STATE OF CONNECTICUT

AUDITORS' REPORT
STATE COMPTROLLER – STATE RETIREMENT FUNDS
FOR THE FISCAL YEARS ENDED JUNE 30, 2002 AND 2003

AUDITORS OF PUBLIC ACCOUNTS

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November 30, 2004

AUDITORS' REPORT
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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, 2002, and 2003. 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, 2002, and 2003, 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 2001-2002 and 2002-2003 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.

Significant Legislation:

Notable legislative changes, which took effect during the audited period, are presented below:

- **Public Act 03-2** – Section 6(b) of the Act established an early retirement incentive program (ERIP) for active full and part-time State employees, who retire directly from State employment between March 1 and June 1, 2003. The incentive allowed an eligible employee to add up to three years to his or her age or service credit. To be eligible for the ERIP a State employee had to meet the following criteria: 1) be at least age 52 by May 31, 2003; 2) be a member of Tier I, Tier II, or Tier IIA of the State Employees' Retirement System (SERS); and, 3) have at least 10 years of actual State service in the SERS or 20 years for hazardous duty employees. The Act also gave the State the option of deferring retirements on a case-by-case basis until no later than June 1, 2004 for (1) hazardous duty employees, (2) State Retirement Division employees, and (3) employees of the Office of Policy and Management (OPM) budget division.

- **Special Act 03-2 –** This Act expanded eligibility for the Early Retirement Incentive Program (ERIP), established under Section 6(b) of Public Act 03-2, to cover State employees who are members of the Teachers' Retirement System and explicitly excluded part-time higher education instructors. In addition, the Act added extensions for the State's option of deferring retirements on a case-by-case basis through June 1, 2004 for (1) employees of the State Treasurer with primary responsibility for the planning and issuing of State debt or in-house short tem investment management of State and municipal funds and, (2) at the request of the CORE-CT steering committee, employees assigned to the CORE-CT project for at least three days a week and critical to its implementation. In addition, the Act allowed the Legislative Management Committee' personnel policies subcommittee to extend the retirement date of any Joint Committee on Legislative Management employee who was determined to be critical to the legislative process to no later than December 1, 2003.

- **Public Act 03-138 –** This Act authorizes an employee who earned municipal retirement credit in a town that is not a member of the Municipal Employee Retirement Fund (MERF) and then went to work for a MERF-member town to purchase retirement credit based on the earlier service under certain conditions. It authorizes such a purchase if the non-MERF town declines to transfer the appropriate retirement contributions to MERF. It specifies the purchase must be the equivalent of (1) two and one-quarter percent or five percent, as appropriate, of the employee's salary during the service period with the non-MERF town; (2) the actuarial cost determined necessary by the state Retirement Commission to fund the increased benefits payable because of the purchase; and (3) interest of six and one-half percent, compounded annually, on the combined payment total of (1) and (2). Prior law permitted the non-MERF town to voluntarily transfer such funds for the employee's previous service, but there is no provision for the employee to purchase service credit. The Act also requires the State Retirement Commission trustees to appoint a representative from MERF towns to act as a municipal liaison to the commission. The liaison will serve at the commission's pleasure under terms and conditions it sets.

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, 2003, were:

Peter R. Blum, Chairman
Claude Poulin, Actuarial Trustee
Robert D. Baus, Actuarial Trustee
Stephen Caliendo, Management Trustee
Robert D. Coffey, Management Trustee
Linda J. Yelmini, Management Trustee
Three Vacant, Management Trustees
Charles W. Casella, Employee Trustee*
Stephen Greatorex, Employee Trustee*
Steven Perruccio, Employee Trustee*
Salvatore Luciano., Employee Trustee*
Thomas P. Culley, Employee Trustee*
Carmen E. Boudier, Employee Trustee*

* State Employees' Bargaining Agent Coalition (SEBAC)

Also, Richard D. Wilber, Management Trustee, David O. Elliott, Management Trustee, and Edward C. Marth, 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, 2003, were:

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

Also, Robert L. Trestman, Ph.D., M.D. served during the audited 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 ($36,400 for 2003 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, 2003.

Actuarial valuations of the system were last prepared as of June 30, 2002, with an interim valuation prepared at June 30, 2003. As a result of these valuations, the unfunded actuarial accrued liability from the most recent valuations follows:

As of June 30,	**2001**	**2002**	**2003**
Unfunded actuarial accrued liability	$4,466,512,623	$4,912,431,497	$6,165,199,771

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 approximately 4,800 active members to retired members as of June 30, 2003, occurred primarily because of the 2003 Early Retirement Incentive Program. The decrease in active members by 7,903 between 2001 and 2003 was the result of a decrease of 4,915 in Tier I members, a decrease of 3,724 in Tier II members, and an increase of 736 in Tier IIA members.

As of June 30,	2001	2002	2003
Active Members	54,867	54,287	46,964
Retired Members	32,275	32,354	37,051
Inactive Members (Terminated Vested)	1,170	1,496	1,677
Totals	**88,312**	**88,137**	**85,692**

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:

	2000-2001	2001-2002	2002-2003
State Contributions	$289,128,616	$321,203,059	$325,908,490
Federal Contributions	86,494,566	94,289,540	95,543,241
Employee Contributions	46,088,785	49,577,375	50,953,367
Investment Income	276,669,027	271,445,717	319,466,083
Net Gain on Sale of Investments*	7,385	1,805,958	10,185,031
Totals	**$698,388,379**	**$738,321,649**	**$802,056,212**

*Note: Net gain on sale of investments primarily represented realized gains from the sale of investments in the Mutual Fixed Income Fund for both fiscal years 2001-2002 and 2002-2003 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.

	2000-2001	2001-2002	2002-2003
Benefit Payments	$615,571,401	$647,511,970	$698,567,399
Employer Refunds	3,603,072	3,689,100	4,311,346
Other Expenses	340,513	271,967	310,622
Net Loss on Sale of Investments*	2,147,682	464,074	1,152,865
Totals	**$621,662,668**	**$651,937,111**	**$704,342,232**

*Note: Net losses on sale of investments represented realized net losses from the sale of investments in the Commercial Mortgage and the Real Estate Funds 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.

	2001	2002	2003
Market Value of Assets	$7,786,625,739	$7,088,897,412	$6,991,626,215
Rate of Return	(3.71%)	(6.61%)	1.91%
Actuarial Value of Assets*	$7,638,853,784	$7,893,683,977	$8,058,586,633
Rate of Return	9.02%	5.84%	5.08%

*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.

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:

	2000-2001	2001-2002	2002-2003
Contributions - Participants	$18,630,236	$20,713,663	$22,832,567
Contributions – State's Share	$29,275,190	$33,895,972	$36,039,648
Remitted to insuring company	$47,674,799	$55,198,042	$58,708,369

A cash balance of $1,762,551 and $1,926,397, as of June 30 2002 and 2003, 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:

	2000-2001	2001-2002	2002-2003
Transfers to Alternate Retirement Fund	$29,275,190	$33,895,972	$36,039,648
Transfers to University Operating Funds	8,438,666	10,160,724	9,861,717
Total Transfers	37,713,856	44,056,696	45,901,365
Less: Fringe Benefit Recoveries	22,858,941	28,165,111	30,653,255
Refunds of Contributions	200	3,558	1,544
Net Charges against Appropriations	**$14,854,715**	**$15,888,027**	**$15,246,566**

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,	2001	2002	2003
Refunds of expenditures applied to expenditures	$ 200	$3,558	$1,544
Refunds of prior year expenditures	-	168	-
Total	**$ 200**	**$3,726**	**$1,544**

State's Attorneys' Retirement Fund:

Sections 51-49, 51-287, and 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 $872,959, $997,276 and $1,072,495 for fiscal years 2000-2001, 2001-2002 and 2002-2003, respectively. The State's Attorneys' Retirement Fund was charged $179,677, $89,886 and $40,000 for pensions paid to retired members during fiscal years 2000-2001, 2001-2002 and 2002-2003, 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:

	2000-2001	2001-2002	2002-2003
Market Value of Investments, June 30	$ 732,869	$ 614,858	$ 618,720
Receipts	59,789	43,334	37,239
Pensions Paid to Retired Members	1,052,636	1,087,162	1,112,495

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:

	2000-2001	2001-2002	2002-2003
Market Value of Investments, June 30	$ 36,190	$ 33,324	$ 30,090
Receipts	2,243	917	525
Pensions Paid to Retired Members	4,823	3,782	3,759

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 2001 (interim), June 30, 2002 and

June 30, 2003 (interim). As a result of these valuations, the unfunded actuarial accrued liability as of June 30, 2001, 2002 and 2003, was determined to be $60,703,475, $70,953,014 and $68,331,849, 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.

	2000-2001	**2001-2002**	**2002-2003**
Actuarial Value of Assets, June 30	$133,052,111	$138,400,649	$142,765,603
Investments at Market Value, June 30	135,740,148	125,264,906	125,215,779
Receipts	17,845,557	15,768,963	17,191,442
Pensions Paid to Retired Members	12,483,614	13,444,832	14,406,914

The asset balances are valued using the Actuarial Valuation of Assets method. This method spreads the recognition of gains and losses over a five-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 2002-2003 fiscal year was mainly due to interest and investment income of $5,506,575, and the gain on the sale of investments of $152,206, 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:

	2000-2001	2001-2002	2002-2003
Market Value of Investments, June 30	$ 32,411	$ 39,902	$ 44,971
Receipts	7,732	7,080	6,869
Pensions Paid to Retired Members	352,624	352,589	356,944

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 $350,624, $353,000 and $355,144 for fiscal years 2000-2001, 2001-2002 and 2002-2003, respectively. The Public Defenders' Retirement Fund was charged $2,000, ($411) and $1,800, respectively for pensions paid to retired members during fiscal years 2000-2001, 2001-2002 and 2002-2003, 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 one percent of their earnings on which Social Security taxes are paid through the Retirement Commission and three and three-quarters percent of earnings in excess of that, while for those not under such Social Security coverage, retirement contributions are three and three-quarters 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, 2001, 2002, and 2003. As a result of these valuations, it was determined that there was no unfunded actuarial accrued liability as of December 31, 2001, 2002 and 2003.

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.

	2000-2001	**2001-2002**	**2002-2003**
Actuarial Value of Assets, Dec. 31	$67,455,525	$68,619,066	$71,229,966
Investments at Market Value, June 30	66,678,879	60,923,941	60,482,840
Receipts	3,671,203	3,617,740	4,164,301
Pensions Paid to Retired Members	2,041,629	2,097,224	2,224,056

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 2002-2003 fiscal year was mainly due to interest and investment income of $2,388,174, 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, 2003, the Fund A had neither active employees enrolled nor any retired employees receiving benefits, as a result of the death, in September 2002, of the Fund's one remaining member. The Fund A was closed in accordance with Public Act No. 93-356 and the balance of the Fund's assets were transferred to the Municipal Employees' Retirement System Fund B.

As of June 30, 2003, municipalities and housing authorities with 8,420 enrolled active employees were participants in Fund B. As of that date, benefits were being paid from Fund B to 4,743 retired employees or to their survivors. This represented net increases of 187 active participants and 171 benefit recipients during the 2001-2002 and 2002-2003 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,	**2001**	**2002**	**2003**
Unfunded actuarial accrued liability	$(115,035,944)	$(83,653,332)	$(39,456,886)

Despite the negative unfunded actuarial accrued liability, contribution rates to the Municipal Employees' Retirement System have been increased to compensate for the expected impact of asset losses on future valuations that will result from the normal application of the smoothing method used to develop the actuarial value of assets.

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,	2001	2002	2003
Policemen and firefighters with Social Security	3.75%	3.75%	4.25%
Others with Social Security	2.75%	2.75%	3.75%
Policemen and firefighters without Social Security	2.75%	2.75%	4.25%
Others without Social Security	3.00%	3.00%	3.75%

Section 7-439b of the General Statutes provides for annual cost-of-living increases for each retired member or surviving annuitant of a retired member receiving regular benefit payments. For each member retired prior to January 1, 2002, who has reached age 65, benefits are adjusted each July first. The annual cost-of-living adjustment for these individuals is within the limits of a minimum of three percent and a maximum of five percent and is based on the determination of the annual yield of the assets of the fund. Members eligible under this category received cost-of-living adjustments of five percent, three percent, and three percent on July 1, 2001, 2002 and 2003, respectively. Those members retired prior to January 1, 2002, who have not reached age 65, were eligible for a cost-of-living adjustment of two and one-half percent on July, 1, 2002, and are eligible for the same percentage increase on July first of each subsequent year until the July first following each member's sixty-fifth birthday. Those members retiring on or after January 1, 2002, are eligible to receive a cost- of-living adjustment beginning on the first July first following such member's retirement date and on each subsequent July first. Within the limits of a minimum two and one-half percent and six percent, the adjustment is sixty percent of the annual increase in the consumer price index up to six percent, plus seventy-five percent of the annual increase in the consumer price index in excess of six percent. Eligible retirees within this category received a cost-of-living adjustment of two and one-half percent on July 1, 2002 and 2003.

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, 2001, 2002 and 2003, 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.

	2000-2001	2001-2002	2002-2003
Actuarial Value of Assets, June 30	$1,353,141,245	$1,403,401,930	$1,417,664,834
Investments at Market Value, June 30	1,297,727,523	1,184,508,260	1,174,440,127
Receipts	72,718,714	71,752,748	81,032,898,
Pensions Paid to Retired Members	54,147,569	57,284,033	61,189,040

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 2002-2003 fiscal year was mainly due to the net increase of $8,792,070 derived from interest and investment income and the gain on the sale of investments; the decrease in receipts during the 2001-2002 fiscal year was mainly due to a net reduction in interest and investment income of $1,425,763, 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 2001-2002 and the 2002-2003 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, 2003, the date of the last available actuarial valuation, six municipalities, with 509 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 pensions paid to surviving dependents.

	2000-2001	**2001-2002**	**2002-2003**
Actuarial Value of Assets, June 30	$17,775,025	$19,664,934	$19,852,168
Assets in excess of net actuarial liabilities	1,203,300	2,715,562	2,308,929
Investments at Market Value, June 30	17,771,116	16,801,504	17,026,910
Receipts - Contributions	357,512	295,471	296,748
Receipts - Investment Income	727,944	537,032	477,683
Pensions Paid to Surviving Dependents	559,636	557,171	753,837

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, 2001, 2002 and 2003 resulted in municipal contribution rates of zero percent of each municipality's active covered payroll as of July 1, 2002, 2003 and 2004, 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 2000-2001, 2001-2002 and 2002-2003 fiscal years, from the above special appropriation account, amounted to $179,137, $196,031 and $182,702, 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,	2001	2002	2003
ING	$513,556,517	$501,458,156	$548,403,341
Hartford	270,771,774	265,399,844	294,505,112
Phoenix	34,329,102	30,582,164	32,036,110
Total	**$818,657,393**	**$797,440,164**	**$874,944,563**

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:

	2000-2001	2001-2002	2002-2003
General Fund:	$	$	$
Alternate Retirement System:			
State share of contributions (A)	14,854,715	15,888,027	15,246,566
State Employees' Retirement System:			
State share of retirement funding	257,806,736	284,527,059	285,694,490
Pensions and Retirements-Other Statutory:			
State share of costs:			
State's Attorneys' Retirement System	872,959	997,276	1,072,495
Public Defenders' Retirement System	350,624	353,000	355,144
Pension payments – miscellaneous (B)	179,137	196,031	182,702
Judges' and Compensation			
Commissioners' Retirement Fund:			
State share of retirement funding	9,837,077	9,597,785	10,125,658
Retired State Employees'			

Health Service Costs:			
State share of costs	171,852,369	202,612,607	239,741,164
Special Transportation Fund:			
State Employees' Retirement System:			
State share of retirement funding	31,321,880	36,676,000	40,214,000
Total Expenditures	**$487,075,497**	**$550,847,785**	**$592,632,219**

(A) Net of refunds and fringe benefit recoveries of $22,859,141, $28,168,669 and $30,654,799, 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 2000-2001, 2001-2002 and 2002-2003 fiscal years appropriations and transfers of $172,874,000, $204,532,200 and $241,597,000, 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:

	2000-2001	**2001-2002**	**2002-2003**
Anthem Blue Cross/Blue Shield	$133,366,838	$154,309,643	$179,909,569
Physicians Health Care/Health Net	21,121,503	28,987,735	38,596,819
MedSpan	190,403	-	-
Medicare Part B	14,941,837	16,368,208	17,759,268
Connecticare	793,674	1,311,982	1,745,095
Anthem Blue Cross/Blue Shield Dental	1,355,802	1,544,653	1,630,147
CIGNA Dental	82,312	90,386	100,266
Total	**$171,852,369**	**$202,612,607**	**$239,741,164**

The increases for the fiscal years 2001-2002 and 2002-2003 were 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 June 12, 2002, was approximately 1,057. There was a slight increase in the backlog from that time through the middle of February 2003 when the reported backlog of applications was 1,198. However, a significant increase in the backlog occurred as a result of the implementation of the 2003 Early Retirement Incentive Program (ERIP), which was enacted under Public Act No. 03-02, January 2003, Regular Session. The Division's records reveal that approximately 5,000 retirement applications were submitted with effective dates of retirement from March 1, 2003, to June 1, 2003, inclusive, as a result of the 2003 ERIP. As a consequence, the backlog increased to approximately 5,900 as of June 30, 2003. We were informed on June 3, 2004, that the backlog was reduced to approximately 5,600.

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 historical 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. Prior to the implementation of the 2003 Early Retirement Incentive Program, the Retirement and Benefit Services Division had made significant progress in reducing the backlog of retirement applications not yet finalized. If not for the latest early retirement incentive, the backlog would have probably been reduced to an acceptable level. The Retirement and Benefit Services Division continues its efforts to reduce the backlog of retirement applications not yet finalized.

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 July 2003, the first phase of the financial modules of the Core-CT project was activated. The Core-CT project replaces the 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. In October 2003, the first phase of the Core-CT Human Resources Management System (HRMS) modules, which includes the interface of the retirement system payroll with the new statewide payroll system, was activated. 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: It was thought that this amendment to the Pension Plan was 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 Retirement and Benefit Services Division has been working with Commission members and consultants for the past two months to come up with a solution for the Codification of

Administrative Amendments to the State Employees' Retirement System, and the Codification of Pension Agreement Changes to the State Employees' Retirement System. The Division will submit a proposal to the Retirement Commission on September 23rd to utilize an existing consulting contract along with staff assignments to accomplish the codification. Our goal will be to accomplish the codification by July 1, 2005."

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 prior recommendation, regarding the failure to comply with this agreement, in our audit report on OPM for the fiscal years ended June 30, 2002 and 2003.

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. 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. 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, prior discussions of the above parties have produced no concluding codifying results since the last SEBAC agreement in 1997.

Effect: The agreements 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: There were inconsistencies within the agreements and only a verbal agreement between the Office of Policy and Management and SEBAC 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: "The Retirement and Benefit Services Division has been working with Commission members and consultants for the past two months to come up with a solution for the Codification of Administrative Amendments to the State Employees' Retirement System, and the Codification of Pension Agreement Changes to the State Employees' Retirement System. The Division will submit a proposal to the Retirement Commission on September 23rd of 2004 to utilize an existing consulting contract along with staff assignments to accomplish the codification. Our goal will be to accomplish the codification by July 1, 2005."

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. Although there apparently were no recent waiver requests, we did note some retirement benefit overpayments, as indicated later in this report.

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 Retirement and Benefit Services 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: Our review of the calculations of retirement benefits for accuracy revealed that the Comptroller's Office made noticeable improvement in its process for computing the benefits owed to eligible beneficiaries during the audited period. However, we found that errors continue to occur due to inadequate internal controls. We reviewed two months of new retirement benefit recipients, some of which were contingent annuitants of the retiree. We reviewed the months of May 2002, and June 2003; in those months, we found errors for 3 of 11, or 28 percent, and 2 of 23, or

9 percent, of the tested recipients (a total of 5 of 34), respectively. All of the five 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. Due to the above errors, we noted both underpayments and overpayments. Underpayments amounted to $658 and ranged from less than a dollar to $497, with current monthly underpayments ranging from $.01 to $17.41. The two overpayments amounted to approximately $68 and ranged from approximately $19 to $50, with current monthly overpayments ranging from $1.23 to $2.87. During our prior audit, we 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 learned 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: "Since the last audit, the Retirement and Benefit Services Division has utilized the computer file which was developed by the State Auditors as a result of the last audit of the Municipal Employees' Retirement System. Two of the cases cited in the current audit were completed before the use of the computer file was implemented; one of which as the current report indicates, was an underpayment of $.01 per month which certainly may have resulted from rounding. Also, since the last audit a second review at time of retirement has been instituted and has increased the accuracy of the calculation of service credit as well as the determination of the final average pay and ultimately the pension amount paid. The Division plans to institute another level of review, which will ensure final wages paid match with those reported at retirement, however, this plan is contingent on hiring additional staff; it cannot be accomplished with the existing resources."

RECOMMENDATIONS

Status of Prior Audit Recommendations:

- **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.** The status of this recommendation was basically unchanged and the recommendation has been repeated.

- **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.** We noted no progress in this area and this recommendation has been repeated.

- **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.** Although we noted a noticeable improvement in the accuracy of the retirement benefit calculations for the retirees or contingent annuitants of retirees of the Municipal Employees' Retirement System during the audited period, the error rate for the calculations tested remains significant enough to warrant repeating our prior audit recommendation.

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 401 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 no 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 five of the 34 calculations reviewed. All five of the errors were caused by the inaccurate identification of the three years of salary to be used to determine the highest average salary. We noted both underpayments and overpayments. Underpayments amounted to $658 and overpayments amounted to approximately $68.

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, 2002 and 2003. 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, 2002 and 2003, 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 auditing standards generally accepted in the United States of America and the standards applicable to financial 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, 2002 and 2003, 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.

Robert Koch
Principal Auditor

Approved:

Kevin P. Johnston Auditor of Public Accounts	Robert G. Jaekle Auditor of Public Accounts