

# STATE OF CONNECTICUT

AUDITORS' REPORT  
TEACHERS' RETIREMENT BOARD  
FOR THE FISCAL YEARS ENDED  
JUNE 30, 1997 AND 1998

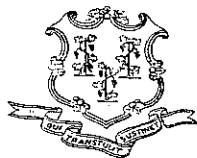
AUDITORS OF PUBLIC ACCOUNTS  
KEVIN P. JOHNSTON ❖ ROBERT G. JAEKLE

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STATE OF CONNECTICUT



AUDITORS OF PUBLIC ACCOUNTS

STATE CAPITOL

210 CAPITOL AVENUE

HARTFORD, CONNECTICUT 06106-1559

KEVIN P. JOHNSTON

ROBERT G. JAEKLE

October 4, 2000

**AUDITORS' REPORT  
TEACHERS' RETIREMENT BOARD  
FOR THE FISCAL YEARS ENDED JUNE 30, 1997 AND 1998**

We have examined the financial records of the Teachers' Retirement Board for the fiscal years ended June 30, 1997 and 1998. 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, and contracts 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, 1998:

Elected Teacher Members:

Active Teachers:

Clare H. Barnett, Chair

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Mary Nicholas

Martin Rudnick

Retired Teachers:

Rosalyn B. Schoonmaker, Vice Chair

Marion S. Jewell

Public Members:

Eugene Cimiano

Deborah Freedman

Elaine T. Lowengard

Augustine M. Masiello

Martin M. Lilienthal

Ex Officio Members:

Theodore Sergi, Commissioner of Education

Joyce A. Thomas, Commissioner of the Department of Social Services

Charles E. Moller, Jr. served during the audited period.

John R. Shears served as Board Secretary (Chief Administrator) until September 30, 1997. Effective October 1, 1997, William Sudol was appointed Board Secretary.

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, 1998, according to the agency, there were 50,589 non-retired members of which, 43,452 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 health insurance costs. Except for the one percent contribution to financing 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.

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 systems' 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. Effective June 30, 1997, interest at the rate of 10.5 percent was credited on members' account balances as of June 30, 1996. Effective June 30, 1998, interest at the rate of 13.3 percent was credited on members' account balances as of June 30, 1997. Effective June 30, 1999, interest at

the rate of 13.5 percent was credited on members' account balances as of June 30, 1998. 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:

1995-1996	8.64%
1994-1995	5.76%
1993-1994	7.53%
1992-1993	8.31%
1991-1992	8.19%

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

Partial year interest on member balances as of the preceding June 30 was credited to members withdrawing or retiring. The annual rate for such credit was 10.3 percent during 1996-1997 and 13.1 percent during 1997-1998.

As discussed more fully in the "Résumé of Operations" section below, funding for the retirement system consists primarily of members' contributions, State contributions and investment earnings. Before 1981-1982, State retirement contributions were made on a "terminal funding" basis. Under that basis, State appropriations were made for the members then retiring. The appropriation would, with such members' contributions and accumulated interest, provide sufficient funds to pay for those members' lifetime benefits.

Beginning in 1981-1982, the State began phasing in funding on an actuarial basis. Under this 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 level 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.)

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, 1998 actuarial evaluation reported that, as of that date, the unfunded accrued liability for retirement benefits amounted to \$3,249,030,560.

**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 \$2,884 and \$9,698 were made from a special revenue fund (Capital Equipment Purchase Fund) in the fiscal years 1996-1997 and 1997-1998.

**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 final fiscal year (1995-1996) of the prior audited period and the two years of this audited period.

	<u>Cash Basis</u>		
	<u>State</u>	<u>Members</u>	<u>Investment</u>
	<u>Actuarial</u>	<u>Contributions</u>	<u>Income</u>
	<u>Funding</u>		
	\$	\$	\$
1995-1996	139,953,000	157,311,757	422,325,904
1996-1997	147,884,700	166,101,294	155,597,667
1997-1998	179,365,000	170,518,696	848,953,444

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 of \$124,818,303 in the fiscal year 1995-1996, \$(156,146,313) in the fiscal year 1996-1997, and \$510,101,620 in the fiscal year 1997-1998. 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 of \$2,718,181 (the fiscal year 1995-1996), \$3,213,3603 (the fiscal year 1996-1997), and \$3,500,000 (the fiscal year 1997-1998) were made for the health insurance cost subsidy provided pursuant to Section 10-183t of the General Statutes. 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 \$173,982,000 for the fiscal year 1996-1997 and \$211,018,755 for the fiscal year 1997-1998. 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 \$147,884,700 for the fiscal year 1996-1997 and \$179,365,000 for the fiscal year 1997-1998. In both fiscal years, the funding level appropriated by the legislature represented approximately 85 percent of the amount required, as determined by the actuary, to adequately fund retirement benefits earned by teachers during those years.

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 amounted to \$6,877,413 (fiscal year 1995-1996.), \$5,537,085 (fiscal year 1996-1997), and \$7,547.776 (fiscal year 1997-1998).

A summary of Fund expenditures for the audited period as compared to the preceding year is presented below.

	<u>1995-1996</u>	<u>1996-1997</u>	<u>1997-1998</u>
	\$	\$	\$
Retirement benefits	430,066,405	468,658,505	511,189,040
Health insurance benefits	26,905,951	28,952,300	31,796,041
Contribution refunds	9,319,249	9,829,807	12,023,580
<b>Totals</b>	<b>\$466,291,605</b>	<b>\$ 507,440,612</b>	<b>\$ 555,008,661</b>

The number of retirees and survivorship beneficiaries receiving payments increased from 17,987 in June 1996 to 18,562, in June 1997 to 19,178 in June 1998.

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

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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 1996	3.0%	2.6%
January 1997	3.3%	2.9%
July 1997	3.0%	2.9%
January 1998	3.0%	2.1%

Health insurance benefits increased primarily because of the increase in retirees and the cost of medical care. Additional comments concerning insurance benefits payments are contained in the "Program Review" section of the report.

Increases in contribution refunds are attributable to increases in the number of retirements and other withdrawals as well as the credited interest increases discussed earlier. Refund amounts are based on membership status, years of service and account balances.

<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, 1996, excess earnings account balance was \$401,745,639. As of July 1, 1998, it had increased to \$1,118,495,578.

As discussed further under the caption "Program Review", 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, 1996, balance of \$14,738,254. The June 30, 1997, balance was \$12,296,649. The June 30, 1998, balance was \$7,347,009.

The State Treasurer is custodian of the Fund's investments. A summary of cost and market value of the Fund's investments as of June 30, 1997 and 1998, compared with June 30, 1996, follows:

<u>As of June 30</u>	<u>Cost</u>	<u>Market</u>
1996	\$5,367,699,272	\$7,447,243,643
1997	5,301,762,588	8,660,136,016
1998	5,971,543,339	9,971,685,707

**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 is presented below showing the last year of the prior audit and the two years of this audit.

	<u>1995-1996</u>	<u>1996-1997</u>	<u>1997-1998</u>
Transfers to Retirement Fund:	\$	\$	\$
State funding	139,953,000	147,884,700	179,365,000
Health insurance subsidy	<u>2,718,181</u>	<u>3,213,564</u>	<u>3,500,000</u>
Total Transfers	142,671,181	151,098,264	182,865,000
Administrative expenses	<u>1,536,658</u>	<u>1,683,117</u>	<u>1,848,827</u>
<b>Totals</b>	<b><u>\$144,207,839</u></b>	<b><u>\$152,781,381</u></b>	<b><u>\$184,713,827</u></b>

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 \$1,219,005 in the fiscal year 1996-1997 and \$1,197,808 in the fiscal year 1997-1998. Average employment amounted to 28 in the 1996-1997 fiscal year and 24 in the 1997-1998 fiscal year. Personal service expenditures decreased by \$21,197 over those two years reflecting the decline in employment. The decrease would have been greater except for large payments in the second year for accrued vacation and sick leave benefits at retirement or termination. Such payments amounted to \$3,831 in the fiscal year 1996-1997 and \$64,916 in the fiscal year 1997-1998.

General Fund receipts amounted to \$5,159 in the fiscal year 1996-1997 and \$5,414 in the fiscal year 1997-1998. They consisted of refunds of expenditures.

**PROGRAM REVIEW:**

**Health Insurance Program:**

We reviewed the Teachers' Retirement Board's statutory health insurance program for retirees.

The various subsections of Section 10-183t of the General Statutes established two categories of health insurance coverage for system retirees. The Board makes expenditures for both. Section 10-183t established the Board's plan providing coverage to participants eligible for Medicare Part A. Medicare Part A provides coverage to eligible participants who have either reached the age of 65 or are disabled. Subsection (b) of Section 10-183t requires that the last employing board of education or the State, if applicable, make available group health insurance plans for eligible retirees. Eligible participants are system retirees, spouses, or surviving spouses not eligible for Medicare Part A and therefore not eligible for participation in the Board's plan. The Board quarterly reimburses the towns and the State for system retirees and retirees' spouses in their plans. During the audited period, the subsidy to a town was required to be no higher than the Board's cost of its own plan. If the town's rate was less than the Board cost, the Board paid the town's rate. If the town's premium was higher than the subsidy, the town paid the difference itself or required covered participants to pay the difference. The Board's subsidy, however, is made on behalf of the participants. Accordingly, towns must first apply any increases in the subsidy to the cost charged to participants.

The General Assembly had established two insurance expenditure accounts to finance the health insurance expenditures. One account is a General Fund (GF) appropriation account (#602) - Retirees Health Service Cost. The other is a retired teachers' health insurance premium account within the Teachers' Retirement Fund. The GF 602 appropriation account had financed 25 percent (45 percent for those on disability retirement) of the cost of the Board's insurance plan. The separate retired teachers' health insurance premium account is used to fund all other insurance costs. These included the remaining portion of the Board's health insurance plan and the payments to towns required by subsection (c) of Section 10-183t of the General Statutes. The retired teachers health insurance premium account is basically funded from contributions (one percent salary deduction) from each active member pursuant to subsection (d) of Section 10-183t.

In December 1992, a review by the Board indicated that the funding of the health insurance premium account was insufficient to cover required future insurance costs. Beginning in the fiscal year 1994-1995, the Board changed its own health insurance plan for retirees. It switched from its insurance carrier to a self-insurance plan. A third party administrator has administered the self-insurance plan. The Board reimburses the administrator for claims paid and pays the administrator a monthly administrative fee. This change seems to have resulted in an improved financial position.

Despite this, additional reviews of the health insurance program in fiscal year 1996-1997

indicated that the health insurance fund would become bankrupt by the end of the fiscal year 1997-1998. These reviews said that the required one percent contribution total from teachers has remained basically level. However, costs have increased because of medical cost inflation and the expanding retiree population.

Because of these concerns, in the beginning of the 1996-1997 fiscal year, the Board decided to implement some cost saving measures. These measures included freezing the existing reimbursement rate to the towns at \$110 per enrollee. Additional comments concerning this are made below.

Subsequently, 1998 legislation was passed revising the Board's health insurance program. That legislation (Public Act 98-155) revised Section 10-183t of the General Statutes. Effective July 1, 1998, it allows the Board to offer optional higher-cost health insurance plans to those covered by the Board's plan. It requires participants choosing an optional higher cost plan to pay the difference in cost. Prior to July 1, 1998, the Board offered a single plan. That plan was its self-insurance plan with prescription benefits but no dental, vision or hearing care coverage. It was provided free to participants. Effective July 1, 1998, the basic plan has been the Board's self-insurance plan without prescription benefits. This basic plan remains free to participants. However, participants who want prescription benefits are required to pay an additional premium. There is also additional cost to those who wish to have additional dental, vision or hearing coverage. Those eligible for the Board's basic insurance but who choose not to participate can receive free dental, vision and hearing coverage.

Also, Public Act 98-155 established a minimum contribution from the General Fund account to fund the Board's plan. In addition, it does away with the requirement that the General Fund appropriation reimburse the Board's health care cost of disability retirees at a higher rate than its regular retirees (45 percent instead of 25 percent.) The reimbursement is now 25 percent of the cost of the basic plan or the per enrollee amount (set at \$110) contributed in the fiscal year 1997-1998, whichever is greater.

The act also set a minimum subsidy to the towns. Effective July 1, 1998, the payment to the towns is to be the greater of the cost of the Board's basic plan, or the per enrollee rate paid to the towns by the Board in fiscal year 1997-1998. However, the payment is not to be more than the cost of the town's insurance. Public Act 98-155 also requires the General Fund to pay 25 percent of the subsidy to towns. (The subsidy was formally funded entirely by the active teachers' contributions via the health insurance premium account.)

Our review of the insurance program revealed other areas needing improvement or comment. Besides the comments below, our comments concerning the need for written procedures contained within the "Condition of Records" section also apply to the health insurance program.

**Plan Administrator - Transaction Processing:**

*Background:* As noted above, the Board has a self-insurance plan for applicable participants. A third party administrator administers the plan. The administrator processes claims, executes payments to the health service providers, and bills the Board for claims paid. The Board reimburses the administrator for claims paid and pays the administrator a monthly administrative fee. However, the administrator does not provide documentation and itemization for the individual health services payments made by it and reimbursed by the Board.

*Criteria:* Sound business practice, and auditing standards, Statement of Auditing Standards number 70 (SAS 70), require that when an outside service organization does such services as the processing, executing, and recording of transactions then an outside audit report on the processing of those transactions should be obtained. Two types of standardized reports exist over this area. One is a report on policies and procedures placed in operation. The other includes that information and extends the review to test of operating effectiveness.

*Condition:* The Plan administrator did not provide the Board with internal control audit reports performed according to the provisions of SAS 70 for the fiscal years 1996-1997 and 1997-1998. It should be noted that an actuary employed by the Board did an operational review of the plan administrator and issued a January 1997 report entitled "Annual Inspection". That report contained two recommendations:

1. To identify whether covered members of the Board's plan have other primary insurance coverage, the plan administrator should distribute a short questionnaire to all members. This would help identify the spouses of retired teachers, as well as spouses who may have other primary coverage, resulting in the Board's plan being secondary.
2. A random sample of approximately 50 claims should be audited (by the plan administrator) to verify that benefits are correctly loaded in the claim system. It would also confirm that claims are being coordinated correctly with other coverage.

That report, although useful, did not fulfill the requirements of SAS 70.

*Cause:* The contract in effect for the fiscal year 1996-1997 did not provide for a SAS 70 report. The contract for the fiscal year 1997-1998 did. However, we were informed that the administrator had difficulty in obtaining an accounting firm to do the audit.

*Effect:* The Board has not been getting adequate assurance that this program is operating properly. Such assurance could be provided if audit reports on the processing of transactions by the plan administrator were obtained.

*Conclusion:* We have been informed that a SAS 70 audit report has been completed for the fiscal year 1998-1999. However, as of March 2000 that report has not yet been forwarded to the Board. Pending the receipt and our review of that report, we are not making a recommendation on this matter.

### Duplicate Insurance Coverage/Subsidization:

*Criteria:* It is unnecessarily costly to taxpayers if the State provides duplicate health insurance coverage for the same individuals.

*Condition:* As of June 30, 1998, 29 individuals (retirees and spouses of retirees) were covered free of charge by both the Board's and a State Comptroller's health insurance plan. Both agencies have been making insurance payments for these individuals. The amount paid by the Board in its self-insurance plan cannot be readily determined. The Board paid its insurance administrator a monthly fee (\$6.21 in the fiscal year 1996-1997 and \$5.85 in the 1997-1998 fiscal year) for each participant and reimbursed the administrator for any claims it paid. However, the plan administrator does not provide detail on the claims it pays for each participant. The State Comptroller paid approximately \$4,000 a month to cover these individuals.

As of March 2000, the Board is without authority to limit or restrict duplicate insurance coverage by the Board and the State Comptroller for participants who are retired State teachers. However, the Board might consider adopting, pursuant to subsection (c) of Section 10-183l of the General Statutes, agency regulation over its insurance program. Such regulations could include the provision, for instance, that to join the Board's plan, eligible participants submit documentation that they have canceled participation in their local board's (or the State Comptroller's) plan or indicate that they had never participated in such a plan.

*Effect:* It appears that extra cost is being paid to provide health insurance for retired public employees and that a more coordinated insurance program might result in savings.

*Cause:* Insurance coverage for the same 29 individuals resulted from

compliance by both State agencies with its legal requirements. The Board is required to provide insurance coverage pursuant to subsection (a) of Section 10-183t of the General Statutes. Pursuant to subsection (b) of Section 10-183t and an arbitration award included in the State pension agreement, the State Comptroller has provided health insurance to Teacher Retirement System retirees who were State employees.

*Recommendation:* The Board should review, update and improve procedures over its health insurance program. (See Recommendation 1)

*Agency Response:* "There is no legal basis to deny coverage to retired members who are covered by the CTRB and SERS Plans. A legislative change to preclude duplicate coverage would be required to resolve this matter. We agree that allowing duplicate coverage is an unnecessary expenditure to the state and that appropriate legislative action should be taken."

#### **Allocation of Health Insurance Cost:**

*Criteria:* As noted above, the General Assembly has established two insurance accounts to finance the Board's health insurance expenditures. The two accounts are a General Fund appropriation account and a separate retired teachers' health insurance premium account within the Teachers' Retirement Fund. The General Fund appropriation account had been required to finance 25 percent of the cost for most participants on the Board's insurance. However, the General Fund account had been required to finance 45 percent of the cost of the plan for disability retirees. The separate retired teachers' health insurance premium account is used to fund the remaining portion of the Board's insurance plan. The retired teachers' health insurance premium account is basically funded from the required contributions from active members pursuant to subsection (d) of Section 10-183t of the General Statutes.

*Condition:* Since July 1, 1994, the Board has charged the General Fund account for 25 percent of the total cost of its plan without charging 45 percent for that portion attributable to disability retirees.

*Cause:* Since the administrator does not itemize claims, the Agency has no basis on which to separately allocate the cost of claims paid for disability retirees.

*Effect:* The failure to charge the General Fund for the proper portion of the insurance cost attributable to disability retirees resulted in the General Fund being undercharged and the separate Teacher's Retirement Fund's STIF account being overcharged during the audited period. It should be

percentage of the total plan membership. However, there is no guarantee that actual health claims paid for disability retirees would be proportional to their membership percentage.

*Conclusion:* A recommendation does not appear appropriate, since Public Act 98-155, effective July 1, 1998, did away with the requirement that the General Fund reimburse the health care cost of disability retirees at a higher rate than regular retirees.

#### **Documentation - Insurance Reimbursements to Towns:**

*Criteria:* Sound business practice requires that sufficient documentation be received before making payments.

*Condition:* The Board reimburses towns for health insurance coverage of applicable retirees and retirees' spouses. The Board has generally relied on the towns as to when to start or end payments for coverage of spouses. The Board has updated its retired members database to include the social security numbers of covered spouses on reimbursed town plans. In the future, the Board plans to contract out the checking for unreported deaths of covered spouses on town plans. However, documentation for other coverage changes would still be needed.

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

*Cause:* We were informed by an Agency administrator that because of staff time limitations a comprehensive verification of reimbursements to towns has not yet been done.

*Recommendation:* The Board should review, update and improve procedures over its health insurance program. (See Recommendation 1)

*Agency Response:* "Generally, billing statements related to health insurance benefits collectively group active and retired members making verification difficult to administer. To do so would require that all health plans use a common identifier (SSN) and that such verification be done electronically."

#### **Deceased Participants Covered by Insurance:**

*Criteria:* Good business practice requires that sufficient controls exist to provide reasonable assurance that overpayments are not made.

reasonable assurance that overpayments are not made.

*Condition:* In early 1998, an employee discovered that 150 deceased spouses and surviving spouses were covered on the Board's insurance. Later that year, in preparation for the change to a multiple policy offering as discussed above, a mass mailing was done. Responses to the mailing revealed an estimated two to three hundred additional deceased spouses and surviving spouses. The change to a multiple policy offering resulted in long lists of insurance changes. The changes for these deceased participants were just one of many insurance changes. Isolation of the exact number of deceased participants from those lists does not seem readily obtainable.

*Effect:* It appears that overpayments of monthly administrative fees were made for a number of individuals whose death had not been previously reported to the Board. Monthly per-enrollee administrative fees were \$6.21 in the fiscal year 1996-1997, \$5.85 in the fiscal year 1997-1998, and \$5.90 in the fiscal year 1998-1999. The Board stopped paying the monthly fee for the deceased individuals when the deaths were discovered. However, it did not make any retroactive adjustments for participants who had died earlier. Staff informed us that in many cases the Board did not know the date of death.

*Cause:* The Board did not receive notification of these deaths. Also, agency procedures were not sufficient to be able to independently check for such death. As noted above, the Board has updated its database of retired members to include the social security numbers of all spouses and surviving spouses. In the future, the Board plans to contract out to check for unreported deaths of covered spouses on its own plan. However, as of February 2000, this step had not yet been taken.

*Recommendation:* The Board should review, update and improve procedures over its health insurance program (See Recommendation 1.) Also, the Agency should improve the documentation and verification of its database of system participants. (See Recommendation 8.)

*Agency Response:* "The Board intends to use an independent contractor to periodically compare its files against the death record of the Social Security Administration. This will allow the Board to recover funds that may have been paid for health insurance benefits following the death of the member /spouse."



**Underpayment of Health Insurance Reimbursement to Towns:**

- Background:* As noted above, the Board reimburses towns for part of the towns' health insurance cost of various system participants.
- Criteria:* Prior to its revision by Public Act 98-155, subsection (c) of Section 10-183t of the General Statutes required this reimbursement to be at the same rate the Board pays for participants on its own plan. Since the Board had been self-insured and did not pay insurance premiums, the Board's actuary would periodically calculate the per participant cost of its insurance program. This cost would be used as the reimbursement rate to towns.
- Condition:* However, in September 1996, the Board decided to freeze the per-enrollee reimbursement rate to the towns at \$110 a month. This was done despite the fact that it was below the per enrollee rate it was then paying on its own plan.
- Effect:* The freezing of the monthly town rate resulted in underpayments compared to payments that would have been made based on the Board's cost of its own plan. Based on that cost in the fiscal years 1996-1997 and 1997-1998, it appears the Board under-reimbursed towns by up to approximately \$2,900,000 for those periods. An exact amount cannot be readily determined. This is because the Board reimburses towns for participants at the lesser of its cost or the town's cost. (We were informed that in the vast majority of cases the towns' cost exceeds the Board's cost.) The reimbursement to the towns is made on behalf of its participants. That is, towns are required to first apply the Board's reimbursement to any cost charged to participants. As a result, some participants might have paid more to the town for their insurance. In other cases, towns paid more for this insurance.
- Cause:* The Board froze the reimbursement rate as part of various steps to ensure the solvency of the insurance fund.
- Conclusion:* No recommendation appears warranted. Public Act 98-155, effective July 1, 1998, revised the payment rate to towns. It also, under certain conditions, legalized the continuation of the frozen rate.

## CONDITION OF RECORDS

Areas warranting comment are presented below.

### Quality of Services Provided:

*Background:* The Board has established a Vision Statement, a Mission Statement and a list of goals and objectives. Its Vision Statement is the following:

“The vision for the Teachers’ Retirement Board is to develop and maintain a partnership with the local school district resulting in effective use of resources to provide accurate, up-to-date information tailored to:

- Meet member’s needs,
- Address the concerns of all stakeholders, and
- Support the timely payment of benefits.”

Its Mission Statement is the following:

“To Obtain Adequate Funding To Pay All Benefits, And To Effectively Administer The Retirement System; To Protect And Administer The Statutory Rights And Benefits Of Members Of The State Teachers’ Retirement System; And To Provide Pre/Post Retirement Services.”

Along with its Vision and Mission Statements above, the Board established a number 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 moneys 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 satisfactions. 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 satisfactions. (See Recommendation 2.)

*Agency Response:*

"We concur with this recommendation. A staff member has been permanently reassigned to deal exclusively with communications, including Internet Access, publications, newsletters etc. It is our intent to use our website and newsletter to conduct a survey of member requirements and satisfaction as a tool to quantify outcome measures related to the quality of service."

**Financial Reporting:**

*Criteria:*

One of the objectives of the Board is to "Produce complete statements

according to generally accepted accounting principles and disseminate to all concerned parties.”

The development of complete financial statements would provide useful informative reports to its Board, its management, and other important parties (such as the Governor, the Legislature, active and retired members, and taxpayers.)

Board members have fiduciary responsibilities as part of their service on the Board.

*Condition:* Board members meet their fiduciary responsibilities in a number of ways. For instance, they approve and are given a copy of the retirement register showing new retirements totals, they do the same for a listing of survivor payments, and for the Medical Review Committee reports of applications for disability retirements. However, Agency staff does not prepare periodic financial reports for the Board. Reports showing itemized comparative receipts and expenditures totals for the Retirement Fund and the insurance account, for instance, could be prepared. Such reports would provide Board members with useful information.

*Effect:* It appears that Board members are meeting their fiduciary responsibility. The submission by staff of periodic financial reports to Board members however, would better enable them to meet that responsibility.

*Cause:* We did not determine the cause.

*Recommendation* Periodic financial reports should be submitted to Board members. (See Recommendation 3.)

*Agency Response:* “The Board will be provided with a summary of monthly retirement and health insurance expenditures as well as a copy of the agency’s monthly B-66 Form related to budgeted expenditures for the fiscal year.”

### **Strategic Planning:**

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

*Condition:* The Board does not prepare formal strategic plans. A number of its written objectives lend themselves to collaboration and establishing timed targets that could be facilitated by a formal strategic planning process. Those goals, for instance, include:

- “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.”

*Effect:* A formal strategic planning process could strengthen Board planning.

*Cause:* The development of a formal strategic plan would tie up significant staff time. Available staff time continues to be devoted to completing daily operations. 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 concur with this recommendation and believe that the Board should establish formal written goals and objectives as they relate to the delivery of services, funding of the system, and administration technology advancements.”

#### **Work Processing – Retirements:**

*Criteria:* Ideally, workload requirements such as the processing of retirement applications should, as far as possible, be balanced throughout the year.

*Condition:* In typical situations employees retire randomly during the year. However, Teachers typically retire at the same time – the end of the school year in June. Also, we were informed that a high percentage of retiring teachers (perhaps as much as 70 percent) purchase additional credited service upon retirement.

*Effect:* An unbalanced workload could cause administrative problems. For

instance, errors are more likely to occur when processing is skewed during a limited time period.

*Cause:* Teacher retirements are inherently skewed to occur at the end of the school year. In addition, under subsection (c) of Section 10-183e of the General Statutes certain additional service time is normally only purchasable by Connecticut teachers upon retirement.

*Conclusion:* We are not making a recommendation at this time. Staff informed us that they are considering introducing legislation that would enable teachers to buy such service at any time while actively teaching instead of only at retirement. (Of course, before doing that, the Board's actuary should review the effects of such legislation on State funding requirements.)

We might also add that a formal strategic planning process might be useful in eliciting and examining various options to smooth out the processing cycle.

#### **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 covering the various operational phases of the Connecticut Teachers Retirement System. (See Recommendation 5.)

*Agency Response:* "The Board recently implemented a new MMS (Manage Membership System) affecting its active database and reporting system and plans to modify its retired payroll system (BPM) within the next eighteen months. Inherent within these systems' changes will be formalized written procedures and documentation. The MMS system includes comprehensive documentation needed to fulfill user requirements."

Similarly, the MMS system will also include formal written documentation. The Board has recently updated its Administrative Procedures Manual and intends to develop an Intra-Net Site and to use new technology to formalize procedures and policies.”

**Financial Recordkeeping:**

*Criteria:* Proper accounting and good internal control require the following:

- a. Retirement benefit account - the Board should maintain a record of all checking account transactions and such record needs to be independently reconciled to bank statements in a timely basis.
- b. Receivables and payables - deceased retirees - accounting records should be maintained of accounts receivable and payable for deceased retirees.

*Condition:* We continued to note the following deficiencies.

- a. Retirement benefit account - the Board does not reconcile this significant account. They do not maintain accounting records showing the transactions and balance of this significant account. Thus, there were no agency records to reconcile to bank statements.
- b. Receivables and payables - deceased retirees - Until April 1995, the Agency had maintained a monthly running record of these totals. 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. 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. Nevertheless, the Board should maintain accounting records over these totals.

*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 needs to improve its financial controls and recordkeeping. (See Recommendation 6.)

*Agency Response:* "The Board will enter into an agreement with the Department of Administrative Services, Bureau of Collection Services to recover funds that are due the system following the death of the member and to develop internal systems to identify those accounts that are receivables/payables.

The Board will also explore through the Office of the State Treasurer and its depository account a more effective means of reconciling its retirement benefit/refund outstanding payments bank statement."

**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:* "With more than 21,000 retired teachers and approximately 44,000 active teachers, the Board must consider new technology to keep pace with the increasing volume and activity related to active/retired teacher accounts. Imaging of records electronically is a critical step in fulfilling the objective to track all changes affecting a member's account activity."

**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 likely results or should result in the payment of refunds, survivorship benefits, cessation of payments to retirees, and/or cessation of health insurance payments or reimbursements. 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' 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 death 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 have been informed that it has been a number of years since the Board last used an outside vendor to do a computer match for deceased retirees. Apparently, the Board has never done a computer match of retirees' spouses covered by health insurance.

Some employees maintain a separate listing of deceased system participants for their area of responsibility (e.g., insurance payments and survivorship payments.) However, the Board does not maintain an independent centralized list or register of deceased system participants.

*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 register of deceased system participants increases the risk that errors could be made and not detected. Also, a register would improve documentation and provide an accounting/audit trail over certain transactions. It might also enable the Board to reduce insurance expenditures. As noted in the "Program Review" section of this report, a number of deceased participants were discovered to have been covered under the Board's insurance. The Board stopped paying the monthly fee when the deaths were discovered. However, the Board did not make retroactive adjustments for participants who had died earlier. Staff informed us that in many cases the Board did not know the date of death. Such information can be obtained later. As noted under the caption "Data Verification" in the "Condition Of Record" section, the Board can use an outside vendor to do a computer match for deceased participants. It is our understanding that the information from that match would include the date of deaths of the participant. Without a centralized register, reconstruction of a list of deceased spouses previously covered by insurance may be difficult. With a register of deceased participants calculation of retroactive adjustments could easily be made.

*Cause:* As noted in the "Program Review" section, the Board updated its membership database. This update resulted in the social security numbers of covered spouses on reimbursed town plans being added to the Board's records. The Board had intended to provide an updated tape containing the social security numbers of retirees and their covered spouses to an outside vendor to check for unreported deaths. Apparently, however, because of time constraints it had not done this.

We did not determine the cause for the absence of a centralized list or register of deceased system participants.

*Recommendation:* The Agency should improve the documentation and verification of its database of system participants. (See Recommendation 8.)

*Agency Response:* "The Board has retained an independent vendor to verify if a retiree/spouse had died and for which retirement or health insurance benefits were being paid. We expect to continue with this program and to test our files no less frequently than on an annual basis.

The Board's payroll [teachers' retirement payments] system contains a complete database of all living and dead members and does not believe that another system or file is necessary to track deceased participants."

**Calculation Documentation – Excess Earnings Account:**

- Background:* As discussed in the “Résumé Of Operations” section, subsection (n) of Section 10-183g of the General Statutes established an “excess earnings account” within the Teachers Retirement Fund. That account allocates part of Fund resources for possible cost of living increases (COLAs) to members who retire on or after September 1, 1992. The account is credited with annual investment returns that exceed 11.5 percent.
- Criteria:* Sound business practice requires that the calculation of transactions be documented.
- Condition:* The Board’s actuary calculates the amount to be credited to the excess earnings fund based on the State Treasurer’s investment income reporting. That actuary also calculates the amount needed to be charged to the excess earnings account for the COLAs to members who retire on or after September 1, 1992. However, the actuary did not, during the audited period, give details on the calculation of the amount to be credited to the excess earnings account for investment income and the amount to be charged for COLAs.
- Effect:* The calculations determined by the actuary cannot be readily verified. It is difficult to verify, for instance, that the actuary’s figure for investment income agrees with the figure shown by the State Treasurer. (The difference between the auditor’s and the actuary’s calculation of the credit to excess earnings is not statistically significant. However, it would be a better business practice to have the actuary’s calculation documented.) The charges to the excess earnings account to cover COLAs cannot be readily verified. It is based on information processed by a tape of data on all retirees. From a tape of the database of all retirees, the actuary extracts information on the benefits being paid to only those subject to the COLA restrictions related to the excess earnings account. It would be good business practice to have such details as the number of retirees involved and their average salary. In that case the calculation could be readily reviewed for its reasonableness. Also such information could assist the Board in the monitoring of transaction totals as discussed below.
- Cause:* We did not determine the cause.
- Recommendation:* The Board should obtain from its actuary documentation for the calculations related to the excess earnings account. (See Recommendation 9.)

*Agency Response:* "The Board will recommend that the Board's actuary provide comprehensive information related to (a) the determination of excess earnings available for distribution, (b) detailed information related to the number of accounts and associated costs to be credited or charged the excess earnings account."

**Agency Monitoring of Transaction Totals:**

*Criteria:* Board management has the responsibility to implement internal controls. Internal controls are processes providing assurance that agency operations are working properly. One component of internal control is the establishing of a formal monitoring system over financial transactions. As discussed in the "Program Review" section, preparing and reviewing periodic financial statements or reports is one way to accomplish this. Another way would be to verify significant accounts by doing formal analytical tests of account totals and reconciliations of account balance changes. Analytical tests consist of reviewing the accuracy of financial information by analyzing expected relationships between that information and other data.

For instance, the Board collects and records teachers' salaries and their contributions based on seven percent of that salary. As a result, the amount of the teachers' contributions collected is predicable by knowing the total amount of teachers' salaries. Consequently, extracting salary totals and multiplying those totals by seven percent and adjusting for beginning and ending receivables should equal the amount of such contributions deposited by the Board in that fiscal year. Doing such a review would give added assurance that salaries, revenues and receivables totals are accurate.

A formal reconciliation could also be done over the changes in members' account balances. That would provide assurance that the credits to teachers' accounts for their contributions are equal to the contributions actually received, that refunds are deducted from members' balances, and that the data processing system over teachers' contributions is providing accurate information, etc.

*Condition:* Reconciliations and analytical analysis, such as the ones discussed above, were not done for the audited period. The Board has been reconciling moneys received from towns for each teacher to his/her salary on an annual basis. The Board also annually reports to teachers their membership balances. These tests, although necessary and important, should be augmented to further ensure that all relevant data

has been entered into the system and the system is processing the information accurately.

*Effect:* The Board has a number of control processes in place. Also, management appears to be closely involved in daily operations. That involvement should help management to identify problems and inaccuracies in financial data. However, the establishment of a formal system of analytical tests of accounts and reconciliations of account balances would provide the Board with greater assurance that transactions are accurate and that accurate financial data is being produced.

*Cause:* One reason why such analyses had not been done was due to inadequacies in the Board's data processing system. However, the system has been updated and future improvements are anticipated.

*Recommendation:* The Board should verify significant account balances by preparing formal analytical tests and/or the reconciliations of various account balance changes." (See Recommendation 10.)

*Agency Response:* "The new MMS System contains the necessary edits to insure proper contributions are recorded based on the salary reported. The system also include edits and the ability to create reports to test salary variances or any other data issues necessary to insure proper internal controls."

*Auditors' Concluding*

*Comments:* We agree that the new system contains various control mechanisms. Our recommendation goes beyond that. It would establish formal procedures to annually reconcile total salaries reported to total contributions received. This would give greater assurance that all contributions have been properly recorded, that receivable totals are correct and that the system is working properly. In addition, our recommendation includes performing reconciliations of other significant account balance changes such as changes in members' account balances.

**Credited Interest Calculation:**

*Background:* As noted in the "Foreword" section of this auditors' report, the Board grants annual interest credit to non retired members' balances. The interest rate is based on the system's investment earnings. Effective with the fiscal year 1996-1997, the Board changed its method of determining the interest credit rate. Prior to that period, interest credits were based on the investment income actually realized (gains/losses on sales, dividends, and interest income) in that year. Unrealized

gains/losses (e.g., price changes of stocks not sold) were not included. Beginning in the 1996-1997 fiscal year, however, unrealized gains were included in the calculation along with realized gains.

*Criteria:* Subdivision (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 investments 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 nine years the difference between book (cost) value and market value of investments at the starting point (June 30, 1996) of the new method.

*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 subdivision (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 legal clarification concerning its new method ("smoothed market value procedure") of calculating the annual interest credit to members. (See Recommendation 11.)

*Agency Response:* "The Board has accepted the recommendation of its actuary to average interest gains and loses related to credited interest to avoid volatility based on market fluctuations and does not believe that a legal issue exists since the Board uses a similar and widely-accepted method related to determining the actuarial value of assets."

*Auditors' Concluding*

*Comments*

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 subdivision (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.

**Contract Monitoring:**

*Criteria:* Section 4-213 of the General Statutes provides that no State agencies may hire a personal service contractor without executing a personal service agreement with such contractor. Subsection (e) of Section 4a-59 of the General Statutes provides that all contracts shall be approved as to form by the Attorney General. Good business practice requires that all contractual agreements be monitored to ensure compliance.

*Condition:* Beginning on July 1, 1997, to at least February 15, 2000, the Board has been paying a contractor for services based on a personal service contractual agreement that was not properly executed. The contractor signed the contract but the Board failed to do so. Furthermore, the contract was not approved by the Attorney General as required.

This contract was between the Board and its self-insurance administrator. The contract called for Board payments of a monthly per insured administrative fee. Up until July 1, 1998, the Board had been providing insurance free to all eligible participants pursuant to Section 10-183t of the General Statutes. However, Public Act 98-155, effective July 1, 1998, revised Section 10-183t. It allows the Board to designate a basic plan and provide additional option plans at additional cost to participants. Pursuant to this change, the contractor and the Board agreed upon a range of multiple monthly fees. The per participant fees varied according to insurance plan chosen by that participant. This range of fees varied from the single fee contained in the contract. Despite this, an amended written contract was not prepared. The unsigned contract covered the period from January 1999 to December 2000. Subsequently, a new contract was signed. It was approved by the Attorney General. This new contract covers the period from April 1, 2000 to June 30, 2001.

The contract further provides that the contractor will provide for an annual internal control audit ("SAS 70" audit) of its services to the Board. It further indicates that if the cost of the SAS 70 audit was less than \$12,000 the contractor would refund the difference to the Board. For the first two years of the contract (fiscal years 1997-1998 and 1998-

1999), SAS 70 audits were not completed. The contractor indicated that there were difficulties in obtaining an accounting firm to do the audit. It would appear that the contract calls for a refund to the Board of \$24,000 for the two years that audits were not done. No refunds were provided. (A Board administrator indicated that he would follow up and review the contract to see if a refund is due.)

We also noted minor overpayments on another contract. The billed rate paid by the Board included charges in excess of the contractual rate.

*Effect:* The Board seems to be in violation of Sections 4-213 and 4a-59,(e) of the General Statutes. In addition, it appears the Board did not adequately monitor contractual provisions. It seems to have failed to timely bill the contractor for the amount of its fees allocated to be used to do the SAS 70 audit.

No ill effects resulted from the minor overpayments made on the other contract. After we brought this to the Board's attention, The Board recovered the overpayments.

*Cause:* The failure of the agency to sign the contract and submit it to the Attorney General for approval appears to have been unintentional. The administrative employee who handled this retired. Finalization of the agreement was apparently overlooked in the transition process. It also seems that the Board did not adequately monitor contractual implementation.

*Recommendation:* The Board should improve the monitoring over its contracts. (See Recommendation 12.)

*Agency Response:* "The Board has instituted controls to insure that all new or amended contracts are properly monitored and to insure that all contracts comply with the guidelines established by the Office of Policy and Management and the Office of the Attorney General."

### **Payroll Processing:**

*Criteria:* Good business practice and sound internal control principles require that as far as possible that duties over transactions be separated among different employees. This reduces the risk of error or fraud. When appropriate separation of duties is impractical, for instance because of limited business office staff, independent verifications and approvals of those transactions should be performed.



- Condition:* Payroll/personnel procedures are centralized in one person. The payroll is computer generated through the State Comptroller. The employee processing the payroll does it "on line" (virtually paperless processing through the computer.) As a result, various internal "bureaucratic" paper controls of approvals and reviews are not in place.
- Effect:* The absence of a separation of duties over the payroll puts the agency at greater risk for errors and even fraud.
- Cause:* The absence of the separation of duties in this area is the result of the fact that the Agency has a small business office staff.
- Recommendation:* The agency should establish a formal payroll review and approval process. (See Recommendation 13.)
- Agency Response:* "We concur with this recommendation and will attempt to provide independent oversight to review agency bi-weekly payroll changes."

#### **Other Matters**

Documentation of contribution refund –We noted some examples of missing documentation for contribution refunds tested by us. In addition, the Board was not able to locate for us any documentation for its June 1998 contribution refunds. Although the amount of refunds involved are not significant, the Board should exercise greater care over maintaining its documentation of contribution refunds.

## RECOMMENDATIONS

### *Status of Prior Audit Recommendations:*

- Review, update, and improve procedures over its health insurance program - In revised form, this is being repeated as Recommendation 1.
- Preparation of operations manual covering the retirement system's various operational phases - This is being repeated as Recommendation 5.
- Prepare comprehensive financial statements. - The Board's actuary has provided certain Government Accounting Standards Board (GASB) required information. The information provided appears to have satisfied the State Comptroller's requirements for the preparation of statewide financial reporting. Accordingly, this recommendation has not been repeated.
- Improved financial controls and recordkeeping - In revised form this is being repeated as Recommendation 5.
- Improved accounting/audit trail over all retirement account information - In revised form this is being repeated as Recommendation 6.
- Comply with State requirements concerning record retention and management. - The Board has filed the required schedule. Also records were not inappropriately discarded during the audited period. Accordingly, this recommendation is not being repeated.
- Follow State budgetary restrictions and accounting requirements. - Agency staff understands these requirements and complied with them during the audited period. Accordingly, this recommendation has not been repeated.
- Propose legislation that would strengthen the Board's ability to get the final reporting forms from towns on a more timely basis. - The Board installed a new computerized system that eliminates the need for year-end town reporting. Accordingly, this recommendation is not being repeated.

### *Current Audit Recommendations:*

1. **The Board should review, update and improve procedures over its health insurance program.**

Comments:

Because of applicable legal provisions, duplicating insurance coverage by the Board and the State Comptroller's Office for some retired State teachers and covered spouses exists. Also, the Board failed to obtain complete documentation for insurance coverage changes on reimbursed town plans. In addition, overpayments were made because deceased spouses of retirees were not timely removed from its insurance coverage. The Board did not receive timely notification of these deaths. However, the Board did not have sufficient procedures to be able to independently check for such deaths.

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

Comments:

The Board has established a Vision Statement, a Mission Statement, goals, and objectives that include meeting the needs of and providing quality service to members. However, the Board does not have a system to measure how well it is doing in accomplishing these pronouncements. Also, Section 4-67m of the General Statutes requires that each agency develop "quantifiable outcome measures, which shall not be limited to measures of activities".

These situations could be corrected by putting in place a system to survey members' requirements and satisfactions. That system should include provision to quantify members satisfaction with the service provided by the Board.

- 3. Periodic financial reports should be submitted to Board members.**

Comment:

Submission of periodic financial reports to Board members would help those individuals meet their fiduciary responsibilities. Those reports could, for instance, show itemized comparative receipts and expenditure totals for the Retirement Fund and the insurance account. They could also show agency General Fund budgeted expenditures.

- 4. The Board should develop a formal strategic plan.**

Comment:

Management has a responsibility to make plans regarding the operations of its agency. The Board has not developed a formal written strategic plan. The Board has

developed a number of written goals and objectives. A formal strategic planning process could help strengthen Board planning and help the Board meet its written goals and objectives.

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

Comment:

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.

6. **The Board needs to improve its financial controls and recordkeeping.**

Comments:

Accounting records are needed for the retirement benefit checking account and reconciliations are needed between such records and the bank statements. Also, 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.

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:

The Board processes a significant number of payments (including electronic bank transfers) to retirees. Also, the Board covers spouses of retirees on its health insurance plan and it reimburses towns for retirees and their spouses on town's health insurance plans. The Board discovered that overpayments were made because a number of deceased spouses of retirees were not timely taken off of its insurance coverage. For notification of participants' deaths the Board often must rely upon such things as newspaper obituaries, notification from the family of retirees, notification from retirees of the death of their spouses covered by insurance, notification by the town of the death of retirees' spouses on reimbursed town plans, etc. The Board cannot completely rely on these sources, however, to provide them with timely information. As a result the Board might not discover such death until much later. In the meantime overpayments might be made.

Sound business practice requires that the Board independently verify that all deceased retirees and their 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 the Board to document the death of system participants. One way to do this would be through a centralized register of deceased participants. The register should contain such information as the name of the deceased, the date of death (if known), the date the Board learned of the death, the membership status of the deceased and the deceased's insurance status (if applicable). This would provide an improved accounting/audit trail over transactions related to the death of system participants.

**9. The Board should obtain from its actuary documentation for the calculations related to the excess earnings account.**

Comments:

Subsection (n) of Section 10-183g of the General Statutes established an "excess earnings account". The account allocates resources of the Teachers' Retirement Fund for possible cost of living increases to members who retired after August 31, 1992. The account is credited with annual investment income that exceeds 11.5 percent. The actuary calculates the amount to be charged and credited to the account. It would be good business practice to have the documentation of the credits and charges. Such details would help the Board verify the reasonableness of not only the excess earning account total but of increases in retirement benefits. It could also assist the agency in estimating future retirement payments.

10. **The Board should verify significant account balances by preparing formal analytical tests of such accounts and/or the reconciliation of various account balance changes.**

Comments:

Board management has the responsibility to implement internal controls. Internal controls are processes providing assurance that agency operations are working properly. Such controls include the establishment of a formal monitoring system over financial data being recorded. One way to do this would be to verify significant accounts by preparing formal analytical tests of those accounts and/or the reconciliation of account balance changes. Analytical tests consist of reviewing the accuracy of financial information by analyzing predictable or expected relationships between that information and other data. For instance, total teachers' contributions of seven percent of their salary can be tested to database totals of total teachers' salary. This would give added assurance that the Board has correctly recorded contributions and that the system is working properly.

11. **The Board should seek legal clarification concerning its new method ("smoothed market value procedure") of calculating the annual interest credit to members.**

Comments:

Pursuant to subdivision (8) of Section 10-183b of the General Statutes, the Board adds annual interest to non-retired members' balances. That subdivision (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 passing clarifying legislation.

12. **The Board should improve the monitoring over its contracts.**

Comments:

Section 4-213 of the General Statutes provides that no State agencies may hire a personal service contractor without executing a personal service agreement with such

contractor. Subsection (e) of Section 4a-59 of the General Statutes provides that all contracts shall be approved as to form by the Attorney General. Good business practice requires that all contractual agreements be monitored to ensure compliance.

The Board has been making payments based on a personal service contract that had not been signed by the Agency or approved by the Attorney General. Also, the conditions of that contract changed due to the passage of Public Act 98-155. The change in conditions resulted in the Board and the contractor agreeing on changes in Board payments to the contractor. Despite this, the Board did not formally amend the existing contract or enter into a new contract.

Also, one of the conditions of that contract was that the contractor would arrange for annual internal control audits ("SAS 70" audit) of its services to the Board. Twelve thousand dollars of the Board's annual payment appears to have been set aside in the contract for the audit. The agreement indicated that if the cost for the audit was less than \$12,000, the contractor would refund the difference to the Board. The audits were not performed for the fiscal years 1996-1997 and 1997-1998. The Board did not bill the contractor for a refund.

**13. The agency should establish a formal payroll review and approval process.**

Comments:

Payroll/personnel services are centralized in one employee. This responsibility should be separated among employees. Because of the Agency's limited office staff this appears to be impractical. Absence a separation of duties, the Agency should establish a formal process of payroll review and approval by an Administrative employee.

## 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, 1997 and 1998. 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, 1997 and 1998, 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, and contracts, 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, 1997 and 1998, we performed tests of its compliance with certain provisions of laws, regulations, and contracts. 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 an instance of noncompliance that is required to be reported under Government Auditing Standards and which is described in the accompanying "Condition of Records" and "Recommendations" sections of this report. That finding is that the Teachers' Retirement Board reimbursed towns for insurance cost below the rate required by the applicable State statute.



We also 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, and contracts 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 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, and contracts. We believe the following findings represent reportable conditions: the failure to obtain an internal control audit report for the Agency's outside self-insurance administrator, the lack of accounting records and the absence of a reconciliation of the retirement benefits checking account, the lack of accounting records over receivables and payables resulting from the deaths of retirees and the failure to perform a retired membership database verification.

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 lack of accounting records and the absence of a reconciliation of the retirement benefit checking account are material or significant weaknesses.

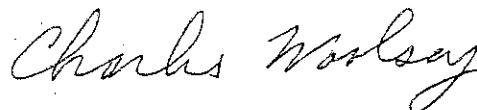
We also noted other matters involving internal control over the Agency's financial operations and over compliance which are described in the accompanying "Condition of Records" and

"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.



Charles Woolsey  
Principal Auditor

Approved:



Kevin P. Johnston  
Auditor of Public Accounts



Robert G. Jaekle  
Auditor of Public Accounts