

STATE OF CONNECTICUT

**AUDITORS' REPORT
TEACHERS' RETIREMENT BOARD
FOR THE FISCAL YEARS ENDED
JUNE 30, 1999, 2000, 2001 and 2002**

AUDITORS OF PUBLIC ACCOUNTS
KEVIN P. JOHNSTON ♦ ROBERT G. JAEKLE

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February 9, 2004

**AUDITORS' REPORT
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We have examined the financial records of the Teachers' Retirement Board for the fiscal years ended June 30, 1999, 2000, 2001 and 2002. This report on that examination consists of the Comments, Recommendations and Certification that follow.

Financial statement presentation and auditing are done on a Statewide Single Audit basis to include all State agencies. This audit examination has been limited to reviewing this Agency's compliance with laws, regulations, contracts and grants and evaluating its internal controls.

COMMENTS

FOREWORD:

Section 10-1831 of the General Statutes established the Teachers' Retirement Board. The Board is responsible for managing the Teachers' Retirement System, which operates generally under the provisions of Title 10, Chapter 167a of the General Statutes. The twelve member Board consists of two ex-officio members (or their designees), five elected by participating members, and five members appointed by the Governor. The Commissioners of Education and Social Services are the two ex-officio members. Elected members consist of three active and two retired teachers. Pursuant to Section 10-1831 of the General Statutes, Board members are not paid but any expense or loss of pay resulting from service is reimbursable.

The following were members of the Board as of June 30, 2002:

Elected Teacher Members:

Active Teachers:

Claire H. Barnett, Chair

Mary Nicholas

Robert E. Scalzo

Retired Teachers:

Rosalyn B. Schoonmaker, Vice Chair

Marion S. Jewell

Public Members:

Eugene Cimiano

Deborah Freedman

Martin M. Lilienthal

Elaine T. Lowengard

Augustine M. Masiello

Ex Officio Members:

Theodore Sergi, Commissioner, State Department of Education

Patricia Wilson-Coker, Commissioner, State Department of Social Services

Joyce Thomas and Martin L. Rudnick also served during the audited period.

William J. Sudol has served as Board Secretary (Chief Administrator) since October 1, 1997.

Membership in the system is compulsory for most public school teachers whose position requires them to hold a teacher's certificate issued by the State Board of Education. The professional staffs of the State's Board of Education and the constituent units of the State's higher education system have the option of belonging to this retirement plan. Alternatively, they can belong to the State Employees' Retirement system or, if eligible employees in higher education, an alternate retirement program as authorized by subsections (u) and (v) of Section 5-154 and subsection (g) of Section 5-160.

As of June 30, 2002, according to the Agency, there were approximately 57,150 non-retired members of which, 49,114 were actively teaching. Active members are required to contribute seven percent of their annual salary to the retirement fund. Of the seven percent, six percent goes toward financing retirement benefits and one percent goes toward financing retiree health insurance costs. Except for the one percent contribution paid to finance retiree health insurance costs, members' contributions are credited to the member's account balance and are refundable if a member ends participation and is ineligible for retirement benefits.

Retired teachers and their spouses eligible for Medicare Part A may join a Teachers' Retirement Board sponsored health insurance plan. The retired teacher pays a set premium for the coverage. This premium is considered subsidized since the health insurance benefits for

participating retirees and spouses are also funded by the previously discussed one percent contribution made by active teachers as well as State appropriations and investment income.

Retired teachers and their spouses who are not eligible for Medicare Part A may elect to continue their health insurance coverage through the local school district in which the retired teacher was employed at the time of their retirement. Since the cost of health insurance varies from district to district, the employer must charge the retired teacher the same premium that is assessed by the insurance company for the type of coverage received. For self-insured plans, the employer must charge the budgetary premium rate for the particular form of coverage. To offset this cost, the Teachers' Retirement Board issues a subsidy payment to the retired teacher's former employer. The current subsidy payment is up to \$110 monthly for the retired member plus an additional \$110 monthly for a spouse enrolled in the local school district plan. These subsidies offset the cost the retired teacher must pay to the former employer.

The Board adds annual interest to non-retired members' account balances. Effective in the fiscal year ended June 30, 1997, the Board changed its method of determining that interest. Previously, the interest rates were based on the system's investment earnings actually received (cash basis) such as gains/losses on sales, dividends, and interest income. Under the new method credited interest is based on a market value basis. Besides income actually received, this method includes price increases or decreases (market value appreciation or depreciation) on investment. The annual interest rates for the audited period were credited at fiscal year end based on the member's account balance the previous June 30 as follows:

Fiscal year 2001-2002	12.0%	Computed on the June 30, 2001 member's account balance
Fiscal year 2000-2001	13.8%	Computed on the June 30, 2000 member's account balance
Fiscal year 1999-2000	14.2%	Computed on the June 30, 1999 member's account balance
Fiscal year 1998-1999	13.5%	Computed on the June 30, 1998 member's account balance

The change in methods resulted in somewhat higher interest rates during the audited period in comparison to prior years. The interest rates for the past five fiscal years prior to the audited period were as follows:

1997-1998	13.3%
1996-1997	10.5%
1995-1996	8.64%
1994-1995	5.76%
1993-1994	7.53%

Additional comments concerning the change in the method of calculating the interest credited are contained in the "Condition of Records" section of this report.

In the event a member's participation in the retirement system is terminated during the fiscal year the interest rate is prorated monthly and applied to the member's balance as of the previous June 30. The annualized rate for partial year interest was as follows:

Fiscal year 2001-2002	13.8%	Computed on the June 30, 2001 member's account balance
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Fiscal year 2000-2001	14.2%	Computed on the June 30, 2000 member's account balance
Fiscal year 1999-2000	13.3%	Computed on the June 30, 1999 member's account balance
Fiscal year 1998-1999	13.1%	Computed on the June 30, 1998 member's account balance

As discussed more fully in the "Résumé of Operations" section below, the Teachers' retirement system is funded on an actuarial basis. The funds consist primarily of members' contributions, State contributions and investment earnings. Under the actuarial basis, funds are set aside during teaching service to cover the State's pension obligation for the members' services. This contribution is calculated based on a set percentage of teachers' payroll from year to year. (That percentage could change based on experience factors or benefit changes.) Full funding was to be phased in pursuant to Section 10-183z of the General Statutes. Beginning in 1992-1993, annual State funding was to be at 100 percent of normal (current service) cost and the unfunded past liability was to be amortized over 40 years. In addition, State contributions include amortization, over 30 years, of the unfunded liability attributed to legislation enacted after June 30, 1980, which liberalized benefits. However, the above funding levels were not achieved. (See "Résumé of Operations" section for further discussion.)

Pursuant to subsection (c) of Section 10-1831 of the General Statutes, the Board is required to employ an actuary. At least once every two years the actuary is to prepare an actuarial valuation of the assets and liabilities (including the normal cost and unfunded liability). The June 30, 2002 actuarial evaluation reported that, as of that date, the unfunded accrued liability for retirement benefits amounted to \$ 3,292,536,729.

RÉSUMÉ OF OPERATIONS:

Fund Accounting:

As required by generally accepted accounting principles (GAAP) for government, the Agency's financial transactions are accounted for through various State funds and within the General Fund by specific appropriation accounts within the budget established by the State Legislature. Unless changed, the budget establishes spending limits. Section 10-183r of the General Statutes provides for funding of the system as follows:

1. Administrative expenses (exclusive of benefits) are paid out of legislative appropriations (i.e., General Fund).
2. Benefits are paid out of the Retirement Fund that consists of members' contributions, General Fund contributions, and earnings of the system.

Also, additional Agency equipment expenditures of \$2,480, \$3,967 and \$19,587 were made from a special revenue fund (Capital Equipment Purchase Fund) in the 1999-2000, 2000-2001 and 2001-2002 fiscal years, respectively.

Teachers' Retirement Fund:

The three major recurring revenue sources of the Teachers' Retirement Fund are active members' contributions, State funding contributions and investment income. A comparison of these is given below for the audited period.

	<u>Cash Basis</u>		
	<u>State Actuarial Funding</u>	<u>Members Contributions</u>	<u>Investment Income</u>
1998-1999	\$ 188,334,000	\$ 173,058,867	\$ 347,236,275
1999-2000	204,445,443	184,937,498	872,883,611
2000-2001	214,665,698	184,067,287	403,911,262
2001-2002	204,511,460	195,539,654	392,654,079

For the most part, member contributions consist of the seven percent salary deduction discussed earlier. Employers collect these deductions and remit them to the Board.

The amounts shown for investment income include gains (or losses) realized from sales of investments. These were \$2,623,640, \$461,947,176, (\$3,335,158) and \$1,584,432 for the fiscal years ended June 30, 1999, 2000, 2001 and 2002, respectively. The investment income figures are based on data from the State Treasurer's Office.

Besides the State funding contribution, which is discussed below, State General Fund contributions were made for the health insurance cost subsidy provided pursuant to Section 10-183t of the General Statutes. State health insurance contributions totaled \$8,445,295, \$8,007,343, \$9,440,747 and \$10,485,935 for the 1998-1999, 1999-2000, 2000-2001 and 2001-2002 fiscal years, respectively. This subsidy provided General Fund financing of 25 percent (45 percent for those on disability retirement) of the cost of the Board's insurance plan, discussed further below.

Pursuant to Section 10-183z of the General Statutes, the required annual State contributions determined by the Board's actuary were \$221,569,693, \$240,524,051, \$252,547,880 and \$210,701,421 for the fiscal years ended June 30, 1999, 2000, 2001 and 2002, respectively. The General Assembly, however, through the budget acts for those years provided that despite the provisions of Section 10-183z, the funding to the Teachers' Retirement Fund would be \$188,334,239, \$204,445,443, \$214,665,698 and \$204,511,460 for the fiscal years ended June 30, 1999, 2000, 2001 and 2002, respectively. The funding level appropriated by the Legislature for the 1998-1999, 1999-2000 and 2000-2001 fiscal years represented 85 percent of the amount determined by the Board's actuary. For the 2001-2002 fiscal year the appropriated amount was approximately 97 percent of the amount determined by the Board's actuary.

In addition to the actuarial Funding by the State, various towns funded an early retirement program pursuant to Section 10-183jj of the General Statutes. Under that program, a town may

pay for the cost of some additional credited service for retirement purposes of participating teachers. Receipts attributed to the early retirement program amounted to \$3,596,680, \$6,993,984, \$7,203,956 and \$3,324,208 for the fiscal years ended June 30, 1999, 2000, 2001 and 2002, respectively.

A summary of Fund expenditures for the audited period is presented below:

	<u>1998-1999</u>	<u>1999-2000</u>	<u>2000-2001</u>	<u>2001-2002</u>
	\$	\$	\$	\$
Retirement benefits	548,836,427	610,526,728	683,083,919	747,349,673
Health insurance benefits	34,333,186	38,015,947	39,692,191	44,049,641
Contribution refunds	<u>14,125,659</u>	<u>20,358,978</u>	<u>7,590,611</u>	<u>7,305,803</u>
Totals	<u>\$ 597,295,272</u>	<u>\$ 668,901,653</u>	<u>\$ 730,366,721</u>	<u>\$ 798,705,117</u>

The number of retirees and survivorship beneficiaries receiving payments increased from 19,178 in June 1998 to 22,303 in June 2002. The rise in retirement benefits from \$548,836,427 in the 1998-1999 fiscal year to \$747,349,673 in the 2001-2002 fiscal year is partly attributed to the increased number of retirees and survivorship beneficiaries. In addition, annual cost of living increases contributed to the rise in retirement benefits paid.

Pursuant to Section 10-183g of the General Statutes, retirees may be eligible to receive annual cost of living ("COLA") increases. Section 10-183g provides for differing COLAs depending on the date members retire. Retirees are eligible for annual increases in the June or January following nine months of their retirement anniversary date. Members who retired before September 1992 are eligible for benefit adjustments according to increases in the Consumer Price Index, with a minimum of three percent and a maximum of five percent.

The calculation differs for those who retired on or after September 1, 1992 and the payment of such COLAs is conditional. Subsection (n) of Section 10-183g established an "excess earnings account" within the Teachers Retirement Fund. This account consists of the Fund's annual investment returns that exceed 11.5 percent. Account balances are applied to the COLA for such retirees. Applicable COLAs are paid only to the extent that there is a sufficient balance in the excess earnings account. The COLA is calculated by using the percentage increase granted by the Social Security Administration. However, no COLA can exceed 6 percent and if the total investment return of the Teachers' Retirement Fund is less than 8.5 percent then the COLA shall not exceed 1.5 percent.

A summary of the COLA increases granted during the audited period is presented below:

<u>COLA DATES</u>	<u>Retirees' Retirement Date</u>	
	<u>Before September 1992</u>	<u>After August 1992</u>
July 1998	3.0%	2.1%
January 1999	3.0%	1.3%
July 1999	3.0%	1.3%
January 2000	3.0%	2.4%

July 2000	3.3%	2.5%
January 2001	3.5%	3.5%
July 2001	3.7%	3.5%
January 2002	3.0%	1.5%
July 2002	3.0%	1.5%

Health insurance benefits paid increased from \$34,333,186 in the 1998-1999 fiscal year to \$44,049,641 in the 2001-2002 fiscal year. These increases are also partly attributed to the increased number of retirees and survivorship beneficiaries.

Contribution refunds are related to the number of withdrawals from the retirement system as well as the credited interest discussed earlier. Refund amounts are based on membership status, years of service and account balances. Contribution refunds decreased from \$14,125,659 for the fiscal year ended June 30, 1999 to \$7,305,803 for the fiscal year ended June 30, 2002.

<u>Service</u>	<u>Refund Amount</u>
Five years or more	Basic six percent contributions plus interest Plus one percent contributions through June 1989 (no interest) Plus voluntary contributions with interest
Less than five years	Basic six percent contributions plus interest Plus voluntary contributions with interest
Retirement	One percent contributions through June 1989 with interest Plus voluntary contributions with interest However retirees can use these amounts for an extra annuity or apply them to the purchase of eligible additional service credit

As discussed above, an excess earnings account was established to allocate part of Fund resources for possible COLA payments to members who retire on or after September 1, 1992. Such retirees will receive otherwise eligible COLA's only to the extent that a balance exists in the account. The June 30, 1998, excess earnings account balance was \$1,117,054,618. As of July 1, 2002, it had increased to \$1,574,029,466.

A separate health insurance premium account exists within the Teachers' Retirement Fund. This account, used to fund the Board's insurance program, had a June 30, 1998, balance of \$7,347,010. As of June 30, 2002, it had increased to \$10,902,581.

The State Treasurer is custodian of the Fund's investments. A summary of cost and market value of the Fund's investments for the audited period is presented below:

<u>As of June 30</u>	<u>Cost</u>	<u>Market</u>
1999	\$6,096,510,488	\$10,807,413,401
2000	\$6,711,749,642	\$11,949,456,155
2001	\$6,814,446,375	\$11,220,376,670
2002	\$6,844,380,906	\$10,125,903,606

General Fund:

Administrative expenses, State funding contributions, and the State health insurance subsidies are paid out of General Fund money appropriated to the Board by the General Assembly. An expenditure summary for the audited period is presented below:

	<u>1998-1999</u>	<u>1999-2000</u>	<u>2000-2001</u>	<u>2001-2002</u>
Transfers to Retirement Fund:	\$	\$	\$	\$
State funding	188,334,000	204,445,443	214,665,698	204,511,460
Health insurance subsidy	<u>8,445,295</u>	<u>8,007,343</u>	<u>9,440,747</u>	<u>10,485,936</u>
Total Transfers	196,779,295	212,452,786	224,106,445	214,997,396
Administrative expenses	<u>1,683,117</u>	<u>1,729,285</u>	<u>2,188,968</u>	<u>2,006,535</u>
Totals	<u>\$198,462,412</u>	<u>\$214,182,071</u>	<u>\$226,295,413</u>	<u>\$217,003,931</u>

As indicated, by far the greatest payments were for transfers to the Connecticut Teachers' Retirement Fund for the State's funding contributions and health insurance cost subsidies. We discussed these payments more fully above under "Teachers' Retirement Fund".

Administrative expenses consisted primarily of personal service payments to employees that totaled \$1,269,293, \$1,318,602, \$1,387,066 and \$1,521,188 for the fiscal years ended June 30, 1999, 2000, 2001 and 2002, respectively. Average employment remained at 29 employees for the audited period. Personal service expenditures increased by \$251,895 for the audited period or an average of six percent per year. This increase reflected cost of living increases and annual increments.

General Fund receipts amounted to \$2,382, \$575, \$28,933 and \$1,111 for the 1998-1999, 1999-2000, 2000-2001 and 2001-2002 fiscal years, respectively. The receipts consisted of refunds of expenditures.

CONDITION OF RECORDS

Areas warranting comment are presented below.

Editing Current Listing of Retirement Enrollees:

Criteria: Good internal controls require that claims presented for payment be supported by adequate documentation and verified for accuracy.

Condition: The Board pays an administrative fee to the third party administrator for each participant in the health insurance program. These administrative fees were \$5.90, \$6.00, \$6.25 and \$6.48 per month per enrollee for the 1998-1999, 1999-2000, 2000-2001 and 2001-2002 fiscal years respectively.

The Board compensates towns for health insurance coverage of participants including applicable retirees and retirees' spouses. These subsidies are \$110 per month per enrollee. In addition, the Board generally relied on the towns for notification to start or end payments for coverage of spouses.

We noted that the Board did not maintain a centralized listing of retirees and/or covered spouses that was continually edited with deceased participant information obtained from a source independent of the notification received from the towns. The Board remains unable to perform timely reconciliations of billings for administrative fees or insurance charges to a continually updated participant listing.

Effect: If deceased retirees or spouses are not removed in a timely manner from a participant centralized listing an overcharge of administrative fees and health insurance reimbursements can occur.

The risk exists that overpayment could be made and not be detected by the Board.

Cause: It appears that the lack of an on-going procedure that routinely performs the data matches contributed to the inability to do timely reconciliations of billings for administrative fees or insurance charges.

Recommendation: The Board should routinely update its current listing of retirees and participants to assure appropriate payment of health insurance

subsidies and administrative fees. (See Recommendation 1.)

Agency Response: “We agree with this finding. TRB now has Social Security numbers for all members and spouses enrolled in the TRB health plan or local school district health plans. This now enables TRB to do a computer match to determine if the member has become deceased. It is our goal to run this program semi-annually, however staffing levels may only allow us to perform this operation annually.”

Quality of Services Provided:

Background: The Teachers' Retirement Board has established a Vision Statement, a Mission Statement and a list of goals and objectives.

Comments on various aspects of these goals and objectives follow:

Criteria: One of the Board's stated objectives is to “Provide a range of services that meet the immediate and long-term needs of the members.” Numerous goals deal with the quality of service provided to system members. For instance, one goal is to “Provide more opportunities to address members' short-term and long-term retirement planning needs through improved methods of providing information”. Another goal is to “Display patience, understanding, and courtesy in responding to members and other stakeholders.”

Section 4-67m of the General Statutes requires the development for each budgeted Agency of “quantifiable outcome measures, which shall not be limited to measures of activities”.

Condition: Despite the establishment of a Vision Statement, a Mission Statement, goals, and objectives that include meeting the needs of and providing quality service to members, the Board does not have any program in place to measure how well it is meeting this ideal.

The Board has developed various program measures in conjunction with its budget requests. However, these all seem to be related to measures of activity. They deal with such measures as monies collected from local school districts, staff hours devoted to various studies and reports, and number of retirees and beneficiaries receiving health insurance subsidies. None of them appear to be related to measuring the quality of service provided.

The Board could conduct surveys that identify members' needs and satisfaction with service. A quantifiable outcome measure

could be established, for instance, by surveying what percentage of respondents rate the quality of service as excellent, good, fair, poor, etc. The survey could be conducted in a number of ways. For instance:

- the Board's internet site could be used to conduct on line surveys,
- returnable post card surveys could be given to members who come in person to the Board's office,
- survey forms could be mailed as part of regular mass mailing or distributions of Annual Reports to members.

Effect: The Board does not have a system in place to measure how well it is meeting its goals of providing quality service to members. Also, it does not appear to have developed, for budget request purposes, any program measures that meet the requirement of Section 4-67m regarding "quantifiable outcome measures, which shall not be limited to measures of activities".

Cause: We did not determine the cause.

Recommendation The Board should develop a system to survey members' requirements and satisfaction with service. (See Recommendation 2.)

Agency Response: "We agree that TRB should conduct a survey of member requirements and satisfaction. Preferably, this should be done through TRB's website in which case the results could be automatically recorded and analyzed. TRB's goal is to create an inter-active website in which case each member would be issued a pin number and be able to access personalized information and have an opportunity to respond to a survey request. Although TRB could conduct a survey using its existing website, the results could be skewed because access is not restricted."

Late Deposit of Receipts:

Criteria: Receipts should be deposited in a timely manner in accordance with Section 4-32 of the General Statutes which generally require that any State Agency receiving any money or revenues for the State amounting to more than \$500 shall deposit such receipts in depositories designated by the State Treasurer within 24 hours of receipt. Adequate controls over checks received require the receiving Agency to have a Receipts Log, to verify that the checks have been deposited and to perform a reconciliation of the Receipts Log to the deposit.

Condition: The procedures for audit of the Teachers' Retirement Board include the examination on a test basis a sample of deposits for compliance with prompt deposit requirements. The test sample contained 21 checks totaling \$1,355,908, ten of the 21 checks were deposited between one and six days late. The late deposits totaled \$1,008,557. This condition was reported to the Governor and other State Officials on September 26, 2001.

In addition, we noted that the Board does not reconcile the deposit slips stamped by the bank to the Receipts Log maintained by the Board to verify the actual deposit of the checks.

Effect: Late deposits may indicate a breakdown in controls regarding safeguarding the State's assets. The procedures do not fulfill the statutory requirements for prompt deposit.

Failure to reconcile the bank deposit to the receipt log may result in a loss of assets. The Board is not assured that all checks received have been deposited.

Cause: The Board has been receiving checks in their office and mailing them to the bank lockbox, which resulted in a delay of deposits.

Controls regarding the safeguarding of assets are not being adhered to in the reconciliation of Board receipt records to the bank deposit records.

Recommendation: The controls over receipt of checks should be improved to ensure prompt deposit of receipts in accordance with statutory requirements and the Board should perform a reconciliation of accounts to verify deposit of all checks received. (See Recommendation 3.)

Agency Response: "We agree with this finding and have made the necessary changes in procedures. All checks received by TRB are logged in and deposited on a daily basis at the local Fleet Bank Branch. The check log is also reconciled to insure that the payments received are reconciled with the bank deposit."

Strategic Planning:

Criteria: A formal planning process would help the Board meet its written goals and objectives.

- Condition:* The Board has identified a number of goals and objectives to pursue for the betterment of the TRB. They include the following:
- Solicit input on process improvements, policies, and use of new tools and technologies.
 - Involve end users in all phases of the systems development life cycle direct participation and/or communication.
 - Review potential new technologies & identify those that can provide cost-effective solutions to business problems.
 - Build an integrated system with less duplication of effort to collect, report, and distribute information.
 - Re-engineer business processes to meet business needs, including redefining job responsibilities & assignments.
 - Establish and use problem-solving teams to identify and solve business process problems.
 - Provide the means, such as policies, procedures, training, and supervision, to help staff implement new processes, roles, responsibilities, and technology.

The Board does not have a formal planning process to help the Board meet its written goals and objectives. A number of the goals and objectives lend themselves to collaboration. By establishing timed targets and utilizing a group effort a formal strategic plan could be developed.

Effect: A formal strategic plan could improve the effectiveness and efficiency of the Board.

Cause: The development of a formal strategic plan would require significant staff time. Available staff time continues to be devoted to completing daily operations. It appears that Agency administration is reluctant to divert such time to the development of a strategic plan.

Recommendation: The Board should develop a formal strategic plan. (See Recommendation 4.)

Agency Response: “We agree with this finding. Although TRB does not have a formal strategic plan, we have implemented major system changes and technological improvements over the past few years and have other major innovations planned for the future. These include use of an inter-active website, imaging, and workflow tracking. The lack of funding and adequate staffing are barriers to developing a formal strategic planning process.”

Operations Manual:

- Criteria:* Formal written procedures are an important aspect of a sound system of internal control. They are particularly important for an operation as complex as the State's Teachers' Retirement System.
- Condition:* A set of comprehensive written procedures has not been prepared for the Agency's various operational phases.
- Effect:* Staff changes or significant absences could result in critical disruptions of Agency operations or in required policies not being followed.
- Cause:* Available staff time continues to be devoted primarily to completing required daily operations.
- Recommendation:* The Board should prepare formal written procedures addressing the various operational phases of the Connecticut Teachers Retirement System. (See Recommendation 5.)
- Agency Response:* "We agree with this finding. TRB has recently integrated to a single database for both its recordkeeping and payroll functions. Most functions and procedures have been documented and staff have received formal and informal training. A long-term goal is to document all policies and procedures on a web-based version (intra-net) so that all staff members will have ready access to this information."

Lack of Checking Account Reconciliation:

- Criteria:* Proper accounting and good internal control require the following:
- The Board should maintain a record of all retirement benefit checking account transactions and such record needs to be independently reconciled to bank statements periodically in a timely manner.
- Condition:* We continued to note the following deficiency.
- Although the Board can determine on an individual basis those checks that are currently outstanding and the total amount of outstanding checks, they do not maintain comprehensive accounting records detailing the transactions and balance of the retirement benefit checking account. Thus, Agency records were inadequate to reconcile to bank statements and reconciliations were

not performed.

Effect: These conditions increase the potential for errors or undetected fraud, and weaken financial reporting.

Cause: The Agency has indicated that these conditions are due to a lack of sufficient staffing.

Recommendation: The Board should develop and maintain accounting records for the retirement benefit checking account and reconcile these records to the bank statements in a timely manner. (See Recommendation 6.)

Agency Response: “We agree with this finding. TRB’s new payroll system now has the capability to interface with the benefit payment checking account. This allows TRB to determine on an individual basis those checks that are currently outstanding and the total amount of outstanding checks.”

Documentation - Retirement Payments Detail:

Criteria: Good business practice and sound internal control principles require that important fiscal and tracking documentation of payments to retirees be readily available for verification and to ensure that unauthorized or incorrect data has not been entered on the retirement accounts.

Condition: Various documents such as withholding tax changes, direct deposit authorizations, name and address changes, etc. are not being maintained in the retirees' files. Such documentation is generally being kept in monthly batches according to the date it was entered into the computer. Data from the computer, however, provides only a limited accounting/audit trail. For certain changes, the computer screen shows only the date of the last entry. (Source documentation is filed in batches by date. As a result, knowing the dates of particular transactions would enable retrieval of source documents.) This means that changes before the last update apparently would not be identified and therefore could not be easily traced.

Effect: We could not readily verify certain payment information. Also, the absence of readily available documentation increases the risk that errors or fraud could occur and not be detected. In addition, if a question or problem concerning such documentation occurred, the Board might not readily, if at all, find such documentation.

Cause: The Agency acknowledges that it would be a good idea to have all source documents placed in the retiree's files. It feels, however, that it does not have the staff time to accomplish this task without decreasing its effectiveness in processing retirement benefits. The fact that the computer is limited to showing only the date of the last update for certain transactions seems to be the result of data processing limitations.

Recommendation: The Board needs to provide an improved accounting/audit trail over all retirement account information. (See Recommendation 7.)

Agency Response: “We agree in part with this finding. Again staffing levels and the volume of forms received require that we prioritize what forms and documents are a critical part of the member’s file or history. Imaging of documents would be the ultimate solution. However, TRB does not have the resources to take advantage of this technology.”

Data Verification:

Background: The Board is required to track the death of active teachers, inactive non-retired members, retired members, spouses of retired members, and surviving spouses of retired members. The deaths of such participants should result in the cessation of payments to retirees, and/or cessation of health insurance payments or reimbursements and may result in the payment of refunds and survivorship benefits. When retirees or retirees’ spouses die, the Board should, of course, remove them from its records to stop retirement payments and/or insurance coverage. For notification of these deaths the Board often must rely upon such things as newspaper obituaries, notification from the family and notification by the town for the death of retirees' and covered spouses on reimbursed town plans. The Board cannot completely rely on these sources, however, to provide them with timely information. As a result the Board might not discover such deaths until much later.

Criteria: Sound business practice requires that the Board independently verify that all deceased retirees and spouses have been removed from its retirement and insurance records. One way to do this would be to provide an outside vendor with a tape containing social security numbers of all retirees and their spouses. This could then be compared by the vendor to a database of social security numbers of deceased individuals.

In addition, sound business practice requires that the Board document information obtained concerning the death of system participants.

- Condition:* We noted that the Board has recently done a computer match of retirees and their covered spouses to determine if any had become deceased. This was accomplished by hiring The Berwyn Group, an outside vendor, to perform a “death audit” of anyone collecting retirement checks from the Board. This match was completed in February 2003. Social security numbers of retirees and their covered spouses were matched to death files on the social security and other pertinent websites. There is no on-going procedure that routinely performs the data matches. The Board previously performed a match in 1999. The Board reported that it is in the process of editing its files based on the information contained in the Berwyn Group match report. The editing process was not complete by the conclusion of our fieldwork.
- Effect:* If the Board is not notified or if it is notified but fails to record the death of a retiree or a retiree's spouse, overpayments could result.
- The lack of a process to periodically perform data matches increases the risk that errors could be made and not detected.
- Cause:* The Board noted that time constraints and costs are the reasons given for not performing on-going computer match procedures to continuously update the health insurance records.
- Recommendation:* The Agency should improve the documentation and verification of its database of system participants. (See Recommendation 8.)
- Agency Response:* “We agree with this finding. See our response to Recommendation No. 1- Editing Current Listing of Retirement Enrollees. TRB’s goal is to perform a death match for benefit payments and health insurance benefits semi-annually.”

Lack of Accounts Receivable and Accounts Payable Systems:

- Criteria:* Proper accounting and good internal control require the following:
- An accounts receivable system to track monies due and record monies received should be set up when funds are due to the Agency. This accounts receivable system should follow principles set out in the State Accounting Manual.

An accounts payable system to track monies owed and record monies paid should be set up when funds are due to surviving relatives.

Condition: We continued to note the following deficiencies.

Receivables and payables - Until April 1995, the Agency had maintained a monthly running record of accounts receivable due from and amounts payable due to the estates of deceased retirees. When the Agency stopped maintaining this record, payables to deceased retirees amounted to \$916,876 and receivables from the estates of deceased retirees amounted to \$288,569.

Effect: The Board cannot provide account balances for receivables and payables related to deceased retirees.

Cause: The Agency has indicated that the absence of accounting records over these totals does not hinder it in processing payments or collecting receivables when surviving relatives are located or request payment from the Board.

Recommendation: The Board should develop and implement accounts receivable and accounts payable systems that address reimbursements due to and from the Board. (See Recommendation 9.)

Agency Response: “We agree with this finding. Several years ago, TRB discontinued the process of prorating monthly benefits when a member died, thereby, in most cases eliminating the need to pay the member’s estate a portion of the member’s monthly benefit. TRB now has a process in place to refer any outstanding obligations or payments due to TRB directly to DAS - Financial Service Center for collection.”

Credited Interest Calculation:

Criteria: Subsection (8) of Section 10-183b of the General Statutes states that credited interest “means interest at the rate from time to time fixed by the Board which shall be substantially that earned by the funds of the system.” That seems to indicate that annual credited interest rates be approximately equal to the system’s investment earnings in the same time period.

Condition: In changing its method of calculating the annual interest credit, the Board put into practice a “smoothed market value procedure”. That procedure does not include all of a year’s annual investment

earnings in that year's calculation. A portion of the annual investment earnings (including unrealized gain/losses) is recognized in the same year. The rest of that year's earnings is phased in over the next ten years. The procedure also includes phasing in, over a nine year period starting June 30, 1996, the difference between book (cost) value and market value of investments. We determined that the Board has not obtained legal clarification concerning this method (smoothed market value procedure) of calculating the annual interest credit to members.

Effect: Under the smoothed market value procedure the annual interest credit rate does not tend to be equal to the amount "substantially earned" by the system's investments in that year. As a result, the Board may not be in compliance with the requirements of subsection (8) of Section 10-183b of the General Statutes.

Cause: The Board believes that the smooth market value procedure will stabilize the credited interest rate over time by minimizing the effects of any wide market fluctuations. They also anticipate that the method will minimize the possibility that market value depreciation will result in the calculation of a negative interest credit rate.

Recommendation: The Board should seek a legal opinion as to whether the "smoothed market value procedure" of calculating the annual interest credit to members complies with Section 10-183b, subsection 8 of the General Statutes. (See Recommendation 10.)

Agency Response: "We do not agree with this finding. The Board has accepted the recommendation of its actuary to average the interest gains and losses related to credited interest to avoid volatility based on market value fluctuations and does not believe there is any conflict with the existing statute since any gains or losses will ultimately be applied over a period of time. This method is also consistent with the method used to determine the actuarial value of assets."

Auditors' Concluding Comments This is a repeat recommendation. The issue of the method that the Board uses to determine the actuarial value of its assets is a different issue than the method that the Board uses to calculate the annual interest credit to members. The requirements of each are covered under different laws. The actuarial value of assets is determined as part of the actuarial determination required under Section 10-183z and subsection (1) of Section 10-183b of the General Statutes. It is subject to the terms of those statutory provisions. The issue of how the Board calculates the annual interest credit to members is subject to the stipulations of part (8)

of Section 10-183b of the General Statutes. This Office intends to seek an opinion on this matter from the Office of the Attorney General.

RECOMMENDATIONS

Our prior report contained a total of 13 recommendations. Of those recommendations, five have been implemented or otherwise resolved. The status of recommendations contained in this prior report is detailed below.

Status of Prior Audit Recommendations:

- The Board should review, update and improve procedures over its health insurance program. In revised form, this recommendation is being repeated as Recommendation 1.
- The Board should develop a system to survey members' requirements and satisfaction. This recommendation is being repeated as Recommendation 2.
- Periodic financial reports should be submitted to Board members. This recommendation has been satisfied.
- The Board should develop a formal strategic plan. This recommendation is being repeated as Recommendation 4.
- The Board should prepare formal written procedures covering the various operational phases of the Connecticut Teachers' Retirement System. This recommendation is being repeated as Recommendation 5.
- The Board needs to improve its financial controls and recordkeeping. This recommendation is being repeated in part as Recommendation 6.
- The Board needs to provide an improved accounting/audit trail over all retirement account information. This recommendation is being repeated as Recommendation 7.
- The Agency should improve the documentation and verification of its database of system participants. This recommendation is being repeated as Recommendation 8.
- The Board should obtain from its actuary documentation for the calculations related to the excess earnings account. This recommendation has been satisfied.
- The Board should verify significant account balances by preparing formal analytical tests of such accounts and/or the reconciliation of various account balance changes. This recommendation has been satisfied.
- The Board should seek legal clarification concerning its new method (smoothed market value procedure) of calculating the annual interest credit to members. This recommendation is being repeated as Recommendation 10.

- The Board should improve the monitoring over its contracts. This recommendation has been satisfied.
- The Agency should establish a formal payroll review and approval process. This recommendation has been satisfied.

Current Audit Recommendations:

- 1. The Board should routinely update its current listing of retirees and participants to assure appropriate payment of health insurance subsidies and administrative fees.**

Comments:

We noted that the Board did not maintain a centralized listing of retirees and/or covered spouses that was continually edited with deceased participant information. The Board remains unable to perform timely reconciliations of billings for administrative fees or insurance charges to a continually updated participant listing.

- 2. The Board should develop a system to survey members' requirements and satisfaction with service.**

Comments:

Despite the establishment of a Vision Statement, a Mission Statement, goals, and objectives that include meeting the needs of and providing quality service to members, the Board does not have any program in place to measure how well it is meeting this ideal.

- 3. The controls over receipt of checks should be improved to ensure prompt deposit of receipts in accordance with statutory requirements and the Board should perform a reconciliation of accounts to verify deposit of all checks received.**

Comment:

We noted late deposits of checks by the Board. In addition, the TRB does not reconcile the deposit slips stamped by the bank to the Receipts Log maintained by the Board to verify the actual deposit of the checks.

4. The Board should develop a formal strategic plan.

The Board has identified a number of goals and objectives to pursue for the betterment of the TRB. The development of a formal strategic plan could help the Board attain these goals and objectives.

5. The Board should prepare formal written procedures addressing the various operational phases of the Connecticut Teachers Retirement System.

Comments:

Such procedures are an important part of a sound system of internal control. They are particularly important for an operation as complex as the Connecticut Teachers' Retirement System. A set of comprehensive written procedures has not been prepared for the Agency's various operational phases.

6. The Board should develop and maintain accounting records for the retirement benefit checking account and reconcile these records to the bank statements in a timely manner.

Comments:

Although the Board can determine on an individual basis those checks that are currently outstanding and the total amount of outstanding checks, they do not maintain comprehensive accounting records detailing the transactions and balance of the retirement benefit checking account. Thus, Agency records were inadequate to reconcile to bank statements and reconciliations were not performed.

7. The Board needs to provide an improved accounting/audit trail over all retirement account information.

Comments:

Various retirement account documentation (such as withholding tax changes, direct deposit authorization forms, name and address changes, etc.) is not maintained in the retirement files for each retiree. Some of this documentation does not seem readily retrievable. As a result, we could not easily verify certain retirement payment information. Also, the absence of readily available documentation over retirement account information increases the risk that errors or fraud could occur and not be detected by the Board. In addition, if a question or problem concerning such documentation occurred, the Board might not find such documentation readily, if at all.

8. The Agency should improve the documentation and verification of its database of system participants.

Comments:

We noted that the Board has recently done a computer match of retirees and their covered spouses to determine if any had become deceased. However, there is no on-going procedure that routinely performs the data matches. The Board previously performed a match in 1999. The Board reported that it is in the process of editing its files based on the information contained in the Berwyn Group match report. The editing process was not complete by the conclusion of our fieldwork.

9. The Board should develop and implement accounts receivable and accounts payable systems that address reimbursements due to and from the Board.

Comments:

The Board has not maintained accounting records over receivables and payables resulting from the death of retirees. Thus, the total of these accounts cannot be readily identified.

10. The Board should seek a legal opinion as to whether the “smoothed market value procedure” of calculating the annual interest credit to members complies with Section 10-183b, subsection 8 of the General Statutes.

Comments:

Pursuant to subsection (8) of Section 10-183b of the General Statutes, the Board adds annual interest to non-retired members’ balances. That subsection (8) states that credited interest “means interest at the rate from time to time fixed by the Board which shall be substantially that earned by the funds of the system.” That appears to require that credited interest rates be substantially at the same rate as the system’s investment earnings in the same time period. Beginning in the fiscal year 1996-1997, the Board used a method (“smoothed market value procedure”) that spreads out the recognition of annual investment earnings over ten years. Also, the method phases in over nine years the difference between book (cost) value and market value of investments at June 30, 1996.

The Board should seek legal clarification of its authority to use this method to calculate the annual interest credit to non-retired member’s balances. This can be done by obtaining an Attorney General’s opinion or by seeking clarifying legislation.

INDEPENDENT AUDITORS' CERTIFICATION

As required by Section 2-90 of the General Statutes we have audited the books and accounts of the Teachers' Retirement Board for the fiscal years ended June 30, 1999, 2000, 2001 and 2002. This audit was primarily limited to performing tests of the Agency's compliance with certain provisions of laws, regulations, contracts and grants, and to understanding and evaluating the effectiveness of the Agency's internal control policies and procedures for ensuring that (1) the provisions of certain laws, regulations, contracts and grants applicable to the Agency are complied with, (2) the financial transactions of the Agency are properly recorded, processed, summarized and reported on consistent with management's authorization, and (3) the assets of the Agency are safeguarded against loss or unauthorized use. The financial statement audits of the Teachers' Retirement Board for the fiscal years ended June 30, 1999, 2000, 2001 and 2002 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 generally accepted auditing standards and the standards applicable to financial-related 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 Teachers' Retirement Board complied in all material or significant respects with the provisions of certain laws, regulations, contracts and grants and to obtain a sufficient understanding of its 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 Teachers' Retirement Board is the responsibility of the management of the Teachers' Retirement Board.

As part of obtaining reasonable assurance about whether the Agency 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 Agency's financial operations for the fiscal years ended June 30, 1999, 2000, 2001 and 2002, 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 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 Teachers' Retirement Board 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 Agency. In planning and performing our audit, we considered the Agency's internal control over its financial operations, safeguarding of assets, and compliance with requirements that could have a material or significant effect on the Agency's financial operations in order to determine our auditing procedures for the purpose of evaluating the Teachers' Retirement Board'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 Agency'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 Agency's financial operations, safeguarding of assets, and/or compliance that, in our judgment, could adversely affect the Agency'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 the following findings represent reportable conditions: the absence of a reconciliation of the retirement benefits checking account and the failure to complete a database verification of retired membership.

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 Agency's financial operations or noncompliance which could result in significant unauthorized, illegal, irregular or unsafe transactions to the Agency 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 Agency'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, of the reportable conditions described above, we believe the absence of a reconciliation of the retirement benefit checking account is a material or significant weakness.

We also noted other matters involving internal control over the Agency'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 Governor, the State Comptroller, 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

We wish to express our appreciation for the cooperation and courtesies extended to our representatives by the personnel of the Teachers' Retirement Board during this examination.

Josepha M. Brusznicki
Principal Auditor

Approved:

Kevin P. Johnston
Auditor of Public Accounts

Robert G. Jaekle
Auditor of Public Accounts

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