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**STATE OF RHODE ISLAND**  
**EMPLOYEES' RETIREMENT SYSTEM**  
**MANAGEMENT COMMENTS**  
**JUNE 30, 1997 AUDIT**

Ernest A. Almonte, CPA, CFE  
Auditor General

State of Rhode Island and Providence Plantations  
General Assembly  
Office of the Auditor General

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March 5, 1999

JOINT COMMITTEE ON LEGISLATIVE SERVICES:

SPEAKER John B. Harwood, Chairman

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Senator Dennis L. Algieri

Representative Gerard M. Martineau

Representative Robert A. Watson

We audited the financial statements of the Employees' Retirement System of the State of Rhode Island (the System) for the year ended June 30, 1997 and have issued our report thereon dated February 13, 1998. In accordance with *Government Auditing Standards*, we have also issued a report dated February 13, 1998 on our consideration of the System's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts.

Our report on the System's compliance and internal control over financial reporting indicated no matters that we considered to be reportable conditions or no material instances of noncompliance. However, during our audit, we noted certain matters involving compliance, internal controls, and other operational matters that are presented for your consideration. These comments and recommendations are intended to enhance compliance with laws, regulations and contracts, improve internal control, or result in other operational efficiencies.

Sincerely,

Ernest A. Almonte, CPA, CFE  
Auditor General

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## RETIREMENT INVESTMENTS

### INCOME AND RETURN OF CAPITAL TRANSACTIONS

The State's investment custodian did not properly classify certain cash distributions from the System's real estate and alternative investment managers. Both the Treasurer's Office and the custodian receive documentation from the managers to identify the distributions as either income or return of capital. However, during fiscal 1997, \$2.5 million of cash distributions were not properly classified in the custodian's records. The fiscal 1997 financial statements were adjusted to properly classify the distributions as income or return of capital.

### RECOMMENDATION

1. Improve the procedures to properly classify cash distributions as either return of capital or income.

#### Auditee Views

*Management of the System concurs with this recommendation.*

## RETIREMENT ADMINISTRATION

### DELINQUENT CONTRIBUTIONS

Pursuant to Sections 16-16-22 (d) and 45-21-42(d) of the RI General Laws, the local employers' retirement contributions for teachers and municipal employees, respectively, must be remitted on a monthly basis, by the 15th of the following month. When the employer's share of retirement contributions for teachers is overdue, Section 16-16-22 (c) of the RI General Laws authorizes the General Treasurer to deduct the amount from State aid due to the municipality. Similarly, Section 45-21-42(c) authorizes the General Treasurer to deduct the amount of overdue employer contributions for municipal employees from any moneys due the municipality from the state for any purpose other than education.

Similar to what was reported in prior audits, most cities and towns generally complied with the above state laws, and only owed for May which was due June 15. However, the employee and employer contributions from five school districts, five municipalities and three police and fire units were delinquent for more than one month as detailed below:

<u>Category</u>	<u>Employee Withholdings</u>	<u>Employer Share</u>	<u>Total Amount Delinquent</u>	<u>Representing Contributions for the following months</u>
Teachers	\$1,938,685	\$1,748,643	\$3,687,328	November 1996 - April 1997
Municipalities	260,837	58,974	319,811	October 1996 - April 1997
Police & Fire	<u>106,500</u>	<u>60,014</u>	<u>166,514</u>	January 1997 - April 1997

Total overdue                    \$2,306,022        \$1,867,631        \$4,173,653

In addition, the employers were late in submitting contributions throughout the fiscal year. When the school districts are late in submitting contributions, the State's share of contributions are also delayed because Retirement invoices the State for its share of teacher contributions only after payments are received from the municipalities. Because the municipal contributions of \$1,748,643 were overdue at June 30, 1997, State contributions of \$1,284,420 were also delayed.

### RECOMMENDATIONS

2. Notify employers of their delinquent contributions on a monthly basis and inform them that State aid will be withheld in accordance with Sections 16-16-22 and 45-21-42(c) of the RI General Laws if payments are not made timely.
3. Comply with Sections 16-16-22 and 45-21-42 of the Rhode Island General Laws if municipalities do not respond to collection efforts.

#### Auditee Views

*Management of the System concurs with these recommendations. During fiscal 1999, the Treasurer's Office withheld school aid or traffic fine payments to six municipalities until the delinquent pension contributions were made current.*

### DISTRESSED COMMUNITIES

During fiscal 1992, three municipalities were allowed to defer the employers' share of retirement contributions for school department personnel because these municipalities were determined to be distressed communities in accordance with the footnote to Section 16-7-20 of the RI General Laws. Additionally, one municipality also deferred its share of contributions to the Teachers' Survivor Benefits (TSB) fund and the federally funded share for teachers' retirement. The deferred amount plus interest, as determined through actuarial study, would be equally divided between 1994 and 2003 and paid directly by the State Department of Elementary and Secondary Education from school operations aid. The actuary calculated the interest payments using simple interest at 8 percent.

One municipality repaid its total deferral of \$932,587.33 on July 22, 1993. Another municipality repaid its deferral of \$127,730.61 for TSB and federally funded contributions by May 18, 1995. Neither community paid any interest on the deferred amounts. The Retirement Office should collect the interest due or request the Board to waive the accrued interest.

### RECOMMENDATION

4. Inquire of the Retirement Board whether the interest due should be collected or waived.

Auditee Views

*Management of the System concurs with this recommendation and will confer with the Board's counsel to determine if further legal action is appropriate.*

RECONCILIATIONS

The Retirement Office and the Office of Accounts and Control both record contributions, service credit purchases, transfers, and refunds in their respective accounting systems. As we reported in prior years, Retirement does not reconcile the balances in their accounting system to those in the State accounting system although the State accounting system is used to prepare Retirement's financial statements. Without the reconciliation process, differences between the two systems, such as those described below, will not be detected.

A police department joined the Municipal Employees' Retirement System on July 1, 1996 and made an initial contribution of \$5,205,000 for prior service costs. The Retirement System properly classified \$1,361,045 of the total as employee contributions; however, the State Accounting System misclassified the total \$5,205,000 as employer contributions. The financial statements were adjusted to properly classify the employer and employee contributions.

The Retirement Office did not bill the State \$452,083 for its share of contributions to the teachers' retirement plan. Three payrolls were omitted from the State share calculation worksheets and one was recorded incorrectly. The Retirement Office did not detect these errors because no one reconciled the worksheet used to calculate state share to the total municipal contributions posted to the Retirement System or State Accounting system. The financial statements were properly adjusted to reflect this receivable from the State.

RECOMMENDATIONS

5. Reconcile Retirement's balances to the State Accounting system balances monthly.

Auditee Views

*Management of the System concurs with this recommendation and plans to have complete reconciliation procedures in place by the end of fiscal 1999.*

6. Bill the State for \$452,083 that represents its share of teacher contributions not previously billed by Retirement.

Auditee Views

*Management of the System concurs with this recommendation and has billed the State.*

A data entry clerk in the Retirement Office enters the changes to the Retirement pension payroll; the State's Office of Library and Information Services produces a detailed monthly report on the changes made. The same data entry clerk in the Retirement Office reviews the report to verify that the changes were properly posted. For control purposes, a second person should at least reconcile the net change in gross pensions to the total changes posted.

#### RECOMMENDATION

7. Require someone independent of the person entering data to the Retirement system to reconcile the net change in gross pensions to the total changes posted.

#### Auditee Views

*Management of the System concurs with this recommendation.*

#### DISABILITY PENSIONS

As we reported in prior years, Retirement's procedures for verifying income earned in Rhode Island does not provide a good basis for income determination. Retirement obtains a listing of state withholding amounts from the R.I. Division of Taxation, but the amount of tax withheld is not an accurate reflection of income earned. In addition, the report is not useful for tracking the income earned by out-of-state pensioners. Although the "Continuing Statement of Disability" form requires all self-employed disability beneficiaries to submit a copy of their Federal tax return and all others to submit identification of their wages (W-2), this is not required by law. Unless all disabled pensioners submit their federal tax form with their W-2 form, one cannot determine if all W-2's have been submitted. All wages, including out of state wages, should be verified to determine that total earnings, including both disability benefits and personal earnings, do not exceed the amount of compensation presently paid to an individual who holds the position from which the pensioner retired.

#### RECOMMENDATION

8. Revisit the legislation and consider clarifying the laws to request federal tax returns from all pensioners who retired on disability.

#### Auditee Views

*Management of the System believes it may be difficult to achieve Board and legislative consensus necessary to reform the disability laws.*

Sections 36-10-17, 16-16-19, and 45-21-23 of the RI General Laws address reexamination of disability beneficiaries and reinstatement to active service. If a reexamination determines that a beneficiary is able to engage in a gainful occupation, the general laws require that his name be placed on

the appropriate lists of candidates for appointment to positions in his department or agency for which he is stated to be qualified, of a salary grade not exceeding that from which he was last retired.

Some employers have refused to rehire former employees unless so ordered by the courts. If the beneficiary is not rehired, although fit for work, Retirement continues to pay his benefits. In one situation, a recipient was found fit to return to work in fiscal 1995, but the town would not rehire the individual. Consequently, the recipient is still collecting a disability pension in fiscal 1997. The general laws do not address payment of disability benefits when an employer refuses to rehire a beneficiary that is able to return to work.

#### RECOMMENDATION

9. Consider clarifying the General Laws governing the payment of disability benefits when beneficiaries are subsequently determined to be fit for work.

#### Auditee Views

*Management of the System believes it may be difficult to achieve Board and legislative consensus necessary to reform the disability laws.*

#### COST OF LIVING ADJUSTMENTS (COLA)

We found five retirees from three different fire departments receiving COLA benefits that were not eligible for these benefits. Each pension plan participating in the Municipal Employees Retirement System has a unique four-digit employer code. The last two digits of the employer codes for the three fire departments were the same as the last two digits of three municipalities that were eligible for COLA benefits. Consequently, the computer program recognized the last two digits of these fire departments' codes as codes for paying COLA benefits. The system did not distinguish between a municipal code and a fire department code.

#### RECOMMENDATION

10. Correct the program to properly recognize the towns and departments that should receive COLA benefits and process payments accordingly.

#### Auditee Views

*Management of the System concurs with this recommendation and has corrected the computer program.*

#### PURCHASE OF SERVICE CREDITS

Employees may purchase retirement credit for service in the military, leaves of absence, layoffs, etc. During fiscal 1997, we tested 28 purchases. In two instances, the number of business days that

elapsed between the receipt of payment for a purchase and the date of deposit was 15 and 23 business days. Rhode Island General Law 11-28-1 requires money belonging to the State to be deposited within seven business days.

### RECOMMENDATION

11. Ensure that receipts are deposited in a timely manner.

#### Auditee Views

*Management of the System concurs with this recommendation and has assigned two employees to this process to ensure that all deposits are made daily.*

In two instances, the method used to calculate the purchase of service credits did not agree to the description provided in the applicable sections of the Rhode Island General Laws. In both cases, the dollar effect was not material, but it may indicate a procedural problem if staff is not well versed in the general laws and office policies.

One case involved the purchase of a layoff period. According to Section 36-9-26 (a) of the Rhode Island General Laws, to correctly calculate a purchase involving a layoff, the entire calculation must be based on the amount the employee would have been paid if there were no layoff. The calculation, however, was not based on the pay the employee would have received during the layoff period. The other purchase involved a restoration of a withdrawal. The employee was not charged for the full amount of the withdrawal in accordance with Rhode Island General Law 16-16-8. In both these cases, a second employee checked the calculations for the service credit purchases.

In addition, the interest amounts on service credit purchases were not uniformly calculated. In some cases, the interest was calculated from the beginning of the leave period to the date of purchase and in other cases, the interest was calculated on a different basis.

### RECOMMENDATIONS

12. Ensure that purchases are calculated according to the applicable general law.

13. Develop a consistent method for applying interest on service credits.

#### Auditee Views

*Management of the System concurs with this recommendation and is currently holding periodic training meetings for its employees. As the automated system is developed, all policies and procedures will be documented.*

## UNWRITTEN POLICIES

We reported in prior years that the Retirement Office has certain policies that have been in place for some time; however, there is no documentation of Retirement Board approval of these policies. The Retirement Board should reaffirm the following policies:

- Retirement uses a formula to determine total service credits for teachers who work less than 3/4 of the number of days each year public schools are required to be in session.
- Retiring teachers are given the option of withdrawing their survivor benefit contributions plus 5% interest compounded annually. Sections 16-16-32 and 16-6-37 of the RI General Laws state that interest will be paid and the rate will be changed from time to time, based upon the amount of interest earned by the teachers' survivors benefit fund.

## RECOMMENDATION

14. Request the Retirement Board to reaffirm both the formula used to determine total service credits for teachers and the rate used to calculate interest on survivor contributions.

### *Auditee Views*

*Management of the System believes the Board had previously approved these policies.*

## CLARIFICATION OF RHODE ISLAND GENERAL LAWS

Some of the laws pertaining to the Employees Retirement System need modification and/or clarification to meet the current needs of the System. The following are examples of certain sections of the laws that may require modification.

- a) A State employee obtained a one-year vocational education teacher's certification that enabled him to purchase five years of service to apply towards retirement. Although the certificate allows this individual to teach, this person is not employed as a teacher. This individual is currently and has been a State employee for the past 20 years. To qualify for this certificate, one must have a high school diploma, take a written and practical examination administered by the Department of Education (may be waived), complete twelve semester hours of professional education courses (six credits must be in vocational education methods and curriculum), and work at least five years in the field that one will teach. Section 16-16-6.2 of the RI General Laws allows vocational education teachers, who are employed by the State or a municipality, to purchase up to five years of service to apply towards retirement, for the length of time they spent working in the field that they are currently teaching. It is not clear whether a vocational education teacher is someone who actually teaches vocational courses to students in a classroom or anyone in possession of a vocational education certificate with appropriate work experience and whose job title falls under the broad definition of "teacher".

- b) Section 36-10-8 of the RI General Laws permits the withdrawal of contributions when state service is terminated; however, the law is silent on the payment of interest on those contributions. At one time, the law explicitly denied interest, but it was later modified and the sentence prohibiting the payment of interest was inadvertently deleted. Although the law does not specially deny interest, it does not appear to be the intent of the law to pay interest to people withdrawing from the system. At least two members have subsequently sued the Retirement Board for the payment of interest on their refunded contributions. To minimize further litigation, Retirement should request the General Assembly to modify the current legislation to explicitly state whether or not interest will be paid on contributions withdrawn from the system.
- c) Sections 8-3-16, 8-8-10.1, 28-30-8.1, and 31-43-11.1 of the RI General Laws establish restricted receipt accounts to hold in trust the retirement contributions of judges appointed after December 31, 1989. Likewise, Section 42-28-22.1 of the RI General Laws establishes a restricted receipts account to hold in trust the retirement contributions of the state police hired after July 1, 1987. There are two plans in effect for both state police and judges. State police and judges hired/appointed prior to the above dates do not contribute to the retirement plans and their pensions are paid directly from state appropriations. In contrast, the State Police and Judges hired/appointed after those dates contribute to the plan and their pensions will be paid from the contributed funds. There is a question on who actually administers the pension plans for the State Police and Judges hired after those dates. The laws empower the Retirement Board to establish rules and regulations to govern the plan; however, it is not clear if the Board administers only the contributions and the investment of those contributions. The laws do not refer to the Retirement Board when discussing the administration of pension benefits. These laws should be clarified to specifically identify who administers the above mentioned plans.
- d) Section 36-8-10.1 of the RI General Laws establishes a restricted receipt account within the State's General fund to pay the expenses of the Retirement Board and the cost of maintaining and administering the retirement system. Sections 36-8-10.1 and 45-21-42.1 of the RI General Laws authorize transfers of up to 1.5% of the investment income received by the Employees Retirement System and the Municipal Employees Retirement System, respectively, to the restricted receipt account. The amount of the transfer is limited by reference to investment income as reported in the annual report of the audited financial statements of the plans or system. Due to a change in accounting principles, the change in fair value of investments is now included as a component of net investment income. One and one-half percent of the total net investment income including change in the fair value is a significantly higher number than what was previously considered as a cap. The law requires some modifications because of this change in accounting principles.
- e) We reported in the prior year that administrative expenses incurred by both the Retirement Board and Office were charged to the State Police and Judicial retirement plans although there is no statutory authority or agreement to allow this. In fiscal year ended June 30, 1997, approximately \$822 and \$274 in administrative expenditures were charged to the State Police

and Judicial plans, respectively. The RI general laws should be modified to address administrative transfers from the State Police and Judicial retirement plans.

### RECOMMENDATION

15. Review various sections of the General Laws affecting the administration of the Retirement System and request the General Assembly to make necessary amendments.

#### Auditee Views

*Management of the System concurs that the laws require periodic revisions and it has had success in modifying certain laws. Regarding the specific items mentioned, the following should be noted:*

- a) The department will refer this issue to the Board's Legislative Sub-Committee for follow-up and possible legislation amendment.*
- b) This issue was discussed in the 1998 legislative session and will again be the subject of legislative discussion in 1999.*
- c) This issue was discussed in the 1998 legislative session and will again be the subject of legislative discussion in 1999.*
- d) The department contends that the change in accounting principle to include unrealized gains/losses as a component of investment income does not impact the calculation for funding administrative expenses because only income received will be included, as intended by the general laws.*
- e) The General Assembly considered the issue in the 1998 session, but the bill did not pass. The bill will be re-filed in 1999.*