



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

FINANCIAL AUDIT DIVISION REPORT

Teachers Retirement Association

Financial Statement Audit

Year Ended June 30, 2009

March 12, 2010

Report 10-07

FINANCIAL AUDIT DIVISION

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OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

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Legislative Audit Commission

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Members of the Teachers Retirement Association Board of Trustees

Ms. Laurie Fiori Hacking, Executive Director
Teachers Retirement Association of Minnesota

In auditing the Teachers Retirement Association's basic financial statements for the year ended June 30, 2009, we considered internal controls over financial reporting. We also tested compliance with significant legal provisions impacting the basic financial statements and did not identify any noncompliance to report. 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 Teachers 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 Jim Riebe, (Audit Manager) and Mark Allan, CPA, (Auditor-in-Charge), assisted by auditors Adam Spooner and Alex Weber.

We consider the deficiencies described in Findings 1 and 3 to be material weaknesses. 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 deficiency described in Finding 2 to be a significant deficiency. A significant deficiency is a deficiency, or 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 Teachers Retirement Association's management on March 5, 2010. 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 Teachers 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 March 12, 2010.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Cecile M. Ferkul

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

End of Fieldwork: January 5, 2010

Report Signed On: March 10, 2010

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Report Summary

Conclusion

The Teachers Retirement Association's (TRA) financial statements were fairly presented in all material respects. However, TRA had some weaknesses in internal control over business operations, as noted below.

Findings

- Prior Finding Partially Resolved: TRA did not identify, analyze, and document its internal controls related to business operations. ([Finding 1, page 3](#))
- Prior Finding Partially Resolved: TRA did not have adequate controls to ensure computer users' access was appropriate on an ongoing basis, and it did not implement adequate mitigating controls over incompatible access. ([Finding 2, page 5](#))
- TRA did not accurately report foreign currency risk in its financial statement footnote disclosures. ([Finding 3, page 6](#))

Audit Scope

We audited TRA's basic financial statements for the fiscal year ended June 30, 2009.

Findings and Recommendations

Prior Finding Partially Resolved:¹ TRA did not identify, analyze, and document its internal controls related to business operations.

Finding 1

TRA did not fully design and implement a comprehensive risk assessment for its business operations. TRA made improvements to its control structure in fiscal year 2009 by establishing an internal audit subcommittee of the Board of Trustees and establishing an internal audit function. In addition, TRA developed and implemented a risk assessment over financial reporting. However, TRA had not considered or addressed the following risks:

- TRA did not have sufficient control procedures in place to ensure employers reported payroll amounts based on statutory requirements. This internal control weakness increased the risk of pension contributions and retirement benefits being overstated or understated. Employers are responsible to report members' eligible salaries in accordance with *Minnesota Statutes*.² According to statute, employer-paid fringe benefits, including contributions to deferred compensation plans and insurance coverage, are excluded from the definition of salary. TRA provided extensive training to employers on how to calculate and report salary information and pension contributions. TRA also had system edits and performed some verification of employer base salaries and pension contributions to provide assurance on employer submissions. Additional control procedures, however, would further reduce the risk of inaccurate employer reporting that can result in errors in the amounts employers contribute to the pension fund and the amounts TRA later pays to annuitants.
- TRA did not have an adequate verification process to ensure that it received all payroll detail reports and contribution payments due from each employer. Although TRA could detect when it received either a payroll detail report or a payment, it did not have a process in place to notify appropriate personnel when it did not receive anything. This condition leads to a higher risk of error and fraud in employers not reporting required information or employees misappropriating receipts if TRA had not received the corresponding payroll reports. TRA received approximately \$455 million in contributions from about 580 employers during fiscal year 2009.

¹ Office of the Legislative Auditor's Financial Audit Division Report [09-05](#), *Teachers Retirement Association Financial Statement Report*, issued February 26, 2009.

² *Minnesota Statutes* 2009, 354.05, subd. 35.

- TRA did not have adequate separation of duties when employers sent payroll detail reports and checks for contributions together. Some employers submitted their payroll details and contribution checks together via US mail.³ In these cases, the same employee had custody of the payroll detail reports and checks which resulted in inadequate segregation of duties and increased the risk of errors or fraud.
- TRA did not have sufficient controls to ensure that it received the correct amount of payments related to the merger of the Minneapolis Teachers Retirement Fund into the state's fund from the City of Minneapolis, as required by statute.⁴ The City of Minneapolis underpaid its direct aids for fiscal year 2009 by approximately \$70,000, an amount immaterial to TRA's financial statements.

Department of Management and Budget's policy states that each agency head has the responsibility to identify, analyze, and manage business risks that impact an entity's ability to maintain its financial strength and the overall quality of its products and government services.⁵ This policy also requires follow-up procedures that, at a minimum, should include mechanisms for monitoring results and reporting significant control deficiencies to individuals responsible for the process or activity involved, including executive management and those individuals in a position to take corrective action. Until TRA fully designs and implements a comprehensive risk assessment, it increases the risk of errors or fraud in its business operations.

Recommendations

- *TRA should continue to develop and implement a comprehensive risk assessment over its business operations.*
- *TRA should design and implement controls to:*
 - *Provide added assurance that participating employers properly calculate and report eligible salary and contributions.*
 - *Ensure it receives all required payroll reports and pension contributions.*
 - *Establish an adequate segregation of duties over employer contributions received together with payroll reports.*
 - *Ensure that it receives the correct aid from the City of Minneapolis related to the former Minneapolis Teachers Retirement Fund.*

³ Most participating employers wire transfer the payment separately from the payroll reports.

⁴ *Minnesota Statutes* 2009, 354A.12, subd. 3a and 3b, and 423A.02, subd. 3.

⁵ Department of Management and Budget Policy Number 0102-01.

Prior Finding Partially Resolved:⁶ TRA did not have adequate controls to ensure computer users' access was appropriate on an ongoing basis, and it did not implement adequate mitigating controls over incompatible access.

Finding 2

TRA did not identify incompatible security access profiles to help managers make informed decisions about the level of access granted to their staff. TRA did make some improvements to limit access to business applications and data by resolving aspects of prior audit findings on security access. TRA had improved its processes to request, review, and authorize access for computer users; periodically review and recertify computer users' access; and notify security staff when an employee leaves the organization. However, by not identifying incompatible security profiles, TRA had the following system access weaknesses and had not developed effective mitigating controls.

- Using the same audit criteria this year as in 2008, 13 employees had incompatible access to the department's business system. (In fiscal year 2008, TRA had 38 employees with this level of incompatible access.) These 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. These incompatibilities allowed employees to modify benefit and refund payments without member knowledge. TRA's business system automatically generated a letter to a member whose bank routing information changed; however, this was not an effective mitigating control as these employees had the ability to modify members' names and addresses.
- One key employee in the contributions refund process that had physical access to refund checks also had the ability to change a retirement member's name, address, and bank routing information in the system. Granting this incompatible access increased the risk of fraudulent activity in the refund process.
- One (compared to five in 2008) of TRA's six employees with access to the state's accounting system had incompatible access. The incompatibilities allowed the employee to encumber funds, create contracts, enter purchase orders, receive goods, and make payments.

Department of Management and Budget's policy specifies that agencies should not grant access that includes incompatibilities and, in cases where incompatible functions cannot be separated, mitigating controls must be implemented and maintained.⁷

⁶ Office of the Legislative Auditor's Financial Audit Division Report [09-05](#), *Teachers Retirement Association Financial Statement Report*, issued February 26, 2009.

⁷ Department of Management and Budget Policy Number 1101-07.

Recommendations

- *TRA should identify and document system access combinations that could be incompatible.*
- *TRA should not grant system access to employees that allows incompatible duties. If incompatible duties cannot be prevented, TRA should design and document effective mitigating controls, including controls over changes to member bank information and transactions processed in the state's accounting system.*

Finding 3**TRA did not accurately report foreign currency risk in its financial statement footnote disclosures.**

TRA did not accurately disclose \$31.8 million of cash and \$10.6 million of fixed income investments as investments held in foreign currencies in its foreign currency risk footnote. Instead, TRA erroneously reported that the funds were invested in other types of foreign currencies not specified in the disclosure. TRA relied on the State Board of Investment to provide the information included in the foreign currency investment disclosure since the board invests the pension's funds. Ultimately, however, TRA is responsible for the accuracy of its financial statements and footnote disclosures.

Government accounting principles require that if a government's deposits or investments are exposed to foreign currency risk, the government should disclose the U.S. dollar balances of such deposits or investments, organized by currency denomination and, if applicable, investment type."⁸ The State Board of Investment provided the foreign currency schedule to TRA that incorrectly summarized cash and fixed income balances into an "other" denomination classification without allocating the amounts to their respective foreign currencies. However, TRA did not question the accuracy of the information received. Uncorrected, the inaccuracies in the foreign currency disclosure may have been misleading to users of TRA's financial statements.

Recommendation

- *TRA should work with the State Board of Investment to ensure the accuracy of the foreign currency risk disclosures reported in TRA's footnotes to the financial statements.*

⁸ Government Accounting Standards Board Statement 40: *Deposit and Investment Risk Disclosures*, paragraph. 17.



March 9, 2010

Mr. James R. Nobles
Legislative Auditor
Room 140 Centennial Building
658 Cedar Street
Saint Paul, MN 55155-1603

Dear Mr. Nobles:

Thank you for the opportunity to review and respond to your report on TRA's internal controls over financial reporting.

Finding #1- Prior Finding Partially Resolved:

TRA did not identify, analyze, and document its internal controls related to business operations.

Recommendation 1:

TRA should continue to develop and implement a comprehensive risk assessment over its business operations.

TRA Response:

As your report noted, TRA demonstrated substantial progress in developing a comprehensive risk assessment but we agree that additional work is necessary. The completed risk assessment will drive further improvements in TRA's internal control structure and the documentation of policies and procedures. The Internal Audit Subcommittee of the TRA Board of Trustees will review the risk assessment analysis at their April 21 meeting and approve an internal audit plan for fiscal year 2011.

TRA Responsibility: TRA Executive Team
 Leslie Nagel, Internal Auditor

Resolution Date: June 30, 2010 for risk assessment and documentation of key
 business processes. Improvements of internal controls ongoing.

Recommendation 2:

TRA should design and implement controls to:

- Provide added assurance that participating employers properly calculate and report eligible salary and contributions.
- Ensure it receives all required payroll reports and pension calculations.
- Establish an adequate segregation of duties over employer contributions received together with payroll reports.

- Ensure that it receives the correct aid from the City of Minneapolis related to the former Minneapolis Teachers Retirement Fund.

TRA Responses:

Bullet 1: TRA has established procedures and resources dedicated to the accuracy of member salary, contribution and service taught. TRA reviews member contracts and bargaining unit agreements to ensure salary reported is in compliance with TRA law. Further, the TRA Executive Director has statutory authority to conduct field audits of employers and to request additional data from the employer units to supplement the verifying of member data. We agree to improve the documentation of the processes and controls currently in place. We are currently working with the Public Employees Retirement Association (PERA) on developing school district audit strategies to improve quality and accuracy of salary and other member data. The establishment of new internal controls and auditing of school district data will be performed using a cost/benefit analysis.

Bullet 2: TRA currently uses a combination of manual and systems edits to verify statutory reporting compliance by employer units. Payroll processors within TRA are assigned to school districts and other employers. Regular communications between TRA staff and employer personnel about payroll reporting reduce the risk that payroll is missing. Enhancements to TRA's systems to improve detection of employer reporting omission are scheduled but will not be fully implemented until 2012. Until that time, mitigating controls and manual processes will be strengthened to address this risk.

TRA Responsibility: Karen Williamson, Asst. Exec. Director- Operations
Kathleen LaClair, Data Integrity Manager
Leslie Nagel, Internal Auditor

Resolution Date: Ongoing

Bullet 3: More TRA employers are opting to pay TRA contributions using electronic means resulting in a much lower volume of checks sent to TRA. We agree to document a listing of checks arriving in the office. To improve internal controls and audit trail, the listing will be performed by a person not assigned to the processing of the bank deposit. The Internal Auditor will periodically test the effectiveness of this new control procedure.

TRA Responsibility: Bob Johnson, Accounting Director
Kathleen LaClair, Data Integrity Manager
Leslie Nagel, Internal Auditor

Resolution Date: April 1, 2010

Bullet 4: TRA became the recipient of direct state and local aids when the former Minneapolis Teachers Retirement Association Fund (MTRFA) was merged into TRA in 2006. TRA management will meet with the City of Minneapolis' Board of Estimate and Taxation to resolve differences between the amount levied and the statutory required contribution.

TRA Responsibility: John Wicklund, Asst. Exec. Director- Administration
Bob Johnson, Accounting Director

Resolution Date: June 30, 2010

Finding #2- Prior Finding Partially Resolved:

TRA did not have adequate controls to ensure computer users' access was appropriate on an ongoing basis, and it did not implement adequate mitigating controls over incompatible access.

Recommendation 1:

TRA should identify and document system access combinations that could be incompatible.

TRA Response:

The process to identify incompatible systems access is already underway as part of the risk assessment process. The next annual review of systems users will be performed by the operational managers in June 2010. If incompatible access for some users is still present, alternative and mitigating controls will be established as discussed in your following recommendation.

TRA Responsibility: Karen Williamson, Asst. Exec. Director- Operations
Mark Roemhild, Systems Manager
Various Operational Managers

Resolution Date: September 30, 2010, with monitoring and testing ongoing

Recommendation 2:

TRA should not grant system access to employees that allows incompatible duties. If incompatible duties cannot be prevented, TRA should design and document effective mitigating controls, including controls over changes to member bank information and transactions processed in the state's accounting system.

TRA Response:

TRA may not be able to completely eliminate incompatible system access due to the nature of the tasks performed and current systems limitations. However, in order to reduce the risk of error or fraud, TRA is currently designing mitigating and/or compensating controls for those employees who have incompatible access. This process is being performed concurrently with the entity-wide risk assessment.

As part of the risk assessment, TRA will be documenting potential risks and controls to mitigate those risks for its key business processes. This documentation will include responsibilities and monitoring activities. TRA's Internal Auditor is coordinating the risk assessment process and will summarize and present the analysis to TRA Management, the TRA Board of Trustees and the Internal Audit Subcommittee. The results of the risk assessment process will identify areas

Mr. James R. Nobles

March 9, 2010

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within TRA that warrant further reviews of internal controls. TRA's Internal Auditor will then perform independent tests to determine whether mitigating controls established are effective at reducing risks to an acceptable level. Testing will also include substantive testing to determine whether unauthorized transactions have occurred.

Your recommendation regarding the refund of contributions process has already been resolved. Effective in June 2009, TRA no longer has physical custody of those refund warrants directly payable to members. We will also incorporate mitigating controls to address incompatible access for one employee with the state's accounting system.

TRA Responsibility: Laurie Hacking, Executive Director
Karen Williamson, Asst. Exec. Director- Operations
John Wicklund, Asst. Exec. Director- Administration
Leslie Nagel, Internal Auditor

Resolution Date: September 30, 2010, with monitoring and testing ongoing

Finding #3:

TRA did not accurately report foreign currency risk in its financial statement footnote disclosures.

Recommendation:

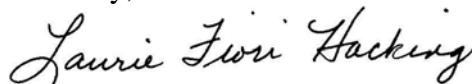
TRA should work with the State Board of Investments to ensure the accuracy of the foreign currency risk disclosures reported in TRA's footnotes to the financial statements.

TRA Response:

For several years, TRA has been reporting the foreign currency risk related to cash and fixed income investments in a summary total in the footnotes to the financial statements. When your auditors raised the issue, TRA staff immediately worked with the Minnesota State Board of Investment (SBI) to provide further detail of these asset categories, denominated in a foreign currency, by currency name. TRA's fiscal year 2009 Comprehensive Annual Financial Report (page 25) correctly reports the detailed required disclosure. Consequently, we consider the issue resolved.

Thank you for the courtesy your staff extended to TRA employees during the audit. Please contact me if you have any further questions.

Sincerely,



Laurie Fiori Hacking
Executive Director