Department of the Treasury
Division of Pensions and Benefits
Selected Pension Services

July 1, 2001 to November 1, 2003
The Honorable James E. McGreevey  
Governor of New Jersey

The Honorable Richard J. Codey  
President of the Senate

The Honorable Albio Sires  
Speaker of the General Assembly

Mr. Albert Porroni  
Executive Director  
Office of Legislative Services

Enclosed is our report on the audit of the Department of the Treasury, Division of Pensions and Benefits, Selected Pension Services for the period July 1, 2001 to November 1, 2003. If you would like a personal briefing, please call me at (609) 292-3700.

April 6, 2004
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Scope
We have completed an audit of the Department of the Treasury, Division of Pensions and Benefits, Selected Pension Services for the period July 1, 2001 to November 1, 2003. Our audit included financial activities accounted for in the Public Employees’ Retirement System (PERS), Police and Firemen’s Retirement System (PFRS), State Police Retirement System (SPRS), and Teachers’ Pension and Annuity Fund (TPAF). The scope of our audit included the following seven areas.

- Pension benefit calculations
- Unpaid loans at retirement
- Employer contributions when members are on Workers’ Compensation
- Social security number identification
- Post-retirement employment
- Disability retiree earnings
- Information technology issues

Annual expenditures of the selected pension trust funds were $4 billion. The prime responsibilities of the division are the administrative functions of the pension trust funds except for the investment of assets which is handled by the Division of Investments. Each of the pension funds’ financial statements is audited annually by an independent accounting firm.

Objectives
The objectives of our audit were to determine whether financial transactions were related to the division’s programs, were reasonable, and were recorded properly in the accounting systems. We also tested for resolution of significant conditions noted in our prior report.
This audit was conducted pursuant to the State Auditor’s responsibilities as set forth in Article VII, Section 1, Paragraph 6 of the State Constitution and Title 52 of the New Jersey Statutes.

Methodology

Our audit was conducted in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

In preparation for our testing, we studied legislation, administrative code, circular letters promulgated by the State Comptroller, and policies of the division. Provisions that we considered significant were documented and compliance with those requirements was verified by interview, observation, and through our samples of financial transactions. We also read the budget message, reviewed financial trends, and interviewed division personnel to obtain an understanding of the programs and the internal controls.

A statistical and nonstatistical sampling approach was used. Our samples of financial transactions were designed to provide conclusions about the validity of transactions as well as internal control and compliance attributes. Sample populations were sorted and transactions were randomly and judgmentally selected for testing.

To ascertain the status of significant findings included in our prior report dated August 23, 2000, we identified corrective action, if any, taken by the division and walked through the system to determine if the corrective action was effective.

Conclusions

We found that the financial transactions included in our testing were related to the division’s programs, were reasonable, and were properly recorded in the accounting systems. In making this determination, we noted certain internal control weaknesses, matters of compliance with laws and regulations, and opportunities for cost-savings merit management’s attention. We also found that the
division has resolved three of the six significant issues noted in our prior report. The unresolved issues have been updated in this report.

**Multiple Employer Pension Calculation**

An employee is considered to be a multiple member if they are employed and reported to the retirement system by more than one participating employer. In calculating a retiree’s pension for PERS, the plan utilizes years of service and salary amount. For most members, the formula to calculate the maximum annual pension is years of service divided by 55 multiplied by the average salary for the three highest years. For multiple members, all base salaries earned in a given year are combined and total years of service is used in calculating the pension. The utilization of combined salary amounts in the calculation is reasonable; however, applying total years of service to each salary component may lead to disproportionate pension benefits.

As an example, if a PERS employee was to complete 33 years of service with a final average salary of $70,000, they would receive an annual pension of $42,000. If during their last three years they were also employed in a PERS part-time position earning an additional $10,000 per year, they would receive an annual pension of $48,000. The part-time position at $10,000 per year for three years would therefore result in an annual pension increase of $6,000. If the part-time position was separately calculated based on the three years of service, it would yield a pension benefit of $545 annually or $5,455 less than the current methodology. Any provision to modify current practice would require legislative change.

For calendar year 2002, we determined that there were 1,414 PERS retirees whose pension calculations had included salaries earned from more than one employer. We randomly selected 60 of
these retirees and performed the alternate calculation which would apply actual years of service to the corresponding salary components. Our analysis projected that the alternate calculation would have resulted in savings of $6.4 million per year. The fact that there were 4,600 active PERS employees with multiple employer status as of the end of calendar year 2002 enhances the potential savings in future years if the alternate methodology was established.

**Recommendation**

We recommend the division consider requesting a legislative change affecting the multiple employer pension calculation, which would be based on years of service for each salary component.

**Auditee Response**

The division acknowledges the inflation of a member’s retirement benefit that results from allowing a part-time salary to be included in the calculation of the member’s final average salary (FAS). However, the division believes a comprehensive study of the PERS and TPAF defined benefits systems is needed. This study should include membership eligibility with respect to:

- part time employment,
- enrollment salary requirements, and
- appointed positions.

Of even greater significance are the concerns listed below that are associated with any legislated change to benefits.

**Restrictions Imposed by Chapter 113, PL 1997**

- Any change in benefits can only be imposed for members with less than five years of service.

**Administratively Burdensome**

- Changes to existing employer reporting requirements for member service and salary will
be administratively burdensome and costly to the employers and the division.

- Existing data processing systems and data collection does not support part time service, salary or benefit calculation.

- Prorating benefits based upon part-time service and salary greater adds to administrative complexity.

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**Retiree Deaths**

When a member of a pension system dies, a family member or survivor usually notifies the division and provides information necessary to determine the status of pension contributions, availability of pension benefits, and calculation of group life insurance proceeds. In regards to retiree deaths, the division reviews reports generated by the Department of the Treasury, Office of Information Technology (OIT) which match pension benefit records against death files provided by the Department of Health and Senior Services, Bureau of Vital Statistics for deaths that occur within the state and by an outside vendor for out-of-state deaths. When a match occurs, the division performs additional follow-up. If the division is able to obtain a member’s death certificate, pension benefits are terminated or paid to a surviving beneficiary in accordance with terms of their retirement agreement. If the division is unable to verify the death of the member by obtaining the death certificate, they send signature requests to be signed by the pension member and notarized. If not returned, a second request is sent out. If this request is not returned, pension benefits are suspended.

We contacted the outside vendor being utilized by the division during our audit period and supplied them with the names and social security numbers of three state employees who we knew were deceased.
They responded that all three former employees were not deceased. This condition creates a heightened risk of ineligible pension payments.

We reviewed the reports generated by OIT and judgmentally selected matches to see if the division was adequately investigating cases. Our review of 37 cases disclosed the following.

- We located a death certificate from the Bureau of Vital Statistics for one member who died in September 1989, but whose pension checks continued for almost 14 years. Signature requests mailed by the division contained inconsistent signatures and were notarized by an individual who appears to be the member’s son. The pension checks appeared to be endorsed by the same individual. This case has been referred to the Division of Criminal Justice.

- Another member who died in March 1998 had pension checks issued for another five years. Although an initial signature request and final signature request in 1999 were not returned, the division did not suspend payments. Based on the member’s address and potential date of death, we located their obituary in a March 1998 edition of a local newspaper. Further review at the Bureau of Vital Statistics found the member to be deceased per their system, although a death certificate would have to be obtained from Pennsylvania since the member died in that state. We could not trace endorsements on checks since this member used direct deposit. This case has been referred to the Division of Criminal Justice.

- We identified another member who died in May 1997 but whose pension checks are still being issued more than six years later. The division did have a signature request returned in January 1998 both signed and notarized. The pension checks were therefore not suspended. Based on the member’s address and potential date of death, we
located their obituary in a May 1997 edition of a local newspaper. Further review at the Bureau of Vital Statistics found the member to be deceased per their system, although a death certificate would have to be obtained from Pennsylvania since the member died in that state. We determined the member’s pension check dated October 1, 2003 had been cashed. This case has been referred to the Division of Criminal Justice.

- We identified a member who died in June 2001 but whose pension checks were not suspended until May 2002, a period of 11 months. Another member died in April 2002 and pension checks were not suspended until October 2002, a period of six months. Both of these deaths were supported by New Jersey Certificates of Death. Based on our review of these cases, no follow-up efforts have been made to recover the overpayments.

The three cases referred to the Division of Criminal Justice have a potential overpayment of $107,000. The results of our testing indicate that the division’s procedures should be improved to reduce erroneous payments.

**Recommendation**

We recommend the division strengthen its monitoring procedures for potential overpayments due to the deaths of retirees and recover improper payments. The utilization of obituaries and more direct involvement at the Bureau of Vital Statistics could reduce the risk of erroneous payments. The division could identify those states where a substantial number of New Jersey retirees reside and request that those states match their death files against our pension records.

**Auditee Response**

The division utilizes various methods to detect deaths of retirees that have not been reported. Our records are matched against the death files of the Bureau of Vital Statistics and a vendor specializing in this area is also retained to help us identify retiree
deaths not reported. Additionally, signature cards are randomly distributed to retirees on a periodic basis which requests the card be returned and notarized as another check to determine whether payments are being made to a deceased retiree. Any data matches or non-return of the signature cards results in further investigations.

During the past year these procedures resulted in the identification of 826 potential retiree deaths not reported. Subsequent to the identification of those retirees they were either removed from payroll or payments were suspended until confirmation of the status of the retiree was resolved. As a result, the division’s procedures for detecting unreported retiree deaths are functioning well.

The specific cases identified by the State Auditor mainly deal with cases of fraud. The division acknowledges the need to enhance our fraud detection procedures and will implement, where feasible, the recommendations of the State Auditor. Furthermore, we are currently working with the Division of Criminal Justice to help resolve these fraud cases and recover the $107,000 in funds identified. Finally, collection procedures have been initiated for any other cases identified with overpayments.

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Post-Retirement Employment

In accordance with state statutes, retirees from PERS and TPAF are permitted to work for private industry, the federal government, a government agency in another state, or a position covered by a different retirement system administered by the State of New Jersey without affecting their retirement benefits. However, prior to January 2002, any PERS retiree had to re-enroll in PERS if their annual salary in a PERS-related public employment position exceeded $10,000. As of January 2002, the retiree must re-
enroll in PERS if their aggregate salary compensation in PERS-related positions exceeded $15,000. TPAF retirees generally have to re-enroll if their position is covered by TPAF with no income limitation. We found that the division is still not monitoring re-employment as recommended in our prior report and relies on the retired member and public employer to report employment after retirement.

The division investigated the 36 PERS retirees presented in our prior report and determined that 20 of the 36 appeared to have earned over the $10,000 allowable threshold. Therefore, they should have been re-enrolled in the system and should not have received retirement benefits. The division’s investigation of the 37 TPAF retirees presented in our prior report found 16 of the cases to be acceptable. However, the division did not look into the remaining 21 cases. We have updated this finding to identify retirees re-employed during calendar year 2002.

We identified 92 PERS retirees from local governments earning wages in excess of $15,000 from local governments eligible to participate in PERS. In 54 of the 92 instances, the retiree was working for the same employer from whom they retired. During calendar year 2002, these individuals earned $2.7 million in wages while receiving $1.6 million in pension income. We also identified 20 PERS retirees earning wages in excess of $15,000 from the State of New Jersey. During calendar year 2002, these individuals earned $420,000 in wages while receiving $470,000 in pension income.

For our review of TPAF, we limited our comparison to individuals who retired from a board of education or school district and then became employed by the same type of entity. We found 131 retirees working for organizations covered by TPAF and PERS. They are collecting $6.2 million in wages while receiving $6.0 million in pension income. We found that 75 of
these individuals are working for the same employer from whom they retired. These results are conservative in that we only included wage earnings of $30,000 or more in our comparison.

The division does not have procedures to identify retirees who should re-enroll in their pension system due to post-retirement earnings in the public sector. For employers participating in multiple pension systems, the division does not have sufficient information about the re-employed retiree’s job duties to determine the pension system in which the employee should be enrolled. The division has gained access to wage reporting records from the Department of Labor, but is not yet utilizing this information to initiate investigations into post-retirement employment.

**Recommendation**

We recommend the division develop monitoring procedures which utilize wage reporting records from the Department of Labor to identify and investigate re-employment activity after retirement.

**Auditee Response**

The division has developed procedures for the detection of retirees who violate N.J.S.A. 43:15A-57.2 and N.J.S.A. 18A:66-53.2. Specifically, procedures that will identify those PERS and TPAF retirees whose post-retirement earnings exceed prescribed thresholds. The procedures have been developed in conjunction with the Department of Labor’s Division of Wage and Hour Reporting and the Office of Information Technology (OIT).

The division selected 2002 as its initial target year. Procedures developed have yet to be tested. In order to adequately administer this program, the division will be required to establish the current position of the retiree through contact with the retiree’s current employer. These employers will be contacted within the next two weeks. Once identified, the division will apply the earnings test to the three immediate prior years as well as current periods. Although the
The initial test is based on calendar year earnings, the division will administer the aforementioned earning test semi-annually thereafter.

The division plans to implement the procedures established to identify post-retirement employment violations in the upcoming months.

The State Auditor referenced exceptions noted in his prior audit report for the period July 1, 1998 to May 31, 2000. The division investigated the 36 PERS exceptions noted and found that 20 had potential merit. The 20 exceptions were referred to the PERS Board of Trustees for their review. The Board reviewed each of the cases presented and imposed various degrees of sanctions, at their discretion. In some cases, retirees provided the Board with additional information that rendered the exception moot.

The State Auditor stated that he identified 37 TPAF retirees in its prior report and further represented that the division investigated 16 of those cases. In reality, the division was presented with 17 cases of potential TPAF post-retirement violations. All were investigated and found to be in compliance.

The division should monitor annual earnings of disability retirees.

Disability Retirees - Annual Employment Earnings

According to N.J.A.C. 17:2-6.14, all disability retirees shall be required to file a report which shall include copies of their Internal Revenue Service 1040 forms, W-2 forms, and other proofs of employment indicating their gross earned income realized as of December 31 of each year. When a PERS or TPAF disability retiree’s earned income for a calendar year is greater than the difference between their pension income and the annual salary they would have received had they not become disabled,
such excess must be refunded to the appropriate pension fund. We found that the division does not monitor the disability retirees’ income earnings.

For calendar year 2002, we matched wage reporting records obtained from the Department of Labor against disability retiree pension records which were adjusted for annual cost-of-living increases. We noted 50 cases where the disability retirees should have refunded $330,000 to the pension funds due to excess earnings. This analysis was based on retirees employed within New Jersey. Additional excess amounts could exist for retirees employed out-of-state.

**Recommendation**

We recommend the division monitor income earnings of disability retirees. The division could use state resources to verify the income of in-state retirees and enforce reporting requirements to verify the income of out-of-state retirees.

**Auditee Response**

The division has developed and implemented procedures for the detection of disability retirees who violate N.J.A.C. 17:2-6.14 and N.J.A.C. 17:3-6.14. The procedures have been developed in conjunction with the Department of Labor’s Division of Wage and Hour Reporting and the Office of Information Technology (OIT).

In its initial examination, the division targeted disability retirees whose 2002 earning exceeded the prescribed limits. Once the retirees were identified, the division examined the earnings of these individuals for calendar years 1999, 2000, 2001, 2002, and 2003. In all, 37 individuals were found to be in violation of the statute (12 TPAF and 25 PERS). The division has or will assess these retirees $1,276,451.76 in excess benefits overpaid as a result of these violations.

Annually, the division will examine both TPAF and PERS disability retirees whose post-retirement
earnings plus the pension portion of their retirement allowance exceeds the retiree’s current salary of their former position.

Unpaid Loans

Prior to retirement, members of PERS, TPAF, PFRS, and SPRS who have at least three years of service in the applicable pension fund may borrow up to 50 percent of the employee share of pension contributions. Members who retire with an outstanding loan balance have the option of paying the loan in full prior to receiving any pension benefits or continuing their monthly loan payment schedule into retirement. If a retiree dies before the loan balance is repaid, the division obtains the remaining balance from group life insurance proceeds.

The division has implemented an outstanding loan balance automated interface in order to identify loans which must be deducted from the pension benefits of retirees. While there are still instances where input errors or timing may result in the interface not identifying an outstanding loan, a quarterly report is generated to accumulate financial information which includes loan balances. Our test of controls revealed that this report is not being properly utilized as a monitoring tool. Our judgmental sample of 40 loan balances found that four loans totaling $45,000 were not being deducted from the retirees’ pension payments. We determined that the Office of Information Technology (OIT) is able to sort the quarterly report’s loan balances by dollar value. However, additional system information is needed to identify payment activity.

Recommendation

We recommend the division develop a report which identifies all inactive retiree loan balances and take appropriate collection action.
Auditee Response

The division acknowledges the need to increase oversight of retired members with uncollected loan balances. Data processing modifications to the reports mentioned by the auditors have been requested and should be completed shortly. This move will improve our ability to identify collection problems much sooner.

Employers should be making the employee share of pension contributions for those receiving Workers’ Compensation benefits.

Insufficient Pension Contributions

Per N.J.S.A. 43:16A-15-2(a), when a member of the retirement system receives periodic benefits payable under the Workers’ Compensation Law during the course of his active service in lieu of his normal compensation, the employee’s pension contribution shall be paid to the retirement system by his employer.

Our review of the state payroll disclosed that the employee share of pension contributions is not being paid by the state in a timely manner. The state has no centralized payroll procedure which identifies these occurrences and initiates the proper deductions. The division does receive reports from the Department of the Treasury, Bureau of Risk Management which list employees receiving Workers’ Compensation benefits; however, the division is not fully utilizing this information due to staffing constraints. Failure to comply with this statute results in the pension funds not having access to the additional contributions. Employees who withdraw from the pension system may not receive the proper reimbursement of pension contributions.

Recommendation

We recommend the division contact the state’s Centralized Payroll and implement procedures to identify and process the employee pension contributions which the state is responsible for making while employees are receiving Workers’ Compensation benefits.
Auditee Response

The processing of service credit and pension contributions for state employees receiving workers’ compensation has historically been a time consuming, manual process requiring significant resource allocation on the division’s part. The recommendation made by the audit team, if acceptable by the other divisions affected, would significantly help in the processing of these cases in a timely manner. We will be meeting with representatives from the Treasury’s Office of Management and Budget, Centralized Payroll and the Division of Purchase and Property, Bureau of Risk Management to formulate an action plan to address this issue.