



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

FINANCIAL AUDIT DIVISION REPORT

**Public Employees Retirement
Association**

Financial Statement Report

Year Ended June 30, 2008

February 13, 2009

Report 09-04

FINANCIAL AUDIT DIVISION

Centennial Building – Suite 140

658 Cedar Street – Saint Paul, MN 55155

Telephone: 651-296-4708 • Fax: 651-296-4712

E-mail: auditor@state.mn.us • Web site: <http://www.auditor.leg.state.mn.us>

Through Minnesota Relay: 1-800-627-3529 or 7-1-1



OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

February 13, 2009

Representative Rick Hansen, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Members of the Public Employees Retirement Association Board of Trustees

Ms. Mary Most Vanek, Executive Director
Public Employees Retirement Association of Minnesota

In auditing the Public Employees Retirement Association's basic financial statements for the year ended June 30, 2008, we considered internal controls over financial reporting. We also tested compliance with significant legal provisions impacting the basic financial statements and identified one instance of noncompliance, detailed in Finding 1. This report contains our findings and recommendations on internal control over financial reporting. However, given the limited nature of our audit work, we do not express an overall opinion on the effectiveness of the Public Employees Retirement Association's internal controls or compliance. In addition, our work may not have identified all significant control deficiencies or instances of noncompliance with legal requirements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. This report meets the audit standard requirements of the American Institute of Certified Public Accountants and the Government Accountability Office to communicate internal control matters identified in a financial statement audit. The audit was conducted by Amy Jorgenson, (Audit Manager) and Tim Rekow, CPA, (Auditor-in-Charge), assisted by auditors Mark Allan, Kayla Peterson, CPA, and Zach Yzermans, CPA.

We consider the internal control deficiency described in Finding 1, related to the preparation of the basic financial statements, to be a material weakness. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis. We consider the internal control deficiency in Finding 2 to be a significant control deficiency. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

We discussed the results of the audit with the Public Employees Retirement Association on December 5, 2008. Management's response to our findings and recommendations is presented

in the accompanying section of this report titled, *Agency Response*. We did not audit the response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Public Employees Retirement Association's management and the Legislative Audit Commission and is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit the distribution of this report, which was released as a public document on February 13, 2009.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Cecile M. Ferkul

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

End of Fieldwork: December 18, 2008

Report Signed On: February 11, 2009

Table of Contents

	<u>Page</u>
Report Summary	1
Findings and Recommendations	3
1. PERA did not have adequate controls to ensure that employers reported and remitted the correct amount of wages and retirement contributions	3
2. Prior Finding Not Resolved: PERA did not have adequate controls to ensure computer users' access was appropriate on an ongoing basis, and it did not restrict access to some computer systems to eliminate incompatible duties.....	4
Agency Response.....	7

Report Summary

Conclusion

The Public Employees Retirement Association's (PERA) financial statements were fairly stated in all material respects. However, PERA had some weaknesses in internal control over financial reporting as noted below.

Findings

- PERA did not have adequate controls to assure that employers reported and remitted the correct amount of wages and retirement contributions.
- PERA did not have adequate controls to ensure computer users' access was appropriate on an ongoing basis, and it did not restrict access to some computer systems to eliminate incompatible duties.

Audit Scope

We audited PERA's financial statements for the fiscal year ended June 30, 2008.

Background

PERA was established in 1931 by the Minnesota Legislature. It serves local governmental entities, including cities, counties, townships, and school districts located throughout the state. PERA administers four separate retirement funds consisting of three defined benefit plans and one defined contribution plan. In 2008, PERA served as a fiscal agent for the City of Duluth to track the investments placed in a trust for the city's nonpension postemployment obligations. For financial reporting purposes, PERA is considered a pension trust fund of the State of Minnesota.

PERA had net assets totaling approximately \$18 billion at June 30, 2008. For the year ended June 30, 2008, they received contributions of about \$750 million and paid benefits and refunds of over \$1.1 billion.

Findings and Recommendations

PERA did not have adequate controls to ensure that employers reported and remitted the correct amount of wages and retirement contributions.

Finding 1

In October 2008, the City of Duluth discovered an error that had resulted in the long-term overpayment of funds to PERA by both the city and its employees. The error occurred from January 1997 through October 2008. The city had incorrectly included some employer paid benefits in its calculation of employees' base salaries. The city used this overstated salary amount to determine its employer contributions to PERA. The city also reported these incorrect base salaries to PERA, who used them to determine the employees' pensions.

According to PERA's records, the error may have affected 1,125 current City of Duluth employees, 368 former employees, and 442 city retirees receiving pension benefits. PERA is working with the City of Duluth and the Internal Revenue Service to determine the fiscal impact of this error. Retired employees may have received overstated benefits because of the error and may be required to reimburse PERA for the overpayments.

According to the *Minnesota Statutes* that regulate PERA, employer-paid fringe benefits are excluded from the definition of salary.³ In addition, PERA's benefits must be based on salary as defined in statutes, which specifically excludes employer-paid amounts to flexible spending accounts, deferred compensation plans, or amounts toward the cost of insurance coverage. In addition, *Minnesota Statutes*⁴ require PERA to refund erroneous employee deductions and adjust any retirement annuity or disability benefit computed using the erroneous salary.

PERA staff believed that extensive, up-front training was sufficient to ensure employers reported salaries and contributions appropriately. PERA did not regularly scrutinize employer contribution amounts to determine reporting accuracy, although it would on occasion follow up on specific questions. PERA did not more closely examine the City of Duluth's contributions after the city contacted PERA in 2007 to ask about what could be included in employee salary amounts.

³ *Minnesota Statutes* 2008, 353.01, subd. 10.

⁴ *Minnesota Statutes* 2008, 353.27, subd. 7 and subd. 7b.

Recommendation

- *PERA should perform reviews of participating employers to ensure they properly calculate and report eligible salary and contributions.*

Finding 2

Prior Finding Not Resolved: PERA did not have adequate controls to ensure computer users' access was appropriate on an ongoing basis, and it did not restrict access to some computer systems to eliminate incompatible duties.

PERA did not have adequate controls to ensure it provided employees with appropriate access to critical resources, such as business applications and data. More specifically, PERA lacked formal processes to:

- request, review, and authorize access for computer users;
- periodically review and recertify computer users' access; and
- notify security staff when employees leave the organization.

PERA did not have adequate documentation to help managers make informed access decisions for their staff. Such documentation would describe, in nontechnical terms, the access options available in the business application and any access combinations that would result in employees having incompatible access. Without adequate information, PERA supervisors often requested employee access to be set the same as another employee's access without explicitly defining the specific access needed to perform essential job duties. This is a high risk practice because it can lead to employees obtaining inappropriate and/or incompatible access. PERA did not have an authorized access request form on file for 18 of 20 employees sampled. Also, two employees sampled did not have access that matched the access defined in their system template.

Some employees had inappropriate access to computer systems. Of most significance, PERA did not adequately restrict system access for business system users.

- Forty-two PERA employees had incompatible access to the department's business system. Based on inquiry and analysis, these 42 employees had the ability to change a retirement member's name, address, and bank routing information without proper controls in place to monitor these changes. The business system automatically generated a letter to a member whose bank routing information was changed; however, this was not an effective mitigating control because these employees had the ability to modify member name and address information as well. The incompatible access allowed users the ability to perform various duties
-

that conflict with each other. This creates vulnerabilities within PERA that could lead to employee errors or fraud.

PERA had no controls in place to check entries or changes to a member's address or bank routing information. PERA could produce a report which showed changes in this information; however, the report was not reviewed by a supervisor or manager.

Recommendations

- *PERA should develop formal procedures to request, review, and authorize access for computer users and periodically review and recertify computer users' access.*
 - *PERA should develop security documentation which defines incompatible duties to provide guidance to managers making decisions about business system access for its employees.*
 - *PERA should establish internal controls to ensure that changes to members' personal information are authorized and correct.*
-

Public Employees Retirement Association of Minnesota

60 Empire Drive, Suite 200

Saint Paul, Minnesota 55103-2088

Member Information Services: 651-296-7460 or 1-800-652-9026

Employer Response Lines: 651-296-3636 or 1-888-892-73

PERA Fax Number: 651-297-2547 ♦ PERA Website: www.mnpera.org



February 11, 2009

James R. Nobles, Legislative Auditor
Office of the Legislative Auditor
Room 140, Centennial Office Building
658 Cedar Street
St. Paul, MN 55155-1603

Dear Mr. Nobles:

Thank you for the opportunity to review and respond to the audit you conducted for fiscal year 2008. We take audit findings very seriously, and are in the process of implementing your recommendations. Our responses to your findings and recommendations are provided below.

1. ***Finding: PERA did not have adequate controls to ensure that employers reported and remitted the correct amount of wages and retirement contributions.***

Recommendation 1: PERA should perform reviews of participating employers to ensure they properly calculate and report eligible salary and contributions.

Response: We have system controls in place that ensure the contributions we receive are calculated correctly based on the salary provided, but we do not have an effective way to ensure that employers interpret state statute correctly in regards to what should or should not be included in eligible salary. As you noted, we have an extensive training program that includes online information, employer handbooks, quarterly newsletters and training sessions conducted throughout the state.

Due to limited resources we have not conducted field audits of our 2000 participating employers. We are in the process, however, of reorganizing the work of our agency to free up the time of two employees so that we might begin conducting employer audits. By June 2009 we plan to partner with the Teachers Retirement Association and begin conducting audits of charter schools. We will then explore expanding the program to our other employers in 2010.

Resolution Date: June 30, 2010

Person Responsible: Cheryl Keating

2. *Finding: PERA did not have adequate controls to ensure computer users' access was appropriate on an ongoing basis, and it did not restrict access to some computer systems to eliminate incompatible duties.*

Recommendation 1: PERA should develop formal procedures to request, review, and authorize access for computer users and periodically review and recertify computer users' access.

Recommendation 2: PERA should develop security documentation which defines incompatible duties to provide guidance to managers making decisions about business system access for its employees.

Recommendation 3: PERA should establish internal controls to ensure that changes to members' personal information are authorized and correct.

Response: We have a process in place to request and authorize initial employee access to business systems, and we do periodically recertify that ongoing access is appropriate, but that process is not a formal, documented process. We are in the midst of formalizing and documenting that process, and expect to have it complete by the end of March 2009. That process will include the system templates to be used when setting up access to business applications. Those templates are designed to avoid incompatible duties.

We are a service agency with 42 members of the staff who rotate the responsibility for receiving hundreds of phone calls every day. Employees who answer phone calls are able to adjust member demographic information as requested by the member. We are making changes to our call center that will enable us to reduce the number of employees who are able to make changes to direct deposit information. We are also making programming changes so that benefit recipients will be able to update their own demographic information using My PERA, the members-only portion of our website, further reducing the number of changes made by staff. We will continue to explore ways we might reduce the risk of unauthorized demographic data changes.

Resolution Date: June 30, 2009

Person Responsible: Dave DeJonge

Sincerely,



Mary Most Vanek
Executive Director