

STATE OF CONNECTICUT



*AUDITORS' REPORT
TEACHERS' RETIREMENT BOARD
FOR THE FISCAL YEARS ENDED
JUNE 30, 2014, AND 2015*

AUDITORS OF PUBLIC ACCOUNTS
JOHN C. GERAGOSIAN

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AUDITORS OF PUBLIC ACCOUNTS

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November 17, 2016

AUDITORS' REPORT TEACHERS' RETIREMENT BOARD FOR THE FISCAL YEARS ENDED JUNE 30, 2014 and 2015

We have audited certain operations of the State of Connecticut – Teachers' Retirement Board in fulfillment of our duties under Section 2-90 of the Connecticut General Statutes. The scope of our audit included, but was not necessarily limited to, the fiscal years ended June 30, 2014 and 2015. The objectives of our audit were to:

1. Evaluate the board's internal controls over significant management and financial functions;
2. Evaluate the board's compliance with policies and procedures internal to the department or promulgated by other state agencies, as well as certain legal provisions; and
3. Evaluate the economy and efficiency of certain management practices and operations, including certain financial transactions.

Our methodology included reviewing written policies and procedures, financial records, minutes of meetings, and other pertinent documents; interviewing various personnel of the department, and testing selected transactions. We obtained an understanding of internal controls that we deemed significant within the context of the audit objectives and assessed whether such controls have been properly designed and placed in operation. We tested certain of those controls to obtain evidence regarding the effectiveness of their design and operation. We also obtained an understanding of legal provisions that are significant within the context of the audit objectives, and we assessed the risk that illegal acts, including fraud, and violations of contracts, grant agreements, or other legal provisions could occur. Based on that risk assessment, we designed and performed procedures to provide reasonable assurance of detecting instances of noncompliance significant to those provisions.

We conducted our audit in accordance with the standards applicable to performance audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform our audit to obtain sufficient,

appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides such a basis.

The accompanying Résumé of Operations is presented for informational purposes. This information was obtained from the department's management and was not subjected to the procedures applied in our audit of the department. For the areas audited, we identified:

1. Deficiencies in internal controls;
2. Apparent noncompliance with legal provisions;
3. Need for improvement in management practices and procedures that we deemed to be reportable.

The State Auditors' Findings and Recommendations in the accompanying report presents any findings arising from our audit of the Teachers' Retirement Board.

COMMENTS

FOREWORD

Section 10-183*l* of the General Statutes established the Teachers' Retirement Board (TRB). 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 fourteen member board consists of:

- Three ex-officio members – Commissioner of the Department of Education, State Treasurer and the Secretary of the Office of Policy and Management (or their designees)
- Six system participants (four active and two retired teachers) elected by their peers
- Five gubernatorial appointees

Pursuant to Section 10-183*l* of the General Statutes, board members serve without compensation, but any expenditures or loss of salary or wages incurred through their service on the board is reimbursable.

The following persons were members of the Teachers' Retirement Board as of June 30, 2015:

Elected Teacher Members:

Retired Teachers:

Clare H. Barnett, Chairperson
Roselyn B. Schoonmaker

Active Teachers:

Al Bredehorst
Michael L. Freeman

Maureen Honan
William Myers

Public Members:

Charles Higgins
Jonathan Johnson
Elaine T. Lowengard
Clifford Silvers
1 Vacancy

Ex Officio Members:

Dianna R. Wentzell, Commissioner, State Department of Education
Denise L. Nappier, Treasurer, Office of the State Treasurer
Benjamin Barnes, Secretary, Office of Policy and Management

Darlene Perez has served as board secretary (administrator) since September 20, 2004.

Other members who served during the audited period were Eugene Cimiano, Lisa Mosey, Michael Freeman, and Stefan Pryor.

The board administers a state subsidized defined-benefit retirement system for public school educators who are employed at least half-time. These educators are not covered by Social Security for their teaching service. The retirement system offers normal, proratable, and early retirement after certain vesting periods. The board also provides health insurance for some retired teachers and their spouses and partially reimburses towns that provide health insurance for those retirees and spouses not covered by the board's health plan.

Membership is compulsory for public school teachers employed at least half-time in a position requiring certification by the State Board of Education. The professional staff of the State Board of Education and the constituent units of the state's higher education system can participate or they can belong to the State Employees Retirement System. Alternatively, certain eligible higher education employees may participate in an alternate retirement program authorized by subsections (u) and (v) of Section 5-154 and subsection (g) of Section 5-160 of the General Statutes.

As of June 30, 2015, according to the board's administrative report, there were 72,754 non-retired members, of whom 53,528 were actively teaching. Active teaching members are required to contribute seven and one quarter percent of their pensionable salary to the retirement fund with six percent helping to finance retirement benefits and the remaining one and one quarter percent helping to finance retiree health insurance. The six percent is credited to the members' account balance and is refundable to members leaving the system, but the one and one quarter percent is not credited to the member's account balance and is not refundable.

Retired teachers and their spouses participating in Medicare Part A and Part B may join the Teachers' Retirement Board's health insurance plan. The retired teacher pays a set premium for the coverage. This premium is subsidized by the previously discussed one and one quarter percent contribution of active teachers, by state appropriations and by investment income. Retired teachers and their spouses not eligible for Medicare Part A and Part B may continue their

health insurance coverage through the last town that employed them as teachers. The town must charge the retired teacher the same premium assessed for active teachers. To offset their cost, the employers (typically boards of education) are subsidized by the TRB. As of June 30, 2015, the subsidy payment for the retired member is up to \$220 monthly plus an additional amount up to \$220 monthly for an enrolled spouse. The subsidies reduce the cost that retired teachers have to pay their former employer.

Except for inactive teachers who have not taught for over 25 years, the board annually adds interest to active and inactive members' account balances. Prior to the fiscal year ended June 30, 1997, interest rates were based on the system's annual investment earnings actually received on a cash basis. After June 30, 1997, upon its actuary's advice, the board changed to a smooth market value basis method of calculating interest, averaging out year-to-year interest variances over a number of years, thereby decreasing large annual swings of interest earned. Those interest rates for the two audited years compared to the previous year are as follows:

Fiscal year 2013-2014	6.7%	Computed on the June 30, 2015, member's account balance
Fiscal year 2012-2013	6.8%	Computed on the June 30, 2014, member's account balance
Fiscal year 2011-2012	7.2%	Computed on the June 30, 2013, member's account balance

In the event a member's participation in the retirement system terminates during the fiscal year, the interest rate is prorated monthly and applied to the member's balance as of the previous June 30th.

The retirement system is funded by member contributions, state contributions, and investment earnings. As discussed more fully in the *Résumé of Operations* section below, required state funding is actuarially determined, whereas member contributions are defined by statute as a set percentage of a teachers' salary. Section 10-183z of the General Statutes provides for a phase-in of full funding. Beginning in the 1992 - 1993 fiscal year, 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 enhanced benefits.

Pursuant to subsection (c) of Section 10-183l 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, 2014, actuarial evaluation reported an unfunded accrued liability for retirement benefits at that date of \$10,802,693,000, compared with \$11,127,397,000 at June 30, 2012.

Significant Legislation

2014-2015 Legislative Session

Public Act 15-244 Section 19: Health insurance premiums for retired teachers were split evenly between the state, the retired teachers' health fund and the retired teacher. This act

freezes the state's share, and requires that the retired teachers' health fund pay any remaining cost to ensure the retiree share of the premium remains at one-third.

RÉSUMÉ OF OPERATIONS

Fund Accounting

The Teachers' Retirement Board'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, as required by generally accepted accounting principles (GAAP) for government. 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 from the General Fund
2. Benefits are paid out of the Retirement Fund by member contributions, General Fund contributions, and investment earnings.

Teachers' Retirement Fund

A comparison of the three major recurring revenue sources of the Teachers' Retirement Fund is presented below for the audited period.

	<u>State Actuarial Funding</u>	<u>Member Contributions</u>	<u>Investment Income</u>
2014-2015	\$984,110,000	\$284,182,298	\$450,177,829
2013-2014	948,540,000	274,901,233	646,809,304

Member contributions consisted primarily of the previously mentioned seven and one quarter percent salary deduction. Employers collect these deductions and remit them to the board.

In addition to the state's actuarial funding transfer to the Retirement Fund, 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 \$16,836,244, \$16,592,321 and \$18,829,361 for the 2012-2013, 2013-2014 and 2014-2015 fiscal years, respectively. In addition to the state's contributions, federal drug subsidy contributions totaled \$10,203,832, \$9,362,367 and \$6,316,064 for the 2012-2013, 2013-2014 and 2014-2015 fiscal years, respectively. During fiscal year 2014-3015, TRB changed health plans to a plan that was not eligible for the federal subsidy, which reduced the amount received for the year. This subsidy provided General Fund financing of a portion of the board's insurance plan cost and the board's subsidy to towns covering retired teachers who obtain health insurance coverage through their last employing board of education.

Pursuant to Section 10-183z of the General Statutes, the required annual state contribution to the Teachers' Retirement Fund is determined each year by the board's actuary. The state's contribution equaled the required contribution for the audited period. See the following table:

	<u>2012-2013</u>	<u>2013-2014</u>	<u>2014-2015</u>
Actuarially Determined Funding	\$787,536,000	\$948,540,000	\$984,110,000
Actual State Contributions	787,536,000	948,540,000	984,110,000
Percentage Funded	100%	100%	100%

In addition to the actuarial funding by the state, various towns funded an early retirement program pursuant to Section 10-183j of the General Statutes. Under that program, a town may pay for the cost of some unserved additional credited service time for participating teachers. Receipts attributed to the early retirement program amounted to \$361,042, \$668,924, and \$668,924 for the fiscal years ended June 30, 2013, 2014 and 2015, respectively.

A summary of fund expenditures for the fiscal years ended June 30, 2013, 2014 and 2015, is presented below for comparative purposes:

	<u>2012-2013</u>	<u>2013-2014</u>	<u>2014-2015</u>
Retirement Benefits	\$1,625,728,865	\$1,714,465,662	\$1,773,408,533
Health Insurance Benefits	101,450,529	105,325,506	124,992,114
Contribution Refunds	14,658,485	18,241,716	50,328,762
Totals	1,741,837,879	1,838,032,884	1,741,837,879

The number of retirees and beneficiaries receiving payments increased from 33,037 in June 2013 to 35,745 in June 2015. The rise in retirement benefits from the 2012-2013 fiscal year through the 2014-2015 fiscal year is, in part, attributable to this increase, but it also reflects annual cost of living adjustments (COLA).

Pursuant to Section 10-183g of the General Statutes, retirees may be eligible to receive annual cost of living adjustments. Section 10-183g provides for differing COLA levels, depending upon the member's retirement date. Retirees are eligible for their first annual increase in the June or January following nine months of their retirement anniversary date. Members who retired before September 1992 are eligible for an annual COLA in line with increases to the Consumer Price Index; subject, however, to a minimum COLA of three percent and a maximum COLA of five percent.

The calculation differs for those who retired after August 31, 1992, and the payment of such COLA has been conditional. Subsection (l) of Section 10-183g of the General Statutes states that the cost of living adjustment will be calculated using the Social Security Administration percentage, provided no cost of living allowance shall exceed six per cent, and if the return earned by the pension assets for the preceding fiscal year is less than eight and one-half per cent, the COLA shall not exceed one and one-half per cent.

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

<u>COLA DATES</u>	<u>Retirees' Retirement Date</u>	
	<u>Prior to September 1992</u>	<u>After August 1992</u>
January 2015	3.0%	1.7%
July 2014	3.0%	1.5%
January 2014	3.0%	1.5%
July 2013	3.0%	1.5%

As noted above, health insurance benefits paid on behalf of retirees increased from \$101,450,529 in the 2012-2013 fiscal year to \$124,992,114 in the 2014-2015 fiscal year. These increases, in part, reflect increases in the number of retirees and beneficiaries and increases in the actual cost of providing healthcare benefits.

Contribution refunds are paid to non-retired teachers who terminate from public school teaching and wish to withdraw their cumulative account balances. Account balances consist of accumulated teacher contributions with credited interest. By withdrawing such funds, the teacher forfeits the right to any retirement benefit for that service. If the former teacher returns to public school teaching, the teacher will have the option of repurchasing the forfeited service. As indicated above, contribution refunds amounted to \$14,658,485, \$18,241,716 and \$50,328,762 in the 2012-2013, 2013-2014, and 2014-2015 fiscal years, respectively. In fiscal year 2014-2015 the agency expanded the definition of refunds to include lump-sum payments to beneficiaries as well as other payments, which resulted in a large increase.

A Health Insurance Premium Account was established in 1989 within the Teachers' Retirement Fund to help provide subsidized health insurance for retired teachers and their spouses. Beginning with the 1989-90 school year, active teachers were required to contribute one percent of their annual pensionable salary to this account. As the number of retirees steadily increased along with costs to the plan, the account balance continued to decline. The board ensured solvency by increasing deductibles, co-payments, and teacher contributions and by obtaining additional state funding. Effective July 1, 2004, the active teacher contribution rate was increased to one and one quarter percent. Beginning July 1, 2005, retired teachers, the state, and the Health Insurance Premium Account are required to pay one-third each of the costs for the board's basic health insurance plan. Prior to July 1, 2005, retired teachers and the state each paid 25 percent of the cost. Fifty percent was paid by the Health Insurance Premium Account. The costs of optional supplemental coverage (dental, vision, and hearing) are borne by the participating retired teachers. During the audited period, the Health Insurance Premium Account was maintained within the Teachers' Retirement Fund. According to the agency, the account balance was \$102,974,330, \$109,841,349, and \$95,361,399 at June 30, 2013, 2014, and 2015, respectively.

The State Treasurer is custodian of the Teachers' Retirement Fund investments. A comparative summary of the cost and market values of the fund's investments is presented below:

<u>As of June 30</u>	<u>Cost</u>	<u>Market</u>
2013	\$10,187,899,181	\$14,453,543,844
2014	\$10,350,435,348	\$16,220,107,287
2015	\$10,153,387,512	\$16,109,803,388

The Teachers' Retirement Fund's assets consist of the investments listed above. Per the State Comptroller's Comprehensive Annual Financial Reports, the net position (assets less liabilities) amounted to \$14,462,903,000, \$16,207,755,000, and \$16,120,053,000 at June 30, 2013, 2014, and 2015, respectively. The net position figure includes fund liabilities but does not include the actuarially determined unfunded accrued liability for retirement benefits discussed in the Foreword section of this report. Instead, that information is presented, pursuant to governmental accounting standards; in a Schedule of Changes in the Net Pension Liability and Plan Net Position table that accompanies the financial reports.

General Fund

Administrative expenses, state funding contributions, and the state health insurance subsidies are paid out of General Fund money appropriated for the board by the General Assembly. A summary of expenditures for the fiscal years ended June 30, 2013, 2014, and 2015 is presented below for comparative purposes:

	<u>2012-2013</u>	<u>2013-2014</u>	<u>2014-2015</u>
Transfers to Retirement Fund			
State Funding	\$787,536,000	\$948,540,000	\$984,110,000
Health Insurance Subsidies	15,882,645	16,630,127	18,829,361
Total Transfers	803,418,645	965,170,127	902,939,361
Administrative Expenses	1,774,577	1,801,419	2,013,686
Totals	<u>805,193,222</u>	<u>966,971,546</u>	<u>1,004,953,047</u>

As indicated, the largest payments by far were for transfers to the Connecticut Teachers' Retirement Fund for the state's funding contributions and health insurance cost subsidies.

Administrative expenses consisted primarily of personal service payments to employees that totaled \$1,402,236, \$1,402,831, and \$1,671,275 for the fiscal years ended June 30, 2013, 2014, and 2015, respectively.

STATE AUDITORS' FINDINGS AND RECOMMENDATIONS

The following recommendations resulted from our current review of the Teachers' Retirement Board:

Reemployed Teacher Health Benefits

- Criteria:* Section 10-183v of the General Statutes allows a retired teacher to be reemployed and compensated in full for up to two years in certain positions designated by the commissioner of the Department of Education or pursuant to Section 10-266p of the General Statutes. It also states that such teacher shall be eligible for the same health insurance benefits provided to active teachers by their employers and that no benefits shall be paid by the Teachers' Retirement Board under section 10-183t while the teacher is employed by the school system.
- Condition:* We noted that in three of seven instances reviewed, reemployed teachers collected 100 percent of the position's salary and continued to receive health benefits through the board under section 10-183t rather than through their employer school districts. These benefits, based on actuarial determined premium amounts, represent the equivalent of \$4,408 of premiums provided by the state and the Teachers' Retirement Fund. Actual cost to the fund can vary substantially.
- Effect:* Rehired teachers received health benefits from the board that they were not eligible to receive.
- Cause:* The Teachers' Retirement Board did not have procedures in place to prevent rehired teachers from continuing to receive health benefits under section 10-183t once they return to full-time employment under section 10-183v of the General Statutes.
- Recommendation:* The Teachers' Retirement Board should institute procedures to ensure that health benefits are provided only to eligible rehired teachers. (See Recommendation 1.)
- Agency Response:* "We agree with this recommendation. Upon discovery we immediately implemented a process to retroactively recoup health benefits paid on behalf of re-employed retired teachers, where applicable, and to suspend such benefits prospectively for newly re-employed retirees."

Outdated State Regulations

- Criteria:* The Regulations of State Agencies help to clarify the General Statutes and should reflect current information.
- Condition:* The board’s regulations have not been updated in over ten years. Certain instances were noted in which they do not reflect current law or board procedures.
- Effect:* The lack of accurate data in the board’s regulations can lead to inefficiencies and practices that are in conflict with the general statutes.
- Cause:* The board has not made updating its regulations a priority.
- Recommendation:* The Teachers’ Retirement Board should review its regulations to determine the necessary modifications or additions to reflect current statutory language and internal procedures. (See Recommendation 2.)
- Agency Response:* “We agree with this recommendation. We recently retained outside legal counsel familiar with the IRS regulations that provide guidance for qualified plans, such as the Teachers’ Retirement Board, and are engaging in a thorough review of our statutes and regulations to determine those that require revisions and/or updates.”

RECOMMENDATIONS

Status of Prior Audit Recommendations:

Our prior audit examination resulted in seven recommendations, of which one is being repeated in our current audit report. The following is a summary of those recommendations and the action taken by the Teachers' Retirement Board.

- *The Teachers' Retirement Board should institute improvements in the retiree health fund accounting to ensure it follows existing procedures, modify inadequate procedures, and create procedures where none exist to maintain necessary fiscal controls for the accurate reporting and safeguarding of assets in the retiree health fund. The Teachers' Retirement Board has implemented new procedures and has taken steps towards corrective action. This recommendation is not being repeated.*
- *The Teachers' Retirement Board should collect the information necessary to comply with Section 10-183ee of the General Statutes. The Teachers' Retirement Board has updated the beneficiary form and has dedicated more resources to address the concerns of this finding. This recommendation is not being repeated.*
- *The Teachers' Retirement Board should establish and follow procedures to properly identify, record, and resolve accounts payable and receivable. The Teachers' Retirement Board has established procedures and has improved in identifying, recording, and resolving accounts receivable and payable. This recommendation will not be repeated.*
- *The Teachers' Retirement Board should comply with the requirements of the disability allowance program. The Teachers' Retirement Board has made significant improvements to comply with the disability allowance program. This recommendation will not be repeated.*
- *The Teachers' Retirement Board should institute procedures to ensure compliance with the requirements of Section 10-183v of the General Statutes for the reemployment of retirees. The Teachers' Retirement Board has made significant improvements in meeting the requirements of Section 10-183v. This recommendation will not be repeated.*
- *The Teachers' Retirement Board should take the necessary steps to improve its internal controls by establishing, updating and maintaining formal, comprehensive written policies and procedures manuals for the accounting unit. The Teachers' Retirement Board has developed more comprehensive written procedures for the accounting unit. This recommendation will not be repeated.*
- *The Teachers' Retirement Board should review its Regulations of State Agencies to determine what modifications or additions would be necessary to reflect current statutory language as well as their internal procedures. This recommendation is being repeated. (See Recommendation 2.)*

Current Audit Recommendations:

The following recommendations resulted from our current review.

- 1. The Teachers' Retirement Board should comply with section 10-183v of the General Statutes and not provide health benefits to rehired teachers who are not eligible to receive such benefits.**

Comments:

Teachers received health benefits while employed full-time as rehired retirees.

- 2. The Teachers' Retirement Board should review its regulations to determine the necessary modifications or additions to reflect current statutory language and internal procedures.**

Comments:

The lack of accurate data in the board's regulations can lead to inefficiencies and practices that are in conflict with the General Statutes.

CONCLUSION

In 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 the course of our examination.



David Tarallo
Principal Auditor

Approved:



John C. Geragosian
Auditor of Public Accounts