006, are included as a part of our Statewide Single Audits of the State of Connecticut for those fiscal years.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America 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 plan and perform the audit to obtain reasonable assurance about whether the State Comptroller's Retirement and Benefit Services Division complied in all material or significant respects with the provisions of certain laws, regulations, contracts and grants and to obtain a sufficient understanding of the internal control to plan the audit and determine the nature, timing and extent of tests to be performed during the conduct of the audit.

Compliance:

Compliance with the requirements of laws, regulations, contracts and grants applicable to the State Retirement Funds is the responsibility of the State Comptroller's management. As part of obtaining reasonable assurance about whether the State Comptroller's Retirement and Benefit Services Division complied with laws, regulations, contracts and grants, noncompliance with which could result in significant unauthorized, illegal, irregular or unsafe transactions or could have a direct and material effect on the results of the Division's financial operations for the fiscal years ended June 30, 2004, 2005 and 2006, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants. However, providing an opinion on compliance with these 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 herein under *Government Auditing Standards*. However, we noted certain immaterial or less than significant instances of noncompliance, which are described in the accompanying "Condition of Records" and "Recommendations" sections of this report.

Internal Control over Financial Operations, Safeguarding of Assets and Compliance:

The management of the State Comptroller's Office is responsible for establishing and maintaining effective internal control over its financial operations, safeguarding of assets, and compliance with the requirements of laws, regulations, contracts and grants applicable to the State Comptroller's Retirement and Benefit Services Division. In planning and performing our audit, we considered the Division's internal control over its financial operations, safeguarding of assets, and compliance with requirements that could have a material or significant effect on the Division's financial operations in order to determine our auditing procedures for the purpose of evaluating the State Comptroller's Retirement and Benefit Services Division's financial operations, safeguarding of assets, and compliance with certain provisions of laws, regulations, contracts and grants, and not to provide assurance on the internal control over those control objectives.

However, we noted certain matters involving the internal control over the Division's financial operations, safeguarding of assets, and/or compliance that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control over the Division's financial operations, safeguarding of assets, and/or compliance that, in our judgment, could adversely affect the Division's ability to properly record, process, summarize and report financial data consistent with management's authorization, safeguard assets, and/or comply with certain provisions of laws, regulations, contracts, and grants. We believe that the following findings represent reportable conditions: the failure to perform timely reconciliations of the reported cash, receipts and disbursements account balances for the Retirement Funds to the State Comptroller's General Ledger; the failure to properly maintain and reconcile its internal accounting records relative to the General Fund appropriations accounts established to fund the State's share of contributions for the various Retirement Funds and the Retired Employees Health Services Costs; the errors found in the calculation of Municipal Employees' Retirement Fund participant benefits.

A material or significant 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 noncompliance with certain provisions of laws, regulations, contracts and grants or the requirements to safeguard assets that would be material in relation to the Division's financial operations or noncompliance which could result in significant unauthorized, illegal, irregular or unsafe transactions to the Division being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over the Division's financial operations and over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material or significant weaknesses. However, we believe that the reportable condition described above concerning errors found in the calculation of Municipal Employees' benefits to be a material or significant weakness.

We also noted other matters involving internal control over the Division's financial operations and over compliance, which are described in the accompanying "Condition of Records" and "Recommendations" sections of this report.

This report is intended for the information of the Governor, the Appropriations Committee of the General Assembly and the Legislative Committee on Program Review and Investigations. However, this report is a matter of public record and its distribution is not limited.

CONCLUSION

In conclusion, we wish to express our appreciation for the assistance and courtesies extended to our representatives by the personnel of the State Comptroller's Retirement and Benefit Services Division during the course of this examination.

Robert Koch
Principal Auditor

Approved:

Kevin P. Johnston
Auditor of Public Accounts

Robert G. Jaekle
Auditor of Public Accounts