

# STATE OF CONNECTICUT



*AUDITORS' REPORT  
STATE COMPTROLLER- STATE RETIREMENT FUNDS AND  
STATE EMPLOYEE AND RETIREE BENEFITS  
FOR THE FISCAL YEARS ENDED JUNE 30, 2009, 2010, AND  
2011*

**AUDITORS OF PUBLIC ACCOUNTS**  
JOHN C. GERAGOSIAN ❖ ROBERT M. WARD

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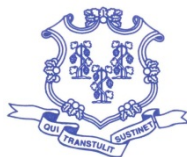
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## AUDITORS OF PUBLIC ACCOUNTS

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November 24, 2015

### **AUDITORS' REPORT STATE COMPTROLLER – STATE RETIREMENT FUNDS AND STATE EMPLOYEE AND RETIREE BENEFITS FOR THE FISCAL YEARS ENDED JUNE 30, 2009, 2010, AND 2011**

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, Family Support Magistrates 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 Division of the State Comptroller's Office for the fiscal years ended June 30, 2009, 2010 and 2011. Also included in that examination were the records 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. We have also reviewed the state's Deferred Compensation Plan and the state's share of health insurance costs for retirees as administered by the Healthcare Policy and Benefit Services Division. 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, 2009, 2010, and 2011, 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 Services Division's and Healthcare Policy and Benefit Services Division's compliance with certain provisions of financial and/or retirement related laws, regulations and contracts, and evaluating each 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 Office of the State Comptroller operates primarily under the provisions of Article Fourth, Section 24, of the State Constitution and Title 3, Chapter 34 of the General Statutes. The Retirement Services Division and Healthcare Policy and Benefit Services Division of the Office of the State Comptroller are responsible for processing the required actions and maintaining the records and accounts of the various retirement plans administered by the Connecticut State Employees Retirement Commission. They provide counseling services to members; administer state employee deferred compensation, dependent care assistance, group life, and health insurance programs; and manage the state unemployment compensation accounts.

### Officers

Nancy S. Wyman was elected State Comptroller in 1994 and served until January 5, 2011. Kevin Lembo was elected State Comptroller in November 2010. He began serving as State Comptroller on January 5, 2011 and continues to serve in that capacity. Mark E. Ojakian served as Deputy Comptroller until January 5, 2011, when Martha Carlson began serving as Deputy Comptroller and continues in that capacity.

Effective January 30, 2009, the Office of the State Comptroller was reorganized. As a result of that reorganization, the Retirement and Benefit Services Division was separated into a new Healthcare Policy and Benefit Services Division, with Dr. Thomas Woodruff serving as director, and a renamed Retirement Services Division, with Deputy State Comptroller Mark E. Ojakian serving as interim division director. Jeanne Kopek took over those duties and became Interim Division Director of Retirement Services in October 2010 and served in that capacity until August 2011, when she was succeeded by Brenda Halpin.

### Significant Legislation

Special Act 09-6 approved a Retirement Incentive Program (RIP) for active full- and part-time state employees who retire directly from state employment with effective retirement dates of June 1, 2009 or July 1, 2009. The act also gave the state the option of deferring retirements on a case-by-case basis.

Public Act 09-7, enacted during the September Special Session of the General Assembly, amended Section 5-259 subsection (m) of the General Statutes to enable the Comptroller to convert to self-insured plans for the benefit period beginning on or after July 1, 2010.

Public Act 10-131, effective June 7, 2010, required the Comptroller to offer non-state public employers the option to purchase prescription drugs through the state's bulk purchasing authority.

## **Boards and Commissions**

### **Connecticut State Employees Retirement Commission**

The Connecticut State Employees Retirement Commission, established under Section 5-155a of the Connecticut General Statutes, is responsible for the administration of the retirement programs mentioned in this report. In accordance with Section 5-155a, the membership of the commission is composed of the State Treasurer or designee, who is a nonvoting ex-officio member; 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 the 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 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 commission members are entitled to reimbursement for necessary expenses incurred in the performance of their official duties. Members of the commission as of June 30, 2011, were:

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

Management trustees Mary Marcial and Stephen Caliendo also served as members of the board during the audited period, retiring in July 2009 and August 2010, respectively. James Dzurenda was appointed by the Governor on November 13, 2009 to succeed Mary Marcial, and Michael Carey was appointed by the Governor on October 1, 2010 to succeed Stephen Caliendo.

The six employee trustees are representatives of the State Employees Bargaining Agent Coalition (SEBAC).

### **Medical Examining Board for State Employee Disability Retirement**

Under Section 5-169 of the Connecticut General Statutes, the Governor shall appoint a board of seven state employee physicians to determine entitlement to disability retirement for members of the State Employees Retirement System named the Medical Examining Board. Effective July 1, 2011, Public Act 11-82 amended Section 5-169 which read “state employee” to now read

“current or retired state employee” regarding physician membership on the board. The members of the board as of June 30, 2011, were:

Catherine F. Lewis, M.D.  
Oluremi Aliyu, M.D.  
Wilner Samson, M.D

Dr. John Meyer and Dr. Albert Arias also served as members of the board during the audited period.

## **RÉSUMÉ OF OPERATIONS**

### **State Employees Retirement Fund**

Title 5, Chapter 66, of the Connecticut General Statutes, entitled 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 Services Division of the Office of the State Comptroller maintains the accounting records pertaining to the operations of the retirement system. In addition, the State Treasurer serves as custodian and investment manager of the retirement system funds.

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

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

The SEBAC 2009 agreement modified sections of SEBAC V and included a retirement incentive plan. Subsequent to the audited period, the SEBAC pension agreement was revised in 2011 for individuals hired on or after July 1, 2011 with the creation of Tier III and a hybrid plan specifically for unclassified employees of the Connecticut State System of Higher Education and the central office staff of the Department of Higher Education. SEBAC 2011 also provides a one-time, irrevocable opportunity for current members of the Connecticut Alternate Retirement Program to transfer membership to the new hybrid plan and purchase credit of their prior state service in that plan at the full actuarial cost. The 2011 SEBAC agreement also made adjustments



to the salary cap, breakpoint calculations, changed the early retirement reduction factor and raised the minimum retirement age to age 63 and 25 years of state service or age 65 and ten years of state service for employees retiring after July 1, 2022. The 2011 SEBAC agreement also extended the provision that the State Employees Retirement System shall not be changed unless mutually agreed to in the SEBAC V agreement through June 30, 2022

The 2009 SEBAC agreement also requires that all employees hired on or after July 1, 2009, and existing employees with less than five years of service as of July 1, 2010 are required to contribute three percent of their salary for ten years, to be deposited into a newly established retiree healthcare trust fund. A revision of the SEBAC pension agreement in 2011 extended the requirement of trust contributions to all other state employees to be phased in beginning July 1, 2013, as follows: one half of one percent of salary for fiscal year ending June 30, 2013, two percent of salary for fiscal year ending June 30, 2014, and three percent of salary for fiscal year ending June 13, 2015 and thereafter, with a period of required contribution of ten years or to the beginning of retirement, whichever occurs first.

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

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

As of July 1, 2011, the State Employees Retirement System consisted of a four-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, and membership in Tier IIA is closed to those employees hired after June 30, 2011. As noted above, Tier III was established for individuals hired on or after July 1, 2011

Tier I is a contributory pension plan. As provided for in Section 5-158f of the Connecticut General Statutes, there are 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. As of June 30, 2011, approximately seven percent of the total workforce was covered under the Tier I plan.

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

and Tier III are contributory plans that provide benefits similar to Tier II, but require contributions. Approximately 37 and 56 percent of the total work force was covered under the Tier II and Tier IIA plans, respectively, at June 30, 2011.

The retirement benefit for which a Tier I, Tier II or Tier IIA member is eligible is based on a formula determined by years of service, age at retirement, type of retirement, average final compensation, plan participation, and the benefit payment option selected. Tier II and Tier IIA also include a breakpoint calculation. Members must have completed at least ten years of service or have reached the age of 70 with at least five years of service to receive a benefit. Members who become disabled may be eligible for disability retirement benefits regardless of their years of service.

Retirements effective June 1, 1997 or earlier were eligible for an annual three percent cost-of-living adjustment (COLA) 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 that 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. The 2011 SEBAC agreement changed the minimum COLA to two percent and maximum COLA to seven and one-half percent for individuals retiring after October 2, 2011.

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

The State Employees Retirement System provides for 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. Those state employees not participating in the State Employees Retirement System include judges, compensation commissioners, certain state's attorneys and public defenders, teachers in the Teachers' Retirement System, and higher education employees in the Alternate Retirement Program.

Under the provisions of Section 5-156a of the Connecticut General Statutes, the State Employees Retirement System is to be funded on an actuarial reserve basis. The General Assembly annually appropriates the amounts necessary to meet this funding plan and such amounts are paid over to the retirement fund in equal monthly installments. These payments are not 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 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 Connecticut General Statutes. Actuarial valuations of the system were prepared as of June 30, 2010, 2012 and 2014, with interim valuations prepared as of June 30, 2009 and 2011, and a roll forward valuation as of June 30, 2013. As a result of these valuations, the unfunded actuarial accrued liability for the audited period was as follows:

<b>As of June 30,</b>	<u><b>2009</b></u>	<u><b>2010</b></u>	<u><b>2011</b></u>
Unfunded actuarial accrued liability	\$9,253,125,542	\$11,704,591,789	\$11,003,960,062

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:

<b>As of June 30,</b>	<u><b>2009</b></u>	<u><b>2010</b></u>	<u><b>2011</b></u>
Active Members			
Tier I	6,865	4,441	3,346
Tier II	22,324	19,487	17,768
Tier IIA	<u>24,007</u>	<u>26,136</u>	<u>26,664</u>
Total Active Members	53,196	50,064	47,778
Retired Members	38,093	41,782	44,051
Inactive Members (Terminated Vested)	<u>1,592</u>	<u>1,602</u>	<u>1,589</u>
Totals	<u>92,881</u>	<u>93,448</u>	<u>93,418</u>

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 for three fiscal years, along with non-recurring revenue for the gain on sale of investments has been provided below:

	<u><b>2008-2009</b></u>	<u><b>2009-2010</b></u>	<u><b>2010-2011</b></u>
State Contributions	\$526,202,174	\$548,509,904	\$645,766,057
Federal Contributions	173,538,851	172,016,675	180,034,856
Employee Contributions	70,875,520	65,662,494	67,679,263
Investment Income	252,767,098	207,783,875	291,056,178
Gain on Sale of Investments	<u>13,157,837</u>	<u>347,635,387</u>	<u>156,449,185</u>
Totals	<u><b>\$1,036,541,480</b></u>	<u><b>\$1,341,608,335</b></u>	<u><b>\$1,340,985,539</b></u>

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

	<u>2008-2009</u>	<u>2009-2010</u>	<u>2010-2011</u>
Benefit Payments	\$1,063,286,151	\$1,263,784,641	\$1,315,660,456
Employer Refunds	7,187,878	8,336,703	7,932,492
Loss on Sale of Investments	873,525	1,218,521	338,471
Totals	<u>\$1,071,347,554</u>	<u>\$1,273,339,865</u>	<u>\$1,323,931,419</u>

The State Treasurer is the custodian of the fund's investments. A summary of the market and actuarial value of assets and rate of return as of June 30<sup>th</sup> for the audited period has been presented below. Investments in the State of Connecticut Combined Investment Funds are verified as part of our audit of the State Treasurer. This summary is based on information from actuarial reports on file with the Retirement Services Division and the divisions' financial statements that were based on State Treasurer data.

<b>As of June 30</b>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Market Value of Assets	\$7,320,843,712	\$7,789,607,302	\$8,980,628,985
Rate of Return	(18.25) %	12.93%	21.15%
Actuarial Value of Assets*	\$8,787,160,426	\$9,349,604,896	\$10,122,765,430
Rate of Return	2.60%	2.57%	3.74%

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

During the audited period, the Alternate Retirement Program was administered by ING. ING assumed the role of the Third-Party Administrator (TPA) under the terms of a contract, effective January 1, 2006. Retirement benefits are based on contributions, distribution of contributions, length of participation, age, and the payment option selected. Payment options include partial or lump-sum withdrawals, systematic withdrawal option, rollover to another eligible retirement plan or IRA, or a combination of various payment and annuity options.

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 Connecticut General Statutes. Effective July 1, 1985, and thereafter, the state share is fixed at eight percent of salary. All participant and state contributions are held in a separate retirement fund in the custody of the

State Treasurer and are forwarded to the insuring company upon certification from the State Comptroller.

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

Contributions from participating employees to the Alternate Retirement Program Fund and the amounts remitted to the insuring company follows:

	<u>2008-2009</u>	<u>2009-2010</u>	<u>2010-2011</u>
Contributions – Participants	\$35,336,337	\$35,468,927	\$37,020,072
Remitted to Insuring Company	35,332,443	\$35,480,927	\$36,997,062

As previously noted, the state’s share of the contributions on behalf of the program was met from appropriations administered by the State Comptroller for the purposes of the Alternate Retirement Program. The state’s share of contributions was remitted directly from the General Fund appropriation account to the TPA. Refunds of contributions from the TPA and fringe benefit recoveries to the General Fund were credited against this share, resulting in net charges against the General Fund appropriation account totaling \$21,674,111, \$24,581,419, and \$22,609,979 for the 2008-2009, 2009-2010, and 2010-2011 fiscal years, respectively.

### **State’s Attorneys Retirement Fund**

Sections 51-49, 51-287, and 51-288 of the Connecticut 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 attorneys and state’s attorneys who elected under the provisions of section 51-278 to be included in the provisions of this section...” In accordance with an opinion of the Attorney General, eligibility for participation in the retirement plan includes those who were state’s attorneys and participants in the plan on June 30, 1973, or who were incumbent state’s attorneys on July 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 members of the State’s Attorney’s Retirement Fund as contributions for retirement purposes. These contributions are deposited in a separate trust fund in the custody of the State Treasurer. Contributions can be refunded if any such attorney leaves office before retirement.

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

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

The investments of the State's Attorneys Retirement Fund, which made up most of the assets of the fund, the employee contributions, net investment income, and pensions paid to retired members are shown below:

	<u>2008-2009</u>	<u>2009-2010</u>	<u>2010-2011</u>
Market Value of Investments, June 30	\$863,547	\$990,782	\$1,112,148
Employee Contributions	23,135	37,083	22,484
Investment Income-Net of Gains/Losses	38,026	33,791	31,599
Pensions Paid to Retired Members	1,015,148	1,131,574	1,134,933

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

### **General Assembly Pension Fund**

Sections 2-8b through 2-8p of the Connecticut 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 an actuarially determined reserve needed to fund those already retired from and receiving benefits from the General Assembly Pension System. As provided for in Section 2-8r, members of the General Assembly, as of July 1, 1985, were to be covered under Tier II of the State Employees Retirement System, unless by December 31, 1990, an election was made by the member to participate in the Tier I plan.

The 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 net investment income and pensions paid to retired members were as follows:

	<u>2008-2009</u>	<u>2009-2010</u>	<u>2010-2011</u>
Market Value of Investments, June 30	\$18,954	\$16,809	\$15,680
Investment Income-Net of Gains/Losses	297	70	38
Pensions Paid to Retired Members	2,214	2,214	1,167

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

Participation in this system is automatic for all commissioners and judges, except that judges with 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.

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

Section 51-49d of the Connecticut General Statutes provides that the Judges Retirement System be funded on an actuarial reserve basis with actuarial surveys of the system performed at least once every two years and with annual certifications to the General Assembly of funding requirements. Actuarial valuations of the system were prepared as of June 30 2008, 2010, 2012 and 2014. As a result of these valuations, the unfunded actuarial accrued liabilities for the audited period were as follows:

<b>As of June 30,</b>	<u><b>2009</b></u>	<u><b>2010</b></u>	<u><b>2012</b></u>
Unfunded actuarial accrued liability	\$75,297,253	\$97,107,583	\$144,847,720

The following shows the actuarial value of assets for the audited period. This value is based on information from actuarial reports on file with the Retirement Services Division. It also shows the net investment income of the Judges and Compensation Commissioners Retirement Fund, the employee contributions, and pensions paid to retired members, which were derived from the division's financial statements that were based on State Treasurer data.

	<u><b>2008-2009</b></u>	<u><b>2009-2010</b></u>	<u><b>2010-2011</b></u>
Actuarial Value of Assets, June 30	\$177,812,345	\$179,739,926	\$176,549,231
Employee Contributions	1,618,254	1,570,091	1,566,429
Investment Income-Net of Gains/Losses	5,438,540	10,103,619	13,064,443
Pensions Paid to Retired Members	18,531,507	18,694,018	19,401,469

Investments in the State of Connecticut Combined Investment Funds are verified as part of our audit of the State Treasurer. 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. Receipts consisted mainly of General Fund appropriation transfers,

investment income, including gain on sale of investments, and employee contributions. Pensions paid to retired members were financed by the Judges and Compensation Commissioners Retirement Fund, mainly with transfers from a General Fund appropriation for Judges and Compensation Commissioners Retirement Contributions. Charges to the General Fund appropriation account amounted to \$14,172,454 for the 2008-2009 fiscal year. For the 2009-2010 and 2010-2011 fiscal years, the General Fund appropriations were reduced to \$0.

### **Public Defenders Retirement Fund**

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

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

Pensions were paid to six retirees/beneficiaries for the audited period. The pensions were mainly financed by the General Fund appropriation for Pensions and Retirements – Other Statutory. Charges to the General Fund appropriation account amounted to \$538,825, \$538,825 and \$511,156 for the 2008-2009, 2009-2010, and 2010-2011 fiscal years, respectively.

### **Probate Judges and Employees Retirement Fund**

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

As provided in Section 45a-49, all contributions required under the system are transmitted by the commission to the State Treasurer, who shall be custodian of the fund with power to invest as much of the fund 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 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 Connecticut General Statutes requires that on or before July 1<sup>st</sup> annually, the commission shall certify to the State Treasurer, on the basis of an actuarial determination, the amount to be transferred to the retirement fund to maintain the actuarial plan adopted by the commission. Payments of these actuarially determined funding amounts are made from the Probate Court Administration Fund. Actuarial valuations of the system were



prepared as of December 31, 2009, and 2011. As a result of these valuations, it was determined that there was no unfunded actuarial accrued liability as of those dates.

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

The following shows the actuarial value of assets for the audited period. This value is based on information from actuarial reports on file with the Retirement Services Division. Actuarial valuations of the system were prepared as of December 31, 2009, 2010, and 2011. The following also shows the net investment income of the Probate Judges and Employees Retirement Fund, the employee contributions, and pensions paid to retired members, which were derived from the division's financial statements that were based on State Treasurer data.

	<u>2008-2009</u>	<u>2009-2010</u>	<u>2010-2011</u>
Actuarial Value of Assets, Dec. 31	\$86,776,445	\$87,361,900	\$85,154,310
Employee Contributions	290,500	296,885	328,185
Investment Income-Net of Gains/Losses	2,492,441	4,688,352	3,625,123
Pensions Paid to Retired Members	3,090,292	3,157,847	3,587,177
Health Services Costs Paid Through Fund	2,702,807	2,739,654	3,465,108

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, operating transfers from the Probate Court Administration Fund, mainly for health service costs, and employee contributions. Pensions paid to retired members were financed by the Probate Judges and Employees Retirement Fund.

### **Municipal Employees Retirement Fund**

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

The Municipal Employees Retirement System is composed of a retirement fund and an administration fund. As of June 30, 2012, municipalities and housing authorities with 8,711 enrolled active employees were participants. As of that date, benefits were being paid to 6,095 retired employees or their survivors.

Any municipality may, by resolution passed by its legislative body and subject to referendum, participate in the system. The effective date of participation shall be at least 90 days subsequent to the receipt by the commission of a certified copy of the resolution. Participation may also be effected through an agreement between a municipality and an employee bargaining

organization in accordance with Section 7-474 subsection (f) of the Connecticut General Statutes.

Section 7-441 of the Connecticut General Statutes, which prescribes the various contributions required of participating municipalities, provides that each municipality must pay to the commission an annual proportionate share of the fund's administrative costs, as determined by the commission on the basis of the number of members employed by each municipality. The participating municipalities were required to contribute \$100 per member per year for such administrative expenses for the fiscal years ended June 30, 2009, 2010 and 2011. These monies were deposited into the Administrative Fund, which was established to account for all administrative contributions and expenditures.

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

Employee contribution rates are set by Section 7-440 of the Connecticut General Statutes. Employees contribute either two and one quarter percent or five percent based on whether or not Social Security contributions are deducted from their salary. Municipal contribution rates are set by the commission based on actuarial valuations, which, under the provisions of Section 7-443 of the Connecticut General Statutes, are required at least every five years. Actuarial valuations of the system were prepared as of June 30, 2010, 2012 and 2014, with roll forward valuations prepared as of June 30, 2011 and 2013. As a result of these valuations, the unfunded actuarial accrued liability for the audited period was as follows:

<b>As of June 30,</b>	<b><u>2009</u></b>	<b><u>2010</u></b>	<b><u>2011</u></b>
Unfunded actuarial accrued liability	\$202,291,655	\$218,081,183	\$231,936,744

The unfunded actuarial liability shifted to a negative position in the 2009 fiscal year due to significant investment losses and a decrease in the ratio of active to retired members. Contribution rates to the Municipal Employees Retirement System were increased to compensate for the 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:

<b>Effective Date July 1,</b>	<b><u>2009</u></b>	<b><u>2010</u></b>	<b><u>2011</u></b>
Policemen and Firefighters with Social Security	9.75%	13.75%	16.37%
General Employees with Social Security	7.50%	9.50%	11.56%
Policemen and Firefighters without Social Security	9.50%	13.50%	15.30%
General Employees without Social Security	7.50%	9.50%	11.40%

Section 7-439b of the Connecticut General Statutes provides for annual cost-of-living increases for each retired member or surviving annuitant of a retired member receiving regular benefit payments. Cost of living increases are determined by the member's date of retirement and age at retirement.

The following shows the actuarial value of assets for the audited period. This value is based on information from actuarial reports on file with the Retirement Services Division. It also shows the investments of the Municipal Employees Retirement System, which made up most of the assets of the fund; the employee contributions; and pensions paid to retired members, which were derived from the division's financial statements that were based on State Treasurer data.

	<u>2008-2009</u>	<u>2009-2010</u>	<u>2010-2011</u>
Actuarial Value of Assets, July 1	\$1,618,566,498	\$1,662,583,369	\$1,753,331,163
Market Value of Investments, July 1	1,345,095,513	1,470,621,054	1,697,937,448
Employee Contributions	14,794,457	14,658,388	16,054,147
Investment Income-Net of Gains/Losses	50,346,283	90,748,766	63,735,746
Pensions Paid to Retired Members	89,272,356	93,932,677	98,924,120

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

### **Policemen and Firemen Survivors Benefit Fund**

The Policemen and Firemen Survivors Benefit Fund operates, generally, under the provisions of Sections 7-323a through 7-323i of the Connecticut General Statutes. The primary objective of the fund is to provide benefits for surviving dependents of deceased municipal policemen and firefighters. Any municipality 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 commission to be necessary to maintain the fund on a sound actuarial basis.

Section 7-323c subsection (d) of the Connecticut General Statutes requires that municipalities annually pay a proportionate share of the administration costs of the fund as determined by the commission. The administrative fee for the fund was \$40 per member for the fiscal years ended June 30, 2009, 2010 and 2011. 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.

There were 603 active employees from nine municipalities participating in the plan as of June 30, 2011.

The following shows the actuarial value of assets for the audited period. These values are based on information from actuarial reports on file with the Retirement Services Division. Actuarial valuations of the fund were prepared as of June 30, 2010, 2012 and 2014. Interim valuations were performed as of June 30, 2009, 2011 and 2013. Also shown are the investments of the Police and Firemen Survivors Benefit Fund, which made up most of the assets of the fund; the employee contributions; net investment income; and disbursements for pensions paid to surviving dependents, which were derived from the division's financial statements that were based on State Treasurer data.

	<u>2008-2009</u>	<u>2009-2010</u>	<u>2010-2011</u>
Actuarial Value of Assets, June 30	\$21,378,422	\$22,629,738	\$22,930,408
Market Value of Investments, June 30	17,815,352	19,424,965	21,859,523
Employee Contributions	458,510	452,616	461,258
Investment Income-Net of Gains/Losses	769,993	666,927	634,544
Pensions Paid to Surviving Dependents	863,433	908,048	929,605

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

### **Pensions and Retirements – Other Statutory**

Sections 3-2a, 6-2b and 11-10a of the Connecticut General Statutes and various special acts authorize pensions and retirements to former Governors and their spouses, certain former county employees and law librarians, and various individuals. These pensions and retirements are paid from a special appropriation of the General Fund entitled Pensions and Retirements – Other Statutory. In addition, this account is used to fund that portion of the retirement benefits paid to retired members of the State's Attorneys and Public Defenders Retirement Funds that is not funded by those retirement funds.

### **Deferred Compensation**

In addition to the retirement programs already noted in this report, Section 5-264a of the Connecticut General Statutes authorizes the Office of the State 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. In addition, a political subdivision of the state may participate in the plan in accordance with Section 5-264a subsection (g) of the Connecticut General Statutes. This deferred compensation is not available to employees until retirement, termination of employment, disability, unforeseeable emergency or death.

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

**State Employees Health Service Costs**

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

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

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

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

	<b>2008-2009</b>	<b>2009-2010</b>	<b>2010-2011</b>
Expenditures - General Fund:			
Employer’s Share - State Employees	\$489,278,029	\$493,352,558	\$490,632,020
Expenditures - Transportation Fund:			
Employer’s Share - State Employees	32,662,370	32,172,617	33,997,343

**Retired State Employees Health Service Costs**

For retirements before July 1, 1997, the state pays 100 percent of the health insurance premiums for each retired employee and their spouse 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. Members retiring on or after July 1, 1997, may be required to assume a share of the premium cost, depending on the plan selected. As of June 30, 2009, 2010 and 2011, there were 38,613, 42,383 and 42,905, respectively, retired state employees receiving health care benefits.

During the 2008-2009, 2009-2010 and 2010-2011 fiscal years, appropriations and transfers of \$475,198,712, \$532,856,000 and \$595,252,100, respectively, were made to cover the state's share of health insurance costs for those eligible retirees. Total amounts expended were \$434,564,847, \$527,877,134 and \$490,898,951 for fiscal years 2008-2009, 2009-2010 and 2010-2011 respectively.

The increases in expenditures during the audited period were due to increases in negotiated premiums and an increase in the number of covered retirees. Changes in benefit design, eligibility requirements, the introduction of a health enhancement program, the conversion of the Medicare-aged prescription drug program to an employer group waiver program were responsible for reductions in expenditures. PharmaCare Management Services provides prescription drug coverage for all health plans.

In the past, the state has funded the health insurance benefits for retired employees as those costs were incurred. Unlike retirement benefits, no reserve was established to provide support for future years. The implementation of Governmental Accounting Standards Board Statement No. 45, (GASB 45) in the 2007-2008 fiscal year required the state to calculate and record the actuarial accrued liability for the future health care benefits of retired employees. As a result, in May 2008, the state created the State Employees Other Post-Employment Benefits Plan (SEOPEBP) administered by the State Comptroller as a single-employer defined benefit other post-employment benefit (OPEB) plan covering retired employees of the state who are receiving benefits from any state-sponsored retirement system, except the Teachers Retirement System and the Municipal Employees Retirement System. The SEOPEBP provides healthcare and life insurance benefits to eligible retirees and their spouses. The cost of post-retirement health care benefits is funded on a pay-as-you-go basis through the transfer of General Fund appropriations to the OPEB - State Employees trust fund. As of June 30, 2014, the fair market value of the net assets within the fund totaled \$166,192,775.

As noted above, the state must provide an actuarial valuation of the OPEB liability. Actuarial valuations of the system were prepared as of April 1, 2008, June 30, 2011 and June 30, 2013 and were as follows:

<b>As of April 1 / June 30</b>	<b><u>2008</u></b>	<b><u>2011</u></b>	<b><u>2013</u></b>
Unfunded actuarial accrued liability	\$26,566,940,000	\$17,904,626,540	\$19,532,514,019

The reduction of the unfunded actuarial accrued liability was due to changes in actuarial assumptions, an increase in the discount rate used to value plan obligations, the establishment of the OPEB trust fund, and changes in plan design and funding methodologies.

## STATE AUDITORS' FINDINGS AND RECOMMENDATIONS

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

### State Employees Retirement System

#### Finalizing Retirement Payrolls

*Criteria:* The process of finalizing retirement applications should be done in an accurate and timely manner. Section 5-156e of the Connecticut General Statutes requires that the Retirement Services Division 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 of receiving a pre-audit benefit.

*Condition:* During our review, we were unable to reconcile our sample of forty pension recalculations to the amounts calculated by the division. Due to our inability to duplicate these results, we determined that a \$500 tolerance level for the annual pension difference would be sufficient. The pension amounts recalculated in our sample were all within \$500 of what the division calculated; however, we are still including this as a finding because the results could not be duplicated.

Additionally, our review revealed that the division consistently pays retirees estimated benefits that are less than the benefits calculated during the pre-audit process, resulting in higher retroactive payments and thus higher interest payments owed at the time of finalization. In our sample of forty retirees, the average monthly underpayment between the calculated estimated benefit and the paid estimated benefit was twenty-seven dollars a month.

There is a significant backlog of retirement applications in the division that have not yet been finalized. At the time of our review (May 2014), there were approximately 11,880 applications on file pending finalization. The average timeframe for our sample of retirees to receive a finalized benefit from the date of retirement was six years and one month. For our sample of forty retirees, the finalized retroactive payments totaled \$416,000 and the interest payments totaled \$41,000.

Furthermore, we also noted that retirees are not offered the option of receiving installment payments instead of one lump sum for the finalized retroactive payment.

*Effect:*

The process of finalizing pension calculations is so complex and labor intensive that it is difficult for the results to be duplicated. This could result in improper payments. Consequently, retirees are not receiving their finalized benefit in a timely manner. The retirement fund must pay interest on the difference between the estimated benefit amounts and the actual amount owed at the time of finalization for any period of time after the first six months. For the 2009, 2010 and 2011 fiscal years, a total of \$785,572, \$449,139, and \$860,203 were paid in interest to finalized pensions. As noted above, there is backlog of 11,880 pensions awaiting finalization with interest payments likely due.

Also, the retirement fund is incurring unnecessary interest expenses due to the intentional underpayments of estimated benefits. While these amounts are not substantial, they are preventable.

There could also be tax burdens placed on individuals who receive lump sum retroactive payments that they were not prepared for.

*Cause:*

The division was using various methods of calculations and a spreadsheet created by outside consultants. This system does not address every situation; therefore, it is not used every time, resulting in manual entries and calculations. The division was unable to provide an explanation on how all of the cells and calculations work within the spreadsheet.

It has been the practice of the division to intentionally underpay the estimated benefit. The division feels it is easier to owe someone money in the case of an underpayment rather than to have to collect an overpayment.

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

The division lacks the necessary resources to make any significant near-term reduction in the number of applications pending finalization. However, it has made efforts to address the condition. There has been movement within the division to shift responsibilities to other units and summer interns are engaged to populate the data into the spreadsheets.

We are unable to determine the cause of not providing individuals the choice to receive installment payments.



*Recommendation:* The Retirement Services Division should continue its efforts to reduce the backlog of retirement applications waiting to be finalized. We also recommend that the division re-evaluate its long-standing practice of underpaying the estimated benefit.

Based on the mission of the agency, it may be beneficial for the division to offer an annuity option on these types of lump-sum retroactive payments, as it may ease the tax burden on retirees receiving them. (See Recommendation 1.)

*Agency Response:* “The Retirement Services Division appreciates the acknowledgement by the Auditors of the efforts that have been made in reducing the back log of the retirement applications awaiting finalization. At this time the Oracle Pension Module is in the design phase and one major section of the module is the automation of the calculation of retirement benefits. Once implemented, retirement benefits will be paid as calculated. In September 2013 the Division began discussions regarding offering retirees’ options on the one-time lump sum payments. However complications were encountered because we did not have the available resources needed to complete this process. We anticipate reviewing this matter once again after the Pension Module implementation.”

### **Finalizations and Calculation of Interest on Post-Audit Lump Sum**

*Criteria:* Section 5-156e of the Connecticut General Statutes requires that the Retirement Services Division 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 of receiving a pre-audit benefit.

*Condition:* Our audit disclosed that at least two different methods were used in calculating the interest to be paid to retired plan members, which resulted in differing amounts. Our recalculations do not support either of these methods. Both of these methods appear to result in interest overpayments of approximately three percent and 0.4 percent, respectively.

*Effect:* Different interest calculation rates were paid to retired plan members depending on which calculation method was in effect at the time a benefit audit was completed. Both methods do not appear to reflect the intent of Section 5-156e of the Connecticut General Statutes, and include additional time in the interest calculation.

*Cause:* The interest calculation method was transferred from a workbook formula calculation to a query, which had different logic.

*Recommendation:* The Retirement Services Division should revise its method for calculating interest on post-benefit audit lump sum payments. (See Recommendation 2.)

*Agency Response:* “The Retirement Services Division is in agreement with these changes. The current Retirement Service Division management team was not aware of this difference and will correct the situation as quickly as possible so that when the new Pension Module configuration is completed it will contain the correct calculation rate.”

### **Financial Statements – State Employees Retirement Fund**

*Criteria:* The Retirement Services Division financial statements have various users, including the Budget & Financial Analysis Division, pension actuaries and the State Employees Retirement Commission. Amounts on the financial statements should be substantiated and reported accurately.

*Condition:* The liability Retirement Interest Payable and the equity amount Retired Members in Contributions reported on the balance sheet of the State Employees Retirement System were and continue to be reported incorrectly.

*Effect:* The State Employees Retirement System balance sheet does not accurately report liabilities and equity.

*Cause:* The method for reporting Retirement Interest Payable and Retired Members in Contributions on the balance sheet was based upon how retiree equity was reduced prior to August 1986.

*Recommendation:* The Retirement Services Division should reassess how it reports Retirement Interest Payable and Retired Members in Contributions to ensure accurate amounts are being reported on the Retirement Services Division financial statements. (See Recommendation 3.)

*Agency Response:* “This has been addressed subsequent to the conversion of Retirement Payroll to Core-CT. Beginning with the Financial Statements dated 06/30/2014 revised Retirement Interest Payable and Retired Member in Contributions has been provided to the Accounting Unit for inclusion on the Financial Statements.”

### **Accounts Receivable – State Employees Retirement Fund**

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

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

*Condition:* Our review of 40 State Employees Retirement System accounts receivable balances from July 1, 2008 through June 30, 2011 disclosed the following:

- Twenty-one instances of the Aged Receivables Report being inaccurate, including 5 instances of a zero or negative original balance recorded and 10 instances of a zero or negative current balance recorded.
- Twelve instances of accounts receivable balances, totaling \$183,561, that have been inactive and outstanding for between 7 and 22 years.
- Three instances of accounts carrying a current balance after being written off by the agency.
- One instance of an additional overpayment being identified but never added to an individual's existing accounts receivable balance.

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

*Cause:* The Investigations and Recovery Unit system utilized by the Retirement Services Division to track accounts receivable balances is not being updated consistently to reflect payments received. The Aged Receivables Report is not being monitored to identify long-standing accounts and zero or negative accounts balances that should be investigated.

*Recommendation:* The Retirement Services Division should track accounts receivable more accurately and should actively follow up on the collection or write-off of inactive accounts. (See Recommendation 4.)

*Agency Response:* “Beginning September 2013 a full time staff member has been assigned to review and update the Accounts Receivable Database. All negative amounts and inconsistent data have been resolved. Additionally, long outstanding receivables are being reviewed by the Retirement Commission for collectability.”

## **Contribution Refunds**

*Criteria:* Internal Revenue Service (IRS) Code Section 402(f) & Notice 2009-68 provide that a “written explanation must describe the rollover rules, the mandatory income tax withholding rules for distributions not directly rolled over, the tax treatment of distributions not rolled over and when distributions may be subject to different restrictions and tax consequences after being rolled over” and “ a reasonable period of time for providing an explanation is no less than 30 days (subject to waiver) and no more than 90 days before the date on which a distribution is made.” Also, the Office of the State Comptroller refund application states that “a refund cannot be paid until at least 30 days after the applicant has completed and returned the election form, acknowledging receipt of the “Safe Harbor Explanation” (describing distribution option and tax consequences).

Per the Connecticut State Library Records Retention Schedule, refund records must be retained for 10 years from the date benefits cease.

*Condition:* During the course of our audit, we found:

- The Office of the State Comptroller regularly sent refunds to individuals prior to the 30-day minimum wait time without a waiver. Fifteen out of our sample of twenty-one applicable refunds were paid anywhere from 4 to 29 days after the Office of the State Comptroller received the signed election form.
- One instance out of 40 in which the refund application packet could not be provided.
- Two instances out of 40 in which the election of payment method on the taxable refund form could not be provided
- One instance in which the application was not signed by the authorized retirement personnel.

*Effect:* The Retirement Services Division is not in compliance with both IRS regulations and its own instructions.

*Cause:* It appears that the condition exists due, in part, to the failure to adhere to procedures and the fact that the system is programmed to automatically processes refunds once the refund application is entered if the employee left state service more than 45 days prior.

*Recommendation:* The Retirement Services Division should comply with IRS regulations requiring a 30-day minimum wait time for contribution refunds, or if an

individual prefers to waive the minimum wait requirement, retain a waiver signed by that individual. (See Recommendation 5.)

*Agency Response:* “Legal counsel for the Retirement Commission disagrees with respect to the conclusions reached by the auditors on the 402(f) notice. The ability to waive the timing rules in the 402(f) notice is the right of a participant and does not involve any IRS action. Under IRS regulations, if a participant affirmatively elects to receive a distribution within 30 days after receipt of the notice the participant will be deemed to have waived the 30 day wait requirement. If an affirmative election is not received within such 30 day period then the Division will not make a distribution prior to the end of such 30 day period.

This condition will be corrected during the design phase of the Oracle Pension Module currently being implemented.”

### **Equity Refunds – Federal Tax Exclusion Rate**

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

The federal tax exclusion ratio is calculated using guidance issued by the Internal Revenue Service (IRS). The rule used to calculate the ratio has changed several times, from the General Rule issued in 1986, through 2011, when the Revised Simplified Rule was implemented.

*Condition:* The Retirement Services Division began using an average exclusion ratio it calculated from the entire retiree population in 1992. The ratio was revised at least once, as of January 1996, but an average continues to be used for all plan members instead of calculating an individual’s specific exclusion ratio. The IRS issued the simplified method for annuities starting after November 18, 1996, and the revised simplified method for annuities beginning after December 31, 1997.

We have calculated within our sample a total \$7,588 in overpayments and \$39,727 in underpayments

*Effect:* Beneficiaries of SERS plan members do not receive their true death benefit, but instead an estimate due to the averaged exclusion ratio. This death benefit may then represent either an underpayment or overpayment, dependent mostly upon the plan member’s age at death. The younger a retiree was at time of death, the greater the likelihood and amount of an underpaid death benefit to the retiree’s beneficiary.

*Cause:* In October 1992, the Retirement Services Division determined that it could not complete the calculation to determine an individual's federal tax exclusion ratio in a timely manner. It does not appear that the division has revisited the issue since the IRS revised its methodology and software for performing these calculations is now readily available.

*Recommendation:* The Retirement Services Division should revise its methodology for calculating the death benefit for the beneficiary of a retired SERS plan member. The federal tax exclusion ratio should be calculated on a case-by-case basis, following the guidance promulgated by the Internal Revenue Service. (See Recommendation 6.)

*Agency Response:* "As a result of Ice Miller's (legal counsel for the Retirement Commission) recommendations for changes (required by IRS), the division meets regularly with appropriate staff to address future changes. The Oracle Pension Module that is targeted for implementation in 2016 will address many of the changes."

### **Disability Retirement – Medical Reviews and Annual Review Forms**

*Criteria:* Sections 5-169 and 5-192p of the Connecticut General Statutes state that a disability retirement continues after a twenty-four month review and "only if such a member is totally disabled for any suitable and comparable job."

The Retirement Services Division requires the physician treating the condition on which the disability retirement is based to complete a medical review form twenty-four months after the individual was approved. This review should be based on a current assessment, and the physician is asked to state whether and to what extent the patient will be able to return to the patient's former job.

The Retirement Services Division requires the return of an annual pension review form, on which retirees identify whether or not they received certain types of income during the past year.

*Condition:* During the course of our audit, we found the following:

- The Office of the State Comptroller incorrectly notified one retiree of approval for a permanent disability retirement when supporting documentation appeared to show that the individual was in fact denied, thus resulting in benefits neither the retiree nor the retiree's beneficiary was entitled to. The individual passed away two years and four months after receiving this letter, and the beneficiary is currently receiving 50 percent of the retiree's disability pension.
- The medical review form does not address any suitable or

comparable jobs; therefore, the Medical Review Board decided permanent disability ratings based on the retirees' specific job held prior to retirement for twenty-six out of our sample of twenty-six individuals.

- There were nine instances out of twenty-six in which the physicians did not answer whether or not the retiree could return to the former job on the medical review form.
- Two instances in which the retiree did not have the required twenty-four month review at the time of our review. The delays exceeded the twenty-four months by 36 and 49 months, respectively, and may have resulted in improper payments.
- The failure to track the return of all disability retiree annual review forms and follow up on cases in which the form was not returned by the retiree.

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

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

*Recommendation:* The Retirement Services Division and the Medical Examining Board should comply with the Connecticut General Statutes regarding disability retirements and confirm that individuals are permanently disabled and not otherwise employed. (See Recommendation 7.)

*Agency Response:* "The Retirement Services Division would like to provide a response to each condition outlined above. With regard to the one retiree that was not entitled to receive a benefit the Retirement Services Division disagrees with the finding. Upon review of the records including the copies provided by the auditor the decision is clearly marked as being tabled by the Medical Examining Board and the minutes reflect this. It appears that the denial was erroneously included in the Medical Examining Board determination. Due to the fact that the decision was tabled the correct letter was sent to the individual that the benefits were continuing and therefore when the retiree became deceased the benefits rightly went to the beneficiary.

Regarding the nine instances in which the physicians did not answer whether or not the retiree could return to the former job on the medical review form, we have revised our internal procedures to ensure that the treating physician who is completing the form is aware that this information needs to be provided. If the information is missing another request is sent to the physician for clarification.

By way of background, prior to 2011 the Medical Examining Board was staffed by three University of Connecticut Health Center (“UConn Health Center”) doctors who were working full time for the UConn Health Center in addition to the work they did for the Medical Examining Board. Meetings could not be scheduled regularly due to their other obligations and as a result there was a back log of applications.

In September, 2011 the Retirement Services Division met with the administration of the UConn Health Center regarding the management of the Medical Examining Board and to brainstorm ways in which the doctors and the Division could work together to alleviate the back log of disability applications.

Part of this process included revising the Medical Examining Board process and procedures to provide better training for the doctors. This internal review revealed that the Medical Examining Board had been evaluating members based on an “own occupation” standard at the twenty-four month review for well over twenty years whereby a disability retiree is evaluated for continued receipt of their disability retirement benefit based on their capability to perform the job duties they were performing when the disability arose.

Upon further review of the internal policies and procedures the Retirement Services Division concluded the “own occupation” standard was inconsistent with the statutory intent. The Retirement Services Division’s internal policies and procedures were reviewed and subsequently revised pending final approval from the Connecticut State Employees Retirement Commission. However, before this issue was brought to the attention of the commission, the Retirement Services Division was informed by the Office of Labor Relations and the State Employees Bargaining Agent Coalition (SEBAC) that the interpretation of a disability statute was a matter for collective bargaining and fell under their purview as the representatives for coalition negotiations on statewide issues related to pension benefits. Consequently, the Retirement Services Division suspended twenty-four month reviews pending a resolution as to the appropriate standard as it would be irresponsible to move forward and terminate a retiree’s disability benefit while there was disagreement by both parties as to the interpretation of the continued eligibility standard.



Since that time the Medical Examining Board has been restructured pursuant to legislation and the back log has been all but eliminated and SEBAC and the State have reached an agreement clarifying the definition of “suitable and comparable.” The Retirement Services Division is revising its processes and procedures to ensure that its staff and the Medical Examining Board are appropriately trained as to the clarifying standard.

An additional measure was taken in 2014 whereby the Retirement Services Division enlisted the assistance of the Office of the Healthcare Advocate to provide a healthcare ombudsman. The role of the healthcare ombudsman is to reach out to disability retirees in an effort to assist with the medical documentation needed to bring the case before the Medical Examining Board. The effort of the healthcare ombudsman has significantly reduced the back log of cases.”

### **Retirement Purchases**

*Criteria:* Collective bargaining agreements, Sections 5-193 and 5-180 subsection (b) of the Connecticut General Statutes, and division policies establish the requirements that must be met for state employees who wish to purchase qualifying prior service.

*Condition:* We reviewed a total of thirty purchases made during the audited period and noted the following:

- Three purchases sampled found employees were allowed to use a combination of lump-sum payments and payroll deductions to purchase their service.
- Three instances in which purchases by payroll deduction were allowed to occur over a period of time greater than what is allowed by the SEBAC agreement and Connecticut General Statutes. When purchases started late or took longer than stipulated, interest was not recalculated to include the additional time.
- Four instances in which the individual was allowed to delay the due date of the lump-sum payment or the start of the payroll deduction.
- Two instances in which the invoice deadline appears to have been altered.
- Twenty instances in which the calculation of gap interest payments for prior military service by Tier IIA employees was altered during the audited period. The division could not provide supporting

documentation as to why it no longer charged gap interest for these purchases. Because of this unsupported decision, there is also no application deadline for Tier IIA employees interested in purchasing prior military service. Tier III employees have an application deadline of one year from date of hire for the same prior military service.

- The calculation methodology in a worksheet template for payroll deduction interest used for Tier I and Tier II employees did not appropriately amortize interest cost. Employees who chose to purchase their time by the payroll deduction method paid a higher interest rate than what is specified by statute.
- There is a considerable backlog of purchase applications. At the time of our review (May 2013), there were an estimated 3,000 unprocessed applications.

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

The backlog also affects employees who submit a purchase application with payroll deductions then retire while waiting for their application to be processed. Since they are no longer active employees and cannot have payroll deductions, they could get a purchase bill for a lump-sum payment for potentially thousands of dollars.

*Cause:* A lack of internal controls allows agencies to loosely adhere to the policies set forth by the Retirement Services Division. The backlog of retirement purchases has increased due to insufficient staffing levels in the Purchasing Unit.

*Recommendation:* The Retirement Services Division should review the staffing levels and processes of the Retirement Purchasing Unit and adhere to them. (See Recommendation 8.)

*Agency Response:* “The Retirement Services Division does not agree with the considerable backlog of purchase applications. We believe that the Auditor reviewing purchases used the total number of purchases in the database not the actual number outstanding. As of May 2015 we have 346 purchases outstanding. With regard to the payroll deductions the Division has strived to instruct the agencies to start the payroll deductions in a timely fashion and set up the goal amount for each payroll deduction. We have conducted information sessions with the Agency Council of Personnel Managers (ACPM) to assist with instructing the agencies on the proper procedures.

Prior to the new management team in the Retirement Services Division a decision was made to mirror the arrangement provided to the members of Tier I where there was no gap interest charged. Subsequently, the Tier II members who had paid interest were issued refunds and the deadline was changed for the members who were interested in purchasing prior military services. For Tier III, the division does not charge gap interest but the members have the deadline of one year from the date of hire to purchase time for the prior military service.

The calculation methodology used for the payroll deduction interest for Tier I and Tier II was different. Under the SEBAC agreement the amortization of interest method was implemented. With the impending implementation of the Oracle Pension Module, most of these issues will be addressed.”

*Auditors Concluding*

*Comments:*

At the time of our review (May 2013), we were informed by division personnel responsible for processing purchase applications that a backlog existed of approximately 3,000 applications, an amount we consider significant. We do, however, recognize the considerable effort made by the Retirement Services Division Purchasing Unit to reduce the backlog to 346 from the date of our review through May 2015.

**Retirement Services Division**

**Lack of Formal, Comprehensive Written Policies and Procedures**

*Criteria:*

Proper internal control dictates that formal written policies and procedures should be established, maintained, and disseminated to provide guidance to employees in the performance of their assigned duties.

The responsibility of designing and implementing internal controls is a continuous process. As conditions change, control procedures may become outdated and inadequate. Management must anticipate that certain procedures will become outdated, inadequate and/or obsolete, and that it will become necessary to modify its internal controls in response.

*Condition:*

The Retirement Services Division lacks current formal, comprehensive written policies and procedures manuals for its various operating units. Previously, the Retirement Services Division prepared and maintained formal, comprehensive written manuals to standardize and document the policies and procedures governing the activities of the various units within the division. These manuals were prepared to ensure effective internal control over each unit’s activities, and to serve as both a point of reference and a basis for training the members assigned to each unit. Although the

various units within the division have experienced significant changes in organizational structure and information processing policies and procedures, some of which were related to the implementation of the Core-CT system, the division has not updated its formal, comprehensive policies and procedures manuals to reflect these changes. Although the division has documented some of the changes that have occurred in the policies and procedures for some of its operating units, we found that the documentation appears to be maintained in an informal and fragmented manner.

*Effect:* The ability to properly train staff, and the effectiveness and efficiency of the functions within the Retirement Services Division may be diminished.

*Cause:* The updating and maintenance of formal, comprehensive written policies and procedures manuals for the various units has not been designated as a high priority.

*Recommendation:* The Retirement Services Division should take the necessary steps to improve its internal controls by establishing, updating, and maintaining formal, comprehensive written policies and procedures manuals for all of its functions. (See Recommendation 9.)

*Agency Response:* “The Retirement Services Division is in agreement with the recommendation and we will have complete and comprehensive written policies and procedures with the new Oracle Pension Module.”

## **Municipal Employees Retirement System**

### **Payroll Recalculations**

*Background:* During 2009, as a follow-up to the errors found during the Municipal Employees Retirement System (MERS) audit for fiscal years ended June 30, 2007 and 2008, the MERS Unit began to review and recalculate all MERS retiree benefits beginning with finalizations completed in July 2001. After starting to review finalizations from that period, it was decided, based on the Retirement Commission’s determination of a statute of limitations of six years, that the review and recalculations of retiree benefits should only go back to July 2003. Finalizations from 2001 that were in the process of being recalculated at the time of the decision were discontinued.

*Criteria:* Section 7-439h of the Connecticut General Statutes provides that, upon discovery of an error that results in a retiree or beneficiary receiving more or less benefits than the individual was entitled to, the Retirement Commission shall notify the affected individual and either pay the

individual the additional amount owed as result of the error or setup a repayment plan for the amount the individual owes MERS.

*Condition:* Our review of MERS retiree benefit changes in 2009 disclosed five instances in which the MERS Unit identified errors in monthly retirement benefit calculations but did not notify the retiree and either pay the retiree the additional amount owed or set up a repayment plan if the retiree owed MERS. We also noted an additional instance in 2009 in which the MERS Unit identified an error in a retiree’s benefit calculation but did not take corrective action until over two years later, when the retiree’s benefit was reviewed in conjunction with a Social Security reduction.

*Effect:* MERS retirees received incorrect payments for more than three years and accrued additional benefit overpayment or underpayment amounts.

*Cause:* The MERS recalculations of benefit payments starting with the 2001 finalizations were put aside when it was decided by MERS, based on the determination of a statute of limitations, to change the starting point of the recalculations to July 2003.

*Recommendation:* The Retirement Services Division MERS Unit should review errors in retirement benefit calculations identified during recalculations performed in 2009 and ensure that affected retirees are notified and the changes in the their benefit payments are implemented. (See Recommendation 10.)

*Agency Response:* “The new management team in the Retirement Services Division will review this process as part of the transition to the Oracle Pension Module that will automate the calculation of retirement payments.”

### **Administration Fund Expenditures**

*Background:* The Office of the State Comptroller maintains electronic retiree and active employee records in Tower IDM, an integrated document imaging and management system.

*Criteria:* In accordance with Connecticut General Statute 3-13c, the Municipal Employees Retirement Fund (MERF) is operated as a trust fund, and in accordance with Connecticut General Statute 5-155a subsection (c), the Connecticut State Employees Retirement Commission administers the fund.

The Office of the State Comptroller, acting in a trustee capacity, should charge MERF only for valid operating expenditures incurred by the unit.

*Condition:* Between June 2007 and September 2008, the Municipal Employees Retirement Administration Fund was charged \$154,368 for products and

services from Vignette Corporation for the set-up and use of Tower IDM. As of April 2013, the MERS Unit was not utilizing and had no plans to utilize Tower IDM for imaging MERS documents.

*Effect:* The Municipal Employees Retirement Administration Fund was charged for services that were not received.

*Cause:* The Municipal Employees Retirement System was never set up to utilize Tower IDM.

*Recommendation:* The Municipal Employees Retirement Administration Fund should be reimbursed the full amount of \$154,368 paid to Vignette Corporation or immediate action should be taken to induce the Municipal Employee Retirement System to utilize Tower IDM, and any excess charges should be refunded to the fund. (See Recommendation 11.)

*Agency Response:* “Over the past three years the Retirement Services Division has reviewed this matter and made several attempts to bring the MERS documents into the imaging system and we have encountered several technology limitations. We are continuing to work through the limitations and are still planning to move forward with the imaging of the documents over the next fiscal year.”

### **Timeliness of Bank Deposits**

*Criteria:* Section 4-32 of the Connecticut General Statutes requires each state agency to deposit and account for any revenue received for the state in excess of \$500 within twenty-four hours of receipt. Although the funds received for the Municipal Employee Retirement Fund and for the Policemen & Firemen Survivors Benefit Fund do not represent state revenue, the fact that these funds are administered entirely by the Office of the State Comptroller makes Section 4-32 applicable.

*Condition:* Our review of MERF contribution deposits during the audited period disclosed twenty instances of late deposits. Ten of the deposits, totaling \$36,911, were one day late. The other ten deposits, totaling \$50,094, were between two and ten days late. There were also nine instances in which the monthly contribution reports were not stamped as received and, therefore, we could not determine whether the deposits were made in a timely manner.

Our review of Policemen & Firemen Survivors Benefit Fund contribution deposits during the audited period disclosed nineteen instances of late deposits. Ten of the deposits, totaling \$31,263, were one day late. The other nine deposits, totaling \$34,255, were between two and eleven days late. There were also nine instances in which the monthly contribution

reports were not stamped as received and, therefore, we could not determine whether the deposits were made in a timely manner.

We also tested 40 Probate Judges & Employees Retirement System receipts for timeliness of deposits and noted six instances (38 contribution reports), totaling \$10,447, in which funds received were deposited late. We also noted ten instances, totaling \$24,865, for which we could not determine the timeliness of deposit because the supporting documentation could not be located by the Retirement Services Division. Late deposits identified ranged from one to four days late and were arrayed as follows:

- Eight contribution reports, totaling \$1,952, were deposited one day late.
- Twelve contribution reports, totaling \$2,397, were deposited two days late.
- Eighteen contribution reports, totaling \$6,098, were deposited four days late.

*Effect:* The division was not in compliance with the timely deposit requirements of Section 4-32 of the Connecticut General Statutes.

*Cause:* The Retirement Services Division did not deposit receipts in a timely manner and did not consistently follow procedures to stamp contribution reports as received. Also, supporting documentation for deposits was not sufficiently maintained.

*Recommendation:* The Retirement Services Division should improve the timeliness of its bank deposits and adhere to the prompt deposit requirements in accordance with the provisions of Section 4-32 of the Connecticut General Statutes. In addition, the division should maintain more complete supporting documentation for its deposits. (See Recommendation 12.)

*Agency Response:* “The Retirement Services Division has improved our processing of timely deposits over the past several fiscal years. The staff members handling the deposits attend the annual training seminars regarding the compliance with the CGS Section 4-32 and we have trained additional staff members to ensure continual compliance in this matter.”

## **Connecticut State Employees Retirement Commission**

### **Referral of Non-Routine Business Matters**

*Criteria:* Section 5-155-9 subsection (b) of the Retirement Commission regulations regarding retirement applications provides that all retirement applications

received by the Retirement Services Division are reviewed for compliance with statutes and submitted for approval to the commission.

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

*Condition:*

Our review disclosed two matters that the Retirement Services Division should have brought to the Retirement Commission for individual approval and review. These are discussed separately in this section.

- 1) In our *Audit Report on the Department of Consumer Protection (DCP) for the Fiscal Years Ended June 30, 2008 and 2009*, we reported that a Department of Administrative Services (DAS) Human Resources employee intentionally altered an employee's attendance record, changing some of the vacation days to sick days to help the employee's spouse receive retirement benefits for which the spouse was otherwise ineligible. The DCP employee died during December 2008, with 24 years, 10 months and 24 days of state service, which was short of the statutorily required 25 years of service to qualify his spouse to receive a lifetime income. At the time of his death, before the records were altered, the employee's accumulated sick and vacation leave balances were 109 and 96 hours, respectively. The retirement application submitted to the Retirement Services Division indicated that the employee had the required 25 years of service, thus the application was processed and the spouse received the retirement benefits. On August 26, 2010, we reported the above matter to the assistant division director of the State Comptroller's Retirement Services Division as an instance of fraud and subsequently provided the supporting documentation that the division required so it could re-open the retirement file and perform another audit of the record. The supporting documentation was provided to the Retirement Services Division on October 22, 2010. We were informed on September 21, 2012, that the Retirement Services Division's recalculation disclosed that the deceased employee was one day short of 25 years. Under the State Employees Retirement System (SERS) unused vacation time must be included when calculating an employees' credited service, thus explaining the difference between the original calculation of state service and the Retirement Services Divisions recalculation. On July 22, 2014, we were told that the retirement application has yet to be finalized because the Retirement Services Division is waiting for information from DAS in order to complete its review. While the initial application was properly processed as routine business, the



Retirement Services Division did not bring to the attention of the Retirement Commission the subsequent finding that the employee's attendance records were altered to allow the employee's widow or spouse to qualify for lifetime retirement benefits.

- 2) The Retirement Services Division approved and authorized payment of retirement benefits to the spouse of a deceased probate judge prior to receiving approval from the Retirement Commission. The Retirement Services Division approved the application in May 2012, providing benefits retroactive to February 2012. In October 2012, the matter was presented to the Retirement Commission as routine business and was approved, when in fact there was a dispute between the Retirement Services Division's attorney and the Comptroller's general counsel regarding the statutory interpretation allowing for such benefits. The dispute concerned whether the eligibility requirements of both age and service, were met. Judges of probate courts who have completed ten years of credited service are eligible to retire and receive normal retirement benefits on the first of any month after attaining the age of sixty-two, or, receive a reduced benefit prior to age sixty-two. The Retirement Services Division's attorney concluded that the judge did not meet the eligibility requirements and the Comptroller's general counsel concluded that the judge met the statutory standard for eligibility for a reduced retirement benefit. In such situations, proper procedure requires that the matter be brought to the Retirement Commission for a decision prior to granting benefits. The judge passed away in February 2012, at the age of 56 with 17 years of service.

*Effect:* The failure to bring these individual matters to the Retirement Commission for review and approval may have resulted in overpayments. We cannot be certain whether overpayments were actually made because we do not know how the Retirement Commission would have decided these cases.

*Cause:*

- 1) We did not determine the cause.
- 2) We were told that this matter was not presented to the Retirement Commission for individual approval because the division sought guidance from the Office of the Attorney General and was verbally instructed that the spouse was eligible for the benefits. We were also told that the retirement application was not included on the Retirement Commission's agenda prior to the Retirement Services Division granting the retirement benefits because the division employee responsible forgot to put it on the agenda.

*Recommendation:* The Retirement Services Division should promptly bring all retirement matters that are non-routine in nature to the attention of the Retirement Commission. (See Recommendation 13.)

*Agency Response:* “The Retirement Services Division is in agreement with the recommendation and in recent years all retirement matters that are non-routine in nature will be brought to the attention of the Retirement Commission as soon as possible.”

### **Per Diem and Travel Expenditures**

*Criteria:* Connecticut General Statutes Section 5-155a established the Connecticut State Employees Retirement Commission. The statute states in part, “The trustees, with the exception of the chairman and the actuarial trustees, shall serve without compensation but shall be reimbursed in accordance with the standard travel regulations for all necessary expenses that they may incur through service on the commission. The chairman and the actuarial trustees shall be compensated at their normal and usual per diem fee, plus travel expenses, from the funds of the retirement system for each day of service to the commission.”

*Condition:* The chairman and the actuarial trustees of the Retirement Commission continue to regularly bill the State Employees Retirement Fund for air travel, hotel, meal, and other costs in excess of what is customary and reasonable for travel on state business.

Some questionable or excessive charges noted during our audit were:

- Eleven reimbursements totaling \$480 of non-itemized room service and hotel club lounge expenses. Since these amounts are not itemized, it is not possible to determine whether individuals are being reimbursed for the purchase of alcoholic beverages.
- The payment of \$300 for a one day and one hour rental of a Hertz ‘Prestige Collection’ rental car.

Total per diem and travel costs approved by the Retirement Commission and paid from the State Employees Retirement Fund totaled \$459,185 for the fiscal year ended June 30, 2009, \$341,067 for the fiscal year ended June 30, 2010 and \$228,573 for the fiscal year ended June 30, 2011.

*Effect:* The State Employees Retirement Fund was charged with administrative costs in excess of what is generally considered reasonable for government service.

*Cause:* State regulations controlling travel expenditures were not made applicable to the Retirement Commission. The definition of “normal and usual per diem fee, plus travel expenses” was never established at the time the chairman and actuarial trustees were originally appointed. The commission, as a body, approves the per diem and travel expenditures of its own members. The commission does not routinely employ teleconferencing as a method to save on time and travel costs for commission members.

*Recommendation:* The Connecticut State Employees Retirement Commission should adopt, or otherwise implement, regulations to limit the cost related to trustee overnight lodging and travel that are commensurate with the reimbursement amounts set forth in state travel regulations.

The Connecticut State Employees Retirement Commission should utilize teleconferencing to save on travel reimbursements. (See Recommendation 14.)

*Agency Response:* “The Retirement Commission Trustees have reviewed the report and strongly object to the statement that the Trustees continue to overcharge the Retirement Fund. After the last Audit report, the Management and Labor Actuaries made sure that they would obtain the government rate on hotels that any airplane ticket would be purchased at least two weeks in advance to take advantage of the reduced fares and they never charge for a first-class ticket. There has been a significant increase in the use of teleconferencing for Subcommittee meetings.

The Trustees expenses were reduced by 50 percent over a three-year period while the workload has increased and there is no mention of that in the report. The Management and Labor Actuaries per diem fees have not been increased in four years.”

## **State Healthcare Policy and Benefit Services Division**

### **Other Post-Employment Benefits (OPEB) Contributions**

*Criteria:* The 2009 and 2011 SEBAC agreements implemented a program that requires active employees to contribute three percent of their salaries to fund their future retiree health benefits.

With a few exceptions, employees who were first hired or rehired on or after July 1, 2009, to a position in which they were eligible for health coverage, were required to begin this contribution. Existing employees who, on July 1, 2010, had fewer than five years of service as of that date were also required to begin this contribution.

The Office of the State Comptroller Memorandum 2010-11 states that applicable earnings are as defined in Section 5-154 subsection (h) of the Pension Agreement. Earnings such as non-reportable reimbursements are not included as such.

*Condition:*

Our review of statewide OPEB contributions disclosed the following:

- There are 386 employees who, as of June 2012, have not begun the required contributions. While some of these employees may be exempt for a rare reason, none have been reviewed by the Office of the State Comptroller Healthcare Policy and Benefit Division.
- 197 employees received one or more paychecks in which their OPEB deduction was in excess of three percent, because of excludable earnings being included in their deduction base. There is a total dollar excess of \$4,659 among the 197 employees, for an average excess of \$24 per employee. The highest excess for an employee was \$206 and the lowest was \$1. Refunds for this error have been issued to employees who have requested them, but no central administrative action has been taken to identify the employees impacted and refund them the excess amounts deducted.
- Four employees received one or more paychecks in which their OPEB deduction was not equal to three percent. It appears the deductions were made for an amount other than three percent in order to adjust for the late start of the deduction.

*Effect:*

There is a very high risk of agency noncompliance with the 2009 and 2011 SEBAC agreements. Specifically, many employees who were required to begin OPEB deductions may not have had those deductions started.

From implementation on July 1, 2009, through the pay period ending May 6, 2010, the OPEB deduction was calculated using all earnings, including non-reportable reimbursements. In subsequent pay cycles, the deduction was modified to filter out excludable earnings codes from contributing to the deduction base. The impacted employees are entitled to a refund they may have not yet received.

*Cause:*

The Healthcare Policy and Benefit Services Division did monitor for agency compliance of OPEB deductions until January 6, 2012, when the employee assigned to that task left. That task was handled by only one employee and those job duties have not been reassigned to any other employee because of insufficient staffing resources. At the time of our review, there was no one in the division monitoring whether agencies have

been compliant in implementing the OPEB deduction for required employees.

The Office of the State Comptroller's Core-CT staff implemented the deduction and assumed that non-reportable reimbursements should contribute to the base when calculating the OPEB deduction. When the issue was brought to the attention of the Healthcare Policy and Benefit Division, management had the impression that the dollar impact was small and that any impacted employees could independently request refunds. The division did not have sufficient staff or resources to identify the number of employees impacted, by what amount, or to centrally administer refunds for impacted employees.

The employing agency specified its own flat amount for the deduction, rather than the table amount, in order to make an adjustment without designating it as such through the proper deduction code. Core-CT does not contain functionality to prohibit the use of a flat amount for deductions. The Office of the State Comptroller does not monitor state agency use of flat deduction amounts for deduction codes, such as OPEB, that it administers.

*Recommendation:* The Healthcare Policy and Benefit Services Division should develop internal controls to proactively identify individuals who should have had an OPEB deduction initiated but who have not. It should also monitor OPEB deductions for accuracy and refund employees when excess deductions occur. (See Recommendation 15.)

*Agency Response:* "The report correctly identifies the challenges encountered by the Healthcare Policy & Benefit Services Division in implementing a state-wide program without tools, staff or resources needed to effectively monitor a program of this magnitude. There is currently no mechanism in place that would prevent an agency from enrolling an employee in active health benefits without also starting an employee's OPEB deduction. This insufficiency should be addressed by implementation of the OPEB module in Core-CT, which is included in the Oracle Pension Module. We expect these tools to be partially completed by fall 2015 and fully operational by spring 2016."

### **Excess OPEB Refunds and Untimely Processing of Refunds**

*Criteria:* The 2009 State Employees Bargaining Agent Coalition (SEBAC) agreement implemented a requirement whereby employees meeting certain conditions, such as being eligible for healthcare coverage upon retirement, must contribute three percent of their salary for ten years to fund such coverage.

The agreement also states that, upon separation from state service, such contributions are refundable to employees. In addition, the state may withhold such refunds until July 2012, but must pay three percent interest per year between the date of separation and payment.

*Condition:* Our review found that 19 employees who separated from state service received OPEB contribution refunds in excess of what they actually contributed. The excess amount totaled \$10,314.

The Payroll Services Division of the Office of the State Comptroller processes only five refund requests per pay period for employees who have already separated from state service. At the time our audit was conducted, on May 17, 2012, there existed a backlog of 38 refunds. The state has never paid interest on the delay between receiving a refund request and paying the refund.

*Effect:* The Office of the State Comptroller is not in compliance with the 2009 SEBAC agreement.

*Cause:* Many state agencies miscalculated refund amounts, reversed paychecks having OPEB refunds on them, or requested duplicate refunds, causing some employees to receive excess refunds. There is no automated means to prevent refunds from exceeding contributions within the system. These instances were not identified by the Office of the State Comptroller.

When an employee has already left state service and then requests a refund of OPEB contributions, the employee's job record must be temporarily reactivated for payment. Because this is a heavily controlled process, it is difficult for the Payroll Services Division to process a large number of refunds in any pay period. Technical difficulties arising from this situation have slowed the process of issuing OPEB refunds. Agencies that do not properly conduct exit interviews are at greater risk for untimely processing because it more often leads to refund requests being made after the employees have left state service.

*Recommendation:* The Healthcare Policy and Benefit Services Division should strengthen its internal controls and develop statewide policies promoting the timely and accurate issuance of OPEB refunds. (See Recommendation 16.)

*Agency Response:* "The Healthcare Policy & Benefit Services Division disagrees with the conclusion that it is not in compliance with the SEBAC 2009 Agreement with respect to payment of interest. The SEBAC 2009 Agreement permitted the State to withhold payment of refunds until July 2012 and in that case required payment of 3 percent interest. The Office of the State Comptroller did not withhold payment of refunds to employees who were separating from service prior to 2012. According to the SEBAC 2009

Agreement, this was the only condition, under which interest was to be credited.

The process for issuing refunds has recently been decentralized. Agencies are now involved in the process of reopening the employment record of their former employees in connection with issuance of refunds. This has sped up processing so that refunds to terminated employees take an average of two to three weeks after receipt of the application. Additional functionality to be included in the OPEB module will further improve the speed of issuing refunds. This is expected to be partially completed by fall 2015 and fully operational by spring 2016.

The Healthcare Policy & Benefit Services Division conducts routine queries to identify employees who have separated from service without requesting a refund of OPEB contributions. In that event the Division notifies former employees that they are entitled to request a refund.

Calculation of correct refund amounts has been facilitated by development of the OPEB tracking pages in Core-CT. However, there is currently no system in place to prevent issuance of a refund to an employee that exceeds the amount of his or her OPEB contributions. Excess and duplicate refunds have occurred when agencies reverse paychecks or fail to submit required paperwork in connection with processing of refunds. The OPEB Module currently under development is expected to prevent the issuance of duplicate payments or refunds in excess of OPEB contributions. This is expected to be partially completed by fall 2015 and fully operational by spring 2016.”

### **Coverage of Ineligible Dependents**

*Criteria:* The Office of the State Comptroller distributes open enrollment documentation to all state agencies summarizing dependent eligibility requirements that state employees and retirees must follow when electing to cover or renew dependents.

Children, including stepchildren and adopted children, may be covered up to age 26 for medical insurance and age 19 for dental insurance. Minor children, for whom an employee or retiree is legal guardian, may be covered up to age 18 for both medical and dental insurance. An event such as a dependent child reaching the maximum age is to be reported to the employee’s human resources department, for current employees, or to the Office of the State Comptroller for retirees, within 31 days of the event.

*Condition:* At the time our audit was conducted (May 8, 2012), a total of 61 employees were covering 66 child dependents while they were above the maximum age.

Because there was no ward relationship coding in Core-CT until October 2011, it is likely that many ward children were covered as non-ward children and allowed to be covered beyond 18 even though they should have been ineligible. It is very difficult to quantify the number of dependent children who were covered above the maximum age or the dollar impact of the additional coverage.

*Effect:* Dependent children have been enrolled in state medical and dental coverage while ineligible because they were above the maximum age. Therefore, the state has paid insurance premiums while fully insured, and claims while self-insured, for ineligible dependents.

*Cause:* Ward relationship coding was not implemented in Core-CT until October 2011. Because this coding was missing from Core-CT until then, there was no way for this age requirement to be enforced.

The Office of the State Comptroller provides exception reports to agencies on a monthly basis indicating employees who have dependents above the maximum age; however, they have not established procedures to follow up with agencies to ensure the prompt removal of these dependents from coverage.

Other causes could not be determined.

*Recommendation:* The Healthcare Policy and Benefit Services Division should strengthen its internal controls to prevent ineligible dependents from receiving medical and dental coverage, and ensure prompt removal of such dependents when they reach the maximum age of coverage. (See Recommendation 17.)

*Agency Response:* “The enrollment of employees and dependents in health benefits is a decentralized process that largely rests with the human resources staff of the employing agency. The employing agency is responsible for reviewing and retaining necessary documents and information to verify a dependent’s eligibility for coverage. Our plan does permit the coverage of dependent adult children above the maximum age of 26 if that dependent is disabled. It is unclear whether any of the 66 coverage dependents identified by the auditors are disabled dependents.

Finally, one of the primary reasons for coverage of ineligible dependents is the employee’s/retiree’s failure to remove a former spouse after entry of a judgment of divorce or legal separation. The Healthcare Policy & Benefit Services Division has recently implemented a process (in



conjunction with the State Auditors) to cross-check our medical benefit eligibility files against the State of CT Judicial database on a regular basis for the purpose of identifying health plan members with recent changes of marital status that failed to remove a former spouse.”

## RECOMMENDATIONS

Our prior report on the fiscal years ended June 30, 2007 and 2008 contained two recommendations. The status of the prior recommendations is presented below:

*Status of Prior Audit Recommendations:*

- **The State Comptroller's Retirement Services Division should take the necessary steps to improve its internal controls by establishing, updating and maintaining formal, comprehensive written policies and procedures manuals for all of its functions.** Our current review revealed that the Retirement Services Division has not made any progress on updating or maintaining its formal, comprehensive written policies and procedures manuals for its various operating units. This recommendation will be repeated (See Recommendation 9).
- **The Connecticut State Employees Retirement Commission should adopt regulations to effect the limitation of the reimbursable costs related to the per diem fees charged and travel expenses incurred by the non-employee trustees for services on behalf of the commission to the lowest reasonable rates.** Our current review revealed that the trustees continue to regularly bill the State Employees Retirement Fund for costs in excess of what are customary and reasonable for travel on state business. This recommendation will be repeated (See Recommendation 14).

*Current Audit Recommendations:*

1. **The Retirement Services Division should continue its effort to reduce the backlog of retirement applications waiting to be finalized. We also recommend that the division re-evaluate its long-standing practice of underpaying the estimated benefit.**

**Based on the mission of the agency, it may be beneficial for the division to offer an annuity option on these types of lump-sum retroactive payments, as it may ease the tax burden on retirees receiving them.**

Comment:

Our review of the finalization process found that while some improvements in procedures have been made, at the time of our review (May 2014) there were still 11,880 applications awaiting finalization. We also noted that retirees receive an estimated benefit that is consistently less than what the calculated estimated benefit is, resulting in higher interest payments. In addition, the division does not offer the retirees an option to receive their lump sum payment in installments to ease any tax burden it may cause.

- 2. The Retirement Services Division should revise its method for calculating interest on post-benefit audit lump-sum payments.**

Comment:

Our review disclosed that there are at least two different methods used in calculating the interest owed on lump-sum payments and our recalculations do not appear to support either of these methods.

- 3. The Retirement Services Division should reassess how it reports Retirement Interest Payable and Retired Members in Contributions to ensure that accurate amounts are being reported on the Retirement Services Division financial statements**

Comment:

Our review of the financial statements for the State Employees Retirement System prepared by the division found that amounts on the balance sheet were not correct and based on outdated calculations.

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

Comment:

Our review of the receivable records disclosed a number of accounts receivables, as of June 30, 2011, that dated back as much as 22 years for which no recent collection activity had been recorded. It also disclosed 21 instances in which the Aged Receivables report was inaccurate.

- 5. The Retirement Services Division should comply with IRS regulations or apply for a waiver eliminating the requirement of a 30-day minimum wait time for contribution refunds, or if an individual prefers to waive the minimum wait requirement, retain a waiver signed by that individual.**

Comment:

Our review of contribution refunds disclosed that the division regularly sent out refunds of contributions to individuals prior to the 30-day minimum wait time without a waiver from the IRS.

- 6. The Retirement Services Division should revise its methodology for calculating the death benefit for the beneficiary of a retired SERS plan member. The federal tax exclusion ratio should be calculated on a case-by-case basis, following the guidance promulgated by the Internal Revenue Service.**

Comment:

The division uses an average exclusion ratio calculated in 1996 for all plan members instead of calculating each individual's specific ratio, resulting in erroneous equity refund amounts.

- 7. The Retirement Services Division and the Medical Examining Board should comply with the Connecticut General Statutes regarding disability retirements and confirm individuals are permanently disabled and not otherwise employed.**

Comment:

The medical review form does not address any "suitable and comparable" job; therefore, the Medical Review Board did not appear to take that into consideration when determining a permanent disability rating. There were also nine instances in which the retirees' physicians did not indicate whether or not the retiree could return to the former job, but the Medical Review Board approved the permanent disability anyway. The division also does not follow up with retirees who do not return the annual review form.

- 8. The Retirement Services Division should review the staffing levels and processes of the Retirement Purchasing Unit and adhere to them.**

Comment:

During our review, we noted numerous instances in which the division did not follow the retirement purchasing regulations. We also noted that there is a backlog of 3,000 purchase applications.

- 9. The Retirement Services Division should take the necessary steps to improve its internal controls by establishing, updating, and maintaining formal, comprehensive written policies and procedures manuals for all of its functions.**

Comment:

The Retirement Services Division has not updated or maintained its formal, comprehensive written policies and procedures manuals for its various operating units. Although we found that the division has documented some of the changes that have occurred in the activities and procedures for some of its operating units, we found that the documentation appears to be maintained in an informal and fragmented manner.

- 10. The Retirement Services Division MERS Unit should review the errors in retirement benefit calculations identified during its recalculations performed in 2009 and ensure that affected retirees are notified and the changes in their benefit payments are implemented.**

Comment:

Our review disclosed five instances in which the MERS Unit identified errors in retiree monthly benefit calculations but did not take corrective action. There was also one instance in which corrective action was not taken until 2 years after the error was found.

- 11. The Municipal Employees Retirement Administration Fund should be reimbursed the full amount of \$154,368 paid to Vignette Corporation or immediate action should be taken to induce the Municipal Employee Retirement System to utilize Tower IDM, and any excess charges should be refunded to the fund.**

Comment:

Our review disclosed that the Municipal Employees Retirement Administration Fund was charged for products and services of an imaging system that they do not utilize.

- 12. The Retirement Services Division should improve the timeliness of its bank deposits and adhere to the prompt deposit requirements in accordance with the provisions of Section 4-32 of the Connecticut General Statutes. In addition, the division should maintain more complete supporting documentation for its deposits.**

Comment:

We noted twenty instances of late deposits in the MERS fund, nineteen in the Policemen and Firemen Survivors Benefit Fund, and six in the Probate Judges and Employees Retirement System all between one and eleven days late. There were also nine instances in the MERS fund, nine in the Policemen and Firemen Survivors Benefit Fund, and ten in the Probate Judges and Employees Retirement System in which the supporting documentation was either not date-stamped or could not be provided.

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

Comment:

Our review disclosed two retirements that the Retirement Services Division treated as routine business when there were issues involving each that should have been individually brought to the attention of the Retirement Commission. We cannot be certain whether overpayments were actually made in these instances because we do not know how the Retirement Commission would have decided these cases.

- 14. The Connecticut State Employees Retirement Commission should adopt, or otherwise implement, regulations to limit the costs related to trustee overnight lodging and travel that are commensurate with the reimbursement amounts set forth in state travel regulations.**

**The Connecticut State Employees Retirement Commission should utilize teleconferencing in order to save on travel reimbursements.**

Comment:

Our review revealed that expenses billed for the per diem fees totaled \$459,185 for fiscal year 2009, \$341,067 for fiscal year 2010 and \$228,573 for fiscal year 2011. We also noted that there were twelve questionable or excessive charges.

- 15. The Healthcare Policy and Benefit Services Division should develop internal controls to proactively identify individuals who should have had an OPEB deduction initiated but who have not. It should also monitor OPEB deductions for accuracy and refund employees when excess deductions occur.**

Comment:

Our review disclosed that there were 386 employees as of June 2012 who had not begun their required OPEB contributions and 197 employees who paid deductions in excess of three percent.

- 16. The Healthcare Policy and Benefit Services Division should strengthen its internal controls and develop statewide policies promoting the timely and accurate issuance of OPEB refunds.**

Comment:

We noted 19 instances in which an employee received a refund of OPEB contributions in excess of what was contributed.

- 17. The Healthcare Policy and Benefit Services Division should strengthen its internal controls to prevent ineligible dependents from receiving medical and dental coverage, and ensure prompt removal of such dependents when they reach the maximum age of coverage.**

Comment:

At the time of our review (May 2012), we noted there were 66 child dependents being covered for medical and dental insurance while being over the maximum age for coverage.

## **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, 2009, 2010 and 2011. This audit was primarily limited to performing tests of the State Comptroller's Retirement Division and Healthcare Policy and Benefit Services Division 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, 2009, 2010 and 2011, 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 Division and Healthcare Policy 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.

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

In planning and performing our audit, we considered the State Comptroller's Retirement Division's and Healthcare Policy and Benefit Services Division's internal control over its financial operations, safeguarding of assets, and compliance with requirements as a basis for designing our auditing procedures for the purpose of evaluating their financial operations, safeguarding of assets, and compliance with certain provisions of laws, regulations, contracts and grant agreements, but not for the purpose of providing assurance on the effectiveness of the division's internal control over those control objectives.

Our consideration of internal control over financial operations, safeguarding of assets, and compliance requirements was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial operations, safeguarding of assets and compliance with requirements that might be significant deficiencies or material weaknesses. However as discussed below, we identified certain deficiencies in internal control over financial operations, safeguarding of assets, and compliance with requirements that we consider to be significant deficiencies.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect on a timely basis unauthorized, illegal, or irregular transactions or the

breakdown in the safekeeping of any asset or resource. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the division's ability to properly initiate, authorize, record, process, or report financial data reliably, consistent with management's direction, safeguard assets, and/or comply with certain provisions of laws, regulations, contracts, and grant agreements such that there is more than a remote likelihood that a financial misstatement, unsafe treatment of assets, or noncompliance with laws, regulations, contracts and grant agreements that is more than inconsequential will not be prevented or detected by the division's internal control. We consider the following deficiencies, described in detail in the accompanying Condition of Records and Recommendations sections of this report, to be significant deficiencies in internal control over financial operations, safeguarding of assets and compliance with requirements: Recommendation 7 – Disability Retirement Medical Reviews and Annual Review Forms, Recommendation 9 – Lack of Formal, Comprehensive Written Policies and Procedures and Recommendation 13 – Other Post Employment Benefits Contributions.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that noncompliance with certain provisions of laws, regulations, contracts, and grant agreements or the requirements to safeguard assets that would be material in relation to the division's financial operations, noncompliance which could result in significant unauthorized, illegal, irregular or unsafe transactions, and/or material financial misstatements by the division being audited will not be prevented or detected by the division's internal control.

Our consideration of the internal control over the division's financial operations, safeguarding of assets, and compliance with requirements, was for the limited purpose described in the first paragraph of this section and would not necessarily disclose all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we do not believe that the significant deficiency described above is a material weakness.

### **Compliance and Other Matters:**

As part of obtaining reasonable assurance about whether the State Comptroller's Retirement Division and Healthcare Policy and Benefit Services Division complied with laws, regulations, contracts and grant agreements, 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, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements. However, providing an opinion on compliance with those 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 or other matters that are required to be reported under *Government Auditing Standards*. However, we noted certain matters which we reported to the division's management in the accompanying Condition of Records and Recommendations sections of this report.

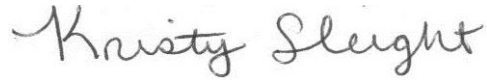


The State Comptroller's Retirement Division and Healthcare Policy and Benefit Services Division and the Connecticut State Employees Retirement Commission's responses to the findings identified in our audit are described in the accompanying Condition of Records section of this report. We did not audit either the State Comptroller's Retirement Services Division's or the Connecticut State Employees Retirement Commission's response and, accordingly, we express no opinion on it.

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

**CONCLUSION**

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



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Associate Auditor

Approved:



John C. Geragosian  
Auditor of Public Accounts



Robert M. Ward  
Auditor of Public Accounts