

MINUTES OF THE AUDIT & COMPLIANCE COMMITTEE MEETING
January 15, 2019

Members Present:

David Morris, Vice Chairperson
Loren Iglarsh, SERS Retiree
Shaun Dawson, SERS Trustee

Others in attendance:

Tim Blair, Executive Secretary
Casey Evans, Chief Internal Auditor (CIA)

The SERS Audit and Compliance Committee met on Tuesday, January 15, 2019 at 9:00 a.m. in the System's Springfield office. The meeting was called to order at 9:00 a.m. with a quorum being established to conduct business.

Seeing that there were no members of the public present for comment, the Committee moved on to the review and approval of the October 30, 2018 Committee meeting minutes. With there being no revisions to the meeting minutes, Retiree Iglarsh moved to approve the minutes as presented and Vice Chairperson Morris seconded the motion. The meeting minutes were approved.

Vice Chairperson Morris turned the meeting over to Chief Internal Auditor (CIA) Evans to discuss internal audit reports and other activities. CIA Evans directed the Committee to an analysis on the accelerated pension benefit payment for retirees. This is commonly known as the automatic annual increase (AAI) buyout. This voluntary program allows Tier 1 SERS members the option to elect to receive a reduced and delayed automatic annual increase in exchange for a lump-sum payment at time of retirement. With this irrevocable election, members would forgo their 3% compounded AAI to receive a 1.5% non-compounded AAI which is delayed to the later of the January 1st following the member's 67th birthday or following the member's first full year of retirement.

In November 2018, the retirement system began providing members that were retirement eligible with a lump sum payment estimate for their consideration and in December 2018, the system began receiving the first election forms back from members applying for retirement. Using a small sample of members electing the accelerated pension payment, it was possible to project forward cumulative benefit payment amounts through the retiree's life expectancy to determine the total amount the retiree could receive under each benefit option. CIA Evans explained that he utilized the Social Security Administration's Life Expectancy Calculator to determine the retiree's life expectancy in the calculations which is based upon the SSA's actuarial tables.

It was observed that the breakeven point for many retirees, or the point where the regular benefit option is equal to the lump-sum payment with the reduced and delayed AAIs, was approximately 13 to 15 years after retirement when most retirees are between the ages of 67 and 77. In the projections provided by internal audit, a retiree that elects the buyout option could be giving up hundreds of thousands of dollars, while members with a larger annual pension, could be possibly giving up more than one million dollars in pension benefits over their projected life expectancy.

It was explained that the cost savings generated was a result of the power of compounding interest. While retirees receive a large lump-sum payment following retirement with their benefit, they are giving up compounding increases which causes their benefits to grow with each passing year. Electing the buyout option, members may receive no AAI for a number of years if they are relatively young at time of retirement. Further, the AAI is non-compounding at 1.5% of the original benefit amount, which causes their annual retirement benefit to grow at a much slower pace.

CIA Evans highlighted four members in which a breakeven analysis and projection of benefit cost savings was provided. The members selected were from a variety of demographics which included both higher and lower annual pensions, male and female retirees, relatively younger retirees and members retiring later in life, as well as both regular formula and alternative formula retirees. Each benefit projection was explained to demonstrate to the Committee how cost savings could be realized should the member live to his or her life expectancy. The schedules also showed the difference in cumulative benefit growth under each payment option.

It was explained that these projections did not include potential cost savings that would be realized from the application of the reduced and delayed AAIs being applied to future survivor benefits, if the member had a qualified survivor upon their death. Since survivor benefits are based upon the retiree's current gross monthly benefit amount, the reduced and delayed AAIs would reduce the retiree's monthly benefit as compared to the traditional benefit payment option and thus the future survivor benefit would be less under the buyout option as compared to the traditional benefit payment option.

CIA Evans explained that in the buyout process the retirement system includes in the buyout election letter a 20-year benefit projection of gross monthly benefit amounts under each option, along with a break-even point determination. Members must make a voluntary and irrevocable election and are encouraged to carefully consider the decision. By statute, all lump-sum payments must be rolled into a qualified retirement plan to ensure the retiree is furthering his or her retirement savings. As of January 7, 2019, 188 retirees of 942 total have elected the accelerated pension payment option for a participation rate of approximately 20%.

CIA Evans explained that during 2018 and 2019, he was recalculating retirement benefits and lump sum payments for unused sick and vacation time payable to staff that have retired from the retirement system. This will continue to be performed for any future retiree, with most recalculations coming shortly after the first payments are made.

There are several internal audit projects in process or getting ready to begin in the Spring of 2019. Currently, an audit covering optional service purchases and member contribution refunds is being conducted. Future work also includes a regularly occurring audit over cash receipts and receivables.

The Committee discussed the FY2018 external audit. Currently, the financial audit report has not yet been released, but SERS expects a clean audit report. It is estimated that the financial audit report would be released likely before the end of January. CIA Evans stated that he was aware of a few minor issues that could be reported in the compliance examination but stated that he expects some prior year findings to be not repeated. It is anticipated that the compliance examination will be released in April or May 2019 and the results would be discussed in either the April or July Audit Committee Meetings.

The retirement systems continue to move forward in the process to interview and hire an internal auditor 1 to assist in the audit process. CIA Evans explained that the fall and winter months can be tough with the lack of another auditor, as he typically is busy with external audit liaison work along with scheduled internal audit work.

Vice Chairperson Morris moved to adjourn the meeting with the motion seconded by Retiree Iglarsh. The meeting was adjourned at 9:50 a.m. ahead of the Board of Trustees quarterly meeting. The next scheduled meeting for the Audit and Compliance Committee will be Tuesday, April 30, 2019 at 9:00 a.m.