STATE OF CONNECTICUT

AUDITORS' REPORT
TEACHERS' RETIREMENT BOARD
FOR THE FISCAL YEARS ENDED JUNE 30, 2005 and 2006

AUDITORS OF PUBLIC ACCOUNTS

KEVIN P. JOHNSTON ❖ ROBERT G. JAEKLE

Table of Contents

INTRODUCTION.....1

COMMENTS.....1
FOREWORD.....1
Significant Legislation.....3
RÉSUMÉ OF OPERATIONS.....5
Fund Accounting.....5
Teachers' Retirement Fund.....5
General Fund.....8

CONDITION OF RECORDS.....10
Financial Output Controls and Reconciliations.....10
Lack of Accounts Receivable and Payable Records Related to the Death of Retirees.....11
Accounts Receivables – Mandatory Contributions.....11
Strategic Planning.....12
Inadequate Segregation of Duties over the Annual Physical Count of the Inventory of Personal Property.....13
SAS 70 Audits of Service Providers.....13
Vulnerability Assessment.....14
Workplace Security Measures.....15
Overpayment of Monthly Administrative Fees to a Health Service Administrator.....16
Reconciliation of Checking Account.....17
Claims Audits.....18
Statutory Provisions.....19
Reemployment of Retired Teachers.....20
Health Insurance Account.....22
Accounting Procedures.....23
Other Matters.....25
Teachers Retirement Board Meetings.....25
Accounting Procedures Manual.....25
Processing Delays.....25
Retired Teachers' Benefit Plan Fund.....25

RECOMMENDATIONS.....27

CERTIFICATION.....31

CONCLUSION.....33

July 20, 2009

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We have examined the financial records of the Teachers' Retirement Board for the fiscal years ended June 30, 2005 and 2006. This report on that examination consists of the Comments, Recommendations and Certification that follow.

Financial statement presentation and auditing are done on a Statewide Single Audit basis to include all State agencies. This audit examination has been limited to reviewing this Board's compliance with laws, regulations, contracts and grants, and evaluating its internal controls.

COMMENTS

FOREWORD:

Section 10-183*l* of the General Statutes established the Teachers' Retirement Board. The Board is responsible for managing the Teachers' Retirement System, which operates generally under the provisions of Title 10, Chapter 167a of the General Statutes. The twelve member Board consists of:

- Two ex-officio members (or their designees) – Commissioners of Education and Social Services
- Five (three active and two retired teachers) system participants elected by their peers
- Five gubernatorial appointees

Pursuant to Section 10-183l of the General Statutes, Board members serve without compensation but any expenditures or loss of salary or wages incurred through their service on the board is reimbursable.

The following persons were members of the Teachers' Retirement Board at June 30, 2006:

Elected Teacher Members:
- Active Teachers:
  - Clare H Barnett, Chair
  - William T. Murray, Jr.
  - Mary Nicholas
- Retired Teachers:
  - Rosalyn B. Schoonmaker, Vice Chair
  - Marion S. Jewell

Public Members:
- Eugene Cimiano
- Deborah Freedman
- Martin M. Lilienthal
- Elaine T. Lowengard
- Thomas I. Knox, Jr. M.D

Ex Officio Members:
- Betty Sternberg, Commissioner, State Department of Education
- Patricia Wilson-Coker, Commissioner, State Department of Social Services

Darlene Perez has served as Board Secretary (Chief Administrator) since September 20, 2004. Her predecessor was William J. Sudol.

The Board administers a State subsidized defined benefit retirement system primarily for public School teachers who are employed at least half-time. These teachers are not covered by Social Security for their teaching service. It offers normal, proratable, and early retirement after a ten year vesting period. As discussed below, the Board also provides health insurance for some retired teachers and their spouses and partially reimburses towns that provide health insurance for those retirees and spouses not covered by the Board's health plan.

Membership is compulsory for public school teachers working at least one-half time in a position requiring certification by the State Board of Education. The professional staff of the State's Board of Education and the constituent units of the State's higher education system can participate or they can belong to the State Employees' Retirement system, or, if eligible employees of the State Board of Higher Education, they can belong to an alternate retirement program authorized by subsections (u) and (v) of Section 5-154 and subsection (g) of Section 5-160 of the General Statutes.

As of June 30, 2006, according to the Board's actuarial valuation there were 61,747 non-retired members of whom, 51,015 were actively teaching. Active teaching members are required to contribute seven and one quarter percent of their gross salary to the retirement fund with six percent helping to finance retirement benefits and the remaining one and one quarter percent helping to finance retirees' health insurance. The six percent is credited to the members' account balance and is refundable to members leaving the system, but the one and one quarter percent is not credited to the member's account balance and is not refundable.

Retired teachers and their spouses eligible for Medicare Part A and Part B may join the Teachers' Retirement Board's health insurance plan. The retired teacher pays a set premium for the coverage. However, this premium is subsidized by the previously discussed 1.25 percent contribution of active teachers, by State appropriations and by investment income. Retired teachers and their spouses not eligible for Medicare Part A and Part B may continue their health insurance coverage through the town that last employed them as teachers. The employer must charge the retired teacher the same premium assessed for active teachers for the type of coverage. To offset their cost, the towns are subsidized by the Board. As of June 30, 2006, the subsidy payment is $110 monthly for the retired member plus an additional $110 monthly for an enrolled spouse. The subsidies reduce the cost that the retired teacher would otherwise have had to pay to their former employer.

Except for non-retired teachers who have not taught for over 25 years, the Board annually adds interest to non-retired members' account balances. Prior to the fiscal year ended June 30, 1997, interest rates were based on the system's annual investment earnings actually received on a cash basis. After June 30, 1997, upon its actuary's advice, the Board changed to a smooth market value" basis method of calculating interest, averaging out year to year interest variances over a number of years decreasing large annual swings of interest earned. Those interest rates for the two audited years compared to the previous two years are as follows:

Fiscal year 2005-2006	9.8%	Computed on the June 30, 2005, member's account balance
Fiscal year 2004-2005	10.9%	Computed on the June 30, 2004, member's account balance
Fiscal year 2003-2004	10.8%	Computed on the June 30, 2003, member's account balance
Fiscal year 2002-2003	9.7%	Computed on the June 30, 2002, member's account balance

In the event a member's participation in the retirement system is terminated during the fiscal year, the interest rate is prorated monthly and applied to the member's balance as of the previous June 30.

The retirement system is funded by members' contributions, State contributions and investment earnings. As discussed more fully in the "Résumé of Operations" section below, State funding is actuarially determined whereas annual contributions are made to cover annual pension benefits earned by active teachers. The contribution is based on a set percentage of the teachers' payroll. (That percentage could change based on experience factors or benefit changes.) Section 10-183z of the General Statutes provides for a phase-in of full funding. Beginning in the 1992-1993 fiscal year, annual State funding was to be at 100 percent of normal (current service) cost and the unfunded past liability was to be amortized over 40 years. In addition, State contributions include amortization, over 30 years, of the unfunded liability attributed to legislation enacted after June 30, 1980, which liberalized benefits. However, as discussed in the "Résumé of Operations" section below, the required funding levels were not always achieved.

Pursuant to subsection (c) of Section 10-183l of the General Statutes, the Board is required to employ an actuary. At least once every two years the actuary is to prepare an actuarial valuation of the assets and liabilities (including the normal cost and unfunded liability). The June 30, 2006, actuarial evaluation reported an unfunded accrued liability for retirement benefits at that date of $6,922,454,893, compared with $ 5,223,799,619 at June 30, 2004.

Significant Legislation:

2006-2007 Legislative Session:

Public Act 07-186 This Act authorizes general obligation bonds of $2 billion to reduce the system's unfunded liability (totaling $6.9 billion as of June 30, 2006, per the actuary's report.) In any fiscal year that bonds are outstanding, the Act automatically appropriates the actuarially determined (per Section 10-183z of the General Statutes) State contributions to the Teachers

Retirement Fund. The Act eliminates the excess earning account within the Teachers' Retirement Fund. That account funded the annual cost of living adjustment (COLAs) for retirees who retired after August 31, 1992. The Act guarantees those retirees, an annual COLA by eliminating the requirement that they only get one if the excess earnings account has enough money to pay for it. The Act also reduces promised retirement COLAs for new teachers who become members of the Teachers' Retirement System on or after July 1, 2007.

2005-2006 Legislative Session:

Public Act 06-190 This Act makes several changes to the Board's programs:

- Allows towns to share cost of its early retirement incentive program with retiring teachers who accept the program. Under prior law, towns unilaterally paid 100 percent of the cost. Now, participating teachers may pay up to 50 percent. It specifies that payments must be made in a lump sum before the teachers retire, although existing law, subsection (e) of Section 10-183jj, allows payments to be made in equal annual installments.
- Allows the Board to pay a new retiree's first monthly benefit payment up to three months after the effective date of retirement. The payment must be retroactive to the retirement date.
- Allows the spouse designated as the sole beneficiary of a teacher who filed for a retirement application but dies before the retirement takes effect to choose either (1) the teacher's pre-retirement benefits, which includes either a lump sum death benefit or return of contributions, or (2) the benefit option selected by the deceased member on such retirement application.
- Allows teachers to purchase up to ten years of retirement service credit for service in the Volunteers in Service to America (VISTA) program and public school service as a social work assistant from January 1, 1969, to December 31, 1986, inclusive. The social work purchase authorization applies only to members who became certified social workers and remained in public school service as social workers after certification.
- Changes eligibility of applicable members (retired teachers and their spouses, surviving spouses, or disabled dependents of members) to participate in the Board's health plan. Eligibility is limited to those who participate in both Medicare Part A hospital insurance and Medicare Part B medical insurance instead of just the former. Otherwise eligible members except for the lack of dual Medicare participation, are eligible to participate in the insurance plans for active teachers by the town that last employed them as a teacher.

Public Act 06-192 Subsection 13 of Public Act 06-192 amended Section 10-183v of the General Statutes regarding limits on the reemployment of retirees as public teachers. For retired teachers teaching subjects designated by the State's Department of Education as subject shortage areas, existing law provided for one year retiree's reemployment without Board approval but the second year must be Board approved. Public Act 06-192 added the condition that the town, as part of its approval request, must certify that no qualified candidate other than the retiree is available.

2004-2005 Legislative Session :

Public Act 05-10 This Act authorizes same sex couples to enter into civil unions. Section 14 and 15 of the Act extend legal rights of spouses provided for in other State statutes to civil union partners. Accordingly, civil union partners are eligible for participation in the Board's health insurance, for the health insurance subsidy given to towns, for pre-retirement death benefits, etc., previously provided exclusively to spouses.

Public Act 05-98 This revision of subsection (a) of Section 10-183t of the General Statutes requires Board health plan participants to be actually participating in Medicare Part A. Subsection (a) of Section 10-183t previously had only required participants to be eligible for Medicare Part A.

RÉSUMÉ OF OPERATIONS:

Fund Accounting:

As required by generally accepted accounting principles (GAAP) for government, the Teachers' Retirement Board's financial transactions are accounted for through various State funds and within the General Fund by specific appropriation accounts within the budget established by the State Legislature. Unless changed, the budget establishes spending limits. Section 10-183r of the General Statutes provides for funding of the system as follows:

1. Administrative expenses (exclusive of benefits) are paid out of legislative appropriations (i.e., General Fund).

2. Benefits are paid out of the Retirement Fund funded by members' contributions, General Fund contributions, and investment earnings.

Minor capital equipment expenditures of $2,945 and $20,025 were made from a special revenue fund (Capital Equipment Purchase Fund) during fiscal years ended June 30, 2005, and 2006, respectively, as compared to $30,870 for fiscal year ended June 30, 2004. In addition, expenditures were paid out of a capital projects fund to upgrade the Board's data processing system to comply with Health Insurance Portability and Accountability Act (HIPAA) provisions. Among other things, HIPPA requires the protection of electronically stored medical records. Protected records include names, addresses, social security numbers and account numbers. Capital Projects Fund expenditures amounted to $16,392 and $58,016 for the fiscal years ended June 30, 2005 and 2006, respectively, as compared to $77,903 for the fiscal year ended June 30, 2004. During the two years under review, the majority ($58,152) of these expenditures were for the purchase and installation of data processing hardware.

Teachers' Retirement Fund:

A comparison of the three major recurring revenue sources of the Teachers' Retirement Fund is presented below for the audited period and for the previous fiscal year:

	State Actuarial Funding	**Members Contributions**	**Investment Income**
2003-2004	$185,348,144	$210,417,889	$440,180,533
2004-2005	$185,348,143	$222,443,846	$460,613,365
2005-2006	$396,248,844	$234,089,789	$425,557,838

For the most part, member contributions consisted of the 7.25 percent salary deduction discussed earlier. Employers collect these deductions and remit them to the Board.

In addition to the amounts shown above for investment income, gains were realized from the sales of investments. These amounted to $66,792,223, $2,275,332, and $45,550,687 for the fiscal years ended June 30, 2004, 2005 and 2006, respectively.

In addition to the State's actuarial funding transfer to the Retirement Fund, which is discussed below, State General Fund contributions were made for the health insurance cost subsidy provided pursuant to Section 10-183t of the General Statutes. State health insurance contributions totaled $12,206,066, $12,881,775 and $17,638,843 for the 2003-2004, 2004-2005 and 2005-2006 fiscal years, respectively. As discussed below, this subsidy provided General Fund financing of a portion of the cost of the Board's insurance plan and the Board's subsidy to towns covering retired teachers not on the Board's plan.

Pursuant to Section 10-183z of the General Statutes, the required annual State contribution to the Teachers' Retirement Fund is determined each year by the Board's actuary. For the 2003-2004 and 2004-2005 fiscal years, the State's actual contribution provided by the budget acts fell short of the calculated required contribution. In the 2005-2006 fiscal year the State's contribution equaled the required contribution. See the following table:

	2003-2004	**2004-2005**	**2005-2006**
Actuarially determined funding	$270,544,487	$281,366,266	$396,248,625
Actual State Contributions	185,348,144	185,348,143	396,248,844
Percentage Funded	**68.51%**	**65.87%**	**100.00%**

In addition to the actuarial funding by the State, various towns funded an early retirement program pursuant to Section 10-183j of the General Statutes. Under that program, a town may pay for the cost of some un-served additional credited service time for participating teachers. Receipts attributed to the early retirement program amounted to $1,495,354, $2,456,777 and $2,802,639 for the fiscal years ended June 30, 2004, 2005 and 2006, respectively.

A summary of Fund expenditures for the fiscal years ended June 30, 2004, 2005 and 2006, is presented below for comparative purposes:

	2003-2004	**2004-2005**	**2005-2006**
Retirement benefits	$874,593,010	$964,597,731	$1,050,132,506
Health insurance benefits	52,015,360	59,138,916	63,061,247
Contribution refunds	5,571,647	8,289,668	10,823,529
Totals	**$932,180,017**	**$1,032,026,315**	**$1,124,017,282**

The number of retirees and beneficiaries receiving payments increased from 24,297 in June 2004 to 26,695 in June 2006. The rise in retirement benefits from the 2003-2004 fiscal year through the 2005-2006 fiscal year is, in part, attributable to this increase but it also in part reflects annual cost of living increases.

Pursuant to Sections 10-183(g) of the General Statutes, retirees may be eligible to receive annual cost of living (COLA) increases. Section 10-183g provides for differing COLA levels depending upon the member's retirement date. Retirees are eligible for their first annual increase in the June or January following nine months of their retirement anniversary date. Members who retired before September 1992 are eligible for an annual COLA in line with increases to the Consumer Price Index; subject however to a minimum COLA of three percent and a maximum COLA of five percent.

The calculation differs for those who retired after August 31, 1992, and the payment of such COLAs has been conditional. Subsection (n) of Section 10-183g of the General Statutes established an "excess earnings account" within the Teachers Retirement Fund. This account consists of the Fund's annual investment returns that exceeded 11.5 percent. Applicable COLAs were paid only to the extent that there is a sufficient balance in the excess earnings account. The COLA is calculated by using the percentage increase granted by the Social Security Administration. However, the annual COLA awarded can not exceed 6 percent, and if the total investment return of the Teachers' Retirement Fund is less than 8.5 percent then the COLA awarded may not exceed 1.5 percent.

As discussed under the caption "Significant Legislation", Public Act 07-186 eliminated, effective July 1, 2007, the excess earning account. Effective in the 2007-2008 fiscal year, the Act guaranties retirees who retire after August 31, 1992, an annual COLA by eliminating the provision that barred the Board from reducing the COLA in any year that the excess earnings account was insufficient to fully fund that COLA.

A summary of the COLA increases granted during the audited period and the preceding year is presented below:

	Retirees' Retirement Date	
COLA DATES	Prior to September 1992	After August 1992
January 2006	3.5%	4.1%
July 2005	3.0%	2.7%
January 2005	3.7%	2.7%
July 2004	3.0%	1.5%
January 2004	3.0%	1.5%
July 2003	3.0%	1.4%

As noted above, health insurance benefits paid on behalf of retirees increased from \$52,015,360 in the 2003-2004 fiscal year to \$59,138,916 in the 2004-2005 fiscal year, and to \$63,061,247 in the 2005-2006 fiscal year These increases in part reflect increases in the number of retirees and beneficiaries but also reflect increases in the actual cost of providing and managing healthcare systems.

Contribution refunds are paid to non retired teachers who terminate public school teaching and who wish to withdraw their cumulative account balances. Account balances consist of accumulated teacher's contributions with credited interest. By withdrawing such funds, the teacher forfeits his or her rights to any retirement benefit for that service. If the former teacher returns to public school teaching, he or she will have the option of repurchasing the forfeited service. As indicated above, contribution refunds amounted to \$8,289,668 and \$10,823,529 in the 2004-2005 and 2005-2006 fiscal years, respectively.

As discussed above, an excess earnings account had been established to allocate part of Fund resources for possible COLA payments to members who retire after August 31, 1992. Such retirees will receive otherwise eligible COLA's only to the extent that a balance exists in the account. The June 30, 2004, excess earnings account balance was $1,460,197,593. As of July 1, 2006, it had increased to $1,591,025,496.

In 1989, a Health Insurance Premium Account was established within the Teachers' retirement Fund to help provide subsidized health insurance for retired teachers and their spouses. Beginning with the 1989-90 school year, active teachers were required to contribute one percent of their annual salary to this account. As the number of retirees steadily increased along with costs to the plan, the account balance continued to decline. The Board ensured solvency by increasing deductibles and co-payments and teachers' contributions and by obtaining additional State funding. Effective July 1, 2004, the active teacher contribution rate was increased to one and one quarter percent. Beginning July 1, 2005, retired teachers, the State and the Health Insurance Premium Account are required to pay one-third each of the costs for the Board's basic health insurance plan. Prior to July 1, 2005, retired teachers and the State each paid 25 percent of the cost. Fifty percent was paid by the Health Insurance Premium Account. The costs of optional supplemental coverage (dental, vision and hearing) are borne by the participating retired teachers. The Health Insurance Premium Account is maintained within the Teachers' Retirement Fund. The Account balance at June 30, 2004, had fallen to $4,019,010. However, as a result of these changes the balance had risen to $12,029,036 at June 30, 2005, and $20,545,453 at June 30, 2006.

The State Treasurer is custodian of the Teachers' Retirement Fund investments. A comparative summary of the cost and market values of the Fund's investments is presented below:

As of June 30	**Cost**	**Market**
2004	$6,905,825,099	$10,860,275,666
2005	$6,792,567,889	$11,392,146,654
2006	$6,853,416,477	$12,189,855,336

The bulk of the Teachers' Retirement Fund's assets consist primarily of the investments listed above. Per the State Comptroller's Comprehensive Annual Financial Reports, the net assets (assets less liabilities) amounted to $10,852,047, $11,397,213, and $12,202,652 at June 30, 2004, June 30, 2005 and June 30, 2006, respectively. The net assets figure includes Fund liabilities but does not include the actuarially determined unfunded accrued liability for retirement benefits discussed in the "Forward" section of this report. Instead that information is, pursuant to governmental accounting standards, presented in a "Schedule of Funding Progress" table that accompanies the financial reports.

General Fund:

Administrative expenses, State funding contributions, and the State health insurance subsidies are paid out of General Fund money appropriated to the Board by the General Assembly. A summary of expenditures for the fiscal years ended June 30, 2004, 2005 and 2006 is presented below for comparative purposes:

	2003-2004	2004-2005	2005-2006
Transfers to Retirement Fund			
State Funding	$185,348,144	$185,348,143	$396,248,844
Health Insurance subsidies	12,206,066	12,869,813	20,168,953
Total Transfers	197,554,210	198,217,956	416,417,797
Administrative expenses	1,838,888	1,775,106	2,051,076
Totals	$199,393,098	$199,993,062	$418,468,873

As indicated, by far the greatest payments were for transfers to the Connecticut Teachers' Retirement Fund for the State's funding contributions and health insurance cost subsidies. We discussed these payments more fully above under "Teachers' Retirement Fund."

Administrative expenses consisted primarily of personal service payments to employees that totaled $1,164,806, $1,258,896 and $1,430,573 for the fiscal years ended June 30, 2004, 2005 and 2006, respectively. This increase reflects staff increases, salary increases and cost of living adjustments.

We noted only immaterial General Fund receipts of about one thousand dollars annually. Such receipts apparently reflect cash received for providing photocopies under the Freedom of Information Act, and the reimbursement of jury duty fees paid to employees. These have apparently been treated as reductions in current expenditures.

CONDITION OF RECORDS

Areas warranting comment are presented below:

Financial Output Controls and Reconciliations:

Criteria: Good business practice requires that management should perform sufficient analytical and quantitative tests to ensure the accuracy of its records and financial reporting.

Condition: The prior audit report recommended that "The Teachers Retirement Board's management should establish and perform procedures to ensure the accurate postings of all major transactions of the Teachers Retirement Board to the accounts of the Comptroller's records." That audit noted, for instance, expenditure vouchers that were posted to the wrong expenditure account. This audit also noted expenditure errors and inconsistencies.

Subsequent to June 30, 2006, the Board established greater input controls over individual postings of receipts and expenditures. For instance, the Board established a procedure requiring management approval of Core-CT expenditure voucher entries before finalization. In addition, a procedure was established to compare daily deposits to bank statement entries to insure that all receipts are posted to Core-CT.

These individual input controls should be augmented by aggregate output controls. For instance, Core-CT receipts and expenditure totals by account should be periodically printed out and reviewed for accuracy and consistency. In addition, Core-CT receipts and expenditure totals should be reconciled to agency receipt and expenditure totals.

Effect: The implementation of financial output controls would strengthen financial reporting and accountability. For instance, a policy of reconciling Agency receipts and expenditure totals to Core-CT totals would have disclosed the discrepancy in the Agency's receipt totals in the health insurance account noted elsewhere in the "Condition of Records" section.

Cause: We did not determine cause.

Recommendation: The Board should implement output control procedures over its financial transactions including the reconciliation of its receipts and expenditure totals to Core-CT totals. (See Recommendation 1)

Agency Response: "The Teachers' Retirement Board agrees with this finding. Consequently, in December 2008, we created procedures for improved internal control of receipts and for the reconciliation of receipts. We are exploring additional financial reporting mechanisms to monitor receipts and expenditure totals."

Lack of Accounts Receivable and Payable Records Related to the Death of Retirees:

Criteria: Proper accounting and internal control require that accounts receivable and payable systems be used to trace monies due to and from the Board. The estates of deceased retirees may owe the Board money or the Board may owe money to the beneficiaries of deceased retirees.

Condition: Until April 1997 when it was stopped, the Board kept a monthly running record of accounts receivable and accounts payable related to retires' deaths. Receivables, at that time, amounted to $267,957 and payables amounted to $755,615.

Effect: Since April 1997, the Board couldn't provide account balances for these receivables and payables thus weakening financial reporting, weakening the safeguarding of State assets, and weakening the ability to match moneys due to moneys received.

Cause: The Board stopped maintaining these records because of staff time limitations; however, the Agency has indicated that the absence of accounting records has not hindered it in processing payments due or collecting receivables.

Conclusion: As of May 2008, the Board has installed separate functions in it computerized pension system (Pension Gold) to capture these receivables and payables. Accordingly, we will not repeat this recommendation but will review this area in our next audit.

Accounts Receivables – Mandatory Contributions:

Criteria: Proper accounting and internal control require that accounts receivables records be maintained to trace money due to the Board.

Pursuant to Section 10-183n of the General Statutes, during the school year, towns monthly deduct seven and one-fourth per cent of each teacher's salary. Under subsection (7) of Section 10-183b, that deduction from teachers' salary is defined as "mandatory contributions". Agency staff indicated that on some occasions employers for various reasons fail to deduct required contributions from a teacher resulting in underpayments of "mandatory contributions" from that teacher. The Board bills the teachers for the underpayment of the mandatory contributions. If the teacher pays he or she is given credit for that contribution and the associated service time. If the member doesn't pay, the associated service time is not recorded. This is done despite the wording of Section 10-183e of the General Statutes that states that a "member shall receive a month of credited service for each month of service as a teacher". That Statute appears to provide that members get full credit for their service whether or not contributions are collected by the town from their pay. However, Agency regulations (Section 10-183*l*-22) provide that a member shall receive a month of credit for each month of service for which mandatory contributions are made. Accordingly, it appears that withholding service time for the underpayment of "mandatory contributions" is appropriate. Nevertheless, because they are by law deemed mandatory, records should be maintained over these underpayments. If the teacher didn't pay for the service time but at a later date (e.g., before retirement) decides to purchase the service time, that teacher will be billed for the mandatory contributions not paid plus interest.

Condition: Although the Board has individually billed the affected teacher, accounts receivable records have not been maintained.

Effect: The total and detail of these underpayments are not available. This weakens financial accountability. Moreover, if these teachers decide to pay for that service time at a latter date (e.g., at retirement), if may be more difficult for TRB to process the payment. This is because the Board might have to contact the town for information and records, which, may not be readily available for the period in question.

Cause: We did not determine the cause.

Conclusion: We brought this situation to the Board's attention and the Board installed a separate function in it computerized pension system (Pension Gold) to capture these receivables. Accordingly, we will not make a recommendation but will review this area in the next audit.

Strategic Planning:

Criteria: A formal Strategic plan would help the Board to better clarify how it plans on meeting its written goals and objectives.

Condition: The Board has identified a number of goals and objectives to pursue. They include the following:

- Review potential new technologies & identify those that can provide cost-effective solutions to business problems.
- Build an integrated system with less duplication of effort to collect, report, and distribute information.
- Re-engineer business processes to meet business needs, including redefining job responsibilities & assignments.
- Establish and use problem-solving teams to identify and solve business process problems.
- Provide the means, such as policies, procedures, training, and supervision, to help staff implement new processes, roles, responsibilities, and technology.

During the period under review the Board did not have a Strategic Plan or a formal strategic planning process to help the Board meet its written goals and objectives.

Effect: The absence of a well developed strategic plan encourages the Board to react to short term problems, rather than to proactively identify and to plan how best to deal with, longer term threats and opportunities.

Cause: Historically the TRB has lacked the staffing and the funding needed to develop a formal strategic plan either internally, or with the help of outside consultants.

Conclusion: As of December 2008, the Board is in the process of preparing a draft of the strategic plan. Therefore a recommendation on this matter is unwarranted. We will review the finalization of the strategic plan in our next audit.

Inadequate Segregation of Duties over the Annual Physical Count of the Inventory of Personal Property:

Criteria: To adequately account for and safeguard State assets, agencies should segregate employees' duties. For instance, employees who perform physical inventory verifications should not also have custody or recordkeeping responsibility for such assets.

Condition: During the audited period, the employees responsible for the custodial and record keeping of personal property were also in charge of verifying the annual physical inventory.

Effect: Controls over the Board's property were weakened.

Cause: Agencies, like the Board with a limited staff often have difficulty in providing for adequate segregation of duties.

Conclusion: After we discussed this with the Board, they segregated duties related to the Board's personal property inventory. Accordingly, a recommendation is unwarranted but we will follow-up in our next audit to determine if the new controls are in place and are working.

SAS 70 Audits of Service Providers:

Background: Three outside service organizations process medical claims for the Board's self-insured health plan covering some retirees and retirees' spouses.

Criteria: The Board has the responsibility of monitoring that these outside organizations use adequate controls in processing the Board's medical claim payments. The most effective way to meet this responsibility is to rely on standardized "SAS 70" audits. The Statement of Auditing Standards (SAS) number 70 is authoritative guidance by the American Institute of Certified Public Accountants that provides a means of independent assurance to service organization users. Under SAS 70 an independent auditor issues a report on the service organization's controls.

Optimally, the Board should request and obtain from its service organizations "Type II SAS 70 reports", "Reports on Policies and Procedures placed in operation and test of operating effectiveness". (A type II report differs, primarily, from a type I report in that it requires that the service organization auditor do detailed testing of the service organization's controls.)

Condition: TRB did not have a procedure in place to require that its three major service providers furnish them with copies of type II SAS 70 audits on a regular basis. Nor did the TRB have a procedure in place to require that a suitable employee review such audits to identify any control weaknesses that might undermine the TRB's confidence in the accuracy of their service providers' invoices.

After we discussed this with the Agency the Board contacted its three major service providers and asked them for a copy of an up-to-date type II SAS 70 audit report. Two of the three provided such a report promptly. The third provided only a financial statement audit and apparently noted that such an audit satisfied all its other clients. However, a financial statement audit (for which the standard independent auditors' report specifically disclaims any opinion on the effectiveness of internal controls) does not provide the level of assurance that is provided by a type II SAS 70 audit.

Effect: In the absence of satisfactory type II SAS 70 audit reports that have been reviewed by a suitable employee, TRB is not able to rely upon the accuracy of its service providers' invoices. Such invoices totaled over seventy million dollars during the audited period.

Cause: TRB did not give a high enough priority to receiving and reviewing type II SAS 70 audits of its service providers on a regular basis.

Recommendation: The Board should require its service providers to furnish them with a copy of a type II SAS 70 audit on a regular basis. In addition, the Board should put in place procedures requiring SAS 70 audits to be reviewed by a suitable employee. (See Recommendation 2.)

Agency Response: "The Teachers' Retirement Board partially agrees with this finding. The Board began requesting the SAS 70 Audits of Service Providers after this requirement was brought to our attention. The auditors suggest a review of the SAS 70 audit report by a suitable employee. In the next fiscal year the agency will explore State contracts that may exist for the review of these audits."

Vulnerability Assessment

Criteria: The Board's significant and complex processes are heavily dependent on its specialized computerized system. Management is responsible for establishing and maintaining effective internal control over its operations. Consequently, management should evaluate the effectiveness of its internal controls to meet problems and threats on an ongoing basis. Inherent in this process is the performance of vulnerability assessments that identifies risks and explores vulnerability solutions. Such a process should also monitor that controls procedures are being performed by employees.

Condition: The Department does not have a systematic formal vulnerability assessment process.

Effect: Vulnerabilities that could have been anticipated and avoided by an ongoing assessment remain. This may lead to problems such as errors, inefficiencies, additional costs and fraud exposure.

Cause: The Department does not have specialized position(s) for a formal, dedicated risk and vulnerability assessment and mitigation function. However, its staff possesses the competencies required to integrate a formal vulnerability assessment and mitigation effort into its overall management process. This did not occur during the period under review, because under the pressure of a high work-load, the need for a formal vulnerability assessment was not recognized as a high priority.

Recommendation: The Board should have a systematic formal vulnerability assessment process. That process should identify risk and explore vulnerability solutions. (See Recommendation 3.)

Agency Response: "The Teachers' Retirement Board agrees with this finding. The agency recognizes the importance of a Vulnerability Assessment of its management processes and will give this recommendation a higher level of priority for the upcoming budget cycle. The Agency annually reviews the Accountability Directive Number 1, Internal Controls and Financial Management document. This document is supplied to the Auditor at the beginning of each audit cycle. We have an existing Disaster Recovery plan and will begin to develop internal control procedures regarding raw data and changes made to that data in our Pension Gold software, which we are heavily dependent on to administer benefits from this system. "

Workplace Security Measures:

Criteria: Connecticut has a "zero tolerance workplace violence policy". Pursuant to Chapter 60a of the General Statutes, the Department of Public Works (DPW) is responsible for administering statewide security in State workplaces. DPW's "Violence in the Workplace Policy and Procedures Manual" (Manual) delineates State agencies' responsibilities which include the establishment of a Threat Assessment Team and the implementation of ongoing workplace assessment and prevention strategies.

Condition: The Board has not complied with certain of the manual's requirements; for instance, it has not established a formal Threat Assessment Team.

Effect: The absence, for instance, of a formal Threat Assessment Team might weaken the Board's ability to prevent and react to workplace violence.

Cause: The Board moved into a new location in April 2008. As of December 2008, DPW is in the process of establishing security measures and devices in the new location. Once DPW finishes, the Board will be able to develop a more specific workplace security policy adapted to and augmenting DPW's general security measures.

An Agency manager told us that the Board is too small to have a formal Threat Assessment Team as required by the Manual. However, the Manual indicates that "Smaller agencies that are unable to convene a full Threat Assessment team should establish a relationship with an agency that can assist in providing resources to them."

Conclusion: No recommendation is made at this time. The next audit will review the Agency's progress in augmenting workplace security policies once DPW has finished configuring overall security measures at the Board's new workplace. Augmentations should include the development (with the help of an outside agency, if necessary) of a formal Threat Assessment Team and the implementation of workplace violation prevention strategies.

Overpayment of Monthly Administrative Fees to a Health Services Administrator

Background: TRB uses an outside administrator to manage its self-insured health care plan. It pays that administrator a monthly per capita administrative fee based on the number of retirees and retiree's spouses enrolled in the plan.

Criteria: The monthly per capita administrative fees should be based on up-to-date enrollment figures.

Condition: The Board's monthly per capita administrative fee is based on the previous month enrollment total adjusted concurrently for new enrollees, who are individually enrolled to ensure immediate coverage; but deletions for the death of enrollees are not concurrently adjusted as the Board might not find out about enrollee's deaths until two months or so after their death.

Effect: Because participant deaths are not taken off the heath plan enrollment data until, at least, one month later, TRB had been overpaying monthly administrative fees.

Cause: We did not determine cause.

Conclusion: After we discussed this with the Agency, it changed its procedure to include an adjustment for enrollees' deaths on its monthly administrative fee calculation. Accordingly, a recommendation on this matter is unwarranted.

Reconciliation of Checking Account:

Background: Responsibility for the State's banking needs lies with the State Treasurer's Office. That Office has a banking service agreement covering a number of major accounts including the Board's retirement checking account. This agreement obligates the contracted bank to provide various services such as check processing, electronic transfer processing and partial account reconciliation services.

Criteria: Proper accounting and good internal control require that the Board maintains a record of all retirement benefit checking account transactions that are independently reconciled to bank statement data in a timely manner.

Condition: The Board did not maintain comprehensive accounting records detailing the transactions and balances of the retirement benefit checking account and, because of that, reconciliations were not performed.

As part of the servicing arrangement, the servicing bank provides monthly records including the detail and balance of outstanding checks. However, there were unexplained discrepancies in that data. For example, we noted instances in which the ending outstanding checks balance in one month differed (in two cases differed significantly) from the beginning outstanding checks balance in the succeeding month without any explanatory data.

We discussed the outstanding check totals discrepancies with an employee of the bank's reconciliation unit who told us that the Agency should contact the bank promptly if discrepancies occur. Otherwise, it would be costly to the State if the bank had to review past records. The Board noted the discrepancies but did not follow-up with the bank. If TRB had maintained records detailing the transaction of the retirement checking account and compared it to the bank's transaction totals, it might have been able to determine the reason for the outstanding check total discrepancy.

Effect: This condition increases the potential for errors or undetected fraud, and weakens financial reporting.

Cause: We did not determine the cause.

Recommendation: The Board should develop and maintain accounting records for the retirement benefit checking account and reconcile these records to the bank statement totals in a timely manner. (See Recommendation 4.)

Agency Response: "The Teachers' Retirement Board agrees with this finding. The agency is in the process of exploring different mechanisms to reconcile the checking accounts. Formal procedures will be available by January 15, 2009."

Claims Audits:

Background: The Board's contract with its health services consultant provides that the consultant "will provide consulting services related to the administration of CTRB [Connecticut Teachers Retirement Board] Health Services Benefit plans."

That consultant has experience in arranging for claims audits for other clients.

Criteria: During the audited period, TRB expended in excess of $72 million in health insurance claims. TRB has a fiduciary responsibility to make regular efforts to cost-effectively identify and eliminate fraudulent and wasteful practices. One widely used approach to this end is to employ a specialist every two or three years to undertake a "claims audit" Claims audits review a percentage of claims payments made during an agreed time period identifying inappropriate claim payments for possible recoveries.

There are two ways of paying a claims audit specialist:

- Direct fee
- Splitting of income from claim recoveries.

It should be noted that hospital and medical claims (the Board's supplemental Medicare coverage plan), which amounted to approximately $30,000,000 during the audited period, are reviewed by Medicare. However, the National Center for Policy Analysis indicated that "one estimate states that fraud and abuse cost Medicare and Medicaid about $33 billion each year." In addition to fraud, Medicare overpayments might result from errors. Also, a limited claim's review is performed by the administrator who handles the Board's prescription coverage plan which paid claims of approximately $38 million during the audited period. Nonetheless, the Board might consider requesting its health service consultant to do a feasibility study of the Board arranging for its own claims audits.

Condition: TRB has not formally taken steps to arrange for a claims audit.

Effect: Claims audits arranged on a splitting of income basis would provide a low risk way to recover overpayments and would provide assurance that claim payments are appropriate.

Cause: It appears that TRB has never formally requested General Fund moneys to fund the cost of a claim audit. Under current legislation (Section 10-183r of the General Statutes) the expenses of a claims audit would be charged to the General Fund. It would make more sense to charge that expense to the health insurance premium account within the Teachers' Retirement Fund established under subsection (d) of Section 10-183t of the General Statutes. Claims audit recoveries would be deposited to that account as refunds of claims payments and the cost of obtaining such income should be charged to the account that benefits from the cost. Accordingly, TRB might consider introducing legislation revising subsection (d) of Section 10-183t to include the expenses of claims audits as allowable expenditures of the health insurance premium account.

Recommendation: The Board should explore the possibility of arranging for claims audits of its self-insured health care plans. (See Recommendation 5.)

Agency Response: "The Teachers' Retirement Board agrees with this finding. The agency will explore the possibility of arranging for claims audits of its self-insured health care plans."

Statutory Provisions:

Criteria: State Statutes should be clear, consistent, and reflect legislative intent.

Condition: We noted instances of errors and contradictions in the laws concerning the Board. For instance:

- Public Act 07-186 makes changes to retirees' cost of living allowance (COLA) provisions. In lieu of a withdrawal, retiring teachers can annuitize their supplemental and voluntary contributions. Public Act 7-186 contains a "typo" that states "except benefits based upon one per cent **of** voluntary contributions". It should state "except benefits based upon one per cent **or** voluntary contributions". The effect of the typo is to make the fixed annuity for new teachers after they retire available for COLA increases. The legislation was intended to completely exclude the fixed annuity from COLA increases but the typo provides that they would be subject to COLA increases.
- Section 10-183jj of the General Statutes as revised by Public Act 06-190 contains a contrary provision concerning payments to the Board for a retirement incentive program for teachers authorized by that Section. Subsection (a) of Section 10-183jj provides that payment shall be made in one lump sum while subsection (e) provides that payment may be made in equal annual installments payments. Subsection (e) also provides that payments by the town or members shall be made in accordance with subsection (b) of Section 10-183n. Because subsection (b) of Section 10-183n deals with continuing monthly contributions deductions from teachers' salaries it further contradicts the lump sum payment requirement in subsection (a) of Section 10-183jj.
- Subsection (d) of Section 10-183t of the General Statutes established a separate retired teachers' health insurance account (account) within the Teachers Retirement Fund. Subsection (a) of that Statute provides for the establishment of the Board's health insurance plan to cover certain eligible retirees and their spouses. Subsection (b) of that Statute provides that retired teachers not eligible for coverage under the Board's plan will be covered under the group health insurance plan maintained for active teachers by the retirees' last school board. Subsection (c) provides that TRB shall pay a subsidy to the local

school board on behalf of retired teachers who are participating in their health insurance plans. Subsection (d) also provides that the account would be used to make payments to the local school boards [subsection (c)] and for payment of premiums on behalf of retired teachers participating in the Board's health insurance plan [subsection (a)] "in an amount equal to the difference between the amount paid pursuant to said subsection (a) and the amount paid pursuant to subsection (c)…." This indicated that the account would only pay the difference between the Board's cost for retirees on its plan and the amount it paid from the account to local school boards. This is not being done and was not the intent of the legislation. The originating legislation for subsection (c) and (d) of Section 10-183t was Public Act 89-342. A stated purpose of that Act was that the Board would subsidize the local school boards on behalf of the retired teachers on their plans at the same per-person premium the Board pays for retired teachers on its basic plan. However, the Board no longer does this because section 59 of Public Act 00-187 revised subsection (c) of Section 10-183t of the General Statutes by freezing the subsidy to the local school board at the amount paid in the 1999-2000 fiscal year. However, subsection (d) was not revised to reflect this statutory change.

Effect: Statutory contradictions and errors increase the possibility that legislative intent will not be carried out.

Cause: We did not determine cause.

Conclusion: We are not making a recommendation at this time. The first law (Public Act 07-186) noted above originated with the State Treasurer's Office. That Agency indicated that it would prepare correcting legislation. The Board indicated that it would prepare correcting legislation for the other items. We will review this area in the next audit.

Reemployment of Retired Teachers:

Criteria: Section 10-183v of the General Statutes limits the reemployment of retired public school teachers in public schools and gives the Board compliance responsibilities. Reemployment limitations differ according to the subject taught. A retired teacher may teach in a subject shortage area without approval for one full year but may with the prior approval of the Board work a second year. The Board requires employing towns to report all subject shortage area reemployment hiring.

Other retirees may be temporarily employed for less than a school year but cannot be paid more than 45 percent of their former position's maximum salary. Any retiree who is paid more than the 45 percent limit is required to reimburse the Board for the excess. Towns are required to report all such employment and the retirees are required to report their service at the end of their assignment.

Condition: Records at the Connecticut Department of Education indicated that during the 2007-2008 school year, various towns hired 175 retirees without notifying the Board. (Towns did report their hiring of 230 retirees.) Retired teachers generally do not report to the Board at the end of their assignment as required. (The Board has not prepared a reporting form for those teachers.) In at least three cases, towns inappropriately paid teachers more than the 45 percent limit. At the time of reaching the limit, the Board suspended pension payments to those retirees until the end of that teaching service. This was inappropriate as the Statutes do not authorize the Board to suspend those retirees' pension. (The retirees are required to pay the Board for the amount of the excess. After we brought this situation to the Board's attention it stopped the policy of suspending these pensions.)

It should be noted that after we informed the Board that various towns failed to report the employment of 175 retirees, the Board contacted each of those towns and requested records on the employment of those retirees.

Effect: The Board's ability to enforce the requirements dealing with the reemployment of retired teachers was weakened. Moreover, noncompliance could result in extra cost to the State. This is because subsection (c) of Section 10-183v provides that upon approval by the Board of a shortage area employment, the town is responsible for the retiree's health insurance benefits cost without the Board's subsidization for that cost under Section 10-183t of the General Statutes. The amount of overpayment, if any, is not readily available.

Cause: It appears that staff time limitations contributed to this situation. In addition, the Board's inappropriate temporary suspension of pension benefits to retirees who were paid more than the 45 percent limit resulted from the Board's failure to update its procedures. At one time, the Statutes did provide for the suspension of pensions. However, that provision was repealed by Public Act 03-232, effective July 1, 2003.

Recommendation: The Board should develop procedures for an enhanced program of monitoring compliance with statutory provisions concerning the reemployment of retired public school teachers in public schools. (See Recommendation 6.)

Agency Response: "The Teachers' Retirement Board agrees with this finding. The Board sent two notices to the employing board of education requesting the reporting of retired members for the current year and one request was sent to request the reporting of employing retirees for the prior school year. Numerous reports were received from the employing board of education as a result of the extra attention spent on this issue by the Teachers' Retirement Board. We will continue to send annual requests to the employing board of educations reminding them of the reporting requirement and we will continue to address this issue at our annual training for school board personnel."

Health Insurance Account:

Criteria: The Board is responsible for administering the retired teachers' health insurance account – a major account in which significant transactions of over $100,000,000 in both receipts and disbursements were processed during the audited period.

The Board has a responsibility to maintain records documenting its transactions and such records should be readily retrievable.

Condition: During the 2005-2006 fiscal year, the Board failed to record on its health insurance account records various transfers from the General Fund amounting to approximately $2,500,000 and interest income amounting to approximately $59,000.

In April 2008, we requested the Board's paperwork related to the fiscal year 2005-2006 transfers from the General Fund to the health insurance account. As of June 2009, the Board has not given us those records.

Effect: It appears that the Board has not adequately accounted for the transactions of the health insurance account and that the balance of the health insurance account has been understated.

The transactions of the account are not properly documented because of missing records.

Cause: The Board failed to completely record all transfers from the General Fund and interest income to the health insurance account ledger.

Subsequent to the audit period, the Board moved. It appears that during the move some records were inadvertently misplaced and remained unaccounted for.

Financial reporting and reconciliation of the health insurance account would have been facilitated if it was recorded on the State Comptroller's records as a separate fund. If that had been the case, a separate fund balance would be maintained that could be reconciled to the Board's manual ledger balance. We discussed this with the State Comptroller's Office. Subsequently that Office established the account as a separate fund.

Recommendation: The Board should improve its recordkeeping over the retired teacher's health insurance account. (See Recommendation 7.)

Agency Response: "The Teachers' Retirement Board partially agrees with this finding. The Comptroller's Office already created the Fund in Core-CT, which will become fully functional in January, 2009. All transactions will be transferred to this fund making the reporting and reconciling easier in the future. We will develop procedures for this reconciliation process along with the other accounting procedures."

Accounting Procedures:

Background: During the audited period, the Board processed over $1 billion of receipts mostly in the form of wire transfers or lockbox payments going directly from the payee to the bank.

Criteria: The State Accounting Manual (SAM), requires all agencies receiving moneys to maintain a Receipts Journal which list receipts when received and includes information on the receipts' classification consisting, in this case, of teachers' six percent contributions, their one and one-half percent contributions, their voluntary payments, their personal payments for extra service credit, refunds of pension overpayments, payments for early retirement plans, etc. SAM further requires that Agencies, where feasible, prepare periodic accountability reports comparing receipts as recorded in the cash receipts journal to what should have been recorded.

Condition: During the audited period, the Board had not maintained a typical cash receipt journal in the form presented by SAM. Instead the Board's financial reporting of receipts came from a generally non detailed monthly listing of cash receipts taken from monthly bank statements adjusted for computer generated information and manual records.

Certain revenue (mandatory six percent contributions, voluntary contributions, and personal payments) are processed through the Board's computer system as increases to active teachers' account balances. (In addition, active teachers' balances are increased by credited interest and reduced by refunds or transfers from the active to retired or inactive teachers' status.) The Board does not reconcile the total changes of member balances to these underlying transactions. Likewise, the Board does not reconcile total active teachers' salaries per its computerized system to the amount of teachers' mandatory salary contributions of six percent and one and one-half percent, as recorded on a cash receipts journal.

Subsequent to the audited period, the Board implemented improved internal control procedures over receipts. However, there still exists the need for the following:

1. To separately account for town's deductions from teachers' salary for voluntary payments and installment payments deducted from teachers salaries and transmitted to the Board with Teachers' mandatory contributions, and
2. To prepare accountability reports

SAM advises that agencies desiring assistance in designing accountability reports or a receipt journal should contact the Policies Services Division of the State Comptroller.

Effect: The absence of a detailed cash receipts journal and accountability reports weakened financial reporting and accountability. For instance, using a detailed cash receipts journal together with an accountability report that reconciles transactions, including cash journal receipt totals, to the computerized total of changes of active teachers' account balances would confirm receipts and the computerized system's processing accuracy.

Recommendation: The Board should, with the assistance of the Comptroller's Office if necessary, review its accounting procedures especially concerning its need to prepare accountability reports. (See Recommendation 8.)

Agency Response: "The Teachers' Retirement Board agrees with this finding."

Other Matters:

Teachers' Retirement Board Meetings:

Our review of the minutes of the meetings of the Teachers' Retirement Board noted three instances (September 8, 2004, September 14, 2005, and September 13, 2006) , where the Administrator, who is not a Board member, acted as "Temporary Chairperson." Specifically, in each instance, the administrator, "…opened the floor to nominations for the office of chairperson…" and after a motion had been made and seconded, "…instructed the Secretary to cast one unanimous vote for…" We were told that this procedure had been followed so that no Board member would have to act as temporary Chairperson and in the process lose their opportunity to be nominated as Chairperson. We are of the opinion that it is improper for a non board member to serve, however well intentioned and however briefly, as an acting board member. We discussed this with Agency management who changed this procedure.

Accounting Procedures Manual:

The Board has a collection of numerous separate procedural statements concerning practices of its Accounting Unit. These statements should be collated together into an all-inclusive formal Accounting Unit procedures manual. If any area is not covered by these separate procedural statements, written procedures over that area should be prepared and entered into that manual.

Processing Delays:

It appears that the Agency processes teachers' retirement applications in a timely manner. However, as of August 2008, the Board had an eight months backlog in its processing of teachers' requests to purchase additional service credit. Staff indicated that there is not a delay in processing retirement applications that include a request to purchase additional service credit because these requests are given priority and not delayed. According to staff the average backlog is six to seven months but in the summer the delay is longer because available staff is dedicated to the processing of teachers' retirement applications. We were informed that the delay had been down to four months but increased because of staff turnover. Contributing to the backlog are staff shortages; the time involved in obtaining verification and documentation from other jurisdictions; and the requirement, when applicable, that teachers divest their balances from other retirement systems. The Board doesn't maintain statistical information on processing statistics (such as average time to process request, number of unprocessed forms as of certain dates, etc.) Such statistics would assist the Board in its monitoring of the Agency. We discussed this with Agency administration and they indicated that they would review the possibility of querying its computer system to generate such statistics. We will review this area in the succeeding audit.

Retired Teacher's Benefit Plan Fund:

Subsection (d) of Section 10-183t of the General Statutes established a separate teachers' health insurance premium account within the Teachers' Retirement Fund. Notwithstanding this, as noted above under the caption "Health Insurance Account", the State Comptroller, to improve financial reporting and management, changed the account to a new separate fund – Retired Teachers' Benefit Plan Fund. The State Comptroller appears to have that authority. Section 24 of Article Fourth of the Constitution of the State of Connecticut and Section 3-112 of the General Statutes authorizes the Comptroller to "prescribe the mode of keeping and rendering all public accounts". Section 3-112 of the General Statutes further provides that the Comptroller shall "Establish and maintain the accounts of the state government". Nonetheless, the State Comptroller's Office notified us that they will introduce legislation revising Subsection (d) of Section 10-183t to change the teachers' health insurance premium account within the Teachers Retirement Fund to a separate fund.

RECOMMENDATIONS

Our prior report contained a total of 14 recommendations. Of those recommendations, twelve have been substantially implemented or otherwise resolved and will not be repeated.. The status of each recommendation contained in our prior report is detailed below.

Status of Prior Audit Recommendations:

- The Teachers' Retirement Board should routinely update its current listing of retirees and participants to assure appropriate payment of health insurance subsidies and administrative fees. Appropriate action has been taken and the recommendation will not be repeated.

- The Teachers' Retirement Board should develop a system to survey members' requirements and satisfaction with service. Appropriate action has been taken and the recommendation will not be repeated.

- The Teachers' Retirement Board should perform a reconciliation of receipts to the revenue records of the State Comptroller. This recommendation is essentially being repeated, albeit, in revised form as Recommendation 1.

- The Teachers' Retirement Board should develop a formal strategic plan. The condition existed during the audit period but appropriate action was taken after the end of the audit period and consequently we are repeating the condition, which led to a resolution, but we are not repeating the recommendation.

- The Teachers' Retirement Board should prepare formal written procedures addressing the various operational phases of the Connecticut Teachers' Retirement System. Appropriate action has been taken and the recommendation will not be repeated.

- The Teachers' Retirement Board should develop and maintain accounting records for the retirement benefit checking account and reconcile these records to the bank statements in a timely manner. This recommendation is being repeated as Recommendation 4.

- The Teachers' Retirement Board needs to provide an improved accounting/audit trail over all retirement account information. Appropriate action has been taken and the recommendation will not be repeated.

- The Teachers' Retirement Board should improve the documentation and verification of its database of system participants. Appropriate action has been taken and the recommendation will not be repeated.

- The Teachers' Retirement Board should develop and implement accounts receivable and accounts payable systems that address reimbursements due to and from the Board. The Board has implemented action to address this situation. Accordingly, the recommendation will not be repeated.

- The Teachers' Retirement Board should seek a legal opinion as to whether the "smoothed market value procedure" of calculating the annual interest credit to members complies with Section 10-183b, subsection (8), of the General Statutes. This recommendation has been resolved by means of a statutory revision and will not be repeated.

- The Teachers' Retirement Board should provide proper separation of duties and supervisory oversight in the administration of the Petty Cash Account. Appropriate action has been taken and the recommendation will not be repeated.

- The Teachers' Retirement Board's management should establish and perform procedures to ensure the accurate posting of all major transactions of the Teachers' Retirement Board to the accounts of the Comptroller's records. The Board has implemented input controls over the posting of transactions. We are not repeating this recommendation.

- The Teachers' Retirement Board should implement internal controls to ensure that its equipment inventory is maintained in accordance with the equipment inventory policies and procedures as set forth in the *State of Connecticut Property Control Manual.* The condition existed during the audit period but appropriate action was taken after the end of the audit period and consequently we are repeating the condition, which led to a resolution, but we are not repeating the recommendation.

- A monthly reconciliation of the Teachers' Retirement Board's funds bank activity to Core-CT accounting activity should be performed regularly. Postings to Core-CT should be made in a timely manner. Agency procedures, should be written, reviewed, approved, and implemented to address the processing of major accounting transactions into Core-CT, and the notification to the Treasurer to transfer funds into the Retirement and Health Funds. Key Board employees should receive Core-CT training. We noted improvement. This recommendation is not being repeated.

Current Audit Recommendations:

1. **The Board should implement output control procedures over its financial transactions including the reconciliation of its receipts and expenditure totals to Core-CT totals.**

   Comments:

   We noted various expenditure classification errors and inconsistencies. The Board does not reconcile its receipts and expenditure totals to centralized State records maintained on Core-CT. The Board has implemented various data input controls. Financial reporting and accountability would be further improved by implementing output controls such as periodically printing out Core-CT expenditure and receipt totals and reviewing them for errors and consistency. Also, the Board should reconcile its receipts and expenditure totals to Core-CT totals.

2. **The Board should require its service providers to furnish them with a copy of a type II SAS 70 audit on a regular basis. In addition, the Board should put in place procedures requiring SAS 70 audits to be reviewed by a suitable employee.**

   Comments:

   The Board did not have a procedure in place to require that their three major service providers furnish them with copies of type II SAS 70 audits on a regular basis. Nor did the Board have a procedure in place to require that a suitable employee review such audits to identify any control weaknesses that might undermine the Board's confidence in the accuracy of their service providers' invoices.

3. The Board should have a systematic formal vulnerability assessment process. That process should identify risks and explore vulnerability solutions.

Comments:

The Department does not have a systematic formal vulnerability assessment and mitigation process. Management is responsible for establishing and maintaining an effective control process over its operations. Consequently, management is responsible to periodically and systematically evaluate operational vulnerabilities.

4. The Board should develop and maintain accounting records for the retirement benefits checking account and reconcile those records to bank statement totals in a timely manner.

Comments:

The Board is custodian of a major retirement disbursement checking account with a bank that provides banking services such as check processing, electronic transfer processing and partial reconciliation services. The Board has not maintained comprehensive accounting records detailing the transactions and balance of the retirement benefit checking account. Agency records were inadequate to reconcile to the bank statement balance and reconciliations were not performed.

In addition, we noted instances in which the ending outstanding checks in one month differed significantly from the beginning outstanding checks in the succeeding month. The Board's records were inadequate to reconcile to the bank's outstanding check transactions. Also the Board did not promptly notify the bank of the discrepancies for possible follow-up.

5. The Board should explore the possibility of arranging for claims audits of its self-insured health care plans.

Comments:

The Board should consider requesting its health service consultant to do a feasibility study of the Board arranging for claims audits. The study should forecast the estimated cost and potential claim recoveries. Also the Board should consider introducing legislation revising subsection (d) of Section 10-183t of the General Statutes to include the payment of claims audits as allowable expenditures of the health insurance premium account within the Teachers' Retirement Fund. Under current legislation, the expenses of a claim audit would be charged to the General Fund. However, recoveries from claims audits would be credited to the health insurance account as refunds of claims payments.

The cost of obtaining this income should be borne by the account that benefits and not the General Fund.

6. **The Board should develop procedures for an enhanced program of monitoring compliance with statutory provisions concerning the reemployment of retired public school teachers in public schools.**

   Comments:

   The Board is responsible for administering compliance with Section 10-183v of the General Statutes which places limits on reemployment of retired public school teachers in public schools. Despite requirements to the contrary, various towns reemployed 175 retired teachers to teach during the 2007-2008 school year without notifying the Board. This limited the Board's ability to ensure that required reemployment restrictions are being followed.

7. **The Board should improve its recordkeeping over the retired teachers health insurance account.**

   Comments:

   We noted that the Board failed to record on its health insurance account records transfers from the General Fund amounting to approximately $2,500,000 and interest amounting to approximately $59,000. As a result, the Board incorrectly recorded the transactions and balance of that account. In addition, paperwork related to the General Fund transfers was not available.

8. **The Board should, with the assistance of the Comptroller's Office if necessary, review its accounting procedures regarding its process of recording cash receipts and the need to prepare accountability reports.**

   Comments:

   During the audited period, the Board's cash receipts recording did not classify receipts by category and was otherwise not in keeping with State Comptroller's requirements. Nor did the Board prepare accountability reports comparing reconciling transactions to changes in members' balances or teachers' percentage of salary contributions to the total salaries of teachers recorded in the Board's computer systems. The use of a more detailed cash receipts journal together with periodic accountability reports comparing receipts per the journal to what should have been received based on total teachers' salaries and increases in active teachers' contributed balances per the Board's computerized pension system would confirm that applicable receipts are collected and that the computerized pension system is processing accurate data. Subsequent to the audit period, the Board implemented procedures improving internal control over receipts. However, there continues the need to prepare accountability reports and improve the accounting for voluntary payment and installment payment receipts from teachers processed through deductions from town payrolls and transmitted to the Board monthly with teachers' mandatory contributions. The State Comptroller's "State Accounting Manual" advises that agencies desiring assistance in designing accounting reports or a receipt journal should contact the Polices Services Division of the State Comptroller.

INDEPENDENT AUDITORS' CERTIFICATION

As required by Section 2-90 of the General Statutes we have audited the books and accounts of the Teachers' Retirement Board for the fiscal years ended June 30, 2005 and 2006. This audit was primarily limited to performing tests of the Board's compliance with certain provisions of laws, regulations, contracts and grants, and to understanding and evaluating the effectiveness of the Agency's internal control policies and procedures for ensuring that (1) the provisions of certain laws, regulations, contracts and grants applicable to the Board are complied with, (2) the financial transactions of the Agency are properly recorded, processed, summarized and reported on consistent with management's authorization, and (3) the assets of the Board are safeguarded against loss or unauthorized use. The financial statement audits of the Teachers' Retirement Board for the fiscal years ended June 30, 2005 and 2006 are included as a part of our Statewide Single Audits of the State of Connecticut for those fiscal years.

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

Compliance:

Compliance with the requirements of laws, regulations, contracts and grants applicable to the Teachers' Retirement Board is the responsibility of the management of the Teachers' Retirement Board.

As part of obtaining reasonable assurance about whether the Board complied with laws, regulations, contracts and grants, noncompliance with which could result in significant unauthorized, illegal, irregular or unsafe transactions or could have a direct and material effect on the results of the Board's financial operations for the fiscal years ended June 30, 2005 and 2006, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants. However, providing an opinion on compliance with these provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

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

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

The management of the Teachers' Retirement Board is responsible for establishing and maintaining effective internal control over its financial operations, safeguarding of assets, and compliance with the requirements of laws, regulations, contracts and grants applicable to the Board. In planning and performing our audit, we considered the Board's internal control over its financial operations, safeguarding of assets, and compliance with requirements that could have a material or significant effect on the Board's financial operations in order to determine our auditing procedures for the purpose of evaluating the Teachers' Retirement Board's financial operations, safeguarding of assets, and compliance with certain provisions of laws, regulations, contracts and grants, and not to provide assurance on the internal control over those control objectives.

However, we noted certain matters involving the internal control over the Board's financial operations, safeguarding of assets, and/or compliance that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control over the Board's financial operations, safeguarding of assets, and/or compliance that, in our judgment, could adversely affect the Board's ability to properly record, process, summarize and report financial data consistent with management's authorization, safeguard assets, and/or comply with certain provisions of laws, regulations, contracts and grants. We believe the following findings represent reportable conditions: the absence of a reconciliation of the retirement benefits checking account, the absence of a policy to regularly obtain and review "SAS 70" audit reports on its health service processing organizations, the absence of policies to obtain data on the status of the reemployment of system retirees in covered public school positions, the absence of appropriate recordkeeping over the retired teachers' health insurance account, and the absence of periodic accountability reports comparing receipts as recorded in the Board's cash receipt journal to what should have been recorded based on total teachers' salaries and the increase of contributed members' balances as recorded in its computerized pension system.

A material or significant weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with certain provisions of laws, regulations, contracts and grants or the requirements to safeguard assets that would be material in relation to the Board's financial operations or noncompliance which could result in significant unauthorized, illegal, irregular or unsafe transactions to the Board being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over the Board's financial operations and over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material or significant weaknesses. However, of the reportable conditions described above, we believe the absence of a reconciliation of the retirement benefit checking account, and the absence of a policy to regularly obtain and review "SAS 70" audit reports on its health service processing organizations, the absence of policies to obtain data on the status of the regulated reemployment of all system retirees, and the absence of appropriate recordkeeping over the retired teachers' health insurance account are material or significant weaknesses.

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

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

CONCLUSION

We wish to express our appreciation for the cooperation and courtesies extended to our representatives by the personnel of the Teachers' Retirement Board during this examination.

Charles Woolsey
Principal Auditor

Approved:

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