

**New Jersey State Legislature
Office of Legislative Services
Office of the State Auditor**

**Department of the Treasury
Contributory Group Life Insurance Program**

July 1, 2015 to July 31, 2016

**Stephen M. Eells
State Auditor**

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New Jersey State Legislature

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Enclosed is our report on the audit of the Department of the Treasury, Contributory Group Life Insurance Program for the period of July 1, 2015 to July 31, 2016. If you would like a personal briefing, please call me at (609) 847-3470.

A handwritten signature in black ink, appearing to read "Stephen M. Eells".

Stephen M. Eells
State Auditor
December 19, 2016

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Scope

We have completed an audit of the Department of the Treasury, Contributory Group Life Insurance Program (program) for the period July 1, 2015 to July 31, 2016. Our audit included financial activities accounted for in the state's General Fund and the Contributory Group Insurance Premium Fund (CGIPF).

The program offers life insurance coverage to members of the Public Employees' Retirement System (PERS) and the Teachers' Pension and Annuity Fund (TPAF). The program is funded by member contributions through payroll deductions that are deposited in the CGIPF. Active PERS members are permitted to participate, as well as active and retired TPAF members. For TPAF retirees to be eligible they must have retired with 10 or more years of pension membership credit or be on disability retirement. The life insurance policies are underwritten by a third-party administrator who pays the claims and is reimbursed by the Division of Pensions and Benefits from the CGIPF. In fiscal year 2016 contributions received totaled \$96.4 million and benefits paid were \$71.3 million per the division. An additional \$2.5 million was paid to the third-party administrator.

Objectives

The objectives of our audit were to determine whether financial transactions were related to the program, were reasonable, and were recorded properly in the accounting systems. A further objective was to determine if the program was properly classified in the state's comprehensive annual financial report (CAFR). Prior to implementation of new government accounting standards, the CGIPF was recorded within the respective pension funds in the state's CAFR. In fiscal year 2015, the CGIPF was presented in the state's General Fund.

This audit was conducted pursuant to the State Auditor's responsibilities as set forth in Article VII, Section I, 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. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

In preparation for our testing, we studied legislation, the administrative code, circular letters promulgated by the Department of the Treasury, and policies of the program. Provisions we considered significant were documented and compliance with those requirements was verified by interview, observation, and through our testing of financial transactions. We also reviewed financial trends and interviewed agency personnel to obtain an understanding of the program and the internal controls. In addition, we reviewed applicable Governmental Accounting

Standards Board statements to determine the appropriate presentation of the CGIPF in the state's CAFR.

A nonstatistical sampling approach was used. Our samples of financial transactions were designed to provide conclusions on our audit objectives as well as internal controls and compliance. Sample populations were sorted and transactions were judgmentally selected for testing.

Conclusions

We found the financial transactions were related to the program, were reasonable, and were recorded properly in the accounting systems. In making this determination, we noted certain reportable conditions regarding fund balance, benefit payments, and the contributory group life insurance contract. In addition, we found the Contributory Group Insurance Premium Fund would be more appropriately presented as a special revenue fund in the state's comprehensive annual financial report rather than in the state's General Fund.

Accounting Treatment

The department should classify the CGIPF as a special revenue fund.

New Jersey Statutes established the Contributory Group Insurance Premium Fund (CGIPF) in 1955. Since its inception, the fund has accumulated a balance of \$579 million as of June 30, 2015. The entire balance was recorded as a liability in the state's General Fund in fiscal year 2015 in accordance with Government Accounting Standards Board (GASB) Statement No. 10 which was issued in November 1989 and permitted risk financing activities to be recorded in a general fund. Risk financing activities are those used to obtain finances to restore the economic damages of losses that strike an organization. GASB Statement No. 66, which was effective for financial statements beginning after December 15, 2012, amended GASB Statement No. 10 and permits risk financing activities to be recorded in a special revenue fund. GASB Statement No. 66 further states that risk financing activities are generally not reported as a single line item in the general fund.

As described in GASB Statement No. 54, "special revenue funds are used to account for and report the proceeds of specific revenue sources that are restricted or committed to expenditures for specified purposes other than debt service or capital projects." Article VIII, Section II, Paragraph 8 of the New Jersey Constitution states that all contributions collected by the State from any employer, employee, or insurer for any fund or program established to provide any other benefits for employees and their families or dependents, shall be dedicated solely to the purpose of providing and administering those benefits. The restriction of the use of funds for the program, as indicated by the New Jersey Constitution, meets the requirement of a special revenue fund.

Recommendation

We recommend that the Department of the Treasury account for the Contributory Group Life Insurance Program as a special revenue fund. We further recommend that a current liability for claims be calculated and the remaining fund equity be classified as restricted fund balance.



Fund Balance

An actuary should review the CGIPF to determine if the fund balance is sufficient.

The fund balance for the Contributory Group Insurance Premium Fund (CGIPF) was \$579 million as of June 30, 2015. The CGIPF is financed by member contributions and interest income. New Jersey Statutes require members of the Public Employees' Retirement System (PERS) and Teachers' Pension and Annuity Fund (TPAF) to join the Contributory Group Life Insurance Program (program) for the first 12 months of membership after which they can withdraw from the program. Once they withdraw from the program, members cannot be

reinstated nor are their contributions refunded.

PERS and TPAF members contribute 0.5 percent and 0.4 percent, respectively, of their base salaries to the fund. The rates are set forth by the respective boards of trustees of each retirement plan and have not changed since 1999 (PERS) and 1980 (TPAF). The program benefits paid for active PERS members are one-and-a-half times their base salary and two times their base salary for active TPAF members. The benefits for retired TPAF members are one quarter of their final base salary for the last 12 months of employment (10 months for 10-month employees). We estimate that the face value of death benefits in force totals \$40 billion.

The fund received \$96.4 million in member contributions and disbursed \$71.3 million in benefit payments in fiscal year 2016. The Division of Pensions and Benefits monitors the fund but has not analyzed whether the fund balance can sustain the program in the event of a catastrophe. This analysis can be performed by an actuary. New Jersey Statutes indicate that every life insurer doing business in New Jersey should have a qualified actuary review reserves to determine if they are computed appropriately, based on the proper assumptions, and comply with state laws. By having an actuary review the program, the division can determine if the fund has an adequate balance and if the contribution rates are appropriate.

Recommendation

We recommend the division obtain an actuarial analysis of the Contributory Group Insurance Premium Fund to determine if the fund has adequate balances and if contribution rates are appropriate.



Benefit Payments

The division should enhance internal controls over the calculation of benefit payments to beneficiaries and estates.

The Division of Pensions and Benefits (division) calculates salaries for benefit payments manually based on quarterly information or biweekly pension certifications provided by employers. The division paid 431 claims totaling \$35.9 million for active members from July 2015 to April 2016. We judgmentally selected 40 benefit payments during this time period for testing and noted that seven benefit payments contained exceptions ranging from an underpayment of \$6,720 to an overpayment of \$1,354. The average dollar value of the exceptions was \$1,682. The exceptions were the result of either human error or salary information not being updated at the time the benefits were calculated.

Recommendation

We recommend that the division strengthen controls over the benefit payment process to ensure accurate payment to beneficiaries and estates.



Contract

The department should solicit bids for the contributory group life insurance contract.

The Contributory Group Life Insurance Program was introduced in 1955. Since its inception, the Department of the Treasury has contracted with the same insurance company to administer the benefit payments for the program without rebidding. Although the department is not required by law to seek competitive bids again, this is a standard government procurement practice which could be beneficial in determining if the current group life insurance plans and administrator payments could be provided at a lower cost.

Recommendation

We recommend that the Department of the Treasury solicit bid proposals for a new contract to administer the program.





State of New Jersey

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FLORENCE J. SHEPPARD
Acting Director

December 16, 2016


David J. Kaschak
Assistant State Auditor
New Jersey State Legislature
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125 South Warren Street
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Trenton, NJ 08625-0067

Dear Mr. Kaschak:

Enclosed are the comments from the Division of Pensions and Benefits and the Office of Management and Budget in response to the audit report of the Department of the Treasury, Division of Pensions and Benefits, Contributory Group Life Insurance Program.

If you have any questions, please contact me at 292-3674.

Sincerely,


John D. Megariotis
Deputy Director

Enclosure

c. Florence J. Sheppard
David J. Pointer
Wendy Jamison
David Ridolfino
Jim Kelly
Lynn Jahn

Accounting Treatment

The department should classify the CGIPF as a special revenue fund.

The Department of the Treasury, Office of Management and Budget (OMB), agrees with the recommendation regarding the Contributory Group Insurance Premium Fund (CGIPF). Although permitted to use a general fund to record the CGIPF, OMB concurs with the Office of the State Auditor. For the 2016 Comprehensive Annual Financial Report, OMB has recorded the CGIPF as a special revenue fund and, based on information provided by the Division of Pensions and Benefits, has recorded a current liability. The remaining fund equity has been classified as restricted fund balance.

Fund Balance

An actuary should review the CGIPF to determine if the fund balance is sufficient.

The Division has not deemed an analysis such as this to be necessary in the past, but will follow the recommendation and seek an actuarial review of the plan.

Benefit Payments

The division should enhance internal controls over the calculation of benefit payment to beneficiaries and estates.

The Division implemented the practice of paying a beneficiary or estate based upon the posted salary to the deceased member's account rather than projecting contributions for the unposted quarter. The process of projecting contributions and then not having those projections paid by the employer through the quarterly processing was causing accounts to be incorrectly paid. By only using the member's posted salary at the time of the death claim processing, the Division is relying on actual data in the member's account. If there are any adjustments to the member's account after quarterly posting, an exception report will identify the additional payments that must be made to the beneficiary or estate.

In addition, the Division is recommending an entire rewrite of the Death Information Benefit System (DIBS), as this system is antiquated and requires a manual process for many procedures in the payment of pension and insurance benefits. The elimination of a manual process will improve the accuracy of paying beneficiaries and estates and enhance internal controls as called for in this audit.

Contract

The department should solicit bids for the contributory group life insurance contract.

The Division concurs with this recommendation and is developing an RFP to solicit bids for a new contract to administer this program.