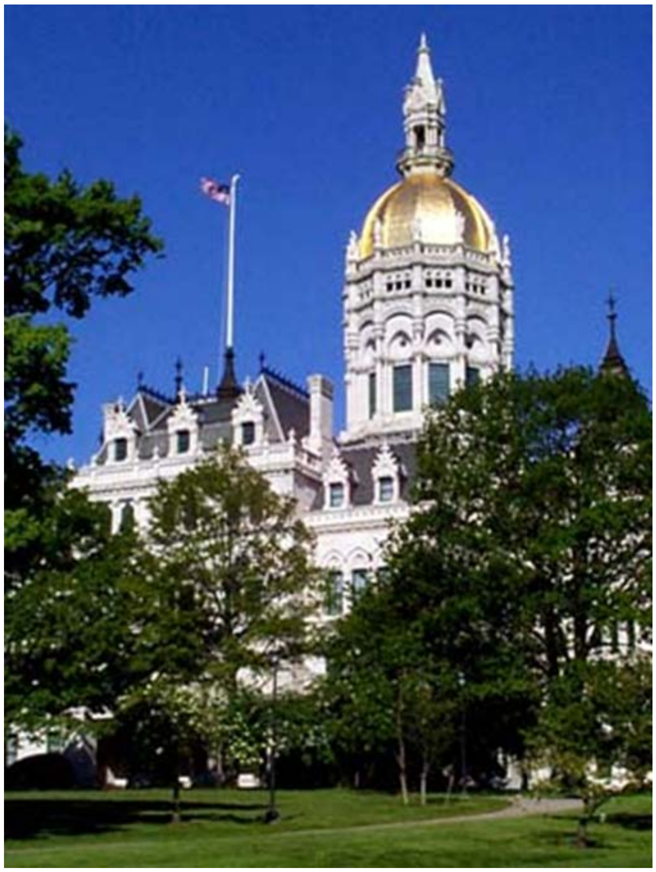
STATE OF CONNECTICUT



AUDITORS' REPORT
OFFICE OF THE STATE COMPTROLLER –
STATE RETIREMENT FUNDS AND
STATE EMPLOYEE AND RETIREE BENEFITS
FISCAL YEARS ENDED JUNE 30, 2015 AND 2016

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

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May 12, 2020

EXECUTIVE SUMMARY

In accordance with the provisions of Section 2-90 of the Connecticut General Statutes, we have audited certain operations of the Office of the State Comptroller – State Retirement Funds and State Employee and Retiree Benefits. The objectives of this review were to evaluate the divisions' internal controls; compliance with policies and procedures, as well as certain legal provisions; and management practices and operations for the fiscal years ended June 30, 2015 and 2016.

The key findings and recommendations are presented below:

Page 19	The State Employees Retirement System paid benefits over the actuarially adjusted maximum benefit limits established in Section 415 of the Internal Revenue Code. The overpayments noted were related to non-hazardous and hazardous duty retirees. The Office of the State Comptroller Retirement Services Division should ensure compliance with Section 415 of the Internal Revenue Code by ceasing all benefit payments in excess of the limitations imposed within that section. (Recommendation 1.)
Page 21	Since a 1989 interest arbitration award, the division's calculation methodology when determining the annual benefit amounts for disability retirees essentially eliminates the statutory offset provisions for retirees with outside earnings. As a result, the state may be incurring millions of dollars in unnecessary disability retirement benefit payments. The Office of the State Comptroller Retirement Services Division should request a formal opinion from the Office of the Attorney General regarding the appropriate annual benefit calculation to use for disability retirees who earn outside salary or wages. The request should specifically consider the intent of Issue #25 of the Interest Arbitration Award between the State of Connecticut and the State Employee Bargaining Agent Coalition (SEBAC) regarding the Connecticut State Employees Retirement System. (Recommendation 2.)
Page 25	Our audit of equity refund distributions disclosed that the Retirement Services Division calculates equity refunds using an average exclusion ratio instead of the simplified method as required by the Internal Revenue Service. The Office of the State Comptroller Retirement Services Division should revise its methodology for calculating death benefits for the beneficiaries of retired SERS plan members. Specifically, the federal tax exclusion ratio should be calculated on a case-by-case basis using the simplified method instead of the average exclusion ratio the division has been using. (Recommendation 3.)
Page 27	Our audit of 10 prior service purchases disclosed 5 instances in which interest was not charged. Further review disclosed that the 5 employees were part of the 136 judicial marshals affected by a memorandum of understanding retroactively reclassifying their service between July 1999 and March 2006 from non-hazardous to hazardous duty. Additionally, none of the 136 judicial marshals were required to make catch-up contributions to the retirement fund. Instead, the division applied the change in employee contributions prospectively. The Office of the State Comptroller Retirement Services Division should strengthen controls over retirement purchases to ensure compliance with the procedures set forth in state statutes and collective bargaining agreements. In addition, the division should consider implementing policies that would require the retroactive collection of contributions that are due. (Recommendation 4.)

STATE OF CONNECTICUT

AUDITORS OF PUBLIC ACCOUNTS

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210 Capitol Avenue
Hartford, Connecticut 06106-1559

ROBERT J. KANE

May 12, 2020

AUDITORS' REPORT

We have audited certain operations of the Office of the State Comptroller – State Retirement Funds and State Employee and Retiree Benefits, including the State Employees Retirement Fund, the Alternate Retirement Program Fund, the State's Attorneys Retirement Fund, the General Assembly Pension Fund, the Judges and Compensation Commissioners Retirement Fund, the Public Defenders Retirement Fund, the Probate Judges and Employees Retirement Fund, the Municipal Employees Retirement Fund and the Policemen and Firemen Survivors Benefit Fund. We have included in that examination the records pertaining to the state's Deferred Compensation Plan as well as those pertaining to the appropriations for the Alternate Retirement System, the Judges and Compensation Commissioners Retirement Fund, the various miscellaneous statutory pensions and the state's share of retirement salaries and health insurance costs for active and retired employees in fulfilment of our duties under Section 2-90 of the Connecticut General Statutes. The scope of our audit included, but was not necessarily limited to, the fiscal years ended June 30, 2015 and 2016. This audit did not include the Teachers' Retirement Fund, as a separate Teachers' Retirement Board administers that fund, which our office audits separately. The objectives of our audit were to:

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

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

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

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

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

The accompanying Résumé of Operations is presented for informational purposes. This information was obtained from various available sources including, but not limited to, the division's management and the state’s information systems, and was not subjected to the procedures applied in our audit of the divisions. For the areas audited, we identified:

1. Deficiencies in internal controls;

2. Apparent noncompliance with policies and procedures or legal provisions; and

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

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

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 required actions and maintaining the records and accounts of the various retirement plans administered by the Connecticut State Employees Retirement Commission. They provide counseling services to members; administer state employee deferred compensation, dependent care assistance, group life and health insurance programs; and manage the state unemployment compensation accounts.

Kevin Lembo was elected State Comptroller in November 2010 and served throughout the audited period. Brenda Halpin served as director of the Retirement Services Division, and Dr.

Thomas Woodruff served as director of the Healthcare Policy and Benefit Services Division during the audited period.

Significant Legislation

- **Public Act No. 15-93 –** Effective October 1, 2015, Section 2 of this act required the Comptroller to offer non-state public employers, their non-state public employees and retirees, if applicable, coverage under the state employee health plan. It further required that these individuals be pooled with the state employee plan, and that premium payments for coverage be remitted to the Comptroller and, in general, be the same as those paid by the state inclusive of any premiums paid by state employees. This act also allowed the Comptroller to charge each non-state public employer participating in the state employee plan an administrative fee calculated on a per member, per month basis. Section 5 of this act prohibited the Comptroller from offering coverage under the state employee health care plan until the State Employees' Bargaining Agent Coalition provided its consent to the General Assembly to incorporate the terms of Sections 1 through 4 of the act into its collective bargaining agreement.

- **Special Act No. 16-16 –** Effective June 7, 2016, Section 1 of this act modified the amount of the amortization contribution payments that the City of Bridgeport must make to the Municipal Employees Retirement System toward the unfunded accrued liability for police and fire members in that system. The modification first lowered the required payment to 35% of the annual required amount established by the commission as of July 2015, and gradually increased the payments to 175% of the annual required amount. The reduction in payment began during fiscal year 2017 and increases through June 30, 2043, at which time the city reverts back to paying 100% of the annual required amount. It should be noted that this act does not affect the normal monthly required pension contributions of the City of Bridgeport into the Municipal Employees Retirement System.

Boards and Commissions

Connecticut State Employees Retirement Commission

The Connecticut State Employees Retirement Commission, established under Section 5-155a of the General Statutes, is responsible for the administration of the retirement programs presented in this report. In accordance with Section 5-155a, the membership of the commission is composed of the State Treasurer or designee, who is a non-voting ex-officio member; 15 trustees, including 6 trustees representing state employees; 6 trustees representing state management; 2 trustees who are professional actuaries; and 1 neutral trustee who serves as chairman. In addition, the State Comptroller serves ex-officio as the non-voting secretary. All trustees serve for a 3-year term except the chairman, who serves a 2-year term. The Governor makes all appointments except for the employee trustees, who are selected by employee bargaining agents. The management and employee trustees jointly determine the appointment 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. The 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, 2016 were:

Peter Adomeit, Chairman
Lisa Grasso Egan, Actuarial Trustee
Claude Poulin, Actuarial Trustee
Sandra Fae Brown-Brewton, Management Trustee
Michael Carey, Management Trustee
Robert D. Coffey, Management Trustee
Richard Cosgrove, Management Trustee
Ronald McLellan, Employee Trustee
Laila Mandour, Employee Trustee
Charles W. Casella, Employee Trustee
Salvatore Luciano, Employee Trustee
Paul Fortier, Employee Trustee
Stephen Greatorex, Employee Trustee

Actuarial trustee Robert Baus, management trustee James Dzurenda and employee trustee Thomas P. Culley also served as members of the commission during the audited period.

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

Medical Examining Board for State Employee Disability Retirement

Under Section 5-169 of the General Statutes, the Governor shall appoint a Medical Examining Board of 7 current or retired state employee physicians to determine entitlement to disability retirement for members of the State Employees Retirement System. The members of the board as of June 30, 2016 were:

Lynn Rudich, M.D., Chairperson
Amarjeet Dargan, M.D.
Manny Katsetos, M.D.
Debra Pollack, M.D.
Nikolai Lieders, M.D.
Kamel Ghandour, M.D.
Richard Blum, M.D.

Dr. Albert Geetter, Dr. Wilner Samson, Dr. Marc Croteau, Dr. Carolyn Drazinic, Dr. Mark Buchanan, Dr. Robert Fitzpatric, Dr. Steven Singer, and Dr. Ariane Sirop also served as members of the board during the audited period.

RÉSUMÉ OF OPERATIONS

State Employees Retirement Fund

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

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

State employee benefits, including pensions, are negotiated through collective bargaining between the state and SEBAC. Since the enactment of the pension agreement, the State of Connecticut and SEBAC negotiations resulted in one arbitration award and five separate agreements, known as SEBAC agreements, which 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 modified the pension agreement and created a new tier entitled Tier IIA, effective July 1, 1997. The SEBAC V pension agreement provided that the State Employees Retirement System shall not be changed through June 30, 2017, unless mutually agreed to by all parties.

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

The SEBAC 2009 agreement also required that all employees hired on or after July 1, 2009, and existing employees with less than 5 years of service as of July 1, 2010 contribute 3% of their salary for 10 years, to be deposited into a newly established retiree healthcare trust fund. A revision of the SEBAC pension agreement in 2011 extended the requirement of the trust contributions to all other state employees to be phased in beginning July 1, 2013 as follows: 0.5% of salary for the fiscal year ended June 30, 2013; 2% of salary for the fiscal year ending June 30, 2014; and 3% of salary for the fiscal year ending June 30, 2015 and thereafter, with a period of required contribution of 10 years or to the beginning of retirement, whichever occurs first.

Revisions in the SEBAC agreement in 2009 and 2011 also made changes in benefits as cost control measures, including the addition of or changes in emergency room and prescription drug copayments, the use of mail-order prescriptions, and the implementation of a voluntary health enhancement plan. The Health Enhancement Program is available to all state employees and retirees (including all enrolled dependents), and requires 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 for members of the State Employees Retirement System and the Probate Judges and Employees Retirement System to use 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 June 30, 2016, the State Employees Retirement System consisted of a 4-tiered system. Membership in each tier generally 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 General Statutes, there are 2 benefit plans within Tier I, referred to as Plan B and Plan C, to which eligible members could elect to belong. Plan B is integrated with Social Security and pays a lower benefit at age 65 or once Social Security disability benefits are received. Plan C benefits are in addition to those provided by Social Security. As of June 30, 2016, approximately 3% of the total workforce was covered under the Tier I plan.

Tier II is a noncontributory plan that provides a single level of benefits to all members, with the exception of hazardous duty members, who must make contributions to the system. Tier IIA is a contributory plan that provides benefits similar to Tier II. Approximately 25% and 44% of the total workforce was covered under the Tier II and Tier IIA plans, respectively, at June 30, 2016.

Tier III is a contributory plan that provides benefits similar to Tier II. Approximately 28% of the total workforce was covered under the Tier III plan as of June 30, 2016.

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

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

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

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

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

The Retirement Commission must prepare a valuation of the system's assets and liabilities at least once every 2 years. The commission is authorized to employ actuaries to prepare such valuations and determine the annual appropriation of state funds necessary to meet the funding plan outlined in Section 5-156a of the General Statutes. Actuarial valuations of the system were prepared as of June 30, 2014 and 2016, with a roll forward valuation as of June 30, 2015. As a result of these valuations, the unfunded actuarial accrued liability for the audited period and prior fiscal year was as follows:

	2013-2014	**2014-2015**	**2015-2016**
Unfunded Actuarial Accrued Liability	$ 14,920,814,520	$ 14,879,731,911	$ 21,693,750,225

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

A comparison of membership information for the State Employees Retirement System as of June 30, 2014 and 2016 is presented below:

	2013-2014	**2015-2016**
Active Members		
Tier I	2,281	1,508
Tier II	15,094	12,716
Tier IIA	23,718	22,020
Tier III	8,883	13,775
Total Active Members	49,976	50,019
Retired Members	45,803	48,191
Inactive Members (Terminated Vested)	1,457	1,412
Total	97,236	99,622

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

		Fiscal Year	
	2013-2014	**2014-2015**	**2015-2016**
State Contributions	$ 1,024,371,178	$ 1,101,007,100	$ 1,218,966,824
Federal Contributions	244,518,635	270,643,832	282,838,166
Member Contributions	144,806,616	187,338,535	135,028,539
Total	$ 1,413,696,429	$ 1,558,989,467	$ 1,636,833,529

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

	2013-2014	**2014-2015**	**2015-2016**
Benefit Payments	$ 1,563,029,412	$ 1,650,464,672	$ 1,729,181,426
Employer Refunds	7,528,594	7,123,788	7,097,228
Total	$ 1,570,558,006	$ 1,657,588,460	$ 1,736,278,654

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

	2013-2014	2014-2015	2015-2016
Market Value of Assets	$ 10,472,567,077	$ 10,737,492,074	$ 10,636,702,645
Rate of Return	15.8%	3.4%	-0.2%
Actuarial Value of Assets	$ 10,584,795,257	$ 11,389,603,128	$ 11,922,965,860
Rate of Return	9.7%	8.5%	5.3%

Alternate Retirement Program Fund

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

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

The retirement contribution rate for participants is 5% percent of salary. Effective July 1, 1985, the state's share is fixed at 8% of salary. All contributions are held in a separate retirement fund in the custody of the State Treasurer and are forwarded to the insuring company upon the State Comptroller's certification.

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

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

	2013-2014	2014-2015	2015-2016
Contributions – Participants	$ 35,812,717	$ 35,395,494	$ 35,113,477
Remitted to Insuring Company	$ 35,884,373	$ 35,705,471	$ 36,472,088

As previously noted, the state met its share of the contributions on behalf of the program from appropriations administered by the State Comptroller for the ARP. The state's share of contributions was remitted directly from the General Fund appropriation account to the third-party administrator (TPA). Refunds of contributions from the TPA and fringe benefit recoveries to the

General Fund were credited against this share, resulting in net charges against the General Fund appropriation account totaling $8,739,312, $941,763, and $(34,354) for the fiscal years ended June 30, 2014, 2015, and 2016, respectively.

State's Attorneys Retirement Fund

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

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

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

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

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

	2013-2014	**2014-2015**	**2015-2016**
Market Value of Investments, June 30	$ 1,472,954	$ 1,521,999	$ 1,544,388
Employee Contributions	$ 24,140	$ 25,326	$ 25,709
Investment Income	$ 8,603	$ 130	$ 203

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

General Assembly Pension Fund

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

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

	2013-2014	2014-2015	2015-2016
Market Value of Investments, June 30	$ 13,080	$ 2	$ -
Investment Income	$ 19	$ 20	$ 25
Pensions Paid to Retired Members	$ 1,728	$ 13,098	$ 2

Our office verifies investment balances as part of our audit of the Office of the State Treasurer. Receipts consisted primarily of investment income. The General Assembly Pension Fund finances pensions paid to retired members.

Judges' and Compensation Commissioners' Retirement Fund

Chapters 871, 872, and 882 of the General Statutes provide a retirement system for judges, compensation commissioners, and family support magistrates. All monies received in connection with the system are to be deposited to the Judges' and Compensation Commissioners Retirement Fund. Funding for the system is to be provided by contributions from the General Fund and 5% payroll deductions from member salaries. The State Employees Retirement Commission administers the system, while the State Treasurer serves as custodian and investment manager of the fund.

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

The retirement salary for which a member is eligible is determined by age at retirement, years of service, and the salary of the office held at retirement. Members must have completed at least 10 years of service to receive a benefit. There are provisions for disability retirement and death benefits.

Section 51-49d of the General Statutes provides that the Judges' Retirement System be funded on an actuarial reserve basis, with actuarial surveys of the system performed at least once every 2 years with annual certifications to the General Assembly of funding requirements. Actuarial valuations of the system were prepared as of June 30, 2014 and 2016, which resulted in unfunded actuarial accrued liabilities of $153,717,765 and $223,742,554, respectively.

The following analysis presents the market value of investments of the Judges' and Compensation Commissioners Retirement Fund, the employee contributions, and investment income for the audited period and prior fiscal year:

	2013-2014	2014-2015	2015-2016
Market Value of Investments, June 30	$ 187,773,636	$ 189,522,842	$ 188,723,769
Employee Contributions	$ 1,640,578	$ 1,791,243	$ 1,831,340
Investment Income	$ 1,605,283	$ 36,306	$ 54,670

Our office verifies investments in the State of Connecticut Combined Investment Funds as part of our audit of the Office of the State Treasurer. Receipts consisted primarily of investments, employee contributions, and investment income.

Public Defenders' Retirement Fund

Sections 51-49, 51-295, and 51-295a of the General Statutes provided 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 this retirement program. A retirement fund was established to receive 5% payroll contributions from participants, including transfers from the State Employees Retirement Fund for transferred service credit.

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

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

Probate Judges and Employees Retirement Fund

Sections 45a-34 through 45a-56 of the 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, the commission transmits all contributions required under the system to the State Treasurer, who shall be custodian of the fund with power to invest as much of the fund that is not required for current disbursements. Sections 45a-44 and 45a-45 require members of the retirement system to make contributions equal to 1% of their earnings on which

Social Security taxes are paid through the commission and 3.75% of earnings in excess of that. For those not covered under Social Security, retirement contributions are 3.75% of earnings.

Section 45a-82 of the General Statutes requires that on or before July 1 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, 2013 and 2015. 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 General Statutes.

The following analysis presents the market value of investments of the Probate Judges and Employees Retirement Fund, employee contributions, interest and investment income, and pensions paid to retired members through the fund for the audited period and prior fiscal year:

	2013-2014	**2014-2015**	**2015-2016**
Market Value of Investments, June 30	$ 90,240,076	$ 89,151,597	$ 86,840,025
Employee Contributions	$ 255,112	$ 234,597	$ 241,362
Interest and Investment Income	$ 807,786	$ 16,894	$ 24,624
Pensions Paid to Retired Members	$ 4,724,403	$ 4,892,803	$ 5,018,348

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

Municipal Employees Retirement Fund

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

The Municipal Employees Retirement System is composed of a retirement fund and an administration fund. As of June 30, 2016, municipalities and housing authorities with 9,373 enrolled active employees were participants. As of that date, benefits were being paid to 7,102 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 also may be effected through an agreement between a municipality and an employee bargaining organization in accordance with Section 7-474(f) of the General Statutes.

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

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

Employee contribution rates are set by Section 7-440 of the General Statutes. Employees contribute either 2.25% or 5%, based on whether Social Security contributions are deducted from their salary. Municipal contribution rates are set by the commission based on actuarial valuations, which, under the provisions of Section 7-443 of the General Statutes, are required at least every 5 years. Actuarial valuations of the system were prepared as of June 30, 2014 and 2016, with a roll forward valuation prepared as of June 30, 2015. As a result of these valuations, the unfunded actuarial accrued liability for the audited period and prior fiscal year was $340,681,183, $323,966,671, and $394,840,827, respectively.

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 below:

Effective Date July 1,	**2014**	**2015**	**2016**
Policemen and Firefighters with Social Security	16.96%	17.06%	17.13%
General Employees with Social Security	11.98%	11.56%	11.74%
Policemen and Firefighters without Social Security	16.01%	15.12%	16.93%
General Employees without Social Security	13.00%	11.13%	12.15%

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

The following analysis presents the market value of investments of the Municipal Employees Retirement System, which made up most of the assets of the fund, the employee contributions, investment income earned, and pensions paid to retired members for the audited period and prior fiscal year:

	2013-2014	2014-2015	2015-2016
Market Value of Investments, June 30	$ 2,161,258,189	$ 2,200,631,782	$ 2,200,885,384
Employee Contributions	$ 18,998,238	$ 22,548,855	$ 20,619,573
Interest and Investment Income	$ 17,744,547	$ 746,103	$ 897,028
Pensions Paid to Retired Members	$ 121,721,228	$ 131,504,666	$ 142,839,735

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

Policemen and Firemen Survivors' Benefit Fund

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

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

Actuarial valuations of this fund were prepared as of June 30, 2014 and 2016, with an interim roll forward valuation performed as of June 30, 2015. As of June 30, 2016, there were 634 active employees from 9 municipalities participating in the plan.

The following analysis presents the market value of investments of the Police and Firemen Survivors' Benefit Fund, which made up most of the assets of the fund, employee contributions, interest and investment income, and disbursements from the pension paid to surviving dependents for the audited period and prior fiscal year:

	2013-2014	2014-2015	2015-2016
Market Value of Investments, June 30	$ 27,185,277	$ 28,097,193	$ 28,435,998
Employee Contributions	$ 521,450	$ 522,888	$ 568,490
Interest and Investment Income	$ 167,697	$ 5,737	$ 8,700
Pensions Paid to Surviving Dependents	$ 1,068,457	$ 1,089,466	$ 1,182,135

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

Pensions and Retirements – Other Statutory

Section 3-2a, 6-2b, and 11-10a of the 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

Section 5-264a of the General Statues authorizes the Office of the State Comptroller, through a third-party administrator, to offer State of Connecticut employees a deferred compensation plan created in accordance with Section 457 of the Internal Revenue Code. This plan permits all permanent employees, including elected and appointed officials and members of the General Assembly, to defer a portion of their salary until future years. This deferred compensation is not available to employees until retirement, termination of employment, disability, unforeseeable emergency, or death.

The Office of the State Comptroller contracted with an administrator selected through a competitive process. Voya Financial, previously ING Financial Advisors, LLC, was the third-party administrator of the state's deferred compensation program through June 2015. Beginning July 1, 2016 the administration was transferred to Prudential Retirement.

State Employees' Health Service Costs

Under the provisions of Section 5-259 of the General Statutes, Connecticut is obligated to pay 100% of the portion of the hospital and medical insurance premium charged for individual coverage and 70% of the portion charged for spouse or family coverage for each state employee and each member of the General Assembly. As with all statutory provisions concerning employee benefits, approved collective bargaining contract language may supersede the provisions of Section 5-259. The state negotiates the hospital and medical insurance plans offered through the collective bargaining process. The SEBAC agreement requires the state to provide Point of Service, Point of Enrollment, Point of Enrollment-Gatekeeper, out-of-area plans, and prescription drug coverage. Based on SEBAC requirements, the Office of the State Comptroller goes out to bid through a request for proposal (RFP) process. Insurance carriers respond to the RFP with proposed costs for the agreement's state plans. The State Comptroller then chooses the carriers and which plans they 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. Based on the payroll transactions submitted by the state agencies, the Office of the State Comptroller charges the General and Special Transportation Fund appropriations for the state's portion of the premiums due to the private insurance carriers and makes payroll deductions for the balance of premiums payable by individuals with additional coverage. Reimbursements to the General Fund are received from certain federal and state funds or restricted accounts charged with salaries of employees covered under the state's health insurance program.

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

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

	2013-2014	**2014-2015**	**2015-2016**
Expenditures – General Fund:			
Employer's Share – State Employees	$ 614,328,850	$ 635,096,886	$ 662,862,284
Expenditures – Transportation Fund:			
Employer's Share – State Employees	$ 39,610,782	$ 44,606,243	$ 46,708,551

Retired State Employees' Health Service Costs

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

During the 2013-2014, 2014-2015, and 2015-2016 fiscal years, appropriations and transfers of $548,693,300, $598,635,039, and $651,397,000, respectively, were made to cover the state's share of health insurance costs for those eligible retirees. Total amounts expended during the aforementioned fiscal years were $548,693,300, $598,635,039, and $645,975,176, respectively.

The increase in expenditures from fiscal years 2013-2014 to 2015-2016 was primarily caused by an increase in medical and pharmacy claims paid.

In the past, the state funded the health insurance benefits for retired employees as costs were incurred. Unlike retirement benefits, the state did not establish a reserve to provide support for future years. During the fiscal year ended June 30, 2008, the Governmental Accounting Standards Board implemented Statement No. 45 (GASB 45), which required the state to calculate and record the actuarial accrued liability for 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 state employees receiving benefits from any state-sponsored retirement system, except the Teachers' Retirement System and the Municipal Employees Retirement System. The SEOPEBP provides healthcare and life insurance benefits to eligible retirees and their spouses. The cost of post-retirement health care benefits is funded through the transfer of General Fund appropriations to the OPEB – State Employees trust fund. As of June 30, 2015, the fair market value of the net assets within the fund totaled $229,638,000.

As noted above, the state must provide an actuarial valuation of the OPEB liability. Actuarial valuations of the system were prepared as of June 30, 2013 and 2015, with roll forward calculations performed for fiscal years 2013-2014 and 2015-2016. Based on the June 30, 2015 actuarial valuation, the unfunded actuarial accrued liability was $18,889,942,595.

STATE AUDITORS' FINDINGS AND RECOMMENDATIONS

Our examination of the records of the Office of the State Comptroller – State Retirement Funds and State Employee Retiree Benefits covering the fiscal years ended June 30, 2015 and 2016 disclosed the following 10 findings and recommendations, of which 9 have been repeated from the previous audit:

STATE EMPLOYEES RETIREMENT SYSTEM

Limitations on Benefits – Internal Revenue Code Section 415 Limits

Background: The State Employees Retirement System is a qualified governmental defined benefit plan as defined in Sections 401(a) and 414(d) of the Internal Revenue Code. To protect the tax qualified status of the plan under Section 401(a), SERS must follow the benefit and contribution limits set forth in Section 415 of the Internal Revenue Code or the entire plan may be disqualified.

Criteria: During calendar years 2015 and 2016, the maximum allowable benefit, per guidance promulgated by the Internal Revenue Service, was $210,000. Section 415(b)(2)(C) requires that this benefit limit be actuarially adjusted when a participant retires prior to reaching age 62, unless the participant is employed by an agency with an overall mission and nature consistent with a police or fire department, as allowed by Section 415(b)(2)(H). The maximum allowable benefit also must be reduced if it is not received as a straight life annuity or a qualified joint and survivor annuity. In effect, an otherwise contingent or fixed annuity would need to be actuarially adjusted to the equivalent straight life benefit before testing for compliance with the limits set forth in Section 415 of the Internal Revenue Code.

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

Condition: During the audited period, the State Employees Retirement System paid benefits over the actuarially adjusted maximum benefit limits established in Section 415 of the Internal Revenue Code. The overpayments noted were related to non-hazardous and hazardous duty retirees.

Effect: Benefit payments made in excess of the limits set forth in Section 415 of the Internal Revenue Code jeopardize the plan's qualified status under Section 401(a).

Cause: Regarding the non-hazardous duty retirees identified as receiving benefits in excess of the limits set forth in Section 415, the division informed us that the issue was due to the timing of their retirements. The Retirement Services Division began applying Section 415 limits on January 1, 2011 and those employees retired prior to that date. The Retirement Services Division also told us that it is in a dispute over the appropriate amount of benefits payable to these retirees, and its tax counsel has been engaged in discussions with the IRS to resolve this matter.

With respect to the hazardous duty retirees, it appears that the Retirement Services Division incorrectly applied the exclusion allowed in Code Section 415(b)(2)(H) and did not make an adjustment to employee pay for individuals who retired before reaching the age of 62, or when the annuity type selected would require conversion. In these instances, the individuals retired from the Connecticut Department of Correction, and based on PLR 201347028 (UIL 415.01-05), these individuals should not have been considered hazardous duty employees for the purpose of Section 415 limit calculations.

Prior Audit Finding: This finding has been previously reported in the last audit report covering the fiscal years ended June 30, 2012 through 2014.

Recommendation: The Office of the State Comptroller Retirement Services Division should ensure compliance with Section 415 of the Internal Revenue Code by ceasing all benefit payments in excess of the limitations imposed within that section. (See Recommendation 1.)

Agency Response: "The Retirement Services Division takes appropriate, affirmative measures to ensure compliance with Sections 401 and 415 of the Internal Revenue Code (IRC). It implemented those measures before any compliance issue was identified by the Auditors of Public Accounts. Our actuaries engage in annual testing for IRC limits. All individuals who have retired since January 1, 2011, and whose benefits have been found to be in excess of the relevant limits, have had their benefits appropriately reduced.

As the Auditors acknowledge, there is currently a dispute over the appropriate amount of benefits that are payable under the IRC to retirees who retired before January 1, 2011. The retirees in question include those former employees of the Connecticut Department of Corrections (DOC) to whom this finding and recommendation refers. Tax counsel has been engaged in discussions with the federal Internal Revenue Service to resolve that dispute since 2012.

It is therefore premature, at best, to assert, with respect to any of these retirees, that the division has ‘incorrectly’ interpreted the IRC provisions that govern their benefits. Furthermore, the division believes these benefits should not be reduced until the division has had the benefit of accurate testing (incorporating all of the relevant adjustment factors); guidance from our actuaries and tax counsel; and, most importantly, guidance from the IRS. Indeed, the division’s authority to reduce the excess benefits of certain other retirees is the subject of pending litigation.

With respect to retirees who retired after January 1, 2011, the Retirement Services Division will continue to work with its actuaries and tax counsel on affirmative measures to apply the provisions of SERS and the IRC appropriately.”

Statutory Offsets for Disability Retirees with Outside Earned Salary or Wages

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

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

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

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

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

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

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

As further evidence that the division is incorrectly calculating disability retirement benefits, the actuarial analysis of the arbitration award, dated October 3, 1989, supports that there was no intention to eliminate the offsets. The analysis states that the past service cost, estimated at $207,000 will remain level and then cease after 36 years. Furthermore, our prior audit found that the total cost, estimated to be $325,000, pales in comparison to the disability retirement payments, totaling $1,572,727, made during fiscal years 2011-2012 and 2012-2013 to 62 disability retirees with outside earnings that, when combined with the disability retirement payments they received, exceeded the statutory maximum benefits allowed. In all 62 instances, disability benefits were not offset as a result of their outside earnings. Our office reported these issues to the Governor and other state officials in a letter dated June 17, 2015.

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

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

Prior Audit Finding: This finding has been previously reported in the last audit report covering the fiscal years ended June 30, 2012 through 2014.

Recommendation: The Office of the State Comptroller Retirement Services Division should request a formal opinion from the Office of the Attorney General regarding the appropriate annual benefit calculation for disability retirees who earn outside salary or wages. The request should specifically consider the intent of Issue #25 of the Interest Arbitration Award between the State of Connecticut and SEBAC regarding the Connecticut State Employees Retirement System. (See Recommendation 2.)

Agency Response: "The Retirement Services Division has reviewed this finding and recommendation and found it to be inaccurate. The plan revisions effected by Issue #25 of the Interest Arbitration Award have proved to be expensive, but that fact does not give the Division authority to disregard them.

As the Auditors of Public Accounts acknowledge, Issue #25 of the Interest Arbitration Award revised Tiers I and II by adding provisions that state (emphasis added):

> ***Notwithstanding any other provisions of law***, each member entitled to disability retirement under this section shall receive a retirement income, ***inclusive of social security and workers' compensation***, which is no less than sixty per cent of their rate of salary at the time their disability occurred. This benefit shall be adjusted in accordance

> with Sections 5-162d, 5-162h or 5-169(h)(3) [for Tier I, or, for Tier II, Sections 5-192s or 5-192p(e)(3)] whichever is greater.

On its face, this language permits the division to take *only* social security and workers' compensation benefits into account when it determines a retiree's minimum income for disability retirement. Consequently, this language precludes application to the minimum disability retirement income of the offset for outside earned income that appears in Sections 5-169(g)(1) and 5-192p(d)(1) of the General Statutes.

The Auditors of Public Accounts appear to believe that the last sentence of the new provisions somehow changes this outcome. According to the Auditors, the statutes that are cited in that sentence 'consider outside earnings as part of the benefit.'

That is only partially correct. Sections 5-162d, 5-162h, and 5-192s all prescribe cost of living adjustments, with no reference to outside earnings or offsets. Sections 5-169(h)(3) and 5-192p(e)(3) create rules for calculating the "100% maximum," set forth in Sections 5-169(g)(1) and 5-192p(d)(1), for disability retirees who receive outside earned salary or wages. In some cases, those rules require adjustments to the values being placed on a retiree's workers' compensation benefits and/or Social Security disability benefits—but not to the value of any outside earned salary, which shall "reflect actual amounts earned."

Even if the reference in the Arbitration Award to Sections 5-169(h)(3) and 5-192p(e)(3) meant that the Retirement Services Division were required to take account of outside earned income, that income could be considered only in connection with adjustments to the 60% minimum income the Award established. In making those adjustments, the division would have to apply *either* Sections 5-169(h)(3) and 5-192p(e)(3), *or* the provisions relating to cost-of-living increases ultimately using the provision that provides the *greater* benefit. Because the latter provisions do not involve offsets for *any* form of outside income, the division would never be able to use outside earned income as the basis for any meaningful reduction to the minimum income of disability retirees.

The Auditors of Public Accounts also observe, correctly, that the Award significantly underestimated the cost of creating a minimum benefit that is not offset by all potential sources of outside income. The division does not dispute that fact, but we believe it does not permit us to ignore the plain and unambiguous language of the Award."

Auditors' Concluding Comment: As indicated in our finding, we do not believe that the intent of Issue #25 was to eliminate the offsets to disability benefits. We believe that a formal opinion from the Office of the Attorney General would clarify this matter.

Equity Refunds – Exclusion Rate

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

Internal Revenue Service Notice 98-2 indicates that the simplified method provided in Section 72(d) of the Internal Revenue Code must be used by distributees to comply with Section 72, and by payers to report the taxable portion of annuity distributions on Form 1099-R.

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

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

Effect: The incorrect method used to calculate the exclusion ratio caused the beneficiaries of SERS plan members to receive estimated death benefits instead of the actual amount owed. These estimated death benefit expenditures resulted in both over and under payments.

Cause: In October 1992, the division determined that it could not complete the calculation to determine an individual's federal tax exclusion ratio on a case-by-case basis in a timely manner. Instead, the division used an average tax exclusion ratio it had developed to calculate the amount of equity refund.

Prior Audit Finding: This finding has been previously reported in the last 2 audit reports covering the fiscal years ended June 30, 2009 through 2014.

Recommendation: The Office of the State Comptroller Retirement Services Division should revise its methodology for calculating death benefits for the beneficiaries of retired SERS plan members. Specifically, the federal tax exclusion ratio should be calculated on a case-by-case basis using the simplified method instead of the average exclusion ratio the division has been using. (See Recommendation 3.)

Agency Response: "Participants in SERS make mandatory contributions to their plans on an after-tax basis. These contributions constitute each member's 'equity' or 'investment' in the retirement contract.

Upon retirement, members of SERS receive retirement income, a portion of which is deemed to be a refund of each member's equity. It is necessary to determine what that portion is, for two reasons. First, retirement income is generally subject to federal taxation, while the return of equity is not taxable. Secondly, under Section 5-168 of the General Statutes, the beneficiary or estate of a SERS retiree is entitled to receive whatever portion of the retiree's equity has not yet been refunded through the payment of retirement income.

Section 72 of the IRC is the statute, which provides that a portion of each payment of retirement income shall be excluded from the calculation of taxable gross income, because it may be considered a refund of equity. Subsection (b) of Section 72, enacted in 1986, provided a formula for calculating the excludable portion of each payment. Under subsection (b), the excludable portion was calculated as a fraction or ratio (the 'exclusion ratio'), in which the numerator is the total investment in the contract, and the denominator is the retiree's total expected return after retirement.

In 1988, the Connecticut General Assembly amended Section 5-168 of the General Statutes, to make it conform to IRC Section 72. For SERS members who retired after August 1, 1986, Section 168(b) now provides that that "the beneficiary shall receive a death benefit 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 [SERS]" (emphasis added). In other words, Section 168 uses the formula that appears in Section 72(b) of the IRC to determine what portion of the retirement payments that were made to the retiree before his or her death constituted a return of the retiree's equity. That determination will, in turn, establish the amount of remaining equity that will fund the retiree's death benefit.

At around the time that Section 5-168 was being amended in this way, the IRS changed its rules, by creating a simplified, safe-harbor method for determining the excludable portion of retirement payments. In 1998, a revised version of that simplified method (which now appears in IRC Section 72(d)) was made mandatory for tax purposes. For this reason, the formula for determining whether all or part of a death benefit constitutes gross income for tax purposes (a formula that is an element of federal tax law) is currently *different* from the formula (required by the Tier I statute) for determining what the amount of the death benefit must be.

The Retirement Services Division calculates death benefits for members of SERS in accordance with the terms of Section 5-168(b) of the General Statutes. In past audit reports, the Auditors of Public Accounts recommended that the Retirement Services Division adopt a different practice from the one the statute directs. The reports suggested that the amount of the death benefit be equal to (i) the amount of the member's retirement contributions, plus interest, (ii) reduced by a proportion calculated under the method prescribed for tax purposes in IRC Section 72(d).

Because of the disparity between Section 5-168 and the federal tax laws, the division sought the advice of legal counsel as to whether it may deviate from the practice prescribed in Section 5-168(b). Because the apparent intent of the General Assembly has been to calculate death benefits in a manner that is consistent with federal tax law, and because doing so could help beneficiaries avoid confusion and inconvenience, counsel recommended that the division follow the simplified method of Section 72(d), rather than the discarded exclusion ratio of Section 72(b).

Relying on that advice, the division has advised the Active and Retiree Payroll Division that the formula for calculating death benefits under Section 5-168 should be revised, in that the exclusion ratio should be replaced by the simplified ratio from IRC Section 72(d). We have been advised that the Active and Retiree Payroll Division is in the process of making the technical adjustments necessary for this change."

Retirement Purchases

Background: In March 2006, SEBAC and the state entered into a memorandum of understanding (MOU) that reclassified certain judicial marshals from non-hazardous to hazardous duty. The MOU indicated that this reclassification would be retroactive from July 1999 and that the Retirement Services Division should provide the hazardous duty retirement credit in accordance with its past procedures.

Criteria: The SEBAC V agreement specifies that, to receive credit for prior period service under tier IIA, employees must pay 5% per year interest from the time such service was rendered to the date of payment.

Condition: Our audit of 10 prior service purchases made during the audited period, totaling $556,218, disclosed 5 instances in which interest was not charged on purchases totaling $47,613. In all 5 instances, the purchases were made by employees in the tier IIA retirement plan.

In addition, we noted that the 5 employees were part of 136 judicial marshals affected by the MOU that retroactively reclassified their service between July 1999 and March 2006 from non-hazardous to hazardous duty. Many of the judicial marshals, including the 5 tested, purchased additional service up to June 1999 during the audited period. Further review into the processing of this MOU disclosed that, for 120 affected judicial marshals that purchased prior service time, none were charged interest. Additionally, we noted that none of the 136 judicial marshals were required to make catch-up contributions to the retirement fund. Instead, the division applied the change in employee contributions prospectively.

Effect: The Retirement Services Division did not fully comply with the various policies and procedures that govern the purchase of service time for employees in the State Employees Retirement System.

In regard to the judicial marshals, the Retirement Services Division did not fully comply with the requirements of the SEBAC V agreement with respect to charging interest on the purchase of service by employees in the tier IIA bargaining unit. Furthermore, these employees will be receiving retirement benefits as tier IIA hazardous duty employees, even though they were not required to make contributions as tier IIA hazardous duty employees for the time they were credited.

Cause: It appears that there were insufficient controls in place to prevent these conditions.

With respect to the judicial marshals, the division informed us that the MOU was silent on the matter of interest, which is why it was not charged. In addition, the division indicated that it did not request catch-up contributions because it has been the division’s policy to apply these types of changes prospectively.

Prior Audit Finding: Part of this finding has been previously reported in the last audit report covering the fiscal years ended June 30, 2012 through 2014. The matter related to the judicial marshals has not been previously reported.

Recommendation: The Office of the State Comptroller Retirement Services Division should strengthen controls over retirement purchases to ensure compliance with the procedures set forth in state statutes and collective bargaining agreements. In addition, the division should consider implementing policies that would require the retroactive collection of contributions. (See Recommendation 4.)

Agency Response:

"The Retirement Services Division has reviewed this finding and recommendation and found it to be inaccurate.

On April 28, 2015, the Office of Labor Relations (OLR) and the State Employees Bargaining Agent Coalition (SEBAC) entered into a 'Memorandum of Understanding In regards to the Judicial Marshals Classification Series' (the MOU). The MOU concerns certain judicial marshals who had been 'employed by the State in the capacity of Special Deputy Sheriffs for at least one year before July 1, 1999.' It allows those marshals to purchase a maximum of three years of service time for their prior service.

The MOU further provides that each purchase shall be effected by an employee's contribution, and that "[t]he amount of said contribution shall be based upon the employee's current salary." The MOU contains no provision authorizing the Retirement Services Division to use interest as a factor in the calculation of such contributions.

For members of Tier IIA, the Auditors of Public Accounts contend that the purchase of service time under the MOU is governed by § 5-193g(l) of the 1997 agreement between SEBAC and the OLR (SEBAC V). That provision concerns contributions made by Tier IIA members 'to receive credit for [a] period or periods of nonstate employment as either vesting or credited service under tier IIA.' It provides that the amount of such contributions shall be 'a sum based on the provision governing contributions for such service under the applicable provision of tier I, plus interest at the rate of five percent (5%) per year… .'

Section 5-193g(l) does not apply to the purchases authorized by the MOU. Section 5-193g(l) concerns the purchase of credit for 'periods of nonstate employment,' whereas the MOU deals with the purchase of credit for periods when certain judicial marshals were 'employed by the State.' Furthermore, the MOU was executed 18 years after SEBAC V, and it does not expressly incorporate any of the terms, either of that agreement or of the Tier I statutes. The division believes it must comply with the terms of the MOU as they are written."

Auditors' Concluding Comment:

With respect to charging interest on the purchase of prior service time, the judicial marshals purchased service performed between 1996 and July 1, 1999. Prior to July 1, 1999, Chapters 66 through 68 of the General Statutes (the State Employees Retirement Act), the State Personnel Act, and Collective Bargaining for State Employees, respectively, did not apply to deputy sheriffs, now judicial marshals. However, regardless of whether the service provided was state or non-state, purchases of prior service time should be treated the same, and if interest is required for the purchase of non-state service, it should also be required for the purchase of prior state service.

It should also be noted that when state employees leave state service before vesting, they receive a payout of the contributions made toward their pensions. If they then return to state service, they are charged interest of 5% per year if they purchase their prior state service. It would appear as though the division should have applied this practice in the case of the judicial marshals purchasing prior service time if it determined it was state service.

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

Criteria: For situations in which employees transfer between retirement plans, all funds previously contributed by those employees should transfer to the new retirement plan to fund their retirement benefits.

Condition: Our prior audit disclosed 28 instances in which employees transferred from ARP to various SERS tier plans without transferring the appropriate amount of prior contributions. In these instances, $2,600,842 was transferred out of the respective transferees' individual ARP account using the standard practice for reversing employer-share ARP contributions that were made in error. As a result, the $2,600,842 was transferred into a general forfeiture account within the ARP plan, which then should have been transferred into the appropriate SERS tier plans. Instead, these funds lapsed into the state's General Fund. In addition, 4 of the employees noted above were undercharged due to a calculation error and owed an estimated total of $80,515. As of May 2019, the division has not collected these amounts. However, the division is currently in the process of evaluating alternatives to recoup these funds, and it hopes to resolve this issue in the near future.

Effect: The failure to collect the funds due to the SERS tier plans increases the already significant SERS unfunded liability.

Cause: The division relied on the standard practice for processing employer-share ARP refunds to recover the $2,600,842. Under normal circumstances, a fringe benefit recovery for ARP retirement would be deposited back into the ARP appropriation as a refund of expenditure. Using the standard recovery method, the division transferred the employer-share ARP contributions that were made in error from the individual's ARP account into the general forfeiture account within the ARP plan. This was then used to net down state voucher payments from the ARP appropriation to cover the employer-share contributions for all ARP employees in subsequent pay cycles. This resulted in an excess balance in the appropriation account that lapsed in the state's General Fund.

With respect to the 4 employees being undercharged, there appears to have been an error in the division's calculation to determine the payment amount.

Prior Audit Finding: This finding has been previously reported in the last audit report covering the fiscal years ended June 30, 2012 through 2014.

Recommendation: The Office of the State Comptroller Retirement Services Division should recover the monies due to State Employee Retirement System, collect the proper amounts from undercharged employees, and transfer those monies to the appropriate SERS tier plans. (See Recommendation 5.)

Agency Response: "The Retirement Services Division is coordinating with the Office of Policy and Management and the Budget and Financial Analysis Division to recover the ARP employer share contribution that should have been transferred to SERS. The recovery will be accomplished by retaining within the SERS Pension Fund the excess SERS fringe benefit recoveries from the current 2019 Fiscal Year that otherwise would have transferred to the General Fund. The Retirement Services Division is further taking steps to recover the additional contribution totals from the 4 employees, noted above, who were undercharged and owe an estimated total of $80,515 in retirement contributions."

Retirement Contributions

Criteria: Section 4-32 of the General Statutes requires the deposit of receipts totaling $500 or more within 24 hours of receipt.

Condition: Our review of 10 contributions, totaling $38,570, disclosed 4 instances in which the division did not stamp $28,521 in receipts with a receipt date.

Effect: Due to the lack of a receipt date, we were unable to determine whether the Retirement Services Division fully complied with the prompt deposit requirements of Section 4-32 of the General Statutes.

Cause: There were insufficient controls in place to prevent these conditions.

Prior Audit Finding: This finding has been previously reported in the last audit report covering the fiscal years ended June 30, 2012 through 2014.

Recommendation: The Office of the State Comptroller Retirement Services Division should improve internal controls to ensure that it date stamps contributions upon receipt and deposits them within the time limits required by Section 4-32 of the General Statutes. (See Recommendation 6.)

Agency Response: "The Retirement Services Division has reviewed this finding and recommendation and found it to be inaccurate. Following the recommendations of the last audit report, the Retirement Services Division improved internal controls to ensure that contributions are date-stamped upon receipt and deposited within the timeframe required by Section 4-32 of the General Statutes. Responsibility for these functions was re-distributed, to the Employer Reporting Unit, which has also assumed responsibility for these functions in connection with the Connecticut Municipal Employees Retirement System (CMERS). In addition to date-stamping receipts, the Employer Reporting Unit keeps detailed records of the date and disposition of contributions.

The materials provided to the division include three instances of receipts that lacked date stamps. In two of those instances, the division's detailed records on the receipt of contributions show that the deposits were made in a timely fashion."

Auditors' Concluding Comment: The division's procedure is to stamp receipts with the current date when they are received. To determine that controls are operating effectively, we relied on the stamped dates to evaluate the timeliness of deposits. We are not suggesting the unstamped receipts were not deposited in a timely manner, but that we were not able to determine, with reasonable certainty, whether the funds were deposited in accordance with the prompt deposit requirements set forth in Section 4-32 of the General Statutes.

Investigations and Recoveries (Accounts Receivable)

Criteria: It is good business practice to periodically review accounts receivable balances to determine collectability, and to write off amounts considered by management to be uncollectible.

Condition: Our audit of 20 State Employees Retirement System accounts receivable balances, totaling $662,581, disclosed 5 instances in which the balance reported on the aged receivables report did not reflect the balance per supporting documentation. The differences amounted to a $105,884 overstatement of accounts receivable.

We also noted 6 instances in which receivable balances, totaling $349,780, had been outstanding for an extended period with no evidence of recent collection attempts. These balances were outstanding from 1 to 19 years.

Effect: The accounts receivable records of the State Employees Retirement System are not accurate, and therefore, the accounts receivable balance reported on the 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 consistently updated to reflect payments received. Additionally, the unit is not monitoring aged receivables reports, which would identify long-standing accounts that should be investigated and/or written off.

Prior Audit Finding: This finding has been previously reported in the last 2 audit reports covering the fiscal years ended June 30, 2009 through 2014.

Recommendation: The Office of the State Comptroller Retirement Services Division should track accounts receivable more accurately and actively follow up on the collection or write-off of inactive accounts. (See Recommendation 7.)

Agency Response: "Following the recommendations of the last audit report, the Retirement Services Division has taken steps to track accounts receivable more accurately and to follow up actively on the collection or write-off of inactive accounts. As previously reported, a full-time staff member has been assigned to review and update the Accounts Receivable database. Long-outstanding receivables are referred to the State Employees Retirement Commission (the Retirement Commission), for a determination about whether to move forward with collection efforts.

The division is currently reviewing its practices, in an effort to find additional ways to ensure that overpayments are collected and applied in a timely fashion. As a result of this review, the division has already consolidated the process of reviewing, collecting, and maintaining records of overpayments for both SERS and MERS into a single unit. The division will continue to monitor this process and improve the accuracy of the accounts receivable records of both SERS and MERS."

MUNICIPAL EMPLOYEES RETIREMENT SYSTEM

Contributions from Municipalities

Criteria: Section 4-32 of the General Statutes requires the deposit of receipts amounting to $500 or more within 24 hours. Although the funds received for the Municipal Employees Retirement Fund do not represent state revenue, the Office of the State Comptroller controls the fund, which makes Section 4-32 applicable.

Condition: Our audit of 15 contribution reports, totaling $91,879, disclosed 6 instances in which the division did not deposit contributions in a timely manner. These contributions totaled $16,487, and were deposited between 1 and 2 business days late.

In addition, we noted 3 instances in which contributions, totaling $41,187, were not stamped with a receipt date. Due to the lack of a receipt date, we were unable to determine whether the deposit of these funds occurred in a timely manner.

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

Cause: The Retirement Services Division MERS Unit did not consistently follow procedures to date stamp contribution reports when they are received.

There were insufficient controls in place to prevent the condition.

Prior Audit Finding: This finding has been previously reported in the last 2 audit reports covering the fiscal years ended June 30, 2009 through 2014.

Recommendation: The Office of the State Comptroller Retirement Services Division MERS Unit should ensure that it deposits all receipts in accordance with the provisions of Section 4-32 of the General Statutes, and should stamp all contribution reports indicating the date it received them. (See Recommendation 8.)

Agency Response: "As discussed above, the Retirement Services Division, following the recommendations of the last audit report, improved internal controls to ensure that contributions are date-stamped upon receipt and deposited within the timeframe required by Section 4-32 of the General Statutes. Responsibility for these functions was re-distributed, to the Employer Reporting Unit, which also assumed responsibility for those functions in connection with CMERS. In addition to date-stamping receipts, the Employer Reporting Unit keeps detailed records of the date and disposition of contributions."

Investigations and Recoveries (Accounts Receivable)

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

Division policy requires the periodic review of accounts receivable balances to determine collectability. Management should write off amounts determined to be uncollectible. It also states that, "if a member is deceased or dies prior to total repayment and if such action is permitted by the payment election option chosen by the member, the Commission may attempt to continue to collect repayment from the member's contingent annuitant or contingent annuitant's monthly benefit entitlement." It goes on to say, "However, if the annuitant refuses to agree to a reduction in payment, the Commission will not seek repayment directly from the annuitant but may seek to collect the overpayment from the member's estate."

Condition: Our audit of 15 Municipal Employees Retirement System accounts receivable balances, with an aggregate original balance due of $442,258, disclosed 2 instances in which the MERS Unit did not follow up on the collection of $52,189 in overpayments in a timely manner. At the time of our audit, these balances had been outstanding from 2 to 3 years.

In addition, we noted 2 instances, totaling $28,659, in which the division has not acted on overpayments due to waiver requests that have been outstanding between 1 and 2 years.

Furthermore, we noted that when retirees passed away and owed MERS a refund, the contingent annuitants were not informed that they did not have to repay the overpayment. Instead, the contingent annuitants received letters that generally stated the amount overpaid and the repayment options. Those options were a lump-sum payment, benefit reductions for a set amount of time, or the opportunity to seek a waiver.

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

Cause: There were insufficient controls in place to prevent the condition.

Prior Audit Finding: This finding has been previously reported in the last audit report covering the fiscal years ended June 30, 2012 through 2014.

Recommendation: The Office of the State Comptroller Retirement Services Division MERS Unit should continue to clear old cases and actively pursue all types of overpayments for repayment or write-off. It also should modify or add language to the repayment letters informing the contingent annuitants or the estates of the deceased retirees that they are not required to repay the overpayment. (See Recommendation 9.)

Agency Response: "As noted above, the Retirement Services Division, following the recommendations of the last audit report, has taken steps to track accounts receivable more accurately and to follow up actively on the collection or write-off of inactive accounts. As previously reported, a full-time staff member has been assigned to review and update the Accounts Receivable database. Long-outstanding receivables are referred to the State Employees Retirement Commission (the Retirement Commission), for a determination about whether to move forward with collection efforts.

The division is currently reviewing its practices, in an effort to find additional ways to ensure that overpayments are collected and applied in a timely fashion. As a result of this review, the division has already consolidated the process of reviewing, collecting, and maintaining records of overpayments for both SERS and MERS into a single unit. The division will continue to monitor this process and improve the accuracy of the accounts receivable records of both SERS and MERS."

STATE HEALTHCARE POLICY AND BENEFIT SERVICES DIVISION

Healthcare Contributions – Outside Agencies

Background: There are various non-state agencies with employees allowed to participate in the state's retirement and healthcare programs. These agencies use accounting systems outside of Core-CT and are referred to as outside agencies.

Criteria: The 2009 SEBAC agreement required all employees hired after July 1, 2009, or with fewer than 5 years of service as of July 1, 2010, to contribute 3% of their salaries to a trust fund to contribute to the healthcare coverage of retired state employees. The required contribution must be made until the employee reaches 10 years of service.

The 2011 SEBAC V revised agreement required all employees who were not paying the 3% contribution from the 2009 agreement to begin participating.

Condition: Our review of 7 contributions from outside agencies that participated in the state's healthcare system disclosed that none of the employees from those outside agencies made the required 3% Other Post Employment Benefit (OPEB) contribution. Based on the total of $3,034,637 in wages reported in those 7 contributions, those agencies should have remitted $91,039 to the state for the required 3% OPEB contribution.

Effect: The outside agencies included in our testing did not fully comply with the requirements set forth in the 2011 SEBAC agreement. Additionally, the state is not receiving contributions to fund OPEB benefits of certain outside agency employees.

Cause: It appears that there was some confusion as to whether the contribution requirements set forth in the 2011 SEBAC agreement applied to those outside agencies. In one known instance, an agency received guidance from the Office of the Governor indicating that it did not apply to certain individuals, which appears to be in direct conflict with guidance issued by the Office of Policy and Management.

Prior Audit Finding: This finding has been previously reported in the last audit report covering the fiscal years ended June 30, 2012 through 2014.

Recommendation: The Office of the State Comptroller Healthcare Policy and Benefit Services Division should ensure that outside agencies who participate in the state's healthcare plan begin contributing the appropriate amount to the Retiree Health Care Trust Fund, as required by the 2011 SEBAC agreement. The division should also identify and collect any past contributions that should have been paid by outside agencies. (See Recommendation 10.)

Agency Response: "The auditor's report observes:

"There are various agencies that have employees that are allowed to participate in the state's retirement and healthcare programs. These agencies use accounting systems outside of Core-CT and are referred to as outside agencies." The auditor concludes that the Healthcare Policy & Benefit Services Division has failed to implement the SEBAC 2011 Agreement with respect to collection of Retiree Health Fund contributions from "from outside agencies that participate in the state's healthcare system."

Sections 5-529(a) and 5-259(e) of the General Statutes allow certain non-state employees to participate state health plans and to obtain retiree health benefits if they are receiving a pension from a state retirement system. Neither the SEBAC Agreements nor OPM directives have addressed how future retiree health benefits for such individuals are to be funded. While it might be good policy to require such groups to pay their fair share toward the cost of future retiree health benefits, thus far the requirement to do so has not been clearly addressed—either by the legislature or OPM.

For those reasons the division takes issue with the auditors finding:
(1) The auditor has not identified any legislative or other authority empowering OSC to collect Retiree Health Fund contributions from health benefit enrollees who are <u>not</u> employed by the state. An OPM directive to the effect that SEBAC 2011 Agreement shall be applied to "<u>all nonunion classified and unclassified officers and state employees in the Executive Branch."</u> (See PA 11-61, Section 165) would not –by its terms—encompass collection of retiree health fund contributions from non-state employees of outside agencies; (2) it is unclear which entity—OPM or the legislature--should address such requirement for employees of said "outside" agencies; and (3) in the absence of such authority an outside agency directing 3% of its employees' compensation to the Retiree Health Fund would risk violating Section 31-71e of the General Statutes, which prohibits an employer from withholding part of an employee's wages without written authorization or applicable law.

In prior years, the division approached the Department of Rehabilitation Services about collection of Retiree Health Fund contributions from blind vending machine operators. The Department advised that there was no requirement for its operators to do so.

In its response to prior audit reports, we believe that the division commented on the absence of legislative authority to implement collection of Retiree Health Fund contributions from outside agencies whose employees have been permitted to enroll in state health benefits. Thus far, the auditors do seem to have recognized that an OPM directive to making SEBAC 2011 Agreement applicable "to nonunion and unclassified officers and state employees in the Executive Branch" may not provide sufficient support for the action they believe is required."

RECOMMENDATIONS

Status of Prior Audit Recommendations

Our prior audit report on the Office of the State Comptroller – State Retirement Funds and State Employee Retiree Benefits covering the fiscal years ended June 30, 2012, 2013, and 2014 contained 16 recommendations. Seven have been implemented or otherwise resolved, and 9 have been repeated or restated with modifications during the current audit.

- The Retirement Services Division should ensure compliance with Section 415 of the Internal Revenue Code by ceasing all benefit payments in excess of the limitations imposed within that section. **Our current audit disclosed that further improvement is needed in this area. Therefore, the recommendation is being repeated. (See Recommendation 1.)**

- The Retirement Services Division should continue its efforts to reduce the backlog of retirement applications awaiting finalization and complete the finalization process in a timely manner. The division should also consider changing its long-standing practice of underpaying estimated retirement benefits to lower interest costs. Furthermore, the division should revise its method for calculating interest on post-benefit audit lump-sum payments. **The Retirement Services Division implemented a new pension module at the end of the audited period that addressed the backlog as well as the issue with the lump-sum interest payments. Therefore, this recommendation is not being repeated for the current audit.**

- Although the primary responsibility for tracking rehired retirees falls on the individual state agencies, the Retirement Services Division should work with those agencies to strengthen controls over the tracking process to ensure compliance with the various restrictions put on pay and length of service. It should also attempt to identify all instances in which rehired retirees exceeded the allowed 120-day working period and recoup the retirement benefits paid out to those employees during the time they were reemployed by the state. Furthermore, it should consider implementing a policy that forecloses the reemployment of retirees within a specified period of time, such as 180 days. **Our current audit disclosed that sufficient improvement has been made in this area. The recommendation is not being repeated.**

- The Retirement Services Division should review the employees identified during our audit who appeared to be ineligible to transfer into the SERS Hybrid plan and take corrective action as needed. Furthermore, the Retirement Services Division should consider reviewing all transfers into the SERS Hybrid plan to ensure that the employees who transferred into the plan were eligible. Appropriate corrective action should be taken when employees are identified who were not eligible to transfer. **The recommendation has been implemented. Therefore, the recommendation is not being repeated.**

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

- The Retirement Services Division should strengthen controls over retirement purchases to ensure compliance with the procedures set forth by the Retirement Purchasing Unit. **Our current audit disclosed that further improvement is needed in this area. The recommendation is being repeated with modification to reflect our current audit findings. (See Recommendation 4.)**

- The Retirement Services Division should improve internal controls to ensure that contributions are date-stamped upon receipt and deposited within the timeframe required by Section 4-32 of the General Statutes. In addition, it should ensure that outside agencies who participate in the state's HEP program begin contributing the appropriate amount to the Retiree Health Care Trust Fund, as required by the 2011 SEBAC agreement. The division should also identify and collect any contributions that should have been paid by outside agencies but were not. **Our current audit disclosed that sufficient improvement has not been made in this area. The recommendation is being repeated. (See Recommendation 6.)**

- The Retirement Services Division should track accounts receivable more accurately and actively follow up on the collection or write-off of inactive accounts. **Our current audit disclosed that further improvement is needed in this area. The recommendation is being repeated. (See Recommendation 7.)**

- The Retirement Services Division should revise its methodology for calculating death benefits for the beneficiaries of retired SERS plan members. Specifically, the federal tax exclusion ratio should be calculated on a case-by-case basis using the simplified method instead of the average exclusion ratio it has been using. **Our current audit disclosed that sufficient improvement has not been made in this area. Therefore, the recommendation is being repeated. (See Recommendation 3.)**

- The Retirement Services Division MERS Unit should continue to clear old deceased cases and actively pursue all types of overpayments for repayment or write-off. **Our current audit disclosed that further improvement is needed in this area. The recommendation is being repeated with modification to reflect our current audit findings. (See Recommendation 9.)**

- The Retirement Services Division MERS Unit should ensure that all receipts are deposited in accordance with the provisions of Section 4-32 of the General Statutes, and should stamp all contribution reports indicating the date the contributions were received. It also should continue to request individual employee contribution and earned interest reports from Bridgeport FFPF, and consider involving the Retirement Commission in this matter, which has the power, per Section 7-448 of the General Statutes, to levy a $100 per day fine for the failure of a municipality to furnish requested information. **Our current audit disclosed some improvement in this area. Therefore, the recommendation is being repeated with modification to reflect our current audit findings. (See Recommendation 8.)**

- The Healthcare Policy and Benefit Services Division should strengthen internal controls to prevent ineligible dependents from being assigned medical and dental coverage. Furthermore, the division should ensure the prompt removal of such dependents upon class-changing events. **Our current audit disclosed that sufficient improvement was made in this area. The recommendation is not being repeated.**

- The Healthcare Policy and Benefit Services Division should strengthen internal controls to ensure that Other Post Employment Benefit (OPEB) deductions are properly applied. It also should ensure that refunds are accurately calculated and processed in a timely manner. Furthermore, the Healthcare Policy and Benefit Services Division should attempt to recover the overpayments made in relation to some of the OPEB refunds that were noted during our audit. **Our current audit disclosed that sufficient improvement was made in this area. The recommendation is not being repeated.**

- The Retirement Services Division should request a formal opinion from the Office of the Attorney General regarding the annual benefit calculation that should be used for disability retirees who have outside earned salary or wages. The request should be specifically directed at the intent of Issue #25 of the Interest Arbitration Award between the State of Connecticut and SEBAC regarding the Connecticut State Employees Retirement System. **Our current audit disclosed that the recommendation has not been implemented. Therefore, the recommendation is being repeated. (See Recommendation 2.)**

- The Retirement Services Division should not execute any transactions that could be considered non-routine business transactions before bringing them to the attention of the Retirement Commission. The division also should recover the monies due to SERS from the higher education institutions as well as collect the proper amounts from the employees who were undercharged, and deposit those monies to the appropriate SERS Tier plans. **Our current audit disclosed some improvement in this area; however, further improvement is needed. The recommendation is being repeated with modification to reflect our current audit findings. (See Recommendation 5.)**

- The Retirement Services Division should recover the $2,344 of interest overpayments made when it returned the funds it erroneously withdrew from the Alternate Retirement Plan accounts of 2 participants who transferred to the State Employees Retirement System. **Our current audit disclosed that the recommendation has been implemented. Therefore, the recommendation is not being repeated.**

Current Audit Recommendations

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

   Comment:

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

2. **The Office of the State Comptroller Retirement Services Division should request a formal opinion from the Office of the Attorney General regarding the appropriate annual benefit calculation for disability retirees who earn outside salary or wages. The request should specifically consider the intent of Issue #25 of the Interest Arbitration Award between the State of Connecticut and SEBAC regarding the Connecticut State Employees Retirement System.**

   Comment:

   Since a 1989 interest arbitration award, the division's calculation methodology when determining the annual benefit amounts for disability retirees essentially eliminates the statutory offset provisions for retirees with outside earnings. As a result, the state may be incurring millions of dollars in unnecessary disability retirement benefit payments. It does not appear that the arbitrator intended to eliminate those statutory offset provisions.

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

   Comment:

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

4. **The Office of the State Comptroller Retirement Services Division should strengthen controls over retirement purchases to ensure compliance with the procedures set forth in state statutes and collective bargaining agreements. In addition, the division should consider implementing policies that would require the retroactive collection of contributions.**

   Comment:

   Our audit of 10 prior service purchases disclosed 5 instances in which interest was not charged. Further review disclosed that the 5 employees were part of the 136 judicial marshals affected by a memorandum of understanding retroactively reclassifying their service between July 1999 and March 2006 from non-hazardous to hazardous duty. We noted that 120 affected judicial marshals purchased additional time and were not charged interest. Additionally, none of the 136 judicial marshals were required to make catch-up contributions to the retirement fund. Instead, the division applied the change in employee contributions prospectively.

5. **The Office of the State Comptroller Retirement Services Division should recover the monies due to the State Employee Retirement System, collect the proper amounts from the undercharged employees, and deposit those monies to the appropriate SERS tier plans.**

   Comment:

   Twenty-eight employees with considerable state service time were allowed to transfer from the Alternative Retirement Plan (ARP) to various State Employee Retirement System (SERS) tier plans without transferring the appropriate amount of prior contributions to the SERS plans to support the participant's future benefits. A total of $2,681,357 is due to the various SERS tier plans.

6. **The Office of the State Comptroller Retirement Services Division should improve internal controls to ensure that it date stamps contributions upon receipt and deposits them within the time limits required by Section 4-32 of the General Statutes.**

   Comment:

   Our review of 10 contributions, totaling $38,570, disclosed 4 instances in which the division did not stamp $28,521 in receipts with a receipt date. Due to the lack of a receipt date, we were unable to determine whether the deposit of these funds occurred in a timely manner.

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

   Comment:

   Our audit disclosed 5 instances in which the balance reported on the aged receivables report did not reflect the balance per supporting documentation. The differences amounted to a $105,884 overstatement of accounts receivable. Additionally, we noted 6 instances in which receivable balances, totaling $349,780, had been outstanding for an extended period with no evidence of any recent collection attempts. These balances were outstanding from 1 to 19 years.

8. **The Office of the State Comptroller Retirement Services Division MERS Unit should ensure that it deposits all receipts in accordance with the provisions of Section 4-32 of the General Statutes, and should stamp all contribution reports indicating the date it received them.**

   Comment:

   Our audit of contributions disclosed 6 instances in which the division did not deposit a total of $16,487 in contributions in a timely manner. In these instances, the division deposited funds between 1 and 2 business days late. In addition, we noted 3 instances in which funds, totaling $41,187, were not stamped with a receipt date. Due to the lack of a receipt date, we were unable to determine whether the deposit of these funds occurred in a timely manner.

9. **The Office of the State Comptroller Retirement Services Division MERS Unit should continue to clear old cases and actively pursue all types of overpayments for repayment or write-off. It also should modify or add language to the repayment letters informing the contingent annuitants or the estates of the deceased retirees that they are not required to repay the overpayment.**

   Comment:

   Our audit disclosed 2 instances in which the MERS Unit did not follow up on the collection of $52,189 in overpayments in a timely manner. At the time of our audit, these balances had been outstanding between 2 and 3 years. We also noted 2 instances, totaling $28,659, in which the division had not acted on overpayments due to waiver requests that have been outstanding between 1 and 2 years. Furthermore, we noted that when retirees passed away and owed MERS a refund, the contingent annuitants were not informed that they were not required to repay the overpayment.

10. **The Office of the State Comptroller Healthcare Policy and Benefit Services Division should ensure that outside agencies who participate in the state's healthcare plan begin contributing the appropriate amount to the Retiree Health Care Trust Fund, as required by the 2011 SEBAC agreement. The division should also identify and collect any contributions that should have been paid by outside agencies in the past.**

    Comment:

    Our review of 7 contributions from outside agencies that participated in the state's healthcare system disclosed that none of the employees from those outside agencies made the required 3% Other Post Employment Benefit (OPEB) contribution. Based on the total of $3,034,637 in wages reported in those 7 contributions, those agencies should have remitted $91,039 to the state for the required 3% OPEB contribution.

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Kaitlyn Lucas

CONCLUSION

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

Michael J. Delaney
Principal Auditor

Approved:

John C. Geragosian
State Auditor

Robert J. Kane
State Auditor