STATE OF CONNECTICUT

AUDITORS' REPORT
STATE COMPTROLLER – STATE RETIREMENT FUNDS
FOR THE FISCAL YEARS ENDED JUNE 30, 2000 AND 2001

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

Table of Contents

November 4, 2002

AUDITORS' REPORT
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FOR THE FISCAL YEARS ENDED JUNE 30, 2000 AND 2001

We have made an examination of the financial records of the State Retirement Funds including the State Employees' Retirement Fund, the Alternate Retirement Program Fund, the State's Attorneys' Retirement Fund, the General Assembly Pension Fund, the Judges' and Compensation Commissioners' Retirement Fund, the Public Defenders' Retirement Fund, the Probate Judges' and Employees' Retirement Fund, the Municipal Employees' Retirement Funds and the Policemen and Firemen Survivors' Benefit Fund, maintained by the Retirement and Benefit Services Division of the State Comptroller's Office for the fiscal years ended June 30, 2000, and 2001. We have included in that examination the records pertaining to the State's Deferred Compensation Plan as well as those pertaining to the appropriations for the Alternate Retirement System, the Judges' and Compensation Commissioners' Retirement Fund, the various miscellaneous statutory pensions and the State's share of retirement salaries and health insurance costs for retirees. This audit did not include the Teachers' Retirement Fund, as a separate Teachers' Retirement Board administers this fund.

Financial statements pertaining to the operations and activities of the State Retirement Funds for the fiscal years ended June 30, 2000, and 2001, are presented on a Statewide Single Audit basis to include all State agencies and funds. This audit has been limited to assessing the State Comptroller's Retirement and Benefit Services Division's compliance with certain provisions of financial and/or retirement related laws, regulations and contracts, and evaluating the State Comptroller's Retirement and Benefit Services Division's internal control structure policies and procedures established to ensure such compliance.

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

COMMENTS

FOREWORD:

The 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. A description of two of the major components of the Department and their functions is presented below:

State Comptroller's Executive Office:

Provides overall policy direction and program and project monitoring for the Department, as well as oversees the Agency's personnel and payroll function. Personnel Services implements State personnel, labor relations and Workers' Compensation standards and procedures and carries out the payroll function for the Agency.

Retirement and Benefit Services Division:

Processes the required actions and maintains the records and accounts of the various retirement plans administered by the Connecticut State Employees' Retirement Commission. It provides counseling services to members, administers State employee deferred compensation, dependent care assistance, group life and health insurance programs, and manages the State unemployment compensation accounts.

OFFICERS:

During the 1999-2000 and 2000-2001 fiscal years the officers of the Office of the Comptroller were as follows:

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

The Retirement and Benefit Services Division Director was Steven Weinberger.

RÉSUMÉ OF OPERATIONS:

Connecticut State Employees' Retirement Commission:

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

Members of the Retirement Commission serve without compensation, except that the chairman and the two actuarial trustees are compensated at their normal per diem rate plus travel expenses. All other Retirement Commission members are entitled to reimbursement for necessary expenses incurred in the performance of their official duties. Members of the Retirement Commission as of June 30, 2001, were:

Peter R. Blum, Chairman
Claude Poulin, Actuarial Trustee
Robert D. Baus, Actuarial Trustee
Richard D. Wilber, Management Trustee
Stephen Caliendo, Management Trustee
Robert D. Coffey, Management Trustee
David O. Elliott, Management Trustee
Linda J. Yelmini, Management Trustee
Vacant, Management Trustee
Charles W. Casella, Employee Trustee*
Steven Perruccio, Employee Trustee*
Salvatore Luciano, Employee Trustee*
Thomas P. Culley, Employee Trustee*
Edward C. Marth, Employee Trustee*
Carmen E. Boudier, Employee Trustee*

* State Employees' Bargaining Agent Coalition (SEBAC)

Also, Michael Ferrucci Jr., Employee Trustee, served during the audited period.

Medical Examining Board for State Employee Disability Retirement:

Under Section 5-169 of the General Statutes the Governor shall appoint a board of seven State employee physicians to determine entitlement to disability retirement for members of the State Employees' Retirement System. The members of the Board as of June 30, 2001, were:

Eileen Storey M.D., Chairman
Edward A. Blanchette, M.D.
Anne H. Flitcraft, M.D.
Jacqueline A. Harris, M.D.
Timothy Silvis, M.D.
Robert L. Trestman, Ph.D., M.D.
Vacant (1)

Also, Karen E. Grimmell, M.D. and Alex Demac M.D. served during the audit period.

State Employees' Retirement Fund:

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

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

Since the enactment of the "Pension Agreement" there has been one arbitration award and various negotiated agreements that have changed the terms of the initial "Pension Agreement". The State of Connecticut and the State Employees' Bargaining Agent Coalition (SEBAC) have negotiated five separate agreements, known as SEBAC agreements, that have modified the terms of the "Pension Agreement". The SEBAC I, II, III and IV agreements were enacted and effective prior to the 1995-1996 and 1996-1997 fiscal years. 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. Tier IIA did not become effective until July 1, 1997.

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

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

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

Tier II is a noncontributory plan that provides a single level of benefits to all members, with the exception of hazardous duty members, who must make contributions to the system. Tier IIA is a contributory plan that provides benefits similar to Tier II, but requires contributions.

The retirement benefits for Tier II and IIA members are determined by their years of service, age at retirement, average final compensation, a breakpoint calculation and the benefit payment option selected. The benefit percentages and calculation of normal retirement for Tier II and IIA members (age 60 with at least 25 years of vesting service; age 62 with at least 10 but less that 25 years of vesting service; or, age 62 with at least 5 years of actual State service) are the sum of 1.33 percent times average salary plus .5 percent times average salary in excess of the year's breakpoint ($32,400 for 2001 and increasing by six percent annually) times years of credited service to a maximum of 35 years; plus 1.625 percent times average salary times years of credited service over 35 years. Members that have completed at least ten years of service and have attained age 55 may elect to receive an early retirement benefit that is provided at a reduced amount. The benefit is reduced by .25 percent for each month you receive a retirement benefit prior to your normal retirement or 3 percent per year up to 21 percent.

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

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

Survivor benefits for members of the State Police Division within the Department of Public Safety are provided for in Section 5-146 through 5-150 of the General Statutes. Section 5-146, subsection (a) as amended by the 1989 Pension Agreement, provides surviving spouses of deceased State police officers with a monthly allowance of $670 payable for life or until remarriage, with payments to commence upon the death of such State police officer. Provision is also made for a surviving spouse to receive an additional monthly benefit for any unmarried dependent children under the age of 18. Such payments range from $300 to $700 per month, depending on the number of children.

The State Employees' Retirement System provides for the retirement coverage of most employees of the State of Connecticut, members of the General Assembly, operators of vending stands in public buildings, certain teachers employed at the E.O. Smith School, employees of Connecticut Institute for Municipal Studies, and in certain cases, employees of the United States Property and Fiscal Office. Prior to December 31, 1992, employees of The Newington Childrens' Hospital, The American School for the Deaf and the Connecticut Institute for the Blind were members of the State Employees' Retirement System. Effective January 1, 1993, new employees or reemployed employees of The Newington Childrens' Hospital, The American School for the Deaf and The Connecticut Institute for the Blind are no longer eligible to become members of the State Employees' Retirement System.

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

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

The Retirement Commission is required to prepare a valuation of the assets and liabilities of the system at least once every two years. The Retirement Commission is authorized to employ the services of actuaries at least once every two years to prepare such valuations and to determine the annual appropriation of State funds necessary to meet the funding plan outlined in Section 5-156a of the General Statutes. Although the Retirement Commission had elected to have annual evaluations performed through June 30, 1998, it had since changed to biennial evaluations; however, there was an interim actuarial valuation prepared at June 30, 2001.

Actuarial valuations of the system were last prepared as of June 30, 2000, with an interim valuation prepared at June 30, 2001. As a result of these valuations, the unfunded actuarial accrued liability from the most recent valuations follows:

As of June 30,	**1998**	**2000**	**2001**
Unfunded actuarial accrued liability	$3,922,542,209	$4,316,115,354	$4,466,512,623

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

A comparison of membership information for the State Employees' Retirement System as of June 30, has been presented below. A significant shift of over 3,800 active members to retired members as of June 30, 1997, occurred because of the 1997 Early Retirement Incentive Program. The increase in active members by 2,029 between 1999 and 2001 could be the gradual refilling of those vacated positions, as Tier I members decreased by 1,025, Tier II decreased by 2,416, and Tier IIA increased by 5,470.

As of June 30,	**1999**	**2000**	**2001**
Active Members	52,838	54,616	54,867
Retired Members	31,831	32,101	32,275
Inactive Members (Terminated Vested)	934	1,137	1,170
Totals	**85,603**	**87,854**	**88,312**

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

	1998-1999	**1999-2000**	**2000-2001**
State Contributions	$ 227,723,785	$ 240,583,331	$ 289,128,616
Federal Contributions	124,140,475	102,176,999	86,494,566
Employee Contributions	38,897,333	43,782,743	46,088,785
Investment Income	245,738,266	286,673,510	276,669,027
Net Gain on Sale of Investments*	19,434,211	301,270,945	7,385
Totals	**$655,934,070**	**$974,487,528**	**$698,388,379**

*Note: Net gain on sale of investments primarily represented a realized gain from the sale of investments in the International Stock Fund in fiscal year 1998-1999 and the sale of investments in the Mutual Equity Fund in fiscal year 1999-2000 by the State Treasurer.

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

	1998-1999	**1999-2000**	**2000-2001**
Benefit Payments	$ 605,421,618	$ 592,649,265	$ 615,571,401
Employer Refunds	2,884,282	3,653,875	3,603,072
Other Expenses	261,329	295,326	340,513
Net Loss on Sale of Investments*	18,083,970	1,619,288	2,147,682
Totals	**$626,651,199**	**$598,217,754**	**$621,662,668**

*Note: Net losses on sale of investments primarily represented realized net losses from the sale of investments in the Real Estate Fund by the State Treasurer.

The State Treasurer is the custodian of the Fund's investments. A summary of the market value, the "Actuarial Value of Assets", and rate of return as of June 30, has been presented below. This summary is based on information from actuarial reports on file with the Retirement and Benefit Services Division; the market values were based on unaudited State Treasurer data.

	1999	2000	2001
Market Value of Assets	$7,519,733,915	$8,284,499,079	$7,786,625,739
Rate of Return	10.29%	13.14%	(3.71%)
Actuarial Value of Assets*	$ *	$7,196,039,538	$7,638,853,784
Rate of Return	*	14.97%	9.02%

*Note: This method spreads the recognition of gains and losses over a five-year period. The resulting value is called the Actuarial Value of Assets and is further adjusted as necessary so that the final actuarial value is within 20 percent (plus or minus) of the market value of assets. No actuarial value is shown for June 30, 1999 since no actuarial valuation was performed; actuarial value of assets at June 30, 1998 was $5,669,865,527.

Alternate Retirement Program Fund:

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

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

The one authorized plan in operation is based on the continuation of an agreement made initially between the Board of Higher Education and the Teachers' Insurance and Annuity Association - College Retirement Equities Fund. Under the terms of this agreement the employee and the State contributions are forwarded monthly to the insurer who issues annuity contracts to individual participants. Retirement benefits are based on contributions, distribution of contributions, length of participation, age and the payment option selected. Terminating employees may request repurchases of the contract (refund) or may choose to remain in the program with no further State contribution. The insurer returns the employer share of repurchased contracts to the State.

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

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

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

	1998-1999	**1999-2000**	**2000-2001**
Contributions - Participants	$15,576,269	$17,946,788	$18,630,236
Contributions – State's Share	$24,541,017	$27,207,776	$29,275,190
Remitted to insuring company	$39,955,452	$44,337,073	$47,674,799

A cash balance of $2,120,331 and $2,350,958, as of June 30 2000 and 2001, respectively, represented participant contributions collected, but not yet forwarded to the insuring company.

The General Fund share of the aforementioned contributions was met from appropriations administered by the State Comptroller for the purposes of the Alternate Retirement System. Transfers were made monthly to the Alternate Retirement Fund and bi-weekly to University operating funds. Refunds of contributions from the insuring company and fringe benefit recoveries to the General Fund resulted in net charges against appropriations as follows:

	1998-1999	**1999-2000**	**2000-2001**
Transfers to Alternate Retirement Fund	$24,541,017	$27,207,776	$29,275,190
Transfers to University Operating Funds	7,210,209	8,353,842	8,438,666
Total Transfers	31,751,226	35,561,618	37,713,856
Less: Fringe Benefit Recoveries	19,746,184	22,218,659	22,858,941
Refunds of Contributions	2,277	298	200
Net Charges against Appropriations	**$12,002,765**	**$13,342,661**	**$14,854,715**

Recoveries of General Fund costs, for terminated employees who repurchased their contracts from the insuring company, are shown below. These recoveries were credited to the General Fund as follows:

For fiscal years ended June 30,	**1999**	**2000**	**2001**
Refunds of expenditures applied to expenditures	$2,277	$298	$200
Refunds of prior year expenditures	4,852	119	-
Total	**$7,129**	**$417**	**$200**

State's Attorneys' Retirement Fund:

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

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

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

The aforementioned sections of the General Statutes do not specifically outline the method of financing retirement salary payments to each retired State's Attorney. Most pension payments have been charged to the General Fund appropriation for "Pensions and Retirements – Other Statutory." The State's Attorneys' Retirement Fund assets were used, if necessary. Charges to the General Fund appropriation account amounted to $1,010,151, $910,593 and $872,959 for fiscal years 1998-1999, 1999-2000 and 2000-2001, respectively. The State's Attorneys' Retirement Fund was charged $5,000, $84,596 and $179,677 for pensions paid to retired members during fiscal years 1998-1999, 1999-2000 and 2000-2001, respectively.

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

	1998-1999	1999-2000	2000-2001
Market Value of Investments, June 30	$ 886,348	$ 901,703	$ 732,869
Receipts	55,955	61,033	59,789
Pensions Paid to Retired Members	1,015,151	995,189	1,052,636

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

General Assembly Pension Fund:

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

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

	1998-1999	1999-2000	2000-2001
Market Value of Investments, June 30	$ 41,392	$ 38,770	$ 36,190
Receipts	2,289	2,358	2,243
Pensions Paid to Retired Members	6,678	4,980	4,823

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

Judges' and Compensation Commissioners' Retirement Fund:

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

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

Section 51-49d of the General Statutes provides that the Judges' Retirement System be funded on an actuarial reserve basis with actuarial surveys of the system performed at least once every two years and with annual certifications to the General Assembly of funding requirements. Actuarial valuations of the system were prepared as of June 30 1999 (interim), June 30, 2000 and June 30, 2001 (interim). As a result of these valuations, the unfunded actuarial accrued liability as of June 30, 1999, 2000 and 2001, was determined to be $61,831,847, $58,251,610 and $60,703,475, respectively.

The retirement salary for which a member is eligible is determined by age at retirement, years of service and the salary of the office held at retirement, as such salary including longevity pay, may be changed from time to time or, if appointed after January 1, 1981, their final compensation. Members become eligible for the normal retirement benefit at age 65, or after 20 years of service. This benefit is equal to two-thirds of the salary of the office, as such salary, including longevity pay, may be changed from time to time or, where applicable, to two-thirds of the member's final compensation.

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

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

	1998-1999	**1999-2000**	**2000-2001**
Actuarial Value of Assets, June 30	$110,672,471	$123,448,718	$133,052,111
Investments at Market Value, June 30	124,336,643	141,210,024	135,740,148
Receipts	14,972,496	15,642,239	17,845,557
Pensions Paid to Retired Members	11,309,460	11,765,099	12,483,614

The asset balances are valued using the Actuarial Valuation of Assets method. This method spreads the recognition of gains and losses over a four-year period and is further adjusted, as necessary, so that the final actuarial value is within 20 percent of the market value of assets. Investments in the State of Connecticut Combined Investment Funds are verified as part of our audit of the State Treasurer. Receipts consisted mainly of General Fund appropriation transfers, investment income, including gain on sale of investments, and employee contributions. The increase in receipts during the 2000-2001 fiscal year was mainly due to gain on the sale of investments of $1,919,966, per Retirement Division financial statements. Pensions paid to retired members were financed by the Judges' and Compensation Commissioners' Retirement Fund, mainly from transfers from a General Fund appropriation for Judges' and Compensation Commissioners' Retirement Contributions.

Public Defenders' Retirement Fund:

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

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

	1998-1999	1999-2000	2000-2001
Market Value of Investments, June 30	$ 24,255	$ 26,563	$ 32,411
Receipts	6,218	7,539	7,732
Pensions Paid to Retired Members	308,737	327,248	352,624

The investment balance was verified as part of our audit of the State Treasurer. Receipts were mainly employee contributions. Pensions paid to retired members were for five retirees/beneficiaries and were mainly financed by the General Fund appropriation for "Pensions and Retirements – Other Statutory." Charges to the General Fund appropriation account amounted to $307,737, $322,248 and $350,624, for fiscal years 1998-1999, 1999-2000 and 2000-2001, respectively. The Public Defenders' Retirement Fund was charged $1,000, $5,000 and $2,000, respectively for pensions paid to retired members during fiscal years 1998-1999, 1999-2000 and 2000-2001, respectively.

Probate Judges' and Employees' Retirement Fund:

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

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

Section 45a-82 of the General Statutes requires that on or before July first annually the Retirement Commission shall certify to the State Treasurer, on the basis of an actuarial determination, the amount to be transferred to the Retirement Fund to maintain the actuarial plan adopted by the Retirement Commission. Payments of these actuarially determined funding amounts are made from the Probate Court Administration Fund. Actuarial valuations of the system were prepared as of December 31, 1999, 2000, and 2001. As a result of these valuations, it was determined that there was no unfunded actuarial accrued liability as of December 31, 1999, 2000 and 2001.

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

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

	1998-1999	**1999-2000**	**2000-2001**
Actuarial Value of Assets, Dec. 31	$59,051,909	$64,489,883	$67,455,525
Investments at Market Value, June 30	65,002,132	70,761,332	66,678,879
Receipts	3,088,419	6,665,795	3,671,203
Pensions Paid to Retired Members	1,751,928	1,998,103	2,041,629

The asset balances are valued using the Actuarial Valuation of Assets method. This method spreads the recognition of gains and losses over a three-year period and is further adjusted, as necessary, so that the final actuarial value is within 20 percent of the market value of assets. Investments in the State of Connecticut Combined Investment Funds are verified as part of our audit of the State Treasurer. Receipts consisted mainly of investment income, including gain on sale of investments, General Fund appropriation transfers, mainly for health service costs, and employee contributions. The increase in receipts during the 1999-2000 fiscal year was mainly due to gain on the sale of investments of $3,066,537, per Retirement Division financial statements. Pensions paid to retired members were financed by the Probate Judges' and Employees' Retirement Fund.

Municipal Employees' Retirement Funds:

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

The Municipal Employees' Retirement System is composed of a Retirement Fund and an Administration Fund. As provided in Section 7-426 of the General Statutes, the Retirement Fund was divided into two parts, namely, Fund A and Fund B. However, Public Act 93-356 formally eliminated Fund A as an option in the Municipal Employees Retirement Act. As of June 30, 2001, Fund A had no active employees enrolled and one retired employee receiving benefits. This individual was an employee of a municipality that is no longer a member of the Municipal Employees' Retirement System.

As of June 30, 2001, municipalities and housing authorities with 8,233 enrolled active employees were participants in Fund B. As of that date, benefits were being paid from Fund B to 4,572 retired employees or to their survivors. This represented net increases of 422 active participants and 338 benefit recipients during the 1999-2000 and 2000-2001 fiscal years, respectively.

Any municipality may, by resolution passed by its legislative body and subject to referendum, participate in the System. The effective date of participation shall be the first day of July at least 90 days subsequent to the receipt by the Retirement Commission of a certified copy of the resolution. Participation may also be effected through an agreement between a municipality and an employee bargaining organization. If so, Section 7-474, subsection (f), of the General Statutes, provides that the effective date of participation shall be the first day of the third month following the month in which a certified copy of the agreement is received by the Retirement Commission, or such later date as may be specified in the agreement. Under Section 7-427, eligible employees of housing authorities who were not already enrolled in Fund B were required to become members thereof on July 1, 1972, unless the board of commissioners of the authority voted against such participation.

Employee contribution rates for Fund B are set by Section 7-440 of the General Statutes. Each employee contributes to the Fund two and one quarter percent of the portion of salary for which Social Security contributions are to be deducted and five percent of the portion for which such contributions are not to be deducted. Municipal contribution rates are set by the Retirement Commission based on actuarial valuations, which, under the provisions of Section 7-443, are required at least every five years. The Retirement Commission at its July 20, 1989, meeting voted to have actuarial valuations performed annually and actuarial valuations have been performed on an annual basis starting with the July 1, 1992, report. Actuarial valuations of the system were prepared as of June 30 and were as follows:

As of June 30,	**1999**	**2000**	**2001**
Unfunded actuarial accrued liability	$(240,549,229)	$ (98,447,612)	$(115,035,944)

Based on the negative unfunded actuarial accrued liability, contribution rates to the Municipal Employees' Retirement System have been reduced to compensate for the funding status.

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

Effective Date July 1,	1999	2000	2001
Policemen and firefighters with Social Security	7.50%	6.00%	3.75%
Others with Social Security	3.75%	2.75%	2.75%
Policemen and firefighters without Social Security	5.75%	4.75%	2.75%
Others without Social Security	4.50%	3.00%	3.00%

Section 7-439b of the General Statutes provides for annual cost-of-living increases effective on July first of each year for each retired member or surviving annuitant of a retired member receiving regular benefit payments, beginning with the first July following the date the retired member reached or would have reached age 65. Within the limits of a minimum of three percent and a maximum of five percent, the increase is based on the determination of the annual yield of the assets of the fund. Eligible recipients received a five percent cost-of-living adjustment on July 1, 1999, 2000 and 2001. Section 7-441 of the General Statutes, which prescribes the various contributions required of participating municipalities, provides that each municipality must pay to the Retirement Commission an annual proportionate share of the Fund's administrative costs, as determined by the Retirement Commission on the basis of the number of members employed by each municipality. During the fiscal years ended June 30, 1999, 2000 and 2001, the participating municipalities were required to contribute $75 per member per year for such administrative expenses. These moneys were deposited to the Administrative Fund, which was established to account for all administrative contributions and expenditures.

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

	1998-1999	1999-2000	2000-2001
Actuarial Value of Assets, June 30	$1,100,660,928	$1,251,609,053	$1,353,141,245
Investments at Market Value, June 30	1,212,958,725	1,373,221,508	1,297,727,523
Receipts	71,434,732	116,905,699	72,718,714
Pensions Paid to Retired Members	43,650,404	50,211,949	54,147,569

The actuarial value of assets was determined on a market related basis. The asset valuation method recognizes assumed investment income fully each year. Differences between actual and assumed investment income were phased in over a closed five-year period. Investments in the State of Connecticut Combined Investment Funds were verified as part of our audit of the State Treasurer. Receipts consisted mainly of investment income and employee and municipal contributions. The increase in receipts during the 1999-2000 fiscal year was mainly due to gain on the sale of investments of $24,727,826 and an increase in employee and municipal contributions of $16,489,433; the decrease in receipts during the 2000-2001 fiscal year was mainly due to a reduction in gain on the sale of investments of $24,718,328 and a decrease in employee and municipal contributions of $18,032,567, per Retirement Division financial statements. Pensions paid to retired members were financed by the Municipal Employees' Retirement Fund.

Policemen and Firemen Survivors' Benefit Fund:

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

In lieu of the payment of survivors' benefits from the Fund, the Retirement Commission may obtain insurance coverage, which provides for such benefits with the premiums for such coverage being paid from the contributions to the Fund.

Section 7-323c, subsection (d), of the General Statutes requires that municipalities annually pay a proportionate share of the costs of the administration of the Fund as determined by the Commission. The administrative fee remained at $30 per member per year for the 1999-2000 and the 2000-2001 fiscal years. Revenues collected through this assessment have been deposited to the Administration Fund of the Municipal Employees' Retirement System as its employees have the responsibility of overseeing the operations of the Policemen and Firemen Survivors' Benefit Fund.

As of June 30, 2001, the date of the last available actuarial valuation, six municipalities, with 510 active employees, were participating in the plan. They were the towns of Derby, Manchester, Middlefield, Milford, New London, and Seymour. Prior to January 1, 1999, to provide the necessary benefits, the Retirement Commission negotiated with a local insurance company for a group annuity contract to meet the plan requirements. During the course of each fiscal year, employee and town contributions, in a total amount equal to the premium on the insurance contract, were deposited monthly to the Survivors' Benefit Fund and forwarded to the insuring company by the Retirement and Benefit Services Division in payment of the premium. During the 1998-1999 fiscal year, assets of the fund amounting to almost $16 million were transferred from the insurance company to the State Treasurer for investment in the Combined Investment Funds.

Prior to January 1, 1999, the Policemen and Firemen Survivors' Benefit Fund functioned principally as a pass-through account for premiums received from participating municipalities, which were, in turn, remitted to a local insurance company for survivor benefit coverage. Administrative assessments were collected from the participating municipalities and deposited to the Administration Fund of the Municipal Employees' Retirement System. A significant feature of the group annuity insurance plan was the accumulation, in a separate reserve account, of assets that were to be used to offset future plan liabilities. Changes in the reserve came from additions for contributions and investment income and from deductions for annuity payments and contract service charges.

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

	1998-1999	1999-2000	2000-2001
Actuarial Value of Assets, June 30	$16,044,093	$18,059,688	$17,775,025
Assets in excess of net actuarial liabilities	5,471,880	2,283,722	1,203,300
Investments at Market Value, June 30	16,807,127	18,059,624	17,771,116
Receipts - Contributions	226,943	444,937	337,512
Receipts - Investment Income	411,425	655,937	727,944
Premiums Paid to Insuring Companies	225,587	-	-
Pensions Paid to Surviving Dependents	328,400	534,899	559,636

Currently, contributions are transferred to the State Treasurer for investment. Disbursements for benefit payments are now processed in the Policemen and Firemen Survivors' Benefit Fund, through the Municipal Employees' Retirement Fund system. The actuarial valuations prepared for June 30, 1999, 2000 and 2001 resulted in municipal contribution rates of zero percent of each municipality's active covered payroll as of July 1, 2000, 2001 and 2002, respectively. As previously mentioned in this report, employee contribution rates are fixed by statute at one percent of the employee's compensation. Administrative assessments are collected from the participating municipalities and are deposited to the Administrative Fund of the Municipal Employees' Retirement System.

Pensions and Retirements – Other Statutory:

Sections 3-2a, 6-2b and 11-10a of the General Statutes and various special acts authorize pensions and retirements to former governors and their spouses, certain former county employees and law librarians, and various individuals. These pensions and retirements are paid from a special appropriation of the General Fund entitled "Pensions and Retirements – Other Statutory." In addition, this account is used to fund that portion of the retirement benefits paid to retired members of the State's Attorneys' and Public Defenders' Retirement Funds that is not funded by those Retirement Funds. Expenditures for State's Attorneys' and Public Defenders' Retirement Funds were disclosed previously. The remaining expenditures for other statutory charges during the 1998-1999, 1999-2000 and 2000-2001 fiscal years, from the above special appropriation account, amounted to $175,613, $178,615 and $179,137, respectively, and were made for that portion related to the above statutes.

Deferred Compensation:

In addition to the retirement programs already noted in this report, Section 5-264a of the General Statutes authorizes the Office of the Comptroller, through a third party administrator, to offer to the State of Connecticut employees a deferred compensation plan created in accordance with Section 457 of the Internal Revenue Service Code. This plan permits all permanent employees, including elected and appointed officials and members of the General Assembly, to defer a portion of their salary until future years. This deferred compensation is not available to employees until retirement, termination of employment, disability, unforeseeable emergency or death. Companies participating in this program and the market value of these accounts at June 30 are listed below.

Market Values at June 30,	1999	2000	2001
Aetna/ING	$477,826,880	$561,971 788	$513,556,517
Hartford	230,549,007	282,867,163	270,771,774
Phoenix	30,323,846	37,211,838	34,329,102
Total	**$738,699,733**	**$882,050,789**	**$818,657,393**

General and Special Transportation Funds Appropriations:

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

	1998-1999	1999-2000	2000-2001
General Fund:	$	$	$
Alternate Retirement System:			
State share of contributions (A)	12,002,765	13,342,661	14,854,715
State Employees' Retirement System:			
State share of retirement funding	199,304,785	215,947,331	257,806,736
Pensions and Retirements-Other Statutory:			
State share of costs:			
State's Attorneys' Retirement System	1,010,151	910,593	872,959
Public Defenders' Retirement System	307,737	322,248	350,624
Pension payments – miscellaneous (B)	175,613	178,615	179,137
Judges' and Compensation Commissioners' Retirement Fund:			
State share of retirement funding	9,283,249	9,324,239	9,837,077
Retired State Employees' Health Service Costs:			
State share of costs	128,593,043	171,851,285	171,852,369
Special Transportation Fund:			
State Employees' Retirement System:			
State share of retirement funding	28,419,000	27,636,000	31,321,880
Total Expenditures	**$379,096,343**	**$439,512,972**	**$487,075,497**

(A) Net of refunds and fringe benefit recoveries of $19,748,461 $22,218,957 and $22,859,140, respectively.
(B) Includes payments to former governors or widows, county employees, law librarians and individuals whose pensions are authorized by special act.

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

During the 1998-1999, 1999-2000 and 2000-2001 fiscal years appropriations and transfers of $130,850,000, $172,230,000 and $172,874,000, respectively, were made to cover the State's share of health insurance costs for those eligible retirees mentioned previously. A summary of the total expended for this purpose follows:

	1998-1999	**1999-2000**	**2000-2001**
Anthem Blue Cross/Blue Shield	$98,527,686	$133,792,989	$133,366,838
MD Health Plan/Physicians Health Care	14,689,873	21,826,010	21,121,503
MedSpan	-	223,258	190,403
Medicare Part B	13,536,076	13,736,876	14,941,837
Kaiser Permanente	672,356	306,558	-
Connecticare	-	602,563	793,674
Anthem Blue Cross/Blue Shield Dental	1,097,432	1,285,187	1,355,802
CIGNA Dental	69,620	77,844	82,312
Total	**$128,593,043**	**$171,851,285**	**$171,852,369**

The 1999-2000 fiscal year increase was mainly due to increases in negotiated premiums.

CONDITION OF RECORDS

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

State Employees' Retirement Fund

Retirement Payrolls:

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

Condition: Retirement allowances, cost-of-living adjustments, survivor benefits and equity refunds reviewed were properly computed. The backlog of retirement applications not yet finalized remains at a substantial amount. The backlog of retirement applications not yet finalized as of October 31, 1998 was approximately 2,860 and 1,218 on September 14, 2000. We were informed on June 12, 2002 that the backlog was reduced to 1,057.

Effect: To a much lesser extent, this means that retirees may not be receiving their finalized benefit in a timely manner. The retirement fund must pay interest on the difference between estimated benefit amounts and the actual amount owed at the time of finalization for any period of time after the first six months.

Cause: Among the causes were the various complexities arising from the pension agreement and other collective bargaining agreements, particularly the retroactive provisions of such agreements, the latest Early Retirement Incentive Program and compliance with the "130 percent cap" provision contained in Section 5-162 of the General Statutes. Service credit information is not easily obtainable because there are no accurate individual time and attendance records on the database. Many of the causes for the backlog of retirement applications awaiting finalization are beyond the control of the Retirement and Benefit Services Division.

Conclusion: No recommendation is made at this time. The Retirement and Benefit Services Division has made significant progress in reducing the backlog of retirement applications not yet finalized and it appears that this will continue. The current level of backlog has been reduced to below the level existing before the 1997 Early Incentive Retirement Program.

State Employee Data Base (SEDB):

Criteria: The implementation of a retirement database to maintain master retirement records available in computer applicable form is critical to processing retirement applications in a timely manner. The three main types of information to be included are demographic, financial and service credit information.

Condition: The database does not contain complete and accurate employment records, both in terms of historical and current service credit information, for members of the retirement system. Often, backup documentation to support service credit information requires the timely support and cooperation of the various State agencies.

Effect: Without accurate service credit data on the retirement database, the processing of retirement applications will continue to be a time consuming process.

Cause: In the past, attempts have been made to collect both historical and current data needed to determine service credit. Historical information up to 1984 has been entered into the database; however, due to the heavy reliance on manual collection procedures, this information has been determined to be inaccurate and incomplete. The process of recording some of the current service credit information is done by entering information sent in by agencies to the Retirement and Benefit Services Division. This information is not validated or otherwise confirmed for accuracy when submitted. It should also be noted that not all agencies comply with the requirement to submit this information in a timely manner.

Conclusion: No recommendation is made at this time. In February 2000, the Governor and State Comptroller announced a major project to replace the State's core financial and administrative systems. The State's central administrative agencies - the Office of the State Comptroller, the Departments of Administrative Service and Information Technology, and the Office of Policy and Management – have banded together to undertake the transition to a new, integrated system encompassing virtually all major functions and all executive–branch State agencies. The Core-CT project replaces core financial and administrative computer systems including central and agency accounting, purchasing, accounts payable, assets, inventory, payroll, time and attendance, workers' compensation, personnel, and other business legacy systems. The project was expected to take three years to complete. Current resources appear to be focused on the implementation of the Core-CT project, including the interface of the retirement system payroll with the new statewide payroll system project to start for October 2003. Once these issues are resolved, additional resources could be utilized. Other functions related to budgeting and retirement could be implemented in a later phase of the project.

Codification of Administrative Amendments to the State Employees' Retirement System:

Criteria: Amendments to the Pension Plan that have been administratively implemented by the Retirement Commission need to be codified to the General Statutes.

Condition: The Retirement Commission has amended the State Employees' Retirement Plan to comply with the Internal Revenue Services (IRS) regulations 401 and 415. This amendment was required to keep the tax-favored status of the plan. Although this amendment was appropriate, the Retirement Commission needs to formalize their actions by submitting legislation to codify this change to the Pension Plan and any other plan revisions made by the Retirement Commission. We noted no current action by the Retirement and Benefit Services Division on this matter.

Effect: Changes to the State Employees' Retirement System have been implemented and the members of the plan have not been informed of these changes. Members affected by this change may over contribute to the retirement system and expect a greater benefit upon retirement.

Cause: Our prior audit noted that this amendment to the Pension Plan was thought to be so obscure, that none of the current members would be affected by this change to the plan.

Recommendation: The Retirement and Benefit Services Division should submit statutory language to the General Assembly to codify the changes to the State Employees' Retirement System that have been administratively enacted by the Retirement Commission. (See Recommendation 1.)

Agency Response: "The specific revision cited herein was effectuated by the Commission in 1997 for the purpose of preserving the tax-deferred status of member contributions. Assuming that there exists a need to incorporate this matter of federal regulatory compliance within the general statutes, the Division will do so through the pension agreement codification project, discussed below."

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

Criteria: Section 5-155a of the General Statutes states that, the general administration and the responsibility for the proper operation of the State Employees' Retirement System is vested with the Retirement Commission and the Commission shall act in accordance with the provisions of the General Statutes and applicable collective bargaining agreements. Sound business practice dictates that action should be taken to codify agreements that impact a pension agreement.

Condition: The existing State Employees' Pension Agreement is an accumulation of various General Statutes, which have been modified by an arbitration award and five separately negotiated pension agreements over a nine-year period. Keeping track of existing benefits can be extremely complicated and cumbersome. The potential exists that some of the changes to the plan benefits could be omitted or not detected.

In the most recent memorandum of agreement between the State of Connecticut and State Employees' Bargaining Agent Coalition (SEBAC), known as SEBAC V, the parties agreed to submit the language of the Pension agreement in statutory form to the Legislative Commissioner's Office for codification in the General Statutes. Although this agreement was signed February 4, 1997, the Office of Policy and Management's (OPM) Office of Labor Relations and SEBAC have yet to submit this language to the Legislative Commissioner's Office. Our office intends to repeat a recommendation, regarding the failure to comply with this agreement, in our audit report on OPM. The OPM audit report also notes that provisions of the SEBAC agreements calling for codification into the General Statutes were not always consistent with the established legislative procedures. It was our understanding that OPM believed that the parties have reached an apparent impasse; and, although there is no formal agreement between the parties to have the State Comptroller's Retirement and Benefit Services Division review proposed statutory language for codification, the process may not go forward without the State Comptroller's Retirement and Benefit Services Division review.

Although not specifically stated, the need for the involvement of the State Comptroller's Retirement and Benefit Services Division is evident by the State Employees' Bargaining Agent Coalition's and OPM's Office of Labor Relations' failure to comply with their agreement and as stated in OPM's most recent audit report response, that OPM has taken all steps that are within its span of control to address this recommendation. Although it is our current understanding that the Director of the Retirement and Benefit Services Division has assumed the lead responsibility to convert the agreed upon language to statutory language and that this is to be accomplished mainly through the efforts of a recently retired staff member, prior discussions of the above parties have produced no concluding codifying results since the last SEBAC agreement in 1997.

Effect: The agreement in the arbitration award and the SEBAC agreements have not been formally adopted in the General Statutes and the impact of each award is not readily available for review. The General Statutes and its history remain incomplete without these timely updates or references. The internal control structure of the system continues to be weakened by the fragmentation of the Pension Agreement. In order to ascertain if a provision is superseded, all of the subsequent documents must be examined. The Retirement Commission's responsibility for the proper administration of the retirement system and to act in accordance with the provisions of the General Statutes and applicable collective bargaining agreements becomes more difficult to maintain with each modification to the Pension Agreement that has not been codified.

Cause: As noted in the OPM audit report, there were inconsistencies within the agreements and only a verbal agreement providing for an independent review of the proposed language. OPM's and SEBAC's attempt to get the Retirement and Benefit Services Division actively involved in the codification process was without authority. It is our understanding that no review has been completed since the last SEBAC agreement was signed on February 4, 1997.

Recommendation: The State Comptroller, through the Retirement Commission and its Retirement and Benefit Services Division, should establish a formal process to complete the codification of all SEBAC agreements, arbitration awards and any administrative actions of the Retirement Commission. (See Recommendation 1.)

Agency Response: "Due to the highly specialized nature of pension administration, both the Office of Labor Relations (OLR) and SEBAC properly recognized as critical the participation of the Division in the conversion of their collective bargaining agreements to statutory language. However, the 1997 contract which contains this codification requirement also imposed upon the Division the responsibility to (1) administer an early retirement incentive program; (2) implement a new membership tier; (3) account for member contributions as pre rather than post-tax; (4) publish revised summary plan descriptions; and (5) address a variety of other complex obligations that continue to consume precious resources to date. Accordingly, the Division's ability to participate in this pension agreement codification project was impaired by these and other operational demands. With the April 1, 2002 retirement of a key Division manager, there is now available a uniquely qualified individual to assume this project's lead. Assuming no impediments to proceeding along these lines, budgetary or otherwise, the Division will work with OLR and SEBAC to draft a Public Act for submission to the General Assembly."

Municipal Employees' Retirement System

Waiver of Repayments:

Criteria: Section 7-439h of the General Statutes provides for the possibility of a Retirement Commission waiver of repayment of overpayments and also stipulates that regulations be established to carry out these provisions.

Condition: No regulations have been established to carry out the provisions of Section 7-439h of the General Statutes. We were informed that there were no recent waiver requests; however, as indicated later in this report, we did note some retirement benefit overpayments.

Effect: The Retirement Commission is unable to act upon waiver requests.

Cause: Although Public Act 88-144 created the provisions for waiver requests of repayments, no regulations establishing criteria for these waivers were ever promulgated.

Recommendation: The Retirement and Benefit Services Division should promulgate waiver regulations for the Municipal Employees' Retirement System so that the Retirement Commission may act upon any waiver requests. (See Recommendation 2.)

Agency Response: "It remains the Division's intention to pursue this matter so that the Commission may act on waiver requests, if any."

Retirement Benefit Calculations:

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

Condition: We reviewed the calculations of retirement benefits for accuracy and found several errors. We reviewed three months of new retirement benefit recipients, some of which were contingent annuitants of the retiree. We reviewed the months of April 2000, June 2001, and February 2002; in those months, we found errors for 12 of 25, 3 of 18, and 3 of 10 recipients (a total of 18 of 53), respectively. Thirteen of the eighteen errors involved the determination of the highest average salary. These errors were caused by various factors including the inaccurate identification of the three years of salary to be used to determine the highest average salary, data entry errors and/or incorrect information received from the municipality. The other errors included the use of an incorrect option factor, incorrect length of service and an incorrect payment due to the number of days in which the benefit began. Due to the above errors, we noted both underpayments and overpayments. Underpayments amounted to $14,524 and ranged from $7 to $10,370, with current monthly underpayments ranging from $.56 to $226.77. The average underpayment was $1,037; the current average monthly underpayment was $31.60, excluding an estate calculation. The $10,370 underpayment was discovered during our review of the original benefit calculation for a new contingent annuitant and included monthly adjustments calculated for over ten years. Overpayments amounted to \$2,056 and ranged from \$18 to \$1,204, with current monthly overpayments ranging from \$8.14 to \$44.60. The average overpayment was \$514; the current average monthly overpayment was \$19.53. The MERF monthly retirement payroll for June 2001 exceeded \$4,400,000. We also noted that some of the reviews of the retirement benefit calculations were not completely documented. We have recently provided a computer file to the agency for its review and use, if applicable, that could eliminate the manual nature of determining the highest average salary. We also understand that the data is no longer manually input, but copied from the database system. We will formally evaluate the effectiveness and extensiveness of any new documented processes during our next audit. The above errors were brought to the agency's attention and adjustments were made.

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

Cause: It appeared that, due to the sometimes complex nature of the average annual pay calculations, the manual nature of the reviews and re-reviews, the old methodology could still lead to inaccurate average annual pay determinations. Situations in which pay amounts varied significantly, due to such things as overtime, made determining the highest three-year total of twelve consecutive monthly segments of salary very difficult. Other errors occurred and were not identified within the review process.

Recommendation: The Retirement and Benefit Services Division should take greater care in the review of the retirement benefit calculations for the Municipal Employees' Retirement System; internal controls relating to the finalization process should be strengthened and reviews should be documented. (See Recommendation 3.)

Agency Response: "The Division understands the methodology employed for this audit to be congruent with that utilized in previous audits, meaning a consistency in the number of retirement files reviewed for the accuracy of their calculations. That being the case, the errors detected in this biennial audit are more reflective of statistical outcomes than the underlying integrity of the benefit calculation process. Nevertheless, the Division is taking the following corrective action. First, to assist in identifying a retiree's final average earnings, the above-referenced computer file will be utilized; and second, to reduce mathematical errors, a new level of review will be incorporated into benefit finalization processes."

RECOMMENDATIONS

Status of Prior Audit Recommendations:

- Submit statutory language to the Legislative Commissioner's Office of the General Assembly to codify the changes to the State Employees' Retirement System that have been administratively enacted by the Retirement Commission. The status of this recommendation was basically unchanged and the recommendation has been repeated in modified form to include codification of arbitration awards and State Employees' Bargaining Agent Coalition agreements.

- Complete the reconciliation of the subsidiary and cash records of the Alternate Retirement Program contributions to the control balances for the program. We noted that the variance between the fund records and the suspense account has been relatively stable over the last several years. The variance fluctuated within a relatively narrow range and was less than $400 at June 30, 2001. We also noted that certain controls reduced the relative risks associated with the receipt and transfer of employee contributions to their respective accounts with an outside vendor. Although we are not repeating the recommendation at this time, we plan to continue monitoring the status of the fund records and the suspense account.

- Promulgate waiver regulations for the Municipal Employees' Retirement System so that the Retirement Commission may act upon any waiver requests. We noted no progress in this area and this recommendation has been repeated.

- The Retirement and Benefit Services Division should ensure that fully executed personal service agreements or contracts are in place before actuarial services are performed or invoices are paid. Our current review noted no similar activity. This recommendation is not repeated.

Current Audit Recommendations:

1. **The Retirement and Benefit Services Division should submit statutory language to the General Assembly to codify the changes to the State Employees' Retirement System that have been administratively enacted by the Retirement Commission; and, the State Comptroller, through the Retirement Commission and its Retirement and Benefit Services Division, should establish a formal process to complete the codification of all SEBAC agreements, arbitration awards and any administrative actions of the Retirement Commission.**

   Comment:

   The Retirement Commission has amended the State Employees' Retirement System to implement provisions of the Internal Revenue Service (IRS) Regulations 401 and 415. This amendment has not been formally codified to the General Statutes. IRS Regulations 405 and 415 impose limitations that must be observed to maintain the plan's tax-favored status. These limitations impose an overall maximum on a member's contributions to the system and limit the maximum compensation that can be used for calculating retirement benefits.

   The existing State Employees' Pension Agreement is an accumulation of various General Statutes, which have been modified by an arbitration award and five separately negotiated pension agreements over a nine-year period. Keeping track of existing benefits can be extremely complicated and cumbersome. The potential exists that some of the changes to the plan benefits could be omitted and never detected. The need for the involvement of the State Comptroller's Retirement and Benefit Services Division is evident by the State Employees' Bargaining Agent Coalition and the Office of Policy and Management's Office of Labor Relations' failure to comply with their agreement and prior discussions by the above parties that produced not concluding codifying results.

2. **The Retirement and Benefit Services Division should promulgate waiver regulations for the Municipal Employees' Retirement System so that the Retirement Commission may act upon any waiver request.**

   Comment:

   Section 7-439h of the General Statutes provides for the possibility of a Retirement Commission waiver of repayments of overpayments and also stipulates that regulations be established to carry out these provisions. During our current review, we noted retirement benefit overpayments.

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

   Comment:

   Our review of the calculations of retirement benefits for accuracy found errors for 18 of the 53 calculations reviewed. Thirteen of the errors were caused by the inaccurate identification of the three years of salary to be used to determine the highest average salary. Underpayments amounted to $14,524 and overpayments amounted to $2,056. One underpayment of $10,370 was discovered during our review of the original benefit calculation for a new contingent annuitant and included monthly adjustments calculated for over ten years. The new use of a computer file could eliminate the manual nature of determining the highest average salary; and, we understand that the data is no longer manually input, but copied from the database system.

INDEPENDENT AUDITORS' CERTIFICATION

As required by Section 2-90 of the General Statutes we have audited the books and accounts of the State Comptroller's State Retirement Funds for the fiscal years ended June 30, 2000 and 2001. This audit was primarily limited to performing tests of the State Comptroller's Retirement and Benefit Services Division's compliance with certain provisions of laws, regulations, contracts and grants, and to understanding and evaluating the effectiveness of the Division's internal control policies and procedures for ensuring that (1) the provisions of certain laws, regulations, contracts and grants applicable to the Division are complied with, (2) the financial transactions of the Division are properly recorded, processed, summarized and reported on consistent with management's authorization, and (3) the assets of the Division are safeguarded against loss or unauthorized use. The financial statement audits of the State Retirement Funds for the fiscal years ended June 30, 2000 and 2001, are included as a part of our Statewide Single Audits of the State of Connecticut for those fiscal years.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial-related audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the State Comptroller's Retirement and Benefit Services Division complied in all material or significant respects with the provisions of certain laws, regulations, contracts and grants and to obtain a sufficient understanding of the internal control to plan the audit and determine the nature, timing and extent of tests to be performed during the conduct of the audit.

Compliance:

Compliance with the requirements of laws, regulations, contracts and grants applicable to the State Retirement Funds is the responsibility of the State Comptroller's management. As part of obtaining reasonable assurance about whether the State Comptroller's Retirement and Benefit Services Division complied with laws, regulations, contracts and grants, noncompliance with which could result in significant unauthorized, illegal, irregular or unsafe transactions or could have a direct and material effect on the results of the Division's financial operations for the fiscal years ended June 30, 2000 and 2001, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants. However, providing an opinion on compliance with these provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards.* However, we noted certain immaterial or less than significant instances of noncompliance, which are described in the accompanying "Condition of Records" and "Recommendations" sections of this report.

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

The management of the State Comptroller's Office is responsible for establishing and maintaining effective internal control over its financial operations, safeguarding of assets, and compliance with the requirements of laws, regulations, contracts and grants applicable to the

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

However, we noted a certain matter involving the internal control over the Division's financial operations, safeguarding of assets, and/or compliance that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control over the Division's financial operations, safeguarding of assets, and/or compliance that, in our judgment, could adversely affect the Division's ability to properly record, process, summarize and report financial data consistent with management's authorization, safeguard assets, and/or comply with certain provisions of laws, regulations, contracts, and grants. We believe the following finding represents a reportable condition: we found errors in the calculation of Municipal Employees' Retirement Fund participant benefits.

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

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

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

CONCLUSION

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

Joseph Capece
Principal Auditor

Approved:

Kevin P. Johnston
Auditor of Public Accounts

Robert G. Jaekle
Auditor of Public Accounts