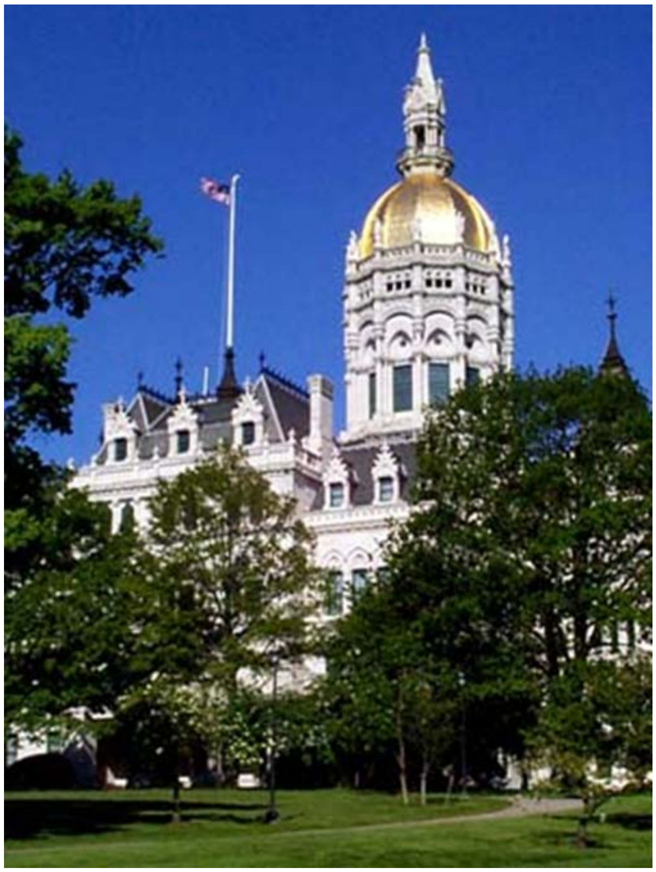
STATE OF CONNECTICUT



AUDITORS' REPORT
STATE COMPTROLLER – STATE RETIREMENT FUNDS AND STATE EMPLOYEE AND RETIREE BENEFITS
FOR THE FISCAL YEARS ENDED JUNE 30, 2012, 2013, AND 2014

AUDITORS OF PUBLIC ACCOUNTS
JOHN C. GERAGOSIAN ❖ ROBERT J. KANE

Table Of Contents

STATE OF CONNECTICUT

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August 31, 2017

AUDITORS' REPORT
STATE COMPTROLLER – STATE RETIREMENT FUNDS AND STATE EMPLOYEE AND RETIREE BENEFITS
FOR THE FISCAL YEARS ENDED JUNE 30, 2012, 2013, 2014

We have audited certain operations of the Office of the State Comptroller – State Retirement Funds and State Employee and Retiree Benefits, including the State Employees Retirement Fund, the Alternate Retirement Program Fund, the State's Attorneys Retirement Fund, the General Assembly Pension Fund, the Judges and Compensation Commissioners Retirement Fund, the Public Defenders Retirement Fund, the Probate Judges and Employees Retirement Fund, the Municipal Employees Retirement Fund and the Policemen and Firemen Survivors Benefit Fund. We have included in that examination the records pertaining to the state's Deferred Compensation Plan as well as those pertaining to the appropriations for the Alternate Retirement System, the Judges and Compensation Commissioners Retirement Fund, the various miscellaneous statutory pensions and the state's share of retirement salaries and health insurance costs for active and retired employees in fulfilment of our duties under Section 2-90 of the Connecticut General Statutes. The scope of our audit included, but was not necessarily limited to, the fiscal years ended June 30, 2012, 2013, and 2014. This audit did not include the Teachers' Retirement Fund, as a separate Teachers' Retirement Board administers that fund. The objectives of our audit were to:

1. Evaluate the office's internal controls over significant management and financial functions;

2. Evaluate the office's compliance with policies and procedures internal to the office or promulgated by other state agencies, as well as certain legal provisions; and

3. Evaluate the economy and efficiency of certain management practices and operations, including certain financial transactions.

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

We conducted our audit in accordance with the standards applicable to performance audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform our audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides such a basis.

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

1. Deficiencies in internal controls;

2. Apparent noncompliance with legal provisions; and

3. Need for improvement in management practices and procedures that we deemed to be reportable.

The State Auditors' Findings and Recommendations in the accompanying report presents any findings arising from our audit of the Office of the State Comptroller – State Retirement Funds and State Employee and Retiree Benefits.

COMMENT

FOREWORD

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

Kevin Lembo was elected State Comptroller in November 2010 and served throughout the audited period. Jeanne Kopek served as Interim Division Director of Retirement Services from October 2010 through August 2011, when Brenda Halpin became the Division Director. Ms. Halpin served as Director of the Division of Retirement Services throughout the remainder of the audited period. Dr. Thomas Woodruff served as Director of the Division of Healthcare Policy and Benefits from January 2009 throughout the audited period.

Significant Legislation

- Public Act No. 12-1 – Effective July 1, 2012, Sections 132 through 140 of this act made several changes to the Judges, Family Support Magistrates, and Compensation Commissioners Retirement System, including: (1) how retirement benefits are calculated for compensation commissioners who began serving on or after July 1, 2011; (2) how cost of living adjustments are calculated for retired officials and their surviving spouses; (3) increasing the retirement age requirements for certain officials with at least 10 but less than 25 years of service; (4) allowing certain officials to maintain their current retirement requirements by increasing their contributions to the retirement system; (5) how retirement benefits are calculated for family support magistrates who began serving before July 1, 2011; and (6) making various minor, technical, and conforming changes.

- Public Act No. 12-66 – Effective July 1, 2012, Sections 1 through 5 of this act made several changes to the Probate Judges and State Employees Retirement Systems, including: (1) conforming the law to existing practice by specifying that compensation probate judges receive for service as administrative judges for regional children's probate courts or special assignment probate judges is included in their calculations and contributions for purposes or retirement benefits; and (2) clarifies a surviving spouse's entitlement to a pension when a judge or employee dies in office.

- Public Act No. 13-247 – Effective July 1, 2013, Section 385 of this act redefined eligibility for a disability retirement in the Municipal Employees Retirement System and changes maximum benefit limits for employees disabled after January 1, 2013.

- Public Act No. 14-217 – Effective July 1, 2014, Section 252 of this act reduced the salary for certain judges, family support magistrates, and compensation commissions, as well as prohibiting any judge from receiving more than one pension from state employment.

Boards and Commissions

Connecticut State Employees Retirement Commission

The Connecticut State Employees Retirement Commission, established under Section 5-155a of the Connecticut General Statutes, is responsible for the administration of the retirement programs presented in this report. In accordance with Section 5-155a, the membership of the commission is composed of the State Treasurer or designee, who is a non-voting ex-officio member; 15 trustees, including 6 trustees representing state employees; 6 trustees representing state management; 2 trustees who are professional actuaries; and 1 neutral trustee who serves as chairman. In addition, the State Comptroller, ex-officio, serves as the non-voting secretary. All trustees serve for a three-year term except the chairman, who serves a two-year term. The governor makes all appointments except for the employee trustees, who are selected by employee bargaining agents. The management and employee trustees jointly determine the appointments of the chairman and the actuarial trustee positions.

Members of the commission serve without compensation, except that the chairman and the 2 actuarial trustees are compensated at their normal per diem rate plus travel expenses. All other commission members are entitled to reimbursement for necessary expenses incurred in the performance of their official duties. Members of the commission as of June 30, 2014 were:

Peter R. Blum, Chairman
Robert D. Baus, Actuarial Trustee
Claude Poulin, Actuarial Trustee
Sandra Fae Brown-Brewton, Management Trustee
Michael Carey, Management Trustee
Robert D. Coffey, Management Trustee
Richard Cosgrove, Management Trustee
Linda J. Yelmini, Management Trustee
Laila Mandour, Employee Trustee
Charles W. Casella, Employee Trustee
Paul Fortier, Employee Trustee
Stephen Greatorex, Employee Trustee
Salvatore Luciano, Employee Trustee
Ronald McLellan, Employee Trustee

Management trustee James Dzurenda and employee trustee Thomas P. Culley also served as members of the commission during the audited period.

The 6 employee trustees are representatives of the State Employee Bargaining Agent Coalition (SEBAC).

Medical Examining Board for State Employee Disability Retirement

Under Section 5-169 of the Connecticut General Statutes, the Governor shall appoint a Medical Examining Board of 7 current or retired state employee physicians to determine entitlement to disability retirement for members of the State Employees Retirement System. The members of the board as of June 30, 2014 were:

Mark Buchanan, M.D., Co-Chairperson
Wilner Samson, M.D., Co-Chairperson
Ariane Sirop, M.D.
Marc Croteau, M.D.
Steven Singer, M.D.
Robert Fitzpatrick, M.D.
Carolyn Drazinic, M.D.

Dr. Catherine F. Lewis and Dr. Oluremi Aliyu also served as members of the board during the audited period.

RÉSUMÉ OF OPERATIONS

State Employees Retirement Fund

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

On June 30, 1982, the legislature passed an act that approved the first pension agreement, a collective bargaining agreement concerning changes to the retirement system for state employees to be effective for the period of July 1, 1982 through June 30, 1988. The pension agreement along with a supplemental agreement, which took effect on March 1, 1983, was incorporated into the Connecticut General Statutes.

State employee benefits, including pensions, are negotiated through collective bargaining between the state and SEBAC. Since the enactment of the pension agreement, the State of Connecticut and SEBAC negotiations resulted in 1 arbitration award and 5 separate agreements, known as SEBAC agreements, which have changed the terms of the initial pension agreement. The SEBAC I, II, III, and IV agreements were enacted and effective prior to the 1996-1997 fiscal year. During the 1996-1997 fiscal year, the SEBAC V pension agreement was enacted, which further modified the pension agreement and created a new tier entitled Tier IIA, effective July 1, 1997. The SEBAC V pension agreement provided that the State Employees Retirement System shall not be changed through June 30, 2017, unless mutually agreed to by all parties.

The SEBAC 2009 agreement modified sections of SEBAC V and included a retirement incentive plan. The SEBAC pension agreement was revised again in 2011 for individuals hired on or after July 1, 2011 with the creation of Tier III and a hybrid plan specifically for unclassified employees of the Connecticut State System of Higher Education and the central office staff of the Department of Higher Education. SEBAC 2011 also provided a one-time, irrevocable opportunity for current members of the Connecticut Alternate Retirement Program to transfer membership to the new hybrid plan and purchase credit of their prior state service in that plan at the full actuarial cost. In addition, the 2011 SEBAC agreement made adjustments to the salary cap, breakpoint calculations, changed the early retirement reduction factor, and raised the minimum retirement age to 63 and 25 years of state service or age 65 and 10 years of state service for employees retiring after July 1, 2022. The 2011 SEBAC agreement also extended the provisions that the State Employees Retirement System shall not be changed unless mutually agreed to in the SEBAC V agreement through June 30, 2022.

The SEBAC 2009 agreement also required that all employees hired on or after July 1, 2009, and existing employees with less than 5 years of service as of July 1, 2010 contribute 3% of their salary for 10 years, to be deposited into a newly established retiree healthcare trust fund. A revision of the SEBAC pension agreement in 2011 extended the requirement of the trust contributions to all other state employees to be phased in beginning July 1, 2013 as follows: .5%

of salary for the fiscal year ended June 30, 2013; 2% of salary for the fiscal year ending June 30, 2014; and 3% of salary for the fiscal year ending June 30, 2015 and thereafter, with a period of required contribution of 10 years or to the beginning of retirement, whichever occurs first.

Revisions in the SEBAC agreement in 2009 and 2011 also made certain changes in benefits as cost control measures, including the addition of or changes in emergency room and prescription drug copayments, the use of mail-order prescriptions, and the implementation of a voluntary health enhancement plan. The Health Enhancement Program is available to all state employees and retirees (including all enrolled dependents), requiring enrolled individuals to adhere to a schedule of health assessments and screenings. There are no additional costs to employees choosing it, but there are increased premium shares and a deductible for those who decline to enroll in or fail to comply with the program.

The Connecticut State Employees Retirement Commission adopted new option factor tables to be used for members of the State Employees Retirement System and the Probate Judges and Employees Retirement System for retirement benefit calculations effective June 1, 2009. New option factors were adopted for the Municipal Employees Retirement System effective July 1, 2009.

As of July 1, 2011, the State Employees Retirement System consisted of a 4-tiered system. Membership in each tier, for the most part, depends upon the employee’s hire date. Membership in the Tier I and Tier II retirement plans is closed to those employees hired after June 30, 1997, and membership in Tier IIA is closed to those employees hired after June 30, 2011. As noted above, Tier III was established for individuals hired on or after July 1, 2011.

Tier I is a contributory pension plan. As provided for in Section 5-158f of the Connecticut General Statutes, there are 2 benefit plans within Tier I, referred to as Plan B and Plan C, to which eligible members could elect to belong. Plan B is integrated with Social Security and pays a lower benefit at age 65 or once Social Security disability benefits are received. Plan C benefits are in addition to those provided by Social Security. As of June 30, 2014, approximately 5% of the total workforce was covered under the Tier I plan.

Tier II is a noncontributory plan that provides a single level of benefits to all members, with the exception of hazardous duty members, who must make contributions to the system. Tier IIA is a contributory plan that provides benefits similar to Tier II. Approximately 30% and 47% of the total workforce was covered under the Tier II and Tier IIA plans, respectively, at June 30, 2014.

Tier III is a contributory plan that provides benefits similar to Tier II. Approximately 18 percent of the total workforce was covered under the Tier III plan as of June 30, 2014.

Tier I, Tier II, Tier IIA, or Tier III members are eligible for retirement benefits based on a formula determined by years of service, age at retirement, type of retirement, average final compensation, plan participation, and the benefit payment option selected. Tier II, Tier IIA, and Tier III also include a breakpoint calculation. Members must have completed at least 10 years of service or have reached the age of 70 with at least 5 years of service to receive a benefit.

Members who become disabled may be eligible for disability retirement benefits regardless of their years of service.

Retirements effective June 1, 1997 or earlier were eligible for an annual 3% cost of living adjustment (COLA) on their anniversary date. The anniversary date is January 1 or July 1, whichever first follows at least 9 full months of retirement. The SEBAC V pension agreement impacted the COLA. For retirements effective July 1, 1999 and later, the COLA will range from a minimum of 2.5% to a maximum of 6% based on a formula that utilizes the increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) for the 12 months immediately preceding the retiree's anniversary date. Retirements between July 1, 1997 and June 1, 1999 were eligible to select, irrevocably, either of the two COLA provisions. The 2011 SEBAC agreement changed the minimum COLA to 2% and maximum COLA to 7.5% for individuals retiring after October 2, 2011.

Members who work in positions designated as hazardous duty may receive normal retirement benefits with 20 years of service regardless of age. Effective July 1, 2011, Tier III hazardous duty employees may receive normal retirement benefits with 20 years at age 50 or 25 years of service regardless of age. There is no early retirement benefit provided to hazardous duty employees, regardless of tier membership.

The State Employees Retirement System provides for retirement coverage of most employees of the State of Connecticut, members of the General Assembly, operators of vending stands in public buildings, certain teachers employed at the E.O. Smith School, employees of the Connecticut Institute for Municipal Studies, and in certain cases, employees of the United States Property and Fiscal Office. Those state employees not participating in the State Employees Retirement System include judges, compensation commissioners, certain state's attorneys and public defenders, teachers in the Teachers' Retirement System, and higher education employees in the Alternate Retirement Program.

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

The Retirement Commission is required to prepare a valuation of the assets and liabilities of the system at least once every 2 years. The commission is authorized to employ the services of actuaries at least once every 2 years to prepare such valuations and determine the annual appropriation of state funds necessary to meet the funding plan outlined in Section 5-156a of the Connecticut General Statutes. Actuarial valuations of the system were prepared as of June 30, 2012 and 2014, with a roll forward valuation as of June 30, 2013. As a result of these valuations, the unfunded actuarial accrued liability for the audited period was as follows:

	June 30, 2012	June 30, 2013	June 30, 2014
Unfunded Actuarial Accrued Liability	$13,273,766,185	$13,983,691,331	$14,920,814,520

All assets were valued using the actuarial value of assets method, which spreads any gains and losses over a 5-year period and makes adjustments, as necessary, so that the final actuarial value is within plus or minus 20% of the market value.

A comparison of membership information for the State Employees Retirement System as of June 30, 2012 and 2014 has been presented below:

	June 30, 2012	June 30, 2014
Active Members		
Tier I	3,153	2,281
Tier II	17,275	15,094
Tier IIA	25,459	23,718
Tier III	1,981	8,883
Total Active Members	47,868	49,976
Retired Members	43,887	45,803
Inactive Members (Terminated Vested)	1,561	1,457
Total	93,316	97,236

The 3 major recurring revenue sources for the State Employees Retirement Fund (SERF) are state funding contributions, federal funding contributions, and member contributions. A comparison of these revenue sources for the audited period has been provided below:

	2011-2012	2012-2013	2013-2014
State Contributions	$ 742,685,744	$ 829,360,072	$ 1,024,371,178
Federal Contributions	183,656,996	228,752,675	244,518,635
Member Contributions	68,776,064	163,999,986	144,806,616
Total	$ 995,118,804	$ 1,222,112,733	$ 1,413,696,429

The 2 major recurring expenditures for SERF are benefit payments to members of SERS and employer refunds. A summary of these expenditures for the audited period are presented below:

	2011-2012	2012-2013	2013-2014
Benefit Payments	$ 1,417,025,660	$ 1,481,708,745	$ 1,563,029,412
Employer Refunds	7,640,334	5,984,203	7,528,594
Total	$ 1,424,665,994	$ 1,487,692,948	$ 1,570,558,006

The State Treasurer is the custodian of the fund's investments. Investments in the State of Connecticut Combined Investments Funds are verified as part of our audit of the Office of the

State Treasurer. A summary of the market and actuarial value of assets and rate of return as of June 30th for the audited period is presented below. This summary is based on information from actuarial reports on file with the Retirement Services Division and the divisions' financial statements that were based on State Treasurer data.

	2011-2012	**2012-2013**	**2013-2014**
Market Value of Assets	$ 8,468,479,084	$ 9,182,442,986	$10,472,567,077
Rate of Return	(1.07)%	11.68%	15.82%
Actuarial Value of Assets	$ 9,744,985,549	$ 9,784,500,362	$10,584,795,257
Rate of Return	0.39%	3.11%	9.73%

Alternate Retirement Program Fund

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

During the audited period, the Alternate Retirement Program (ARP) was administered by ING. Retirement benefits are based on contributions, distribution of contributions, length of participation, age, and the payment option selected. Payment options include partial or lump-sum withdrawals, a systematic withdrawal, rollover to another eligible retirement plan or IRA, or a combination of various payment and annuity options.

The retirement contribution rate for participants is 5% percent of salary while the state's share is determined from a schedule in Section 5-156 of the Connecticut General Statutes. Effective July 1, 1985 and thereafter, the state share is fixed at 8% of salary. All participant and state contributions are held in a separate retirement fund in the custody of the State Treasurer and are forwarded to the insuring company upon certification from the State Comptroller.

Section 5-156 of the Connecticut General Statutes provides that expenditures forwarded to the insuring company from the Alternate Retirement Program Fund account may exceed the appropriation to such account, if such deficiency is due to anticipated reimbursements to the account and if such reimbursements are anticipated to be made within 6 months of such expenditures. The transfers of the state share from the General Fund appropriations must be made in the month following the employee contributions and is paid directly to the insurance company and, therefore, is no longer transferred to and paid from the Alternate Retirement Program Fund.

Contributions from participating employees to the Alternate Retirement Program Fund and the amounts remitted to the insuring company during the audited period are as follows:

	2011-2012	2012-2013	2013-2014
Contributions - Participants	$ 39,309,305	$ 36,774,417	$ 35,812,717
Remitted to Insuring Company	$ 39,373,323	$ 35,360,961	$ 35,884,373

As previously noted, the state's share of the contributions on behalf of the program was met from appropriations administered by the State Comptroller for the purpose of the Alternate Retirement Program. The state's share of contributions was remitted directly from the General Fund appropriation account to the third party administrator (TPA). Refunds of contributions from the TPA and fringe benefit recoveries to the General Fund were credited against this share, resulting in net charges against the General Fund appropriation account totaling $20,950,297, $16,923,948, and $8,739,312 for the fiscal years ended June 30, 2012, 2013, and 2014, respectively.

State's Attorneys Retirement Fund

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

Section 51-278 requires the State Comptroller to deduct 5% of the salaries of members of the State's Attorneys Retirement Fund as contributions for retirement purposes. These contributions are deposited in a separate trust fund in the custody of the State Treasurer. Contributions can be refunded if an attorney leaves office before retirement.

The retirement salary for which a member is eligible is determined by age at retirement, years of service, and the salary of the office held at the time of retirement. Provisions exist for disability retirements and death benefits.

The aforementioned sections of the Connecticut General Statutes do not specifically outline the method of financing retirement salary payments to each retired state's attorney.

The investments in the State's Attorneys Retirement Fund, which made up most of the assets of the fund, the employee contributions, and net investment income are presented below:

	2011-2012	2012-2013	2013-2014
Market Value of Investments, June 30	$ 1,195,324,000	$ 1,271,590,000	$ 1,472,954,000
Employee Contributions	$ 22,740,000	$ 22,750,000	$ 24,140,000
Investment Income	$ 33,473,000	$ 33,486,000	$ 8,603,000

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

General Assembly Pension Fund

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

The assets of the General Assembly Pension Fund consisted primarily of investments in the State Treasurer's Short Term Investment Fund. The net investment income and pensions paid to retired members during the audited period are presented below:

	2011-2012	2012-2013	2013-2014
Market Value of Investments, June 30	$ 14,697,000	$ 14,788,000	$ 13,080,000
Investment Income	$ 27,000	$ 23,000	$ 19,000
Pensions Paid to Retired Members	$ 1,008,000	$ 756,000	$ 1,728,000

Investment balances were verified as part of our office's audit of the State Treasurer. Receipts consisted primarily of investment income. The General Assembly Pension Fund finances pensions paid to retired members.

Judges' and Compensation Commissioners Retirement Fund

Sections 51-19 through 51-50b, inclusive, and Section 51-51 of the Connecticut General Statutes provide a retirement system for judges, compensation commissioners, and family support magistrates. All monies received in connection with the system are to be deposited to the Judges' and Compensation Commissioners Retirement Fund. Funding for the system is to be provided by contributions from the General Fund and payroll deductions from member salaries at a rate of 5%. The State Employees Retirement Commission is the administrator of the system, while the State Treasurer serves as custodian and investment manager of the fund.

Participation in this system is automatic for all commissioners and judges, except that judges with 10 years of credited service in the State Employees Retirement System at the time of their initial appointment may elect to remain in that system, as provided for in Section 5-166a of the Connecticut General Statutes.

The retirement salary for which a member is eligible is determined by age at retirement, years of service, and the salary of the office held at retirement. Members must have completed at least ten years of service to receive a benefit. Provisions exist for disability retirement and death benefits.

Section 51-49d of the Connecticut General Statutes provides that the Judges' Retirement System be funded on an actuarial reserve basis with actuarial surveys of the system performed at least once every 2 years with annual certifications to the General Assembly of funding requirements. Actuarial valuations of the system were prepared as of June 30, 2012 and 2014, which resulted in unfunded actuarial accrued liabilities of $144,847,720 and $153,717,765, respectively.

The following analysis presents the market value of investments of the Judges' and Compensation Commissioners Retirement Fund, the employee contributions, and investment income, which were derived from the division's financial statements that were based on State Treasurer data.

	2011-2012	**2012-2013**	**2013-2014**
Market Value of Investments, June 30	$ 156,909,687	$ 168,327,147	$ 187,773,636
Employee Contributions	$ 1,565,124	$ 1,519,610	$ 1,640,578
Investment Income	$ 4,472,156	$ 5,062,759	$ 1,605,283

Investments in the State of Connecticut Combined Investment Funds are verified as part of our office's audit of the State Treasurer. Receipts consisted primarily of investments, employee contributions, and investment income.

Public Defenders' Retirement Fund

Section 51-49, 51-295, and 51-295a of the Connecticut General Statutes provide a separate retirement program for each public defender incumbent on July 1, 1978, similar to the program for state's attorneys. In addition, effective July 1, 1986, the Chief Public Defender and the deputy could elect membership in this retirement program. A retirement fund was established to receive contributions from participants at the rate of five-percent of salary, including transfers from the State Employees Retirement Fund for transferred service credit.

Retirement salary determination, eligibility, death benefits, and funding arrangements are similar to those previously explained for the State's Attorneys Retirement Fund.

Pensions were paid to 5 retirees/beneficiaries during the audited period. The pensions were mainly financed by the General Fund appropriation for Pensions and Retirements – Other Statutory.

Probate Judges and Employees Retirement Fund

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

As provided in Section 45a-49, all contributions required under the system are transmitted by the commission to the State Treasurer, who shall be custodian of the fund with power to invest as much of the fund that is not required for current disbursements. Section 45a-44 and 45a-45 require members of the retirement system to make contributions equal to 1% of their earnings on which Social Security taxes are paid through the commission and 3.75% of earnings in excess of that, while for those not under Social Security coverage, retirement contributions are 3.75% of earnings.

Section 45a-82 of the Connecticut General Statutes requires that on or before July 1st annually, the commission shall certify to the State Treasurer, on the basis of an actuarial determination, the amount to be transferred to the retirement fund to maintain the actuarial plan adopted by the commission. Payments of these actuarially determined funding amounts are made from the Probate Court Administration Fund. Actuarial valuations of the system were prepared as of December 31, 2011, and 2013. As a result of these valuations, it was determined that there was no unfunded actuarial accrued liability as of those dates.

The retirement salary for which a member is eligible is determined by any Social Security coverage, the retirement date, the years of service, and the average final compensation, in accordance with the provisions of the aforementioned sections of the Connecticut General Statutes.

The following analysis presents the market value of investments of the Probate Judges and Employees Retirement Fund, employee contributions, interest and investment income, pensions paid to retired members, and health services costs paid through the fund that were derived from the division's financial statements, which were based on data from the State Treasurer.

	2011-2012	2012-2013	2013-2014
Market Value of Investments, June 30	$ 78,043,907	$ 81,893,304	$ 90,240,076
Employee Contributions	$ 248,590	$ 200,419	$ 255,112
Interest and Investment Income	$ 2,203,900	$ 2,521,184	$ 807,786
Pensions Paid to Retired Members	$ 4,369,760	$ 4,492,171	$ 4,724,403
Health Services Costs Paid	$ 182,936	$ -	$ -

Investments in the State of Connecticut Combined Investment Funds are verified as part of our office's audit of the State Treasurer. Receipts consisted primarily of investment income, including gain on sale of investments, operating transfers from the Probate Court Administration Fund, mainly for health services costs, and employee contributions. Pensions and health services costs paid to retired members were financed by the Probate Judges and Employees Retirement Fund.

Municipal Employees Retirement Fund

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

The Municipal Employees Retirement System is composed of a retirement fund and an administration fund. As of June 30, 2014, municipalities and housing authorities with 8,477 enrolled active employees were participants. As of that date, benefits were being paid to 6,511 retired employees or their survivors.

Any municipality may, by resolution passed by its legislative body and subject to referendum, participate in the system. The effective date of participation shall be at least 90 days subsequent to the receipt by the commission of a certified copy of the resolution. Participation may also be effected through an agreement between a municipality and an employee bargaining organization in accordance with Section 7-474 subsection (f) of the Connecticut General Statutes.

Section 7-441 of the Connecticut General Statutes, which prescribes the various contributions required of participating municipalities, provides that each municipality must pay to the commission an annual proportionate share of the fund's administrative costs, as determined by the commission on the basis of the number of members employed by each municipality. These monies were deposited into the Administrative Fund, which was established to account for all administrative contributions and expenditures.

The retirement amount for which a member is eligible is determined by the years of service and the average final compensation over the 3 highest paid years. Members must have completed at least 25 years of service, or attain the age of 55 with 5 years of service to receive a benefit. Provisions exist for disability retirements and death benefits.

Employee contribution rates are set by Section 7-440 of the Connecticut General Statutes. Employees contribute either 2.25% or 5% based on whether Social Security contributions are deducted from their salary. Municipal contribution rates are set by the commission based on actuarial valuations, which, under the provisions of Section 7-443 of the Connecticut General Statutes, are required at least every 5 years. Actuarial valuations of the system were prepared as of June 30, 2012 and 2014, with a roll forward valuation prepared as of June 30, 2013. As a result of these valuations, the unfunded actuarial accrued liability for the audited period was $322,050,452, $283,352,616, and $340,681,183, respectively.

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

Effective Date July 1,	**2012**	**2013**	**2014**
Policemen and firefighters with Social Security	16.96%	17.01%	16.96%
General employees with Social Security	11.98%	11.85%	11.98%
Policemen and firefighters without Social Security	16.01%	16.46%	16.01%
General employees without Social Security	13.00%	12.66%	13.00%

Section 7-439b of the Connecticut General Statues provides for annual cost of living adjustments (COLA) for each retired member or surviving annuitant of a retired member receiving regular benefit payments. A COLA is determined by the member's date of retirement and age at retirement.

The following analysis presents the market value of investments of the Municipal Employees Retirement System, which made up most of the assets of the fund, the employee contributions, investment income earned, and pensions paid to retired members, which were derived from the division's financial statements that were based on State Treasurer data.

	2011-2012	**2012-2013**	**2013-2014**
Market Value of Investments, June 30	$ 1,675,298,816	$ 1,828,132,661	$ 2,161,258,189
Employee Contributions	$ 15,356,707	$ 17,682,230	$ 18,998,238
Interest and Investment Income	$ 47,529,869	$ 55,969,701	$ 17,744,547
Pensions Paid to Retired Members	$ 105,330,945	$ 113,776,637	$ 121,721,228

Investments in the State of Connecticut Combined Investment Funds are verified as part of our office's audit of the State Treasurer. The actuarial value of assets was determined on a market-related basis. The asset valuation method recognizes assumed investment income fully each year. Differences between actual and assumed investment income were phased in over a closed 5-year period. Pensions paid to retired members were financed by the Municipal Employees Retirement Fund.

Policemen and Firemen Survivors' Benefit Fund

The Policemen and Firemen Survivors' Benefit Fund generally operates under the provisions of Section 7-323a through 7-323i of the Connecticut General Statutes. The primary objective of the fund is to provide benefits for surviving dependents of deceased municipal policemen and firefighters. Any municipality, by ordinance or collective bargaining agreement approved by its legislative body, may participate in the plan. Employee contribution rates are fixed by statute at 1% of the employee's compensation. Municipal contributions, however, are made in amounts determined by the commission to be necessary to maintain the fund on a sound actuarial basis.

Section 7-323c subsection (d) of the Connecticut General Statutes requires that municipalities annually pay a proportionate share of the administration costs of the fund as determined by the commission. The fee is charged on a per member basis. Revenues collected through this assessment are deposited to the Administration Fund of the Municipal Employees Retirement System, as its employees have the responsibility of overseeing the operations of the Policemen and Firemen Survivors' Benefit Fund.

Actuarial valuations of this fund were prepared as of June 30, 2012 and 2014, with an interim roll forward valuation performed as of June 30, 2013. As of June 30, 2014, there were 591 active employees from nine municipalities participating in the plan.

The following analysis presents the market value of investments of the Police and Firemen Survivors' Benefit Fund, which made up most of the assets of the fund, employee contributions, interest and investment income, and disbursements from the pension paid to surviving dependents, which are derived from the division's financial statements that were based on data from the State Treasurer.

	2011-2012	2012-2013	2013-2014
Market Value of Investments, June 30	$ 22,558,598	$ 23,975,814	$ 27,185,277
Employee Contributions	$ 469,870	$ 471,544	$ 521,450
Interest and Investment Income	$ 607,431	$ 625,363	$ 167,697
Pensions Paid to Surviving Dependents	$ 978,929	$ 1,042,184	$ 1,068,457

Investments in the State of Connecticut Combined Investment Funds are verified as part of our office's audit of the State Treasurer. Contributions are transferred to the State Treasurer for investment. Disbursements for benefit payments are processed in the Policemen and Firemen Survivors' Benefit Fund through the Municipal Employees Retirement Fund system.

Pensions and Retirements – Other Statutory

Section 3-2a, 6-2b, and 11-10a of the Connecticut General Statutes and various special acts authorize pensions and retirements to former Governors and their spouses, certain former county employees and law librarians, and various individuals. These pensions and retirements are paid from a special appropriation of the General Fund entitled Pensions and Retirements – Other

Statutory. In addition, this account is used to fund that portion of the retirement benefits paid to retired members of the State's Attorneys and Public Defenders Retirement Funds that is not funded by those retirement funds.

Deferred Compensation

In addition to the retirement programs already noted in this report, Section 5-264a of the Connecticut General Statues authorizes the Office of the State Comptroller, through a third party administrator, to offer State of Connecticut employees a deferred compensation plan created in accordance with Section 457 of the Internal Revenue Service Code. This plan permits all permanent employees, including elected and appointed officials and members of the General Assembly, to defer a portion of their salary until future years. In addition, a political subdivision of the state may participate in the plan in accordance with Section 5-264a subsection (g) of the Connecticut General Statutes. This deferred compensation is not available to employees until retirement, termination of employment, disability, unforeseeable emergency, or death.

The Office of the State Comptroller has contracted with an administrator selected by a competitive process. For the audited period, ING Financial Advisors, LLC was the third party administrator of the state's deferred compensation program.

State Employees' Health Service Costs

Under the provisions of Section 5-259 of the Connecticut General Statutes, Connecticut is obligated to pay 100% of the portion of the hospital and medical insurance premium charged for individual coverage and 70% of the portion charged for spouse or family coverage for each state employee and each member of the General Assembly. As with all statutory provisions concerning employee benefits, the provisions of Section 5-259 may be superseded by the language contained in any approved collective bargaining agreement. The hospital and medical insurance plans offered are negotiated through the collective bargaining process. The state must provide Point of Service, Point of Enrollment, Point of Enrollment-Gatekeeper, and out-of-area plans, as well as prescription drug coverage as a result of the SEBAC agreement. Based on SEBAC requirements, the Office of the State Comptroller goes out to bid through a request for proposal (RFP) process. Insurance carriers respond to the RFP with proposed costs for state plans called for by the agreement. The State Comptroller then chooses which carriers to select and what plans each carrier must offer.

Each fiscal year, the state's share of employee health services is initially met from General and Special Transportation Fund appropriations authorized for this purpose. On the basis of payroll transactions submitted by the state agencies, the Office of the State Comptroller charges the General and Special Transportation Fund appropriations for the state's portion of the premiums due to the private insurance carriers and makes payroll deductions for the balance of premiums payable by individuals with additional coverage. Reimbursements to the General Fund are received from certain federal and state funds or restricted accounts charged with salaries of employees covered under the state's health insurance program.

Effective July 1, 2010, the State of Connecticut adopted self-insured funding for medical claims rather than making premium payments. The base rates for all benefit plans are determined by an actuarial consultant. The derived rates are used to establish state employee payroll deductions and to establish adequate appropriations for the state share to cover health claims based on historical trends in claims data.

An analysis of the total payment of the state's share of such costs for the audited period follows:

	2011-2012	2012-2013	2013-2014
Expenditures - General Fund:			
Employer's share - State Employees	$ 518,350,613	$ 559,778,575	$ 614,328,850
Expenditures - Transportation Fund:			
Employer's share - State Employees	$ 33,263,330	$ 34,725,291	$ 39,610,782

Retired State Employees' Health Service Costs

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

During the 2012, 2013, and 2014 fiscal years, appropriations and transfers of $565,145,867, $614,094,650, and $548,693,300, respectively, were made to cover the state's share of health insurance costs for those eligible retirees. Total amounts expended during the aforementioned fiscal years were $549,063,351, $587,439,438, and $548,693,300, respectively.

The increase in expenditures from fiscal year 2012 to 2013 was primarily caused by an increase in medical and pharmacy claims paid during 2013 as compared to the prior year. In addition, retirement payroll was implemented in Core-CT during 2013, which changed how retiree health insurance was charged to the General Fund retiree health appropriations. The reduction in expenditures from fiscal year 2013 to 2014 was due to the reduction in medical and pharmacy claims paid during 2014 as compared to the prior fiscal year.

In the past, the state has funded the health insurance benefits for retired employees as costs were incurred. Unlike retirement benefits, no reserve was established to provide support for future years. During the fiscal year ended June 30, 2008, Governmental Accounting Standards Board Statement No. 45 (GASB 45) was implemented, which required the state to calculate and record the actuarial accrued liability for the future health care benefits of retired employees. As a result, in May 2008, the state created the State Employees Other Post-Employment Benefits Plan (SEOPEBP) administered by the State Comptroller as a single-employer defined benefit other post-employment benefit (OPEB) plan covering retired employees of the state who are receiving benefits from any state-sponsored retirement system, except the Teachers' Retirement System and the Municipal Employees Retirement System. The SEOPEBP provides healthcare and life insurance benefits to eligible retirees and their spouses. The cost of post-retirement health care benefits is funded through the transfer of General Fund appropriations to the OPEB – State Employees trust fund. As of June 30, 2014, the fair market value of the net assets within the fund totaled $166,192,775.

As noted above, the state must provide an actuarial valuation of the OPEB liability. Actuarial valuations of the system were prepared as of June 30, 2011 and 2013, with roll forward calculations performed for 2012 and 2014. Based on the June 30, 2013 actuarial valuation, the unfunded actuarial accrued liability was $19,532,514,000.

STATE AUDITORS' FINDINGS AND RECOMMENDATIONS

Deficiencies in internal controls, apparent noncompliance with legal provisions, and necessary improvements in management practices and procedures are presented below.

State Employees Retirement System

Limitations on Benefits - Internal Revenue Code Section 415 Limits

Background: The State Employees Retirement System is a qualified governmental defined benefit plan as defined in Sections 401(a) and 414(d) of the Internal Revenue Code. To protect the tax qualified status of the plan under Section 401(a), SERS must follow the benefit and contribution limits set forth in Section 415 of the Internal Revenue Code or the entire plan may be disqualified. There are certain procedures established by the US Treasury to avoid a disqualification by correcting plans that are not in compliance.

Criteria: During calendar year 2014, the maximum allowable benefit, per guidance promulgated by the Internal Revenue Service, was $210,000. Section 415(b)(2)(C) requires that this benefit limit be actuarially adjusted when a participant retires prior to reaching age 62, unless the participant is employed by an agency with an overall mission and nature consistent with a police or fire department, as allowed by Section 415(b)(2)(H). The maximum allowable benefit must also be reduced if it is not received as a straight life annuity or a qualified joint and survivor annuity. In effect, an otherwise contingent or fixed annuity would need to be actuarially adjusted to the equivalent straight life benefit before testing for compliance with the limits set forth in Section 415 of the Internal Revenue Code could occur.

Private letter ruling (PLR) 201347028 (UIL 415.01-05) addresses an inquiry on whether correctional employees should be classified as qualified participants for the purposes of applying the exception to the adjustment to their benefit limits set forth in Section 415(b)(2)(C). According to the PLR, corrections, probation, parole, and other public safety officers are not included in the definition of qualified participant under Section 415(b)(2)(H). It goes on to state that the legislative history of that section includes a Senate amendment to specifically include correctional employees as qualified participants, but that amendment was never adopted. With respect to the ruling, the PLR concluded that the corrections department did not constitute a police department organized and operated by the state, and, therefore, employees of the corrections department would not be considered qualified participants.

Condition:	During the audited period, the State Employees Retirement System paid benefits over the actuarially adjusted maximum benefit limits established in Section 415 of the Internal Revenue Code. Our testing disclosed 170 hazardous duty retirees who retired from state agencies that did not appear to meet the requirement of operating as a police or fire department. Since this requirement was not met, these retirees should have had their benefits actuarially adjusted when retirement occurred before age 62 or when the annuity type selected would require conversion. We also noted 28 retirees that did not have hazardous duty retirement and were receiving benefits in excess of the limits set forth in Section 415. The most common reason for this was a failure to convert the annuity type.
Effect:	Benefit payments made in excess of the limits set forth in Section 415 of the Internal Revenue Code jeopardize the plan's qualified status under Section 401(a). Furthermore, a total of $2,277,420 in benefits was paid out in excess of the Section 415 limits during the audited period; $1,563,689 of this total was associated with hazardous duty retirements and the remaining $713,731 related to non-hazardous duty retirements.
Cause:	It appears that the Retirement Services Division incorrectly applied the exclusion allowed in Code section 415(b)(2)(H) and did not make an adjustment to employee pay for individuals who retired before reaching the age of 62, or when the annuity type selected would require conversion. The controls in place did not effectively identify and limit payments to retirees that were in excess of the limits set forth in Section 415 of the Internal Revenue Code.
Recommendation:	The Retirement Services Division should ensure compliance with Section 415 of the Internal Revenue Code by ceasing all benefit payments in excess of the limitations imposed within that section. (See Recommendation 1.)
Agency Response:	"The Retirement Services Division consulted with our actuaries regarding this finding and recommendation. Upon further review it is established that the testing and analysis done by the Auditors of Public Accounts is flawed and resulted in a conclusion that is incorrect. The process of calculating a benefit based on the section 415 limits is very complicated. The amount is adjusted in a number of ways: (i) the portion of any benefit attributable to after-tax contributions is excluded in applying the limit, (ii) if the benefit is payable in other than the form of a life annuity or a joint and survivor annuity with the member's spouse then the limit must be reduced to reflect the actuarial value of the form of benefit, (iii) if the individual is a hazardous duty employee under the IRC

(Internal Revenue Code) rules (a member of a police or fire department) and has at least 15 years of service in such department then the limit is not reduced to reflect commencement prior to age 62, (iv) if the individual does not qualify as a hazardous duty employee under IRC rules then the limit is adjusted to reflect commencement prior to age 62.

Of the 170 hazardous duty employees 101 were found by the actuaries to not be over the limit due to benefit amounts, after tax contributions and public safety positions; 33 of those retirees retired prior to January 1, 2011; and 36 were not found to be a part of the testing group for hazardous duty employees.

The overly broad conclusion that the Retirement Services Division has incorrectly applied the 415 limitations and failed to put the proper controls in place to identify and limit payments to retirees is patently false. On the contrary, prior to 2011, there were no controls in place to ensure compliance. In fact, prior to 2011, even the Auditors of Public Accounts, who have performed routine audits on a regular basis of this agency over the years, did not identify any compliance issues with calculating the 415 limits. Since 2011 tax counsel has been hired to seek advice from the IRS regarding plan qualification and compliance and the actuaries have been engaged in annual testing for 415 and 401 limits. Currently, all individuals whose benefits have been found to be in excess of the 415 limits are reduced accordingly. It would be irresponsible, without accurate testing which incorporates all of the adjustment factors, and without receiving guidance form the IRS and our actuaries and tax advisors, to cease paying all benefits in excess of the limits. The Retirement Services Division will continue to work with its trusted actuaries and tax attorney to ensure compliance with the section 415 and 401 limits."

Auditors' Concluding Comment: We respectfully disagree with the conclusions reached by the Retirement Services Division and believe that certain information is not being taken into account with respect to the 170 hazardous duty employees. As noted in the criteria of our finding and in the agency response, these employees are being considered hazardous duty employees for purposes of calculating whether their benefits exceed the limit set forth by Section 415. We believe that this classification is incorrect because the determination of whether an employee is hazardous duty for purposes of calculating whether their benefits exceed the 415 limit is based on whether the employer is a police or fire department of the state, not the employee's job classification. In the instances identified, the employer was neither a police nor a fire department of the state.

In regards to our prior audits not including a recommendation related to section 415 limits, an audit is not a full review of all records and processes in place at an agency. In effect, other areas of the division may have been the focus of prior audits, which is why this issue was not included in prior reports. Moreover, the lack of a recommendation in an audit report should not be interpreted as an absence of an issue, because not all areas are examined and not all transactions within an area can be reviewed in most cases.

As technology advances and records are converted from paper form to electronic and stored in databases, our ability to cover larger amounts of information/documentation during our audits increases. In turn, we are able to identify and point out areas in which improvements may be needed and efficiencies can be obtained in a much more timely and economical manner. We look forward to continuing to work with the division to ensure that any issue with 415 limits, or any other issue, is resolved.

Finalizing Retirement Payroll and Calculating Interest on Post-Audit Lump Sum

Criteria: The process of finalizing retirement applications should be done in an accurate and timely manner. Section 5-156e of the Connecticut General Statutes requires that the Retirement Services Division pay 5% interest per year on any lump sum amount owed to the retiree at the time of finalization that has not been paid within 6 months. Interest does not start accruing until after the first 6 months of receiving a pre-audit benefit.

Condition: During our prior audit, we noted several issues while reviewing the finalization process used by the Retirement Services Division, which included:

- The inability to reconcile our recalculation of finalization payments for the retirees selected for testing to the divisions calculations;
- The division consistently paid retirees estimated benefits that were less than the benefits calculated during the pre-audit process, resulting in higher retroactive payments and thus higher interest payments owed at the time of finalization;
- Different methods were used in calculating interest to be paid to retired plan members;
- Retirees were not offered the option of receiving installment payments instead of one lump-sum for the finalized retroactive payment; and
- There was a significant backlog of retired applications in the division awaiting finalization.

The division's response was that it was working on implementing a new Oracle Pension Module that would address the issues noted. Due to the close proximity of the issuance of our prior audit report and our current audit testing, the new module was still in the implementation process. Furthermore, the Retirement Services Division informed us that the aforementioned issues likely persisted throughout the audited period. We did note, however, that the division has made significant progress in implementing the module. We intend to reevaluate this area in our next audit.

Effect: Finalization calculations are not always performed using the same methodology. This makes it difficult to determine whether the method used was performed correctly.

Regarding the underpayment of retirement benefits that lead to larger retroactive payments once the finalization process is complete, a total of $602,083, $722,648, and $838,846 in interest was paid in fiscal years 2012, 2013, and 2014, respectively. In effect, the retirement fund is incurring unnecessary interest expenses due to the intentional underpayment of estimated retirement benefits.

Furthermore, the method to calculate the interest owed on lump-sum payouts used by the division does not appear to reflect the intent of Section 5-156e of the General Statutes.

Cause: In regards to the finalization calculations, the division was using various calculation methods as well as a spreadsheet created by outside consultants. This system does not address every situation; therefore, it is not always used, resulting in manual entries and calculations.

Our previous audits note a number of causes that made it more difficult for division staff to promptly complete retirement finalizations. Various complexities arising from the pension agreement and other collective bargaining agreements exist, particularly the retroactive provisions of such agreements and verifying compliance with the "130-percent cap" provision governing an employee's retirement base salary.

With respect to the underpayments, it has been the practice of the division to intentionally underpay estimated benefits because the division feels that it is easier to pay a retiree amounts owed for an underpayment than it is to collect for an overpayment.

Recommendation: The Retirement Services Division should continue its efforts to reduce the backlog of retirement applications awaiting finalization and complete the finalization process in a timely manner. The division should also consider changing its long-standing practice of underpaying estimated retirement benefits to lower interest costs. Furthermore, the division should revise its method for calculating interest on post-benefit audit lump-sum payments. (See Recommendation 2.)

Agency Response: "The present administration of the Office of State Comptroller is the first to meaningfully tackle the inherited problems of a back-log in retirement finalization. To that end, OSC has undertaken a multi-year multi-phase project to modernize pension services. The new system is based on the state's core financial and human resource system Core-CT.

In 2010 OSC utilized Core-CT to provide benefits administration functionality for the State Employees Retirement System (SERS) and in 2013 the SERS monthly benefit payment process was incorporated into Core-CT. Customer relationship management (CRM) was implemented in November 2016. The CRM implementation now allows OSC to restructure the Retirement Services Division to better serve its members. The changes included a customer service center, which utilizes new technologies such as the Avaya call center telephone system and IBM's FileNet enterprise content management system. All interactions with the customer service center are logged and CRM cases are created. The CRM cases provide the retirement analyst with all the relevant case information and electronic versions of any supporting documents.

The final phase of the project, the pension benefit calculator, is being phased in now. The first benefit calculations went into production in July 2016. The remaining calculations will be implemented by July 2017. Since July the new system has processed 971 current retirements and has reduced the finalization backlog by 4,670 to date. The division is eliminating an average of about 1,000 more each month. The remaining finalization backlog cases, excluding disability cases, are on track to be completed by July 2017.

Upon the project's completion Core-CT will handle the complete employment lifecycle from hire through retirement. This new system will provide complete employment records, a better on-line experience for members, including self-service and elimination of obsolete systems. Once fully implemented, an employee's retirement finalization will occur within two months of the retirement date. Taken together this is a tremendous improvement in moving Connecticut toward highly efficient and lower cost processes."

Monitoring Rehired Retirees - Statewide

Criteria: The powers and duties of the Retirement Commission are set forth in Section 5-155a of the General Statutes. As part of its duties, the commission administers SERS and has general supervision and oversight of the operation of the retirement system.

Per the 1989 SEBAC Agreement and Executive Order 27-A, a retiree may be rehired for a period of time, not to exceed 120 days within a calendar year. It also limits the number of periods a retiree can be rehired to 2 calendar years.

Office of Policy and Management General Notice No. 2006-18 reiterates the fact that, under the provisions of Section 5-164a(c), as amended by the SEBAC agreement, retired members of SERS who are reemployed by the state can work no more than 120 days in a calendar year without impairing their pension rights. The notice goes on to state that in instances in which rehired retirees work in excess of the 120-day limit, they must reimburse the retirement fund for all retirement income payments received during the period of reemployment. The notice also requires that all branches of government use the job code 1373VR in Core-CT to allow proper tracking of rehired retirees and prevent violations of the aforementioned restrictions.

Based on guidance provided in a formal Attorney General opinion regarding limits on compensation provided to reemployed retirees and an Office of Fiscal Analysis memorandum discussing compensation paid to rehired retirees, rehired retirees are not eligible to receive overtime, longevity payments, mileage reimbursement, or payouts for leave accruals earned during the length of their reemployment. The guidance also indicates that, since retirees are already receiving health insurance and retirement benefits, agencies should not enroll them in active employee health insurance or state retirement plans.

In general, qualified plans under Section 401(a) of the Internal Revenue Code may not begin distribution of benefits to current employees under the age of 62 when there is not a qualifying event, such as a bona fide separation of service prior to reemployment. If there is an understanding between the employee and employer that there is no separation of service, such as in an early retirement incentive plan in which the employer plans to hire the employee back after retirement, the employee does not meet the requirements of being considered retired for purposes of receiving benefits from the retirement plan. Furthermore, Section 1.409A-1(h)(1)(ii) of the Treasury Regulations provides that, whether a termination of employment has occurred is based on whether the facts and circumstances indicate that the employer and employee reasonably anticipated that no further services would be performed after a certain date, or that the level of bona fide services the employee would perform after such date would permanently decrease to no more than 20 percent of the average level of bona fide services performed over the immediately preceding 36-month period, or the full period of services to the employer if the employee has been providing services to the employer less than 36 months. However, Section 401(a)(36) indicates that this standard does not apply to employees who qualify for in-service distributions after reaching age 62.

Condition: Our statewide review of 29 retirees, who were rehired by the state during the audited period, disclosed 20 instances in which retirees were reemployed for periods in excess of the 2 calendar year limit. It also appears that in 18 of these instances, based on the payments received by the retiree, either the reemployment period exceeded the 120-day working period limit, or the rate of pay limit set forth in the SEBAC agreement and Executive Order 27-A was exceeded. Additionally, we found that 7 of the retirees tested were under the age of 62 and had either a very brief break in service between their retirement date and their date of reemployment, or no break at all. In these instances, reemployment as a rehired retiree began between 6 days prior to retirement and 19 days after retirement. In effect, it appears that a true separation of service did not occur for these employees.

In addition, we found various instances in which 16 of the tested rehired retirees received excess benefits totaling $198,538. In the instances noted, the excess benefit payments were arrayed as follows:

- Three instances in which employees received payouts for unused leave time amounting to $19,680 in aggregate;
- Three instances in which an agency made employer contributions to SERS totaling $59,175;
- Fourteen instances in which mileage reimbursements, totaling $56,465, were issued;
- Nine instances, totaling $19,612, in which employee allowances were paid;
- Five instances in which medical insurance costs amounting to $27,219 were paid;
- Nine instances, totaling $10,891, in which longevity was paid;
- Six instances in which overtime amounting to $4,623 in aggregate was paid; and
- Two instances in which payments, totaling $833, were issued in relation to out-of-state travel.

Furthermore, we noted that 21 of the 29 rehired retirees reviewed were not coded with the correct job code in Core-CT.

Effect: In the instances in which it appears that the rehired retirees exceeded the 120-day reemployment limit set forth in the SEBAC agreement and Executive Order 27-A, these employees may have received retirement benefits that they were not entitled to. In accordance with the aforementioned guidance, the retirement benefits paid to these employees during the time of reemployment should have been refunded to the state. Retirement benefits paid to the employees identified during calendar years 2012 and 2013 amounted to $1,284,121 and $1,318,460, respectively. Of the total amount of retirement benefits paid, at least $428,040 and $439,487 was received during periods of reemployment that appeared greater than 120 days during the 2012 and 2013 calendar years, respectively. Furthermore, allowing rehired retirees to work in excess of the 120-day limit puts the plan at risk of losing its qualified status under Section 401(a) of the Internal Revenue Code, which could have a significant impact on both the state and the participants of the plan.

Regarding the instances in which employees did not appear to have a true separation from service, benefit payments made to these employees put the plan at risk of being disqualified under Section 401(a) of the Internal Revenue Code. Such disqualification would result in adverse tax consequences to the employees participating in the plan and the state.

With respect to the instances noted in which excess benefits were paid to rehired retirees, the state incurred $198,538 in unnecessary costs that it was not obligated to, and should not have paid.

In regards to the issue of the incorrect job code used in Core-CT, this makes it difficult, if not impossible, to track the length of time worked by or the amount of pay granted to rehired retirees employed by the state. In effect, enforcing compliance with the various restrictions in place for rehired retirees becomes difficult, if not impossible.

Cause: It appears state agencies were not always following the method developed to track rehired retirees, which appears to have, at least in part, led to the conditions noted above.

Recommendation: Although the primary responsibility for tracking rehired retirees falls on the individual state agencies, the Retirement Services Division should work with those agencies to strengthen controls over the tracking process to ensure compliance with the various restrictions put on pay and length of service. It should also attempt to identify all instances in which rehired retirees exceeded the allowed 120-day working period and recoup the retirement benefits paid out to those employees during the time they were reemployed by the state. Furthermore, it should consider implementing a policy that forecloses the reemployment of retirees within a specified period of time, such as 180 days. (See Recommendation 3.)

Agency Response: "As noted in the recommendation, the primary responsibility for tracking rehired retires falls on the administration and their individual state agencies. That said, the legislature and the Executive Branch have already enacted several measures to regulate the use of the Temporary Worker Retiree (TWR) Program. The provisions of Conn. Gen. Stat. §5-164a(c), as modified by the Pension Award dated September 25, 1989, clearly states that retired members of the State Employee Retirement System who are reemployed by the state can work no more than 120 days (960 hours) in a calendar year without impairing their pension rights.

In 2009, Governor Rell issued Executive Order 27-A, which prohibits state retirees from returning to state service for more than two 120-day terms. The order also (1) capped a returning worker's pay at 75 percent of his or her pay immediately prior to retirement and (2) required returning retirees to be approved by the Department of Administrative Services (DAS) commissioner, Office of Policy and Management secretary, and the Governor.

In January 2012, Governor Malloy also issued Executive Order 18, which allows the DAS commissioner to grant the Department of Transportation commissioner exceptions to the two-term limit if (1) the retiree can provide snow removal and emergency operations functions during the snow season and (2) there is an insufficient pool of otherwise eligible retirees available. The order maintains the 120-day annual limit for such TWRs and prohibits them from returning for more than four annual terms.

As noted above, it is the legislature and the Executive Branch that have the authority to promulgate and implement policies as it relates to the TWR. The Temporary Worker Retiree Program is administered by the Executive Branch through DAS and OPM. In accordance with its duties to administer this program, both DAS and OPM have released notices reiterating to all state agencies the importance of following the directives of the statute when retirees are rehired into any state job. Furthermore, in addition to the information contained in OLR General Notice 2006-18, all Core-CT transactions involving retirees are to be audited by the Department of Administrative Services Central Audit Unit to ensure that all position data, job data and employment data meet the requirements set forth in OLR General Notice 2006-18.

This agency will work with DAS and OPM to ensure that current and future requirements that have been set for the TWR program are being administered appropriately once promulgated."

ARP and SERS to Hybrid Retirement Plan Transfers

Background: In September 2010, there was an arbitration award referred to as the SEBAC ARP grievance (SAG) award that allowed employees of the Alternate Retirement Plan to join SERS using plan assets held in their ARP accounts to purchase benefits in SERS. The implementation of this award has been delayed due to the State Employees Retirement Commission's decision to seek advice on certain tax-related matters by requesting a private letter ruling from the IRS.

Subsequent to the SAG award, the 2011 SEBAC agreement was ratified and contained a provision that created a SERS Hybrid retirement plan option for new employees in higher education otherwise eligible for membership in the existing Alternate Retirement Plan. The SERS Hybrid plan is a defined benefit plan with a "cash out" option intended to be qualified under Section 401(a) of the Internal Revenue Code.

Criteria: Per the 2011 SEBAC agreement, ARP participants employed prior to July 1, 2011 as well as those who retired between January 1, 2009 and July 1, 2011, can transfer into the new SERS Hybrid plan. In order to transfer into the plan and receive credit for all prior state service during which they participated in ARP, the agreement requires that eligible employees pay the full actuarial cost to the SERS Hybrid plan for that prior service. The agreement also states that those ARP participants eligible to participate in the SAG award may immediately transfer into the SERS Hybrid plan if they do not want to wait for the IRS ruling; however, once this election is made, the employee will not be eligible to later participate in the SAG award.

Condition: During the audited period, we identified 340 transfers into the SERS Hybrid plan. We tested 8 of these transfers and noted 2 instances in which the cost to the employee transferring into the plan appeared to be calculated incorrectly. In one instance, an employee was overcharged by $7,480, and in the other an employee was undercharged by $9,010.

We also noted 4 instances in which employees did not appear to meet the criteria to be eligible to be in the plan. In 3 of these instances, the employees worked at agencies that were not considered higher education institutions, but were allowed to transfer into the SERS Hybrid plan and retire. In the fourth instance, the employee worked at a higher education institution when she transferred into the SERS Hybrid plan, but subsequent to her retirement, she was rehired at an agency that was not a higher education institution and should have been removed from the SERS Hybrid plan and moved into the SERS Tier III plan.

Furthermore, a review of the general information related to the entire 340 transfers disclosed 19 additional instances in which employees were allowed to transfer into the SERS Hybrid plan but did not appear to meet the qualification requirements based on their employing agencies and the retirement plan those employees were currently enrolled in, which was SERS.

Effect: With respect to the over and under charges for employees to buy into the SERS Hybrid plan, retirement payments issued to these employees are incorrect because they are based on the amount of time purchased.

In regards to the employees and retirees who do not appear to be eligible to participate in the SERS Hybrid plan, they may be receiving benefits in excess of what is allowed by the 2011 SEBAC agreement. Furthermore, allowing ineligible employees or retirees to transfer into the SERS Hybrid plan puts the plan at risk of disqualification.

Cause: Regarding the 2 incorrect buy-in calculations, it appears that a different methodology may have been used when determining the payment amount.

With respect to the other issues noted, the 2011 SEBAC agreement is silent on various matters, such as whether employees currently participating in SERS can purchase prior ARP time. This may have, at least in part, led to some confusion as to whether certain employees were eligible to transfer into the SERS Hybrid plan.

Recommendation: The Retirement Services Division should review the employees identified during our audit that appeared to be ineligible to transfer into the SERS Hybrid plan and take corrective action as needed. Furthermore, the Retirement Services Division should consider reviewing all transfers into the SERS Hybrid plan to ensure that the employees who transferred into the plan were eligible. Appropriate corrective action should be taken when employees are identified who were not eligible to transfer. (See Recommendation 4.)

Agency Response: “The Retirement Services Division respectfully disagrees with the Auditors finding that the employees they have identified are ineligible to transfer to the SERS Hybrid plan. Transfers have occurred pursuant to the SEBAC 2011 agreement and in consultation with the Office of Labor Relations and SEBAC when clarification was needed. The Retirement Services Division will continue to review the ARP to SERS Hybrid transfers to ensure that they are being processed in accordance with the SEBAC 2011 Agreement and will review any procedural change or corrective action that may be needed with the necessary stakeholders, including the State Employee Retirement Commission, the Office of

Labor Relations and State Employee Bargaining Agent Coalition (SEBAC).”

Disability Retirement – Medical Reviews and Annual Review Forms

Criteria: Sections 5-169 and 5-192p of the General Statutes state that, if a member of state service becomes permanently disabled, “such member is eligible for disability retirement for twenty-four months. Thereafter, disability retirement continues only if such member is totally disabled for any suitable and comparable job.”

The Retirement Services Division requires the physician treating the condition on which the disability retirement is based to complete a medical review form 24 months after the individual was initially approved. This review should be based on a current assessment, and the physician should state whether and to what extent the employee will be able to return to the former position.

Condition: Our review of 30 disability retirees who were due for a 24-month review during the audited period disclosed 17 instances in which reviews were either performed in an untimely manner, or not performed at all. In 5 of these instances, the reviews were performed between 8 months and slightly more than 1½ years after they were due. In the other 12 instances, a review was not performed. As of June 2015, these reviews were between 3 and almost 4½ years past due.

In addition, we noted 2 instances in which 24-month review forms were not completely filled out. In both instances, the doctors did not answer whether the retiree could return to work. Also, 1 form did not contain the date the doctor performed the physical examination.

Furthermore, we noted that the backlog of 24-month reviews for disability retirees had increased from 231 as of the end of the audited period in June 2014, to 382 as of the date of our review in June 2015.

Effect: There is a considerable risk that individuals are receiving disability retirement benefits they are not entitled to, resulting in improper costs to the State Employees Retirement Fund.

Cause: Physicians are not provided with a clear description of the 24-month job standard with the medical review form. Therefore, they may feel that they cannot accurately assess whether the retiree meets the standards and opt to leave it blank. It also appears that there is a weakness in internal controls for tracking the medical review forms, which contributed to this issue.

Recommendation:	The Retirement Services Division and the Medical Review Board should comply with the Connecticut General Statutes regarding disability retirements and confirm that individuals are permanently disabled. (See Recommendation 5.)

Agency Response:

"During the audit period in question, the Medical Examining Board (MEB) had been evaluating members based on an "own occupation" standard at the twenty-four (24) month review for well over twenty years. Upon review of the Retirement Services Division's internal policies and procedures the Retirement Services Division concluded the "own occupation" standard was inconsistent with the statutory intent and that while the statute does not define "suitable and comparable" it has historically been defined in Department of Labor statutes and regulations as <u>any</u> job that a disability retiree is capable of performing considering his age, education, physical limitations, vocational skill, and experience. "Comparable" generally refers to the ability to earn wages at pre-disability levels; that is, whether the "suitable" occupation has the potential to pay the disability retiree at a comparable (not identical) wage level.

As a result of this review the Retirement Division's internal policies and procedures were revised pending final approval from the Retirement Commission. Before this issue was brought to the attention of the Retirement Commission, the Retirement Services Division was informed by the Office of Labor Relations and SEBAC that the interpretation of a disability statute was a matter for collective bargaining and fell under their purview as the representatives for coalition negotiations on statewide issues related to pension benefit.

This matter was resolved with a Memorandum of Understanding between the current administration through the Office of Labor Relations and SEBAC, dated August 5, 2016 where the suitable and comparable language was clarified. Additionally, changes were made to Connecticut General Statute 5-169 (c) effective July 1, 2014. These changes increased the pool of doctors that would be available to serve on the MEB from seven to twenty-five.

Currently there are ten doctors serving on the MEB. With the increase in the number of doctors, the Division has been able to plan and schedule more meetings which have in turn resulted in a dramatic decrease in the time an application is presented to the MEB for a decision. Prior to the change in statute and the new processes and procedures and training that mas implemented in response to that change, members that applied for disability retirement waited upwards of one year to have their application reviewed by the MEB. Currently, an initial application which is fully complete (all necessary medical documentation has been provided) will be presented before the Medical Examining Board within approximately two months of the applicant's date of retirement.

The Medical Examining Board doctors have been trained so that they have an understanding of the new definition for suitable and comparable and have applied this understanding in reviewing the applications that have been due for twenty-four month review. To date there are only 213 twenty-four month review cases that need to be processed and those will be scheduled for review by early 2017. The Division has also processed another 231 twenty-four month review cases for those individuals, pursuant to the Memorandum of Understanding, who are collecting social security disability retirement and therefore eligible for continued receipt of their disability retirement benefit.

Finally, regarding the annual surveys, staffing realignments have resulted in timelier processing of the surveys."

Retirement Purchases

Criteria: Collective bargaining agreements, Section 5-193 and 5-180 subsection (b) of the General Statutes, and division policies establish the requirements that must be met for state employees who wish to purchase qualifying prior service to be counted for retirement purposes. The SEBAC V agreement also specifies that interest at a rate of 5% per year must be paid from the time such service was rendered to the date of payment to receive credit for prior period service under tier IIA.

Condition: Our review of 30 prior service purchases made during the audited period disclosed the following:

- Two instances in which employee service purchases, totaling $10,531, were allowed to exceed the period stipulated in the service purchase application. Both instances exceeded the 24-month limitation set forth in SEBAC V and 1 of the instances exceeded the 36-month limitation set forth by Connecticut General Statute 5-175(b);

- Eight instances in which employees were not charged gap interest. Five instances of Tier IIA employees purchasing 5-193IK prior military service credit and 3 instances of Tier II employees purchasing 5-192UML military leave. In 1 of these instances, the employee was originally charged gap interest, but it was later refunded;

- Thirteen instances in which the supporting documentation uploaded into Tower, the division's imaging system, and sent to employees appeared to have the mailed and due dates modified;

- Three instances in which purchases were paid after the due date; and
- One instance in which an employee paid for her purchase with 2 separate payments, which is against division policy, when it should have been one lump sum.

Effect: The application of the rules and regulations governing the purchase of service time for employees in the State Employees Retirement System is inconsistent.

Cause: The lack of internal controls allows agencies to loosely adhere to the policies set forth by the Retirement Services Division.

Recommendation: The Retirement Services Division should strengthen controls over retirement purchases to ensure compliance with the procedures set forth by the Retirement Purchasing Unit. (See Recommendation 6).

Agency Response: “The implementation of the new pension module in Core-CT will address this issue and consistently apply the proper criteria for purchasing prior service to be counted for retirement purposes, thereby rectifying any variances in the calculations.”

Retirement and Healthcare Contributions

Criteria: Section 4-32 of the General Statutes states that receipts amounting to $500 or more are required to be deposited within 24 hours. It further states that receipts of less than $500 can be held until they equal $500, but not for more than 7 calendar days.

Per the 2009 SEBAC agreement, all employees hired after July 1, 2009, or with fewer than 5 years of service as of July 1, 2010 are to contribute 3% of their salaries to a fund established for the provision of health care coverage to retired state employees until the employee reaches 10 years of employment.

The 2011 SEBAC V revised agreement required all employees not paying the 3% contribution from the 2009 agreement to begin paying a contribution. The agreement phased in the contribution by requiring payment of .5% starting in July 2013, increasing it to 2% starting in July 2014, and then to 3% in July 2015.

Condition: Our review of 20 contributions of $44,601 in aggregate made during the audited period disclosed 3 instances in which receipts totaling $1,849 were deposited in an untimely manner. In the instances noted, deposits were made between 2 and 10 business days late.

Additionally, we noted 6 instances in which receipts totaling $33,737 were either not stamped with a receipt date or appeared to be stamped with an incorrect receipt date, as the date was after the deposit date. Due to the lack of an accurate receipt date, we were unable to determine whether these funds were deposited in a timely manner.

Furthermore, we performed a review of agencies that participate in the state's Health Enhancement Program (HEP) and use accounting systems other than Core-CT, which are also referred to as outside agencies. During our review, we identified 118 employees working in these outside agencies who were not contributing the required additional contribution amount set forth in the 2011 SEBAC agreement. Based on these instances, there were at least $11,420 in contributions that had not been received as of the time of our testing in August 2015.

Effect: The Retirement Services Division is not in full compliance with the prompt deposit requirements set forth in Section 4-32 of the General Statutes.

Regarding the contributions that were not being made by outside agencies, those agencies were not in full compliance with the requirements set forth in the 2011 SEBAC agreement. Furthermore, the employees of those agencies were receiving benefits from the state's HEP program without making the required contributions.

Cause: The controls in place were not sufficient to prevent the above conditions from occurring.

With respect to the instances in which contributions were not being received from outside agencies, it appears that there was some confusion as to whether the contribution requirements set forth in the 2011 SEBAC agreement applied to those agencies.

Recommendation: The Retirement Services Division should improve internal controls to ensure that contributions are date-stamped upon receipt and deposited within the timeframe required by Section 4-32 of the General Statutes. In addition, it should ensure that outside agencies who participate in the state's HEP program begin contributing the appropriate amount to the Retiree Health Care Trust Fund, as required by the 2011 SEBAC agreement. The division should also identify and collect any contributions that should have been paid by outside agencies but were not. (See Recommendation 7.)

Agency Response: "It is unclear what deficits are being referred to here or which division is being commented upon. The Healthcare Policy and Benefit Services

Division (not the Retirement Services Division) on rare occasions will receive checks made payable to the Treasurer's Office for previously refunded OPEB contributions, which employees can elect to repay upon being rehired. The Healthcare Policy and Benefit Services Division has no control over the date or the time when the employing agency forwards such check. There are no other checks that are sent to the Healthcare Policy & Benefit Services Division with respect to OPEB.

The report correctly notes that there is some confusion as to whether outside agencies that use an accounting system other than CORE-CT are subject to the provisions of SEBAC 2011 with regard to the Retiree Health Fund contributions. There has been no clear guidance on this issue and no existing mechanism to resolve it.

The Health Enhancement Program (HEP) is an optional wellness program, which provides reduced premiums for members who elect to participate. There is no "additional" contribution associated with membership in HEP, and HEP has no impact on a person's obligation to make OPEB contributions.

The Healthcare Policy & Benefit Services Division has been working with CORE-CT on development of a system to more effectively monitor the OPEB process, which will prevent state agencies from enrolling employees in health benefits without simultaneously enrolling them in OPEB contributions and will control the refund process. We expect this program to be operational sometime in early 2017 and believe that it should resolve some of the difficulties encountered. However, it bears repeating that the Healthcare Policy & Benefit Services Division has been made responsible for overseeing the process of collecting (and refunding) OPEB contributions without any allocation of the personnel, resources or systems required to put more effective oversight in place."

Auditors' Concluding Comment:

For clarification purposes, the issues noted relating to the untimely deposit of contributions and receipt documentation relate to the Retirement Services Division.

The issue related to the 118 employees working in outside agencies who appear to be required to make additional contributions is directed towards the Healthcare Policy & Benefit Services Division to inform it of this matter.

Investigations and Recoveries (Accounts Receivable)

Criteria: Per the State Accounting Manual, "accounts receivable records should be accurate, complete, and maintained in a manner to indicate the length of time the debt has been outstanding."

Accounts receivable balances should be periodically reviewed to determine their collectability and amounts judged by management to be uncollectible should be written off.

Condition: Our audit of 30 State Employees Retirement System accounts receivable balances disclosed 5 instances in which the balance reported on the aged receivable report did not reflect the balances per supporting documentation. In these instances, the variances amounted to an overstatement of $12,647.

We also noted 9 instances in which receivable balances, totaling $121,253, had been outstanding for an extended period of time with no evidence of any recent attempts to collect on the balances. These balances had been outstanding for periods ranging from 7 to 22 years.

Effect: The records of the State Employees Retirement System accounts receivable are not accurate. Therefore, the accounts receivable balance reported on the Retirement Services Division State Employees Retirement System financial statements is inaccurate.

Cause: The Investigations and Recovery Unit system utilized by the Retirement Services Division to track accounts receivable balances is not being updated consistently to reflect payments received. The aged receivables report is not being monitored to identify long-standing accounts that should be investigated and/or written off.

Recommendation: The Retirement Services Division should track accounts receivable more accurately and should actively follow up on the collection or write-off of inactive accounts. (See Recommendation 8.)

Agency Response: "The Retirement Services Division has already taken steps to more effectively track accounts receivable. As of September 2013, a full-time staff member has been assigned to review and update the Accounts Receivable database. All negative amounts and inconsistent data have been corrected. Additionally, long-outstanding receivables are being reviewed by the Retirement Commission to make a determination as to whether or not the Commission should move forward with collection efforts."

Equity Refunds – Exclusion Rate

Criteria: Section 5-168 of the General Statutes provides for a death benefit to the beneficiary of members who retired on or after August 1, 1986. This amount is equal to the member's retirement contributions plus interest, reduced by the federal tax exclusion ratio multiplied by the income payments made to the member from the State Employees Retirement Fund.

Section 72(d) of the Internal Revenue Code provides that, in general, gross income shall not include any monthly annuity payments made under a qualified employer retirement plan that does not exceed the amount obtained by dividing the investment in the contract (as of the annuity starting date) by the number of anticipated payments determined under IRS guidance.

Internal Revenue Service Notice 98-2 indicates that the simplified method provided in Section 72(d) of the Internal Revenue Code must be applied to distributees to comply with Section 72, and by payers to report the taxable portion of annuity distributions on Form 1099-R. The notice further states that payments not made on a monthly basis must be adjusted to take into account the period on the basis of which such payments are made.

Condition: Our audit of equity refund distributions disclosed that the Retirement Services Division calculates equity refunds using an average exclusion ratio instead of the simplified method as required by the Internal Revenue Service.

Effect: Due to the incorrect method used to calculate the exclusion ratio, the beneficiaries of SERS plan members do not receive their true death benefit. Instead, they receive an estimate based on an average exclusion ratio which, depending on the plan member's age at death, will result in an underpayment or overpayment of death benefits to the beneficiary. The younger a retiree was at time of death, the greater the likelihood and amount of an underpaid death benefit to the retiree's beneficiary.

Cause: In October 1992, the Retirement Services Division determined that it could not complete the calculation to determine an individual's federal tax exclusion ratio in a timely manner, and, therefore, developed an average tax exclusion ratio that it used for the calculation. It does not appear that the division revisited the issue after the IRS revised its methodology.

Recommendation: The Retirement Services Division should revise its methodology for calculating death benefits for the beneficiaries of retired SERS plan members. Specifically, the federal tax exclusion ratio should be calculated on a case-by-case basis using the simplified method instead of the average exclusion ratio it has been using. (See Recommendation 9.)

Agency Response: "The Retirement Services Division disagrees that the methodology for calculating death benefits for the beneficiaries of retired SERS plan members should be calculated on a case-by-case basis using the simplified method instead of the exclusion ratio it has been using. The Division contends that using the average exclusion ratio is appropriate but, given the recommendation, will seek the advice of tax counsel for further clarification regarding this matter."

Municipal Employees Retirement System

Investigations and Recoveries (Accounts Receivable)

Criteria: Section 7-439h of the General Statutes states that upon discovery of an error that results in a retiree or beneficiary receiving more benefits than they were entitled, the Retirement Commission shall notify the affected individual and set up a repayment plan for the amount owed to the Municipal Employees Retirement System (MERS).

Agency policy, effective July 2013, states that if a member is found to be noncompliant in attempts to collect an overpayment, the Retirement Commission should be notified so that it may take additional steps to collect, such as working with the Office of the Attorney General.

Accounts receivable balances should be periodically reviewed to determine their collectability. Amounts judged by management to be uncollectible should be written off.

Condition: Our audit of 30 Municipal Employees Retirement System accounts receivable balances, with an aggregate original balance due of $1,306,844, disclosed 9 instances in which the MERS Unit did not follow up on the collection of overpayments, totaling $95,024, in a timely manner. In 5 of these instances, totaling $79,299, the time between the initial notification and follow-up by the MERS Unit ranged from roughly 4 to 5½ years. In the other 4 instances, initial notification of the overpayments, totaling $15,725, was sent out, but there has been no other attempt to follow up on those amounts since. At the time of our audit, these balances had been outstanding for periods ranging from 4 to 5 years.

In addition, we noted 1 instance in which the balance reported on the aged receivables report did not accurately reflect the receivable balance, per supporting documentation. In this instance, the aged receivables report was overstated by $55,557.

Furthermore, during the course of our audit, we noted that the total population of MERS deceased retirees and beneficiaries, including those listed in the exceptions above, suggests that as of June 30, 2014, there were 168 individuals owing $366,780 in aggregate that were not being actively pursued for collection or being considered for write-off.

Effect: The records of the Municipal Employees Retirement System accounts receivables are not accurate. Therefore, the accounts receivable balance reported on the Municipal Employees Retirement System financial statements is inaccurate.

Cause: The controls in place were not sufficient to prevent the above conditions from occurring.

Prior to July 2013, the MERS Unit was not tracking deceased retiree and beneficiary overpayments in its accounts receivable database. As of July 2013, procedures have been established to track deceased overpayments.

Recommendation: The Retirement Services Division MERS Unit should continue to clear old deceased cases and should actively pursue all types of overpayments for repayment or write-off. (See Recommendation 10.)

Agency Response: "The MERS unit continues to investigate and clear deceased cases and actively pursue all types of overpayments for repayment or write-off. The MERS unit has policies and procedures in place to track these overpayments. The MERS system will be implemented into Core-CT in early 2017, at which time the tools for achieving timely recoveries will be more efficient."

Contributions from Municipalities

Criteria: Section 4-32 of the General Statutes states that receipts amounting to $500 or more are required to be deposited within 24 hours. It further states that receipts of less than $500 can be held until they equal $500, but not for more than 7 calendar days. Although the funds received for the Municipal Employees Retirement Fund (MERF) do not represent state revenue, the fact that the fund is controlled entirely by the Office of the State Comptroller makes Section 4-32 applicable.

Section 7-442b of the General Statutes states that municipalities that volunteer to transfer previous employer and employee retirement funds to MERF shall transfer the contribution amounts with interest from the date of payment into the fund to the date the employee became a member of MERS.

Section 7-440 of the General Statutes entitles members of MERS leaving municipal employment to a refund of all contributions, including those made to another system and transferred to MERF, with interest.

Retirement Services Division policy includes notifying retirees in their award letters of the amount of their employee contributions on a pre-tax and post-tax basis, as well as their earned interest. This information is used by the employees to compute the amount of their pension subject to federal income tax.

Condition: Our review of 55 contribution payments received from various municipalities during the audited period, amounting to $745,724 in aggregate, disclosed 16 instances in which contributions totaling $324, 906 were not deposited in a timely manner. In the instances noted, deposits were made 1 to 19 business days late.

In addition, we noted 13 instances in which contributions totaling $144,971 were not stamped with a receipt date. Due to the lack of a receipt date, we were unable to determine whether the funds were deposited in a timely manner.

Furthermore, we tested 2 municipalities that joined MERS during the audited period to ensure that all required contributions had been made. Our testing disclosed that the City of Bridgeport Fire Fighters' Pension Fund (Bridgeport FFPF) began participating in MERS in April 2012 and transferred $22,509,819 and $17,613,070 to MERF in July 2012 and July 2013, respectively. These transfers represented the balance of assets held by the City of Bridgeport Fire Fighters' Pension Fund and included municipal contributions, employee contributions, and interest. As of May 2015, Bridgeport FFPF has not provided the Retirement Services Division MERS Unit with a breakdown of the asset transfers, including the individual employee contributions and earned interest reports.

Effect: The Retirement Services Division MERS Unit was not in full compliance with the prompt deposit requirements set forth in Section 4-32 of the General Statutes.

With respect to the issue with Bridgeport FFPF, there is an effect at both the employee level and at the financial statement level. At the municipal employee level, without the individual employee contribution and earned interest figures prior to joining MERS, the Retirement Services Division MERS Unit does not have accurate records of employee total contributions and earned interest. Employee earned interest would also be understated since the balance of employees' prior contributions has not been actively earning additional interest since they joined MERS. This represents a problem if a member of Bridgeport FFPF requests a refund of contributions with interest since the data is not readily available. The same problem would exist for a Bridgeport FFPF retiree who elects the straight life annuity option and dies before contributions and interest have been depleted, since the remainder is paid in a lump sum to the designated beneficiary or the retiree's estate. Furthermore, employee post-tax and pre-tax contributions that are communicated to municipal employees at retirement in their award letter could be incorrect, which, if gone unnoticed, could increase the federal taxes levied on the retiree's pension.

At the financial statement level, the equity of members in their contributions amount on the MERF balance sheet appears to be understated since members' equity is inaccurate without complete employee contribution amounts. Interest payable on participant contributions also appears to be understated since employees are not actively earning interest on their contributions prior to joining MERS.

Cause: The Retirement Services Division MERS Unit did not consistently follow procedures to stamp contribution reports as received. However, it should be noted that the number of untimely deposits decreased significantly since our last audit.

Regarding the issue with Bridgeport FFPF, despite multiple requests, Bridgeport FFPF has been unable to provide individual employee contribution and earned interest reports.

The controls in place were not sufficient to prevent this condition from occurring.

Recommendation: The Retirement Services Division MERS Unit should ensure that all receipts are deposited in accordance with the provisions of Section 4-32 of the General Statutes, and should stamp all contribution reports indicating the date the contributions were received. It should also continue to request individual employee contribution and earned interest reports from Bridgeport FFPF, and consider involving the Retirement Commission in this matter, which has the power, per Section 7-448 of the General Statutes, to levy a $100 per day fine for the failure of a municipality to furnish requested information. (See Recommendation 11.)

Agency Response: "The Retirement Services Division has assigned additional staff to timely process receipts and deposits in order to ensure compliance with the provisions of Section 4-32. The Division has also instituted annual training for its MERS unit staff members that process receipts and deposits to ensure compliance with internal policies and procedures as well as statutory provisions.

The individual employee contribution and earned interest reports for the Bridgeport Fire have been completed and the Retirement Commission, as with all other things within their purview, was apprised of this matter and will make a determination as to what action, if any, should be taken regarding the failure of municipalities to furnish requested information."

State Healthcare Policy and Benefit Services Division

Healthcare Coverage for Dependents

Criteria: Open enrollment documentation distributed to all state agencies by the Office of the State Comptroller summarizes dependent eligibility requirements that state employees and retirees must follow in their election to cover or continue to cover dependents. Children, including stepchildren and adopted children, may be covered up to age 26 for medical and age 19 for dental. Minor children for whom an employee or retiree is legal guardian may be covered up to age 18 for both medical and dental. Disabled children can be covered beyond these age limits.

Condition: At the time of our testing in April 2015, we identified 52 dependents receiving coverage who were above the maximum age limit for coverage and not identified as disabled in Core-CT. With respect to the dependents identified as being above the maximum age limit for healthcare coverage, 14 dependents had medical and prescription coverage and 38 dependents had dental coverage.

Effect: Dependents exceeding the maximum age limit for healthcare coverage were provided with state medical and dental coverage. In effect, the state may have paid insurance claims for ineligible individuals.

Cause: The Healthcare Policy and Benefit Services Division generates reports that detail unprocessed employee and dependent changes and dependents who have reached the maximum age for coverage and distributes these reports to the applicable state agencies. However, we noted that the Healthcare Policy and Benefits Services Division rarely follows up on individuals who continually appear on the reports.

Recommendation: The Healthcare Policy and Benefit Services Division should strengthen internal controls to prevent ineligible dependents from being assigned medical and dental coverage. Furthermore, the division should ensure the prompt removal of such dependents upon class-changing events. (See Recommendation 12.)

Agency Response: "While we are always open to suggestions for improving existing policies and procedures we do not believe that this finding is substantial. The state's health plan covers 210,000 lives. Over the last three years, the state has processed roughly 280,000 benefit transactions, not including annual open enrollment. The state plan has different maximum ages for coverage of dependent children: age 26 for medical benefits and age 19 for dental benefits.

The PeopleSoft system allows us to use only one age to configure an automated dependent removal process. The state chose age 26 as the configuration value to be used for this monthly automated process. The system identifies and automatically removes dependents over the age of 26 from the medical and pharmacy plans and issues the required COBRA notice.

There is no automatic process within Core-CT to detect and remove over-age dependents of active employees from dental coverage. Each month OSC distributes an Overage Dependent Report to agency HR/payroll/benefits officers for medical and dental plans with the expectation that the agencies will remove ineligible dependents from the active employee plan. The Office of the Comptroller removes ineligible dependents from coverage under the retiree dental plan.

It should also be noted that the correction and reprocessing of benefit transactions can (and frequently does) override system edits resulting in the restoration of an ineligible dependent to coverage. If an agency processes a transaction out of sequence or fails to verify the transaction's enrollment screens after processing, the system can give the appearance that a dependent has never been removed from coverage, even though that is not the case. These are just two examples of issues that our Overage Dependent Report is designed to capture. Since the reports are run monthly, the errors might accumulate until the reports are run.

Given the absence of an automated process to capture overage dependents enrolled in the dental plan, it is not surprising that the number of dependent enrollment errors in that plan exceeds the number of enrollment errors on the medical plan. In view of the sheer volume of benefit transactions in the system we believe the number of erroneous enrollments is statistically minimal. Having said that, per our usual practice, we will continue to work with the agencies to remove ineligible dependents from coverage."

Retiree Health Contributions and Refunds

Criteria: The 2009 and 2011 SEBAC agreements implemented a program whereby active employees are required to contribute a portion of their salary, dependent upon when they were hired, to fund their future retiree health benefits. These contributions persist for a period of 10 years from when they commence employment.

With few exceptions, employees who were first hired or rehired on or after July 1, 2009 to a position in which they are eligible for health coverage, and existing employees who on July 1, 2010 had fewer than 5 years of service, were required to contribute 3% of their salaries beginning on those respective dates.

The SEBAC 2011 agreement expanded the requirement to include all other employees eligible for health coverage. These employees must contribute a total of .5% of their salary starting in July 1, 2013; a total of 2% of their salary starting July 1, 2014; and a total of 3% of their salary starting July 1, 2015.

The SEBAC 2011 agreement also states that, upon separation from state service, such contributions are refundable to employees if they do not meet the requirements to qualify for retiree healthcare. In addition, the state may withhold such refunds until July 2012, but must pay 3% interest per year between the date of separation and payment.

Condition: During our audit, we reviewed Other Post Employment Benefit (OPEB) contributions and refunds on a statewide basis. Our review disclosed the following:

- Two hundred eighty-four employees who, as of June 2015, were not having their required contributions deducted from their pay. Although some of these employees may be exempt, none of them had been reviewed by the Healthcare Policy and Benefit Division to determine whether that was the case;

- Thirty-three paychecks with deductions that were not based on the proper percentage of applicable earnings, resulting in a variance of $845;

- Fifty paychecks related to 50 separate employees in which the incorrect deduction code was used;

- Six employees had incorrect deduction start or end dates on their records in Core-CT, increasing the risk that deductions taken from their paychecks would vary from what was required;

- One employee who was assigned an incorrect deduction code;

- Sixteen employees who, upon separation from state service, received refunds of their OPEB contributions in excess of what they contributed. The excess payments totaled $15,896;

- Seven refunds, totaling $8,231, that were processed more than a month after the requests were received. Delays ranged from 55 days to 695 days; and

- Nine instances in which, due to lack of information, we could not determine whether refunds of OPEB contributions, totaling $11,901, were made in a timely manner.

In addition, we noted that the Core-CT module used to monitor OPEB deductions does not always include all applicable earnings listed for employees. Therefore, some paychecks with missed deductions do not appear and any analysis performed using this information would appear erroneously accurate. Furthermore, the module does not contain historical data for changing deduction percentages.

Effect: There is an increased risk that incorrect deductions are taken from paychecks and that these incorrect deductions will go undetected due to incomplete or misleading data in Core-CT.

The Healthcare Policy and Benefit Services Division was not in full compliance with the contribution and refund requirements set forth in the 2009 and 2011 SEBAC agreements.

Cause: In regards to the contribution issues, the Healthcare Policy and Benefit Services Division uses several queries that attempt to filter for employees who would be required to contribute. However, setting up employees and reviewing compliance is a manual process, which makes it difficult to catch all errors due to the amount of time involved.

With respect to the refunds of excess OPEB contribution amounts, the division informed us that state agencies sometimes miscalculate the refund amount, reverse paychecks having OPEB refunds, or request duplicate refunds. The division informed us that, because there is no automated system in place to detect these issues, it is difficult to identify overpayments.

In regards to the late refunds, the division told us that refund requests are submitted to the Healthcare Policy and Benefit Services Division in batches of 5, which can cause a delay in the refund process.

Recommendation: The Healthcare Policy and Benefit Services Division should strengthen internal controls to ensure that Other Post Employment Benefit (OPEB) deductions are properly applied. It should also ensure that refunds are accurately calculated and processed in a timely manner. Furthermore, the Healthcare Policy and Benefit Services Division should attempt to recover the overpayments made in relation to some of the OPEB refunds that were noted during our audit. (See Recommendation 13.)

Agency Response: "As a preliminary matter, we'd like to address the report's conclusion that the Healthcare Policy & Benefit Services Division (HPBSD) "was not in full compliance with the contribution and refund requirements set forth in the 2009 and 2011 SEBAC agreements."

Since the program was initially implemented in 2009 and, as a result of continued cuts to agency budgets, HPBSD was not provided with either the systems or the personnel to monitor compliance with the OPEB program on a real-time basis. While HPBSD was given overall responsibility to describe the rules, administer the program, and communicate with state agencies, the absence of systems to support the program meant that any enforcement activities could only take place on a retrospective basis and could only succeed with the cooperation and assistance of all state agencies.

Most elements of the OPEB program are decentralized. Responsibility for correct enrollment of employees in OPEB, initial evaluation of exemption claims, setting start and end dates for OPEB contributions, advising terminating employees of their rights, and processing refunds at time of termination rest largely with the employing agency's HR and Payroll personnel.

OPEB contributions are collected through Core-CT payroll using a general deduction code. There is currently no mechanism within Core-CT to prevent agencies from issuing refunds in excess of OPEB contributions or to require them to enroll healthcare-eligible employees for OPEB deductions, or if enrolled, to assign them to the correct deduction code.

Having made these observations, we fully expect that many of the deficiencies noted in the auditor's report will be alleviated with the implementation of a new module in Core-CT that is presently under construction. The new module is expected to require enrollment in OPEB at the time of hire, at the same time as health and retirement plan eligibility are determined, to prevent overpayments, and to permit HPBSD to conduct real-time research.

With regard to the refund process, we disagree with the auditor's interpretation of the requirements of the SEBAC 2011 agreement in several respects. The draft audit report observes "that upon separation from state service such contributions are refundable to employees. In addition, the state may withhold such refunds until July 2012, but must pay three-percent interest per year between the date of separation and payment." To the extent that the auditor suggests interest may be due on refunds or that the SEBAC Agreement requires a refund of contributions upon separation from service, we respectfully disagree.

The SEBAC 2009 Agreement provided, "Contributions are refundable to employees who leave state employment prior to completing 10 years of service. If any such employee is reemployed, the employee shall be required to make contributions for ten (10) years starting with the date of reemployment. If requested, contributions shall be refunded on or after the employee's separation, except that the state may withhold refunds until July 2012 and in such cases shall pay three percent (3%) per annum interest between the date of separation and the July 2012 payment." (Emphasis added).

SEBAC 2009 specified that an employee had the right to request a refund upon separation from service. If an employee fails to request an OPEB refund, none is issued. This makes sense because a fair percentage of employees do return to state service and elect to leave the OPEB funds in place while seeking rehire. If a refund is issued the rehired employee must either repay the refunded contributions or lose credit for healthcare eligible service for purposes of retiree health benefits. In addition, if an employee separates from employment after accruing sufficient service to qualify for future retiree health benefits, no refund is permissible.

SEBAC 2009 provided for payment of interest on delayed refunds only if the state elected to withhold refunds until July 2012. This optional withholding of refunds until July 2012 did not occur. Therefore, any suggestion that payment of interest might be required because of "late or delayed" refunds is unwarranted.

The mechanism for requesting an OPEB refund has been explained in numerous Division and Comptroller's Memoranda. HPBSD worked with Core-CT to revise the termination procedures and to emphasize the need for agencies to make separating employees aware of the requirement for requesting a refund. An example of this can be found at http://www.osc.ct.gov/2012memos/healthcare/201201hp.htm.

However, the duty to advise employees about the right to request a refund of OPEB contributions upon separation from service rests with the HR personnel of the employing agency. If the employee is unaware of the right to a refund and the agency fails to provide the information at the time of termination there will be no automatic refund of OPEB contributions.

In 2014, HPBSD ran queries to identify employees who had separated from service without receiving OPEB refunds. That research revealed some 775 former employees who had not requested refunds. HPBSD contacted everyone we were able to locate and ended up processing approximately 576 refunds for employees who were previously unaware of their rights. We were unable to locate approximately 200 former employees even after using a person-locating service.

With respect to the audit report's description of alleged lapses, we make the following observations: the process for collection of Retiree Health Fund contributions is for the agency HR personnel to make the initial determination of an employee's right to an exemption from OPEB, which can be based on ineligibility for a retirement plan due to visa status, adjunct faculty status, seasonal employment, other retiree coverage, etc. If an exemption is claimed, the agency is responsible for noting the exemption status on the CO-1300, and forwarding that form to HPBSD for review. Absent agency compliance with the initial step, the HPBSD is not made aware that a new employee has not been signed up for OPEB or the reason for the omission. HPBSD is unable to monitor enrollment for OPEB in real time because we do not have access to relevant facts, such as visa status, that might indicate a basis for an exemption. As a result, HPBSD must rely on retrospective queries to determine whether healthcare-eligible employees have been signed up for the OPEB deduction by agency HR and Payroll staff.

This problem should be rectified by the OPEB module under development in Core-CT which will automate enrollment in health and pension plans with OPEB enrollment.

Agency personnel are the only ones permitted to enter the deduction code in an employee's record. HPBSD runs queries to identify incorrectly coded employees and has advised agencies to correct those problems where noted. HPBSD also runs quarterly queries to identify employees who are eligible for active health benefits but not contributing.

We understand that the initial query done by the auditors did not capture the OTRS/OTR2 deduction codes.

Agency HR personnel are responsible for enrolling employees and setting deduction start and end dates. When the SEBAC 2009 Agreement took effect, employees affected by that policy only had to contribute to OPEB until they had completed 10 years of service. That requirement changed under SEBAC 2011 so that all employees were subject to payment of 10 years of contributions.

In 2011, the HPBSD, in cooperation with the Payroll Services Division, sent out auto queries to all agencies notifying them of the requirement to adjust end dates for OPEB contributions for identified employees who began contributions in 2010.

The initial responsibility for entering revised deduction end dates rested with agency HR and Payroll personnel; HPBSD conducts periodic queries to determine whether OPEB deduction end dates have been corrected. We expect that this challenge will be addressed as part of the OPEB module development.

OPEB contributions are collected using a general deduction code in Core-CT. When the OPEB collection process was implemented in 2010, this was the only collection mechanism available. Using a general deduction code has many limitations. For example, Core-CT is unable to prevent issuance of a refund check in excess of contributions that are made using a general deduction code. The agency payroll and HR personnel are responsible for processing refund requests for terminating employees and for correctly determining the amount of the refund due; OSC processes refunds for employees whose refund request was not received until after termination. In an effort to prevent overpayments HPBSB reviews a log of petty cash checks prior to issuance to former employees; however, it is presently impossible to capture incorrect agency-generated refunds before checks are issued, especially where the agency fails to provide HPBSD with a copy of the refund application in advance or where the agency reverses and reissues a paycheck.

"Seven refunds, totaling $8,231, that were processed more than a month after the requests were received. In the instances noted, delays ranged from 55 days to 695 days."

"In regards to the late refunds, we were told refund requests are submitted to the Healthcare Policy and Benefit Services Division in batches of five, which can cause a delay in the refund process."

The SEBAC 2009 and 2011 agreements do not impose a deadline for issuance of a refund. Completion of a refund for a terminated employee is a time-consuming, manual process that requires coordination among Payroll, DAS and the employing agency. Due to OPM position controls, a request must be made by OSC's Payroll Division to Core-CT and DAS to re-open the terminated employee's position so that a petty cash check can be issued; following issuance of the petty cash check, the two departments must coordinate with each other a second time to ensure that the employee's position is closed again. The submission of OPEB refund in batches of five was deemed necessary to prevent the OPEB refund process from interfering with other workflows within OSC's Payroll Division.

"The Healthcare Policy and Benefits Services Division should strengthen internal controls to ensure that OPEB deductions are properly applied. It should also ensure that refunds are accurately calculated and processed in a timely manner. Furthermore, the Healthcare Policy and Benefits Services Division should attempt to recover the overpayments made in relation to some of the OPEB refunds that were noted during our audit."

Finally, recoveries of overpayments have been attempted from time to time. However, asking former employees to repay excess refunds has been met with limited success. In one instance HPBSD enlisted the help of DAS, and was able to obtain a partial repayment by seizing the former employee's state tax refund. The most successful strategy going forward would be to prevent overpayments from occurring through appropriate controls within the Core-CT system. We expect this issue to be addressed as part of the OPEB module development."

Other Matters

At the time this audit was being conducted, our office was also conducting an investigation that covered certain areas relating to the State Employees Retirement System. During that review, some issues were noted that were deemed significant enough to include in this report. These matters are as follows:

Statutory Offsets for Disability Retirees with Outside Earned Salary or Wages

Background: Issue #25 of the Interest Arbitration Award between the State of Connecticut and SEBAC regarding the Connecticut State Employees Retirement System, signed September 8, 1989, created a minimum benefit amount of no less than 60% of the employees' rate of salary at the time their disability occurred, and required that the benefit be adjusted annually. Prior to this agreement, the Retirement Services Division applied the statutory offsets for disability retirees with outside earnings when it performed its annual benefit calculation, which reduced the amount SERS paid to those retirees. The division changed its calculation methodology after this agreement became effective, which resulted in essentially eliminating the statutory offset provisions.

Criteria: For Tier I members, Issue #25 of the arbitration award added a new subsection (k) to Section 5-169 of the General Statutes that states, "Notwithstanding any other provision of law, each member entitled to disability retirement under this section shall receive a retirement income, inclusive of social security and workers' compensation, which is no less than sixty per cent of their rate of salary at the time their disability occurred. This benefit shall be adjusted in accordance with Sec 5-162d, Sec 5-162 (h) or Sec 169 (h) (3) whichever is greater." It should be noted that this new subsection has not been codified.

The statutes referred to in the new subsection (k) apply to the annual benefit increase each disability retiree is entitled to. Section 5-169 (h) (3) of the General Statutes only applies to the maximum benefit per subdivision (1) of Section 5-169 (g) and shall only be considered if the member had outside earned salary or wages. Section 5-169 (g) of the General Statutes applies a maximum benefit, which includes outside earned salary or wages.

For Tier II members, Issue #25 of the arbitration award added a new subdivision (3) to Section 5-192p (d) of the General Statutes that states, "Notwithstanding any other provision of law, each member entitled to disability retirement under this section shall receive a retirement income, inclusive of social security and workers' compensation which is no less than sixty per cent of their rate of salary at the time their disability occurred. This benefit shall be adjusted in accordance with Sec 5-192s or Sec 5-192p (e) (3) whichever is greater." This new subdivision has not been codified.

The statutes referred to in the new subdivision (3) apply to the annual benefit increase each disability retiree is entitled to. Section 5-192p (e) (3) of the General Statutes only applies to the maximum benefit provided in subdivision (1) of subsection (d) of Section 5-192p and shall only be considered if the member has outside earned salary or wages. Section 5-192p, subsection (d), subdivision (1) of the General Statutes applies a maximum benefit, which includes outside earned salary or wages.

Condition: The 1989 arbitration award created a minimum benefit when an employee goes out on disability, which is to be adjusted annually in accordance with applicable statutes. As noted in the Criteria, those statutes consider outside earnings as part of the benefit.

Since the effective date of the arbitration award, the division has not considered outside earnings, some of which are substantial, to be part of the benefit but instead a reduction of the benefit, which in turn results in the retiree receiving the minimum 60% amount referred to in the arbitration award. By treating retirees' outside earnings this way, the division has essentially eliminated the statutory offset, which has resulted in millions of dollars in unnecessary disability retirement benefit payments.

As further evidence that the division is incorrectly calculating disability retirement benefits, the actuarial analysis of the arbitration award, dated October 3, 1989, supports that there was no intention to eliminate the offsets. The analysis states that the past service cost, estimated at $207,000 will remain level and then cease after 36 years. Furthermore, the total cost, estimated to be $325,000, pales in comparison to the disability retirement payments, totaling $1,572,727, made during fiscal years 2012 and 2013 to 62 disability retirees with outside earnings that, when combined with the disability retirement payments they received, exceeded the statutory maximum benefits allowed. In all 62 instances, disability benefits were not offset as a result of their outside earnings. Our office reported these issues to the Governor and other state officials in a letter dated June 17, 2015.

Effect: The failure to reduce the disability retirement payments made to disability retirees with outside earnings appears to have resulted in significant overpayments of benefits. Unless the division changes the methodology it uses to calculate these payments, it will continue to make overpayments, which will add to the already significant SERS unfunded liability.

Cause: The division believes that it is calculating the annual benefit for disability retirees in accordance with Issue #25 of the arbitration award.

Recommendation: The Retirement Services Division should request a formal opinion from the Office of the Attorney General regarding the annual benefit calculation that should be used for disability retirees who have outside earned salary or wages. The request should be specifically directed at the intent of Issue #25 of the Interest Arbitration Award between the State of Connecticut and SEBAC regarding the Connecticut State Employees Retirement System. (See Recommendation 14.)

Agency Response: “The Division disagrees with this finding. During the 1988-1994 Pension Arbitration Award negotiations the issue of guaranteed minimum disability coverage was discussed as a part of Issue #25. SEBAC proposed that there be a provision that provided a minimum disability benefit which would include Social Security and Workers’ Compensation with a floor of sixty percent (60%) of the salary rate at the time that the disability occurred. The arbitrator adopted this last best offer of SEBAC. As reflected in the award there was no consideration of outside earnings in the adoption of Issue #25. The SEBAC and the Office of Labor Relations have clarified to the Division the application of the rule. Any change to the procedures would have to be determined by the neutral arbitrator.”

Employee Transfers from ARP to SERS Tiers I, II, and IIA

Background: Previously, the procedures in place within the Retirement Services Division allowed for plan changes in certain instances. In following these procedures, the employees identified would have, at some point, voluntarily selected ARP as their retirement plan, making them no different in that regard to employees included in the SAG award. In other words, their final choice could be considered their irrevocable choice. Since this practice was inconsistent with IRS regulations applicable to qualified plans like SERS and ARP, the division modified its procedures in 2008 to comply with IRS regulations.

Criteria: Section 5-155-9 subsection (c) of the Retirement Commission regulations states in part that all applications to purchase credit, obtain any benefit authorized by law, or refund contributions, found to meet statutory requirements or regulations, are processed by the Retirement Services Division as routine business. Those identified as restricted by the commission are submitted for individual approval.

Condition: Our review disclosed transactions and employee retirement plan transfers that were not routine business and were not brought to the Retirement Commission for review and approval prior to the division executing them. The details regarding these matters follow.

Twenty-eight employees with considerable state service time were allowed to transfer from ARP to various SERS Tier plans without making any payment to those SERS plans to support their future benefits. These transfers appeared to be allowed based solely on emailed instructions received from the Office of Labor Relations (OLR) or a SEBAC representative. When these email instructions were first received in 2013, there were 14 employees allowed to transfer. However, as of June 29, 2015, the number of employees who were allowed to transfer increased to 28; 24 to SERS Tier II, 2 to Tier IIA, and 2 to Tier I. Although those allowed to transfer could be considered similar to those included in the SAG award, SEBAC and OLR considered them to be different because the employees were already in a SERS Tier plan and, therefore, should not have been allowed to switch to ARP. Instead, it was determined that the employees should be placed in the SERS Tier plan that they never should have been allowed to transfer out of. Furthermore, although the SAG award private letter ruling (PLR) was pending, the division transferred the employees as instructed in the emails without informing the commission of its intention to make those transfers or verifying that the employees met the established criteria to transfer.

For those employees allowed to transfer, it was noted that, although most appeared to have met the established criteria, there were some instances in which we could not determine whether the criteria was met due to lack of documentation and others that, based on information available to us, did not appear to meet the criteria to transfer. In 1 of these instances, an email from an employee the division referred to as an “expert in Tier placement issues,” determined the only option for the employee was to transfer to the SERS Hybrid plan, but the division allowed the employee to transfer to the SERS Tier II plan instead. In another instance, an employee whose participation in ARP did not appear to be caused by an error was still allowed to transfer. This employee transferred from an Executive Branch agency that did not offer ARP to a higher education institution that did, which would have allowed for a voluntary change to ARP. This employee stated in an email that she felt she had been steered into selecting ARP, which was precisely the argument that resulted in the SAG award.

In relation to the aforementioned transfers, emails from OLR and SEBAC included instructions for the division to transfer the required employer and employee contributions held in each employee's individual ARP account to the appropriate SERS Tier Plan. The division withdrew a total of $2,600,842 from those ARP accounts; however, the money was never transferred to any of the SERS Tier plans. Instead, the division returned the money to the higher education institutions in the form of reduced future employer contributions to ARP for other employees. Under federal rules, this money should not have been returned to the employer and, instead, should have been put into the SERS plans that will benefit the transferred employees. Like the decision to allow the employees to transfer from ARP to a SERS Tier plan, the decision to allow participants' ARP withdrawals to be returned to the higher education institutions was made without input from the commission.

Furthermore, because of a calculation error made by the Retirement Services Division, there is an estimated $80,515 due to SERS from 4 of the employees noted above. Emails from OLR and SEBAC indicated that the amounts employees were to pay to SERS would be 8/13ths of their ARP balances for transfers to Tier II, and 10/13ths for Tier I and IIA transfers. The division incorrectly calculated the amounts for the employees who transferred to Tier I and IIA, causing an under-withdrawal of funds owed to SERS. We informed the division of this matter and requested documentation to support that the correct amounts were withdrawn and deposited to SERS. However, as of December 9, 2015, nothing has been provided to indicate that the division corrected these errors.

Effect:

The employee transfers could have the same legal compliance issues that were initially identified with the SAG award group. This includes offering more than 1 retirement plan election to members, and offering an election during a member's career rather than at commencement of employment. In addition, it may have violated the terms of the retirement plans and federal tax laws. Informing the commission of the transfers before executing them could have avoided any legal concerns.

The failure to transfer the money for the employees allowed to transfer to the SERS Tier plans increases the already significant SERS unfunded liability. As of June 29, 2015, the higher education institutions owed $2,600,842 to SERS Tier plans and the 4 undercharged employees owed an estimated total of $80,515.

Cause: The division informed us that it did not think it was necessary to bring these matters before the entire commission because it was considered a labor issue that was approved by the state's negotiator, who was also a member of the commission. It should be noted, however, that the SAG award was also a labor issue and was brought before the commission, which resulted in the implementation of the award being put on hold.

The division processed the transfers without verifying that each employee met the established criteria to transfer.

Regarding the employee ARP withdrawals that were returned to the higher education institutions instead of being transferred to SERS, the division told us that after several internal meetings, it was concluded that the funds would not be transferred to SERS and would remain in the ARP Appropriation account because that is where the 8% employer share resides.

With respect to the 4 employees being undercharged, there appears to have been an error in the calculation used by the division to determine the payment amounts.

Recommendation: The Retirement Services Division should not execute any transactions that could be considered non-routine business transactions before bringing them to the attention of the Retirement Commission. The division should also recover the monies due to SERS from the higher education institutions as well as collect the proper amounts from the employees who were undercharged, and deposit those monies to the appropriate SERS Tier plans. (See Recommendation 15.)

Agency Response: "The Retirement Services Division has continually brought all non-routine business transactions before the Retirement Commission for consideration. After internal discussions with the Budget and Financial Analysis Division of the Office of the State Comptroller it was determined that the recovery of monies due to SERS from the Institutes of Higher Education is not feasible due to the complexity of recovering the cost of the fringe benefit. All amounts from employees who were undercharged have been recovered and deposited into the Alternate Retirement Program."

Overpayments of Interest to Retirement Fund Participants

Background: Beginning in June 2013, the Retirement Services Division allowed 28 employees to transfer from ARP to various SERS Tier plans. The required employer and employee contributions held in the employees' individual ARP accounts were to be withdrawn and transferred to the SERS Tier plan that the employee transferred to. It was initially determined that the entire employee ARP account balance was to be withdrawn, with the required amount paid to SERS, and the remaining amount refunded to the employee. The first 2 employees who transferred had their entire ARP balances withdrawn, but before they were refunded to them, it was determined that refunds were not allowed. The money was held in the ARP and subsequently returned to their ARP accounts, with interest. The total amount held in the ARP account for the 2 employees was $89,488. It was withdrawn from their accounts on August 23, 2013 and returned on December 27, 2013, a period of 126 days. In addition, interest totaling $3,580 was paid to their accounts.

Criteria: When dealing with simple interest, the interest amount is calculated by multiplying the original amount by the interest rate, and then multiplying that by the period of time that the original amount earns interest. Interest rates are typically on an annual basis, thus the period of time should be prorated to the appropriate portion of the year.

Condition: Our review of the interest paid to the 2 employees disclosed that the division incorrectly calculated the interest amounts. It was agreed that 4% interest should be paid on the $89,488 that was incorrectly withdrawn from their ARP accounts. The division calculated the interest to be $3,580, which is 4% of the overdrawn amount, but it did not consider the time period that the monies were held (126 days). This resulted in the division paying roughly 12% interest rather than the agreed upon 4%, and an overpayment of $2,344. Since the money was held for 126 days, the amount that should have been paid at 4% interest was $1,236, calculated as $89,488 multiplied by 4% and then multiplied by 126 days divided by 365. The division informed us that it has no intention of recovering the overpayments.

Effect: The state incurred unnecessary costs by overpaying $2,344 in interest.

Cause: The division told us that its interpretation of how to calculate the interest appears to be different from our interpretation, and that the division believes it calculated the amount appropriately.

Recommendation: The Retirement Services Division should recover the $2,344 of interest overpayments made when it returned the funds it erroneously withdrew from the Alternate Retirement Plan accounts of 2 participants who transferred to the State Employees Retirement System. (See Recommendation 16.)

Agency Response: "The Retirement Services Division has recovered all overpayments related to the two transactions identified."

RECOMMENDATIONS

Our prior report on the fiscal years ended June 30, 2009, 2010, and 2011 contained 17 recommendations for improving operations, 10 of which are being repeated or restated with modification in our current audit report. Our current audit report presents 16 recommendations, including 6 new recommendations.

Status of Prior Audit Recommendations:

- **The Retirement Services Division should continue its effort to reduce the backlog of retirement applications waiting to be finalized. We also recommend that the division re-evaluate its long-standing practice of underpaying the estimated benefit. Based on the mission of the agency, it may be beneficial for the division to offer an annuity option on these types of lump-sum retroactive payments, as it may ease the tax burden on retirees receiving them.** The current audit disclosed that the conditions in the prior audit continued throughout the audited period. Therefore, the recommendation is being repeated (See Recommendation 2).

- **The Retirement Services Division should revise its method for calculating interest on post-benefit audit lump-sum payments.** The current audit disclosed that further improvement is needed in this area. The recommendation is being repeated (See Recommendation 2).

- **The Retirement Services Division should reassess how it reports Retirement Interest Payable and Retired Members in Contributions to ensure that accurate amounts are being reported on the Retirement Services Division financial statements.** This recommendation was addressed in a separate audit and will not be repeated.

- **The Retirement Services Division should track accounts receivable more accurately and should actively follow-up on the collection or write-off of inactive accounts.** The current audit disclosed that further improvement is needed in this area. Therefore, the recommendation is being repeated (See Recommendation 8).

- **The Retirement Services Division should comply with IRS regulations or apply for a waiver eliminating the requirement of a 30-day minimum wait time for contribution refunds, or if an individual prefers to waive the minimum wait requirement, retain a waiver signed by that individual.** The current audit disclosed that sufficient improvement has been made in this area. The recommendation is not being repeated.

- **The Retirement Services Division should revise its methodology for calculating the death benefit for the beneficiary of a retired SERS plan member. The federal tax exclusion ratio should be calculated on a case-by-case basis, following the guidance promulgated by the Internal Revenue Services.** The current audit disclosed issues with the methodology used for calculating death benefits for beneficiaries. The recommendation is being repeated (See Recommendation 9).

- **The Retirement Services Division and the Medical Review Board should comply with the Connecticut General Statues regarding disability retirements and confirm individuals are permanently disabled and not otherwise employed.** The current audit disclosed that sufficient improvement has not been made in this area. The recommendation is being repeated (See Recommendation 5).

- **The Retirement Services Division should review the staffing levels and processes of the Retirement Purchasing Unit and adhere to them.** The current audit disclosed that further improvement is needed in this area. The recommendation is being repeated with modification (See Recommendation 6).

- **The Retirement Services Division should take the necessary steps to improve its internal controls by establishing, updating, and maintaining formal, comprehensive written policies and procedures manuals for all of its functions.** The current audit disclosed that improvement has been made in this area. Therefore, the recommendation is not being repeated.

- **The Retirement Services Division MERS Unit should review the errors in retirement benefit calculations identified during its recalculations performed in 2009 and ensure that affected retirees are notified and the changes in their benefit payments are implemented.** The current audit disclosed that the recommendation had been implemented. Therefore, the recommendation is not being repeated.

- **The Municipal Employees Retirement Administration Fund should be reimbursed the full amount of $154,368 paid to Vignette Corporation or immediate action should be taken to induce the Municipal Employee Retirement System to utilize Tower IDM, and any excess charges should be refunded to the fund.** The current audit disclosed that the MERS Unit intends to use FileNet when the new Pension Module Project is implemented. We were also informed that the Municipal Employees Retirement Administration Fund will be made whole by allowing a reduction in rent charged to the fund over a period of years that will amount to $154,368 in savings to the fund. The recommendation is not being repeated.

- **The Retirement Services Division should improve the timeliness of its bank deposits and adhere to the prompt deposit requirements in accordance with the provisions of Section 4-32 of the Connecticut General Statutes. In addition, the division should maintain more complete supporting documentation for its deposits.** The current audit disclosed continued issues with the timeliness of contribution deposits. Therefore, further improvement is needed in this area. The recommendation is being repeated with modification to reflect the current audit findings (See Recommendation 11).

- **The Retirement Services Division should promptly bring all retirement matters that are non-routine in nature to the attention of the Retirement Commission.**

Further improvement is needed in this area. The recommendation is being repeated (See Recommendation 15).

- **The Connecticut State Employees Retirement Commission should adopt, or otherwise implement, regulations to limit the costs related to trustee overnight lodging and travel that are commensurate with the reimbursement amounts set forth in state travel regulations. The Connecticut State Employees Retirement Commission should utilize teleconferencing in order to save on travel reimbursements.** The current audit disclosed that sufficient improvement had been made in this area. Therefore, the recommendation is not being repeated.

- **The Healthcare Policy and Benefit Services Division should develop internal controls to proactively identify individuals who should have had an OPEB deduction initiated but who have not. It should also monitor OPEB deductions for accuracy and refund employees when excess deductions occur.** The current audit disclosed that the division has begun to take steps to remedy this issue; however, further improvement is needed in this area. We also noted some additional issues in this area during our testing. Therefore, the recommendation is being repeated with modification to reflect our current audit findings (See Recommendation 13).

- **The Healthcare Policy and Benefit Services Division should strengthen its internal controls and develop statewide policies promoting the timely and accurate issuance of OPEB refunds.** The current audit disclosed that some improvement has been made in this area. However, further improvement is needed. The recommendation is being repeated (See Recommendation 13).

- **The Healthcare Policy and Benefit Services Division should strengthen its internal controls to prevent ineligible dependents from receiving medical and dental coverage, and ensure prompt removal of such dependents when they reach the maximum age of coverage.** The current audit some improvement in this area; however, further improvement is needed. Therefore, the recommendation is being repeated (See Recommendation 12).

Current Audit Recommendations:

1. **The Retirement Services Division should ensure compliance with Section 415 of the Internal Revenue Code by ceasing all benefit payments in excess of the limitations imposed within that section.**

   Comment:

   Our review of benefit payments disclosed various instances in which benefit amounts paid to retirees exceeded the limits set forth in Section 415 of the Internal Revenue Code. By exceeding these limits, the plan may be in danger of disqualification.

2. **The Retirement Services Division should continue its efforts to reduce the backlog of retirement applications awaiting finalization and complete the finalization process in a timely manner. The division should also consider changing its long-standing practice of underpaying estimated retirement benefits to lower interest costs. Furthermore, the division should revise its method for calculating interest on post-benefit audit lump-sum payments.**

   Comment:

   Our review of the finalization process disclosed that improvements continue to be made. However, there were still 12,043 applications awaiting finalization at the end of the audited period. We also noted that retirees continued to receive estimated benefits that were consistently less than what they should have received, resulting in higher interest payments.

3. **Although the primary responsibility for tracking rehired retirees falls on the individual state agencies, the Retirement Services Division should work with those agencies to strengthen controls over the tracking process to ensure compliance with the various restrictions put on pay and length of service. It should also attempt to identify all instances in which rehired retirees exceeded the allowed 120-day working period and recoup the retirement benefits paid out to those employees during the time they were reemployed by the state. Furthermore, it should consider implementing a policy that forecloses the reemployment of retirees within a specified period of time, such as 180 days.**

   Comment:

   Our statewide review of rehired retirees disclosed various instances in which rehired retirees were working in excess of the 120-day limit and receiving benefits in excess of what they should have been.

4. **The Retirement Services Division should review the employees identified during our audit who appeared to be ineligible to transfer into the SERS Hybrid plan and take corrective action as needed. Furthermore, the Retirement Services Division should consider reviewing all transfers into the SERS Hybrid plan to ensure that the employees who transferred into the plan were eligible.**

Appropriate corrective action should be taken when employees are identified who were not eligible to transfer.

Comment:

Our review of ARP to SERS Hybrid retirement plan transfers disclosed 23 instances in which it appears that individuals allowed to transfer from ARP into the new Hybrid plan were not eligible to do so.

5. **The Retirement Services Division and the Medical Review Board should comply with the Connecticut General Statutes regarding disability retirements and confirm that individuals are permanently disabled.**

Comment:

Our review disclosed various instances in which 24-month reviews that should have been performed during the audited period were either not performed, or performed in an untimely manner. We also noted 2 instances in which 24-month medical review forms were not completely filled out by the doctors preparing them.

6. **The Retirement Services Division should strengthen controls over retirement purchases to ensure compliance with the procedures set forth by the Retirement Purchasing Unit.**

Comment:

During our review, we noted numerous instances in which the division did not follow the retirement purchasing regulations.

7. **The Retirement Services Division should improve internal controls to ensure that contributions are date-stamped upon receipt and deposited within the timeframe required by Section 4-32 of the General Statutes. In addition, it should ensure that outside agencies who participate in the state's HEP program begin contributing the appropriate amount to the Retiree Health Care Trust Fund, as required by the 2011 SEBAC agreement. The division should also identify and collect any contributions that should have been paid by outside agencies but were not.**

Comment:

Our review disclosed three instances in which deposits were not made in accordance with the prompt deposit requirements set forth in Section 4-32 of the General Statutes. We also noted several instances in which deposits were not stamped with a receipt date and we could not determine whether those funds were deposited in a timely manner. Furthermore, while reviewing outside agencies that should be making contributions in accordance with the 2011 SEBAC agreement, we identified 118 employees who had not been making these contributions.

8. **The Retirement Services Division should track accounts receivable more accurately and should actively follow up on the collection or write-off of inactive accounts.**

    Comment:

    Our review disclosed 5 instances in which the balance reported on the aged receivable report did not reflect the balances on supporting documentation. In addition, we noted 9 instances in which balances were outstanding for an extended period of time with no evidence of any recent attempts to collect on those balances. These balances were outstanding for periods between 7 and 22 years.

9. **The Retirement Services Division should revise its methodology for calculating death benefits for the beneficiaries of retired SERS plan members. Specifically, the federal tax exclusion ratio should be calculated on a case-by-case basis using the simplified method instead of the average exclusion ratio it has been using.**

    Comment:

    Our review of equity refunds disclosed that the Retirement Services Division is using an incorrect method to calculate the federal tax exclusion ratio, which affects the amount of death benefits paid to beneficiaries.

10. **The Retirement Services Division MERS Unit should continue to clear old deceased cases and should actively pursue all types of overpayments for repayment or write-off.**

    Comment:

    Our review of the MERS deceased retirees and beneficiaries listing as of June 30, 2014, disclosed various instances in which receivables owed to the retirement system were not being actively pursued for collection or considered for write-off.

11. **The Retirement Services Division MERS Unit should ensure that all receipts are deposited in accordance with the provisions of Section 4-32 of the General Statutes, and should stamp all contribution reports indicating the date the contributions were received. It should also continue to request individual employee contribution and earned interest reports from Bridgeport FFPF, and consider involving the Retirement Commission in this matter, which has the power, per Section 7-448 of the General Statutes, to levy a $100 per day fine for the failure of a municipality to furnish requested information.**

    Comment:

    Our review of 55 contribution payments from municipalities disclosed 16 instances in which funds were not deposited in a timely manner. Furthermore, we noted another 13 instances in which payments were not stamped with a receipt date. We could not determine whether the funds were deposited in accordance with the prompt deposit requirements of Section 4-32 of the General Statutes.

12. **The Healthcare Policy and Benefit Services Division should strengthen internal controls to prevent ineligible dependents from being assigned medical and dental coverage. Furthermore, the division should ensure the prompt removal of such dependents upon class-changing events.**

    Comment:

    At the time of our audit, April 2015, we identified 52 dependents who were above the maximum age limit for coverage.

13. **The Healthcare Policy and Benefit Services Division should strengthen internal controls to ensure that Other Post Employment Benefit (OPEB) deductions are properly applied. It should also ensure that refunds are accurately calculated and processed in a timely manner. Furthermore, the Healthcare Policy and Benefit Services Division should attempt to recover the overpayments made in relation to some of the OPEB refunds that were noted during our audit.**

    Comment:

    Our review of Other Post Employment Benefit (OPEB) contributions and refunds disclosed various issues with respect to employees having the correct amount of OPEB contributions deducted from their pay as well as delayed and incorrect refunds of OPEB contributions.

14. **The Retirement Services Division should request a formal opinion from the Office of the Attorney General regarding the annual benefit calculation that should be used for disability retirees who have outside earned salary or wages. The request should be specifically directed at the intent of Issue #25 of the Interest Arbitration Award between the State of Connecticut and SEBAC regarding the Connecticut State Employees Retirement System.**

    Comment:

    Since the effective date of the interest arbitration award, the calculation methodology used by the division, when determining the annual benefit amounts for disability retirees, essentially eliminates the statutory offset provisions for retirees with outside earnings. It does not appear that it was the intent of the arbitrator to eliminate those statutory offset provisions.

15. **The Retirement Services Division should not execute any transactions that could be considered non-routine business transactions before bringing them to the attention of the Retirement Commission. The division should also recover the monies due to SERS from the higher education institutions as well as collect the proper amounts from the employees who were undercharged, and deposit those monies to the appropriate SERS Tier plans.**

Comment:

Twenty-eight employees with considerable state service time were allowed to transfer from ARP to various SERS Tier plans without any payment to the SERS plans to support the benefits those participants will someday receive. The division transferred the 28 employees to the SERS Tier I, II, or IIA plans based solely on emails it received from the Office of Labor Relations and/or a SEBAC representative without informing the commission of its intention to make those transfers, or verifying that the employees met the established criteria to transfer. A total of $2,681,375 is due to the various SERS Tier plans.

16. **The Retirement Services Division should recover the $2,344 of interest overpayments made when it returned the funds it erroneously withdrew from the Alternate Retirement Plan accounts of 2 participants who transferred to the State Employees Retirement System.**

Comment:

The division overpaid interest to 2 ARP accounts, in the amount of $2,344, due to a calculation error.

CONCLUSION

In conclusion, we wish to express our appreciation for the cooperation and the courtesies extended to our representatives by the personnel of the Office of the State Comptroller during the course of our examination.

Michael J. Delaney
Principal Auditor

Approved:

John C. Geragosian
Auditor of Public Accounts

Robert J. Kane
Auditor of Public Accounts