

O L A

OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Financial Audit Division Report

**Teachers Retirement Association
of Minnesota**

Year Ended June 30, 2006



May 24, 2007

07-11

Financial Audit Division

The Office of the Legislative Auditor (OLA) is a professional, nonpartisan office in the legislative branch of Minnesota state government. Its principal responsibility is to audit and evaluate the agencies and programs of state government (the State Auditor audits local governments).

OLA's Financial Audit Division annually audits the state's financial statements and, on a rotating schedule, audits agencies in the executive and judicial branches of state government, three metropolitan agencies, and several "semi-state" organizations. The division also investigates allegations that state resources have been used inappropriately.

The division has a staff of approximately forty auditors, most of whom are CPAs. The division conducts audits in accordance with standards established by the American Institute of Certified Public Accountants and the Comptroller General of the United States.

Consistent with OLA's mission, the Financial Audit Division works to:

- Promote Accountability,
- Strengthen Legislative Oversight, and
- Support Good Financial Management.

Through its Program Evaluation Division, OLA conducts several evaluations each year.

OLA is under the direction of the Legislative Auditor, who is appointed for a six-year term by the Legislative Audit Commission (LAC). The LAC is a bipartisan commission of representatives and senators. It annually selects topics for the Program Evaluation Division, but is generally not involved in scheduling financial audits.

All findings, conclusions, and recommendations in reports issued by the Office of the Legislative Auditor are solely the responsibility of the office and may not reflect the views of the LAC, its individual members, or other members of the Minnesota Legislature.

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FINANCIAL AUDIT DIVISION

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Audit Participation

The following members of the Office of the Legislative Auditor prepared this report:

Cecile Ferkul, CPA, CISA	Deputy Legislative Auditor
Tom Donahue, CPA	Audit Manager
Patrick Phillips, CPA	Auditor-in-Charge
Tim Rekow	Auditor
Sara Becker	Auditor

Report Summary

Audit Conclusions/Finding

On December 20, 2006, we issued an unqualified opinion on the financial statements of the Teachers Retirement Association of Minnesota (TRA) as of and for the year ended June 30, 2006.

This is a related report on internal controls over financial reporting and compliance with certain legal requirements. It contains one finding concerning supplementary information in TRA's 2006 financial report that was not presented in compliance with generally accepted accounting principles.

Background Information

TRA serves as the administrator of a multi-employer, cost sharing defined benefit fund. TRA administers a basic plan (without social security coverage) and a coordinated plan (with social security coverage) in accordance with *Minnesota Statutes 2006*, Chapters 354 and 356. Its members include teachers employed in Minnesota's public elementary and secondary schools, charter schools, the Minnesota State Colleges and Universities (MnSCU) system, and all other state educational institutions, with the exception of teachers employed by the cities of Saint Paul and Duluth and the University of Minnesota. Effective June 30, 2006, the Minnesota Legislature merged the Minneapolis Teachers Retirement Fund Association into TRA. TRA provided retirement coverage for 79,164 active members, 44,683 retired members, and 11,773 deferred members (members who no longer contribute but are eligible for future annual benefits).

At June 30, 2006, TRA's total net assets held in trust for pension benefits were approximately \$17.8 billion. For the year ended June 30, 2006, TRA received contributions of about \$356 million and paid benefits and refunds of about \$1.2 billion.



**Report on Internal Control Over Financial Reporting and on
Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance With *Government Auditing Standards***

Representative Rick Hansen, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Members of the Teachers Retirement Association of Minnesota Board of Trustees

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

We have audited the financial statements of the Teachers Retirement Association of Minnesota (TRA) as of and for the year ended June 30, 2006, and have issued our report thereon dated December 20, 2006. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered TRA's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable 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 misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether TRA's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of the financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

However, we are reporting in Finding 1, an instance where TRA did not fully comply with generally accepted government accounting principles concerning the presentation of required supplementary schedules in its comprehensive annual financial report. While this instance resulted in only an explanatory paragraph in our Independent Auditor's Report, dated December 20, 2006, it should be noted that the Governmental Accounting Standards Board is currently considering changes to the presentation of the required schedules, which, if implemented, could result in an audit qualification.

This report is intended solely for the information and use of the Legislative Audit Commission and the Teachers Retirement Association of Minnesota's management 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 May 24, 2007.

/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 20, 2006

Report Signed On: May 21, 2007

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Current Finding and Recommendations

1. TRA's required supplementary information as presented in its comprehensive annual financial report did not fully comply with generally accepted accounting principles.

TRA presented certain required supplementary information according to actuarial valuations required by the Legislative Commission on Pensions and Retirement. Those actuarial valuations do not meet the requirements of the Governmental Accounting Standards Board (GASB). GASB establishes generally accepted accounting principles for government financial reporting. The schedules (the Schedule of Contributions From the Employer and Other Contributing Entities, and the Schedule of Funding Progress) included an actuarial asset valuation for part of the retirement plans' assets¹ that was not related to the market value of those assets, as required by GASB.²

GASB requires these schedules because they provide vital information about whether the plan is accumulating sufficient assets to meet its future pension obligations. A plan that is fully or over funded (a 100% funding ratio or greater) has sufficient funds to pay the retirement benefits promised to its retirees, provided that the expected investment returns are achieved. A plan that is under funded (a funding ratio less than 100%) may not have sufficient funds to meet its future pension obligations if expected investment returns are not achieved.

*Minnesota Statutes*³ state that the annual financial reports prepared by the retirement systems, including TRA, "must conform with generally accepted governmental accounting principles, applied on a consistent basis." Furthermore, *Minnesota Statutes*⁴ state that the "actuarial valuation must contain those actuarial calculations that are necessary to allow the retirement plan administration . . . to prepare the pension-related portions of its annual financial reports to meet generally accepted accounting principles for the public sector." However, the statutes and the contract with the actuary require the actuary to provide the relevant calculations in accordance with the most recent *Standards for Actuarial Work* adopted by the Legislative Commission on Pensions and Retirement. Those standards require that the assets of the Post Retirement Investment Fund "must equal the actuarial present value of projected benefits." This method of asset valuation is not in accordance with GASB requirements. Thus, the

¹ TRA's retirement assets are invested in two pools – one pool invests the funds accumulating for current employees (the active funds) and the other pool invests the funds accumulating for retirees (the Post Retirement Investment Fund). The active funds' assets were valued based on a "smoothed" market value. The Post Retirement Fund's assets were valued equal to the valuation of the Post Retirement Fund's liabilities at year end, as required by *Minnesota Statutes*. When an employee retires, TRA moves funds sufficient to fund the retirement obligation from the active funds to the Post Retirement Investment Fund. When investment returns in the Post Retirement Investment Fund are not sufficient to fund benefit obligations, a deficit in the fund occurs.

² GASB requires that the actuarial asset valuation be "market related," meaning that it can vary from market values to "smooth" increases and decreases in market values over a period of years. Although the active funds' assets were valued based on a "smoothed" market value, the Post Retirement Investment Fund's assets were valued equal to the valuation of the Post Retirement Investment Fund's liabilities at year end.

³ *Minnesota Statutes* 2006, 356.20, subd. 4.

⁴ *Minnesota Statutes* 2006, 356.215, subd. 10.

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actuary's asset valuation calculations did not provide the retirement systems with the information needed to present appropriate disclosure information.

According to TRA's estimates, from the Management Discussion and Analysis section of its comprehensive annual financial report, using the market value of the Post Retirement Investment Fund's assets to determine the plans' funding ratio would have reduced the funding ratio from 92.05% to 85.91%.

The two required supplementary schedules are not a part of TRA's basic financial statements and, therefore, we are not required to express and do not express an opinion on them.

Recommendations

- *TRA should present its required supplementary schedules in compliance with generally accepted accounting principles.*
- *TRA should work with the Public Employees Retirement Association, the Minnesota State Retirement System and its actuary to determine those actuarial valuation calculations that are necessary to prepare the pension-related portions of their annual financial reports that meet generally accepted accounting principles.*

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Status of Prior Audit Issues As of December 20, 2006

Most Recent Audit

January 26, 2006, Legislative Audit Report 06-02 covered the fiscal year ended June 30, 2005. The audit scope included employer and employee contributions, annuity benefits, and refunds. We audit TRA on an annual basis. There were no reportable issues in that report.

State of Minnesota Audit Follow-Up Process

The Department of Finance, on behalf of the Governor, maintains a quarterly process for following up on issues cited in financial audit reports issued by the Legislative Auditor. The process consists of an exchange of written correspondence that documents the status of audit findings. The follow-up process continues until Finance is satisfied that the issues have been resolved. It covers entities headed by gubernatorial appointees, including most state agencies, boards, commissions, and Minnesota state colleges and universities. It is not applied to audits of the University of Minnesota, any quasi-state organizations, such as metropolitan agencies or the State Agricultural Society, the state constitutional officers, or the judicial branch.



May 18, 2007

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

Dear Mr. Nobles:

Thank you for the opportunity to respond to your written finding contained in your financial audit report of TRA for the fiscal year ended June 30, 2006.

Finding: TRA's required supplementary information as presented in its comprehensive annual financial report did not fully comply with generally accepted accounting principles.

Recommendation 1: TRA should present its required supplementary schedules in compliance with generally accepted accounting principles.

Recommendation 2: TRA should work with the Public Employees Retirement Association, the Minnesota State Retirement System and its actuary to determine those actuarial valuation calculations that are necessary to prepare the pension-related portions of their annual financial reports that meet generally accepted accounting principles.

TRA agrees with your audit report finding and recommendations. As indicated in your report, the actuarial value of assets of the Minnesota Post Retirement Investment Fund (MPRIF) has been reported in TRA's supplementary information using a methodology that is not based on the market value of the assets. This occurred because the Legislative Commission on Pensions and Retirement (LCPR) Standards for Actuarial Work required TRA and its actuary to report the actuarial value of MPRIF assets using a now obsolete accounting methodology that was formerly, but no longer, compliant with generally accepted accounting principles (GAAP).

TRA, along with the other two statewide retirement systems, wrote to the LCPR on January 3, 2007 requesting that it change its Standards for Actuarial Work. TRA is working with the other two statewide retirement systems, the actuarial consultants, and the Legislative Commission on Pensions and Retirement (LCPR) to resolve this problem. The 2007 Omnibus Pension Bill contains a provision that requires the LCPR Standards for Actuarial Work to comply with GAAP. The LCPR Chairwoman has pledged that a hearing will be held before August to review the LCPR Actuarial Standards for Actuarial Reporting. We are recommending an asset valuation methodology that is a market-related basis and would allow TRA to present its supplementary information consistent with GAAP.

James R. Nobles
May 18, 2007
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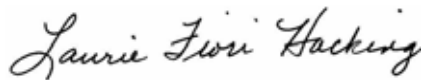
Our request to the LCPR will be to implement modifications effective for the forthcoming July 1, 2007 actuarial valuations. This change would allow TRA to produce its fiscal year 2007 Comprehensive Annual Financial Report (CAFR) in compliance with GAAP and include TRA's share of the MPRIF funding deficit in the overall TRA funding ratio.

TRA Staff Responsible: Laurie Fiori Hacking, Luther Thompson, John Wicklund

Expected Date of Resolution: December 31, 2007 upon completion of the June 30, 2007 Comprehensive Annual Financial Report.

Thank you for your work on this issue to improve the clarity and completeness of TRA's financial and actuarial reporting. If you have any further questions, please do not hesitate to contact me.

Sincerely,

A handwritten signature in cursive script that reads "Laurie Fiori Hacking".

Laurie Fiori Hacking
Executive Director