

Special Report

Consolidated Public Retirement Board

Relatively Few Public Employees Retirement System Disability Retirees Had Significant Amounts of Earned Income as Documented by W-2 Forms, But Some Had Unidentified Sources of Income

Disability Retirees of the Teachers Retirement System Are Permitted by State Law to Earn Unlimited Amounts of Income, Unlike Disability Retirees of the Public Employees Retirement System. There is, However, No Clear Reason For This Difference Between the Two Retirement Systems



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John Sylvia
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May 21, 2006

The Honorable Edwin J. Bowman
State Senate
129 West Circle Drive
Weirton, West Virginia 26062

The Honorable J.D. Beane
House of Delegates
Building 1, Room E-213
1900 Kanawha Boulevard, East
Charleston, West Virginia 25305-0470

Dear Chairs:

Pursuant to the West Virginia Sunset Law, we are transmitting a Special Report of the Consolidation Public Retirement Board, which will be presented to the Joint Committee on Government Operations on Sunday, May 21, 2006. The issues covered herein are "Relatively Few Public Employees Retirement System Disability Retirees Had Significant Amounts of Earned Income as Documented by W-2 Forms, But Some Had Unidentified Sources of Income;" and "Disability Retirees of the Teacher Retirement System Are Permitted by State Law to Earn Unlimited Amounts of Income, Unlike Disability Retirees of the Public Employees Retirement System. There is, However, No Clear Reason for This Difference Between the Two Retirement Systems."

We transmitted a draft copy of the report to the Consolidation Public Retirement Board on May 8, 2006. We held an Exit Conference with the Board on May 12, 2006. We received the agency response on May 16, 2006.

Let me know if you have any questions.

Sincerely,

Handwritten signature of John Sylvia in cursive script.
John Sylvia

JS/wsc

Joint Committee on Government and Finance

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Executive Summary

Issue 1: Relatively Few Public Employees Retirement System Disability Retirees Had Significant Amounts of Earned Income as Documented by W-2 Forms, But Some Had Unidentified Sources of Income.

Seventeen (17) pre-retirement age individuals had earned income documented by W-2 forms. Out of the 17 retirees, 2 retirees had earned incomes above \$20,000.

The Legislative Auditor identified 151 pre-retirement age PERS disability retirees whose 2004 federal adjusted gross incomes (AGI) were higher than the sum of their W-2 and 1099R documented incomes by over \$1,000.

The Performance Evaluation and Research Division obtained data from the CPRB on all PERS disability retirees as of July 8, 2005. West Virginia Code §5-10-20 defines a person in PERS under the age of 60 as being of pre-retirement age. The West Virginia State Tax Department provided the 2004 state individual income tax returns for 788 individuals who received disability retirement prior to CY 2004. Seventeen (17) pre-retirement age individuals had earned income documented by W-2 forms. Out of the 17 retirees, 2 retirees had earned incomes above \$20,000.

Prior to the passage of House Bill 2984 during the 2005 Regular Legislative Session, state law required the CPRB to reduce the annuity of a disability retiree whose disability annuity payments plus earned income in a given year totaled in excess of his or her annual rate of compensation (ARC). This law was in effect during CY 2004, which is the time period represented by the sample of tax returns. The Legislative Auditor found that if income verification were in place, 8 individuals had earnings that would have resulted in a reduction of their annuities under the old law, totaling \$44,328.

Under the new income restrictions of House Bill 2984, the CPRB is required to terminate the annuities of disability retirees who earn income in excess of the federal Substantial Gainful Activity amount. According to the Social Security Administration, the Substantial Gainful Activity amount for CY 2004 was \$810 per month or \$9,720 for the year. Two (2) retirees with W-2 incomes in excess of \$20,000 would have had their annuities terminated under the new law if it were in effect during CY 2004. A total reduction of \$5,647 would have resulted under the old law.

The Legislative Auditor identified 151 pre-retirement age PERS disability retirees whose 2004 federal adjusted gross incomes (AGI) were higher than the sum of their W-2 and 1099R documented incomes by over \$1,000. This meant that there were other sources of income besides W-2 earnings and 1099R income for retirees and their spouses. The undocumented sources of income of a single filer or a married couple could be a variety of sources such as interest income, dividends, rental income, real estate transactions and business income. The federal tax return would

identify these sources of income. If the income is from a business or rental property, and the disability retiree is involved in Substantial Gainful Activity, then that person's benefits could be affected. Sixty-two (62) disability retirees had undocumented sources of income that ranged from \$1,000-\$5,000, while 43 individuals had undocumented sources of income above \$10,000.

According to the CPRB's interpretation of West Virginia Code §18-7A-25, once designated as disabled, retired teachers can continue to work provided that they do not return to teaching. Unlike PERS disability retirees, the disability retirees of the Teachers Retirement System (TRS) are not subject to earned income limits.

While the number of clearly documented cases of PERS disability retirees working and receiving disability annuities appears to be relatively small, there are some who reported unidentified sources of income. This income could involve substantial gainful activity on the part of the disability retiree. This analysis indicates that reexamining a larger number of PERS disability retirees is warranted and using tax information as a means to identify those who should be reexamined should be considered.

Issue 2: Disability Retirees of the Teachers Retirement System Are Permitted by State Law to Earn Unlimited Amounts of Income, Unlike Disability Retirees of the Public Employees Retirement System. There is, However, No Clear Reason For This Difference Between the Two Retirement Systems.

The Legislative Auditor's staff identified a proportion of TRS disability retirees (11 out of 90) who had unidentified sources of income, just as they did with PERS disability retirees.

According to the CPRB's interpretation of West Virginia Code §18-7A-25, once designated as disabled, retired teachers can continue to work provided that they do not return to teaching. Unlike PERS disability retirees, the disability retirees of the Teachers Retirement System (TRS) are not subject to earned income limits. It is not clear why there is such a significant difference between these two retirement systems with respect to the ability of disability retirees to earn income. One possible explanation is that these two systems were created separately before they were consolidated under the CPRB.

The Legislative Auditor's staff took a sample of 90 individuals from the 1,986 TRS disability retirees as of February 14, 2006 and obtained their 2004 state income tax returns. The Legislative Auditor's staff identified a proportion of TRS disability retirees (11 out of 90) who had unidentified sources of income, just as they did with PERS disability retirees. Since the TRS has no earned income limits for disability retirees, the Legislative Auditor's staff compared the incomes of TRS disability retirees to

the statutory limits placed on PERS disability retirees. The Legislative Auditor's staff identified one pre-retirement age individual who earned \$8,300 in W-2 Form income and \$15,636 in unidentified sources of income. It is not clear how this individual's annuity would have been affected if he was subject to the earned income limits of the PERS. However, his earnings were close to the Substantial Gainful Activity amount under the new law, and the unidentified sources of income may have involved substantial gainful activity. It is apparent that there were relatively few TRS disability retirees with large amounts of earnings, which was similar to PERS. Nevertheless, there is no logical basis for the distinction made between these two retirement systems with respect to limits on earned income. **Therefore, the Legislative Auditor recommends that the Legislature consider amending the West Virginia Code to place new TRS disability retirees under the same earnings restrictions as established under PERS, and that at least a limited form of earnings verification be implemented by the CPRB.**

Recommendations

1. *The Legislative Auditor recommends that the Consolidated Public Retirement Board implement a process by which it verifies the earnings of at least a limited number of Public Employees Retirement System disability retirees.*
2. *The Legislative Auditor recommends that the Consolidated Public Retirement Board conduct a study on the earnings of all Public Employees Retirement System disability retirees who are living out of state by requesting federal tax returns from these individuals.*
3. *The Legislative Auditor recommends that the Consolidated Public Retirement Board reexamine a larger number of Public Employees Retirement System disability retirees, and consider using earned income obtained from statements of earnings as an indicator of a retiree's continued disability and therefore, criteria for scheduling reexaminations.*
4. *The Legislative Auditor recommends that the Legislature consider amending the West Virginia Code to require the Consolidated Public Retirement Board to place new Teachers Retirement System disability retirees under the same earned income restrictions as*

Public Employees Retirement System disability retirees.

5. *If the Legislature places new Teachers Retirement System disability retirees under the same earned income restrictions as the Public Employees Retirement System, the Consolidated Public Retirement Board should consider verification of earned income for at least a limited number of new Teachers Retirement System disability retirees.*

Review Objective, Scope and Methodology

Objective

The objective of the Special Report on the Consolidated Public Retirement Board (CPRB) is to address the following questions:

1. Do significant numbers of disability retirees of the Public Employees Retirement System (PERS) earn enough income to lose their disability annuities under House Bill 2984 or to have had their annuities reduced under the previous law, thereby supporting Recommendation 2 of the January 2006 Full Performance Evaluation of the CPRB, which recommended that the Legislature consider amending Chapter 5, Article 10 of the West Virginia Code to require the Consolidated Public Retirement Board to obtain an annual statement of earnings from each disability retiree to verify income for possible disability annuity terminations, and that it be a criminal offense to provide false income information to the CPRB?
2. Do significant numbers of disability retirees of the Teachers Retirement System (TRS) earn substantial amounts of income, thereby supporting Recommendation 4 of the January 2006 Full Performance Evaluation of the CPRB, which recommended amending the earned income criteria of West Virginia Code §18-7A-25, making it consistent with that of PERS?

Scope

The scope of this review extends from CY 2004 through February 14, 2006 for the analysis of PERS and TRS disability retirees' incomes.

Methodology

This report focuses on disability retirees of the PERS and TRS. The CPRB provided the identities of all PERS disability retirees as of July 8, 2005 and all TRS disability retirees as of February 14, 2006 for the purpose of determining the earned incomes of each retiree for CY 2004. The CPRB provided data for both PERS and TRS disability retirees regarding their Social Security Numbers, annual annuities, dates of birth, and dates of retirement. The West Virginia State Tax Department was able to provide copies of CY 2004 West Virginia Personal Income Tax returns

for a total of 902 disability retirees, which represented 47.3% of the total population of 1,904 PERS disability retirees. The Legislative Auditor's staff was able to use tax returns for 788 disability retirees who did not retire during CY 2004, excluding the rest, since their tax returns for CY 2004 might have included data on pre-retirement income.

The Legislative Auditor's staff also requested tax returns from the State Tax Department for a sample of 100 TRS disability retirees. The State Tax Department was able to provide information for a total of 90 individuals. There was a total population of 1,986 TRS disability retirees as of February 14, 2006.

Income tax return data included 1099R and W-2 Income Statements submitted by PERS and TRS disability retirees, which clearly verified their incomes. W-2 Income statements were a clear measure of earned income, while 1099R forms were classified for the purposes of this evaluation as unearned income. The Legislative Auditor's staff used the sums of 1099R and W-2 income data for each individual and compared them to the federal adjusted gross incomes (AGI) provided in each tax return. Any unidentified income in excess of the sum of 1099R and W-2 forms was a possible source of additional earned income.

The CPRB was unable to provide the annual rate of compensation (ARC) for those who retired before 1998, due to limitations in the CPRB's data system. The CPRB did have data for final average salaries for those who retired after 1989. A PERS retiree's final average salary is the average of the highest 36 months of compensation received during his or her last ten years of employment. The Legislative Auditor's staff used final average salary data for analysis purposes when the ARC was unavailable, since usually it would be a reasonable approximation of that number.

Issue 1

Relatively Few Public Employees Retirement System Disability Retirees Had Significant Amounts of Earned Income as Documented by W-2 Forms, But Some Had Unidentified Sources of Income.

Issue Summary

The Legislative Auditor's staff obtained copies of the 2004 state income tax returns for 788 retirees. The Legislative Auditor found that only 17 of 788 (2.1%) individuals had earned income as recorded by W-2 forms

The Legislative Auditor initiated an evaluation of the Consolidated Public Retirement Board's (CPRB) disability retirement process within the Public Employees Retirement System (PERS). Although the CPRB is authorized to verify the earned income of PERS disability retirees, the CPRB has not exercised this authority. The Legislative Auditor was initially concerned that without earned income verification, the State is paying more in PERS disability retirement benefits than it should. Furthermore, passage of House Bill 2984 in 2005 may make income verification more important since the new law is now more stringent regarding the amount of earned income a disability retiree can receive.

In addition, there were 151 (19.1%) tax returns that had undocumented sources of income of more than \$1,000, ranging from \$1,000 to over \$78,000. This is income that exceeded the income reported by W-2 and 1099R forms submitted by retirees and their spouses for joint returns.

The Legislative Auditor found that there was a relatively small number of individuals who had earned income as reported by W-2 forms, but there were individuals who reported undocumented sources of income on their tax returns. The Legislative Auditor's staff obtained copies of the 2004 state income tax returns for 788 retirees. The Legislative Auditor found that only 17 of 788 (2.1%) individuals had earned income as recorded by W-2 forms. Under the old law, 8 of these disability retirees earned enough to result in an adjustment of their disability annuities totaling over \$44,000. Two (2) individuals earned over \$23,000 which should have reduced their disability annuities under the old law and would have terminated their annuities if the income had been earned under the new law. In addition, there were 151 (19.1%) tax returns that had undocumented sources of income of more than \$1,000, ranging from \$1,000 to over \$78,000. This is income that exceeded the income reported by W-2 and 1099R forms submitted by retirees and their spouses for joint returns. This income could be rental or business that may involve Substantial Gainful Activity of the disability retiree that could affect the retiree's annuity eligibility. The federal tax return is needed to determine what type of income was undocumented. The Legislative Auditor did not obtain this tax information. The Legislative Auditor concludes that it may not be cost effective to verify earned income of all PERS disability retirees because of the limited number of retirees with earned income. However, the tax data show that a limited form of income verification is warranted,

such as a sample.

A Review of PERS Disability Retirees' State Tax Returns Show Few Have Earned Income Recorded By W-2 Forms.

The Performance Evaluation and Research Division obtained data from the CPRB on all PERS disability retirees as of July 8, 2005. West Virginia Code §5-10-20 defines a person in PERS under the age of 60 as being of pre-retirement age. The West Virginia State Tax Department provided the 2004 state individual income tax returns for 788 individuals who received disability retirement prior to CY 2004. Seventeen (17) pre-retirement age individuals had earned income documented by W-2 forms. Table 1 provides data on the distribution of 2004 PERS disability retirees' W-2 earnings. Out of the 17 retirees, 2 retirees had earned incomes above \$20,000.

Prior to the passage of House Bill 2984 during the 2005 Regular Legislative Session, state law required the CPRB to reduce the annuity of a disability retiree whose disability annuity payments plus earned income in a given year totaled in excess of his or her annual rate of compensation (ARC).

Table 1				
CY 2004 Pre-Retirement Age PERS Disability Retirees: Distribution of W-2 Form Earnings				
	\$50- \$1,000	\$1,001-\$5,000	\$5,001- \$10,000	Over \$20,000
Number of PERS Disability Retirees	7	4	4	2

Source: The Consolidated Public Retirement Board and PERD analysis of income tax returns from the West Virginia State Tax Department.

Prior to the passage of House Bill 2984 during the 2005 Regular Legislative Session, state law required the CPRB to reduce the annuity of a disability retiree whose disability annuity payments plus earned income in a given year totaled in excess of his or her annual rate of compensation (ARC). This law was in effect during CY 2004, which is the time period represented by the sample of tax returns. The term annual rate of compensation refers to an amount equal to a retiree's total compensation for the 12 months prior to disability retirement. Before 2005, West Virginia Code §5-10-26(c) read as follows:

The Legislative Auditor found that if income verification were in place, 8 individuals had earnings that would have resulted in a reduction of their annuities under the old law, totaling \$44,328 (see Table 2)

If a disability retiree, who has not attained sixty years, becomes engaged in a gainful occupation, business or employment, and the sum of his earnings from such occupation business or employment and his disability annuity shall be reduced to an amount which when added to the amount so earned by him shall equal his said annual rate of compensation. If his earnings are later changed, his disability annuity shall be correspondingly adjusted.

The Legislative Auditor found that if income verification were in place, 8 individuals had earnings that would have resulted in a reduction of their annuities under the old law, totaling \$44,328 (see Table 2). As Table 2 shows, in each case the annual annuity amount and earned income exceeded the ARC. The difference between these two amounts was the amount of the reduction in the annual annuity. The one concern with the annuity reduction method defined in Code (§5-10-26(c)) was that some individuals had relatively low ARC amounts because some were forced to take uncompensated leave due to extended illness, and therefore, received no pay during the last 12 months prior to receiving disability retirement. In fact, two individuals in Table 2 had \$0 ARC, and 36 individuals in the sample had \$0 ARC. For individuals with relatively low ARCS, any amount of earnings could have resulted in a substantial annuity reduction, as evident in cases 1, 2, and 4.

Table 2 Relationship of Earned Income and Disability Annuities Under the Old Law (Actual Examples)							
Sample Cases	(1) ARC*	(2) FAS**	(3) Annual Disability Annuity	(4) WV Earned Income	(5) (Annuity) + (WV Earned Income)	(6) (Annuity) + (WV Earned Income) - (ARC)	(7) Amount to Reduce Annual Disability Annuity
Case #1	\$6,327	\$26,320	\$12,092	\$328	\$12,420	\$6,093	\$6,093
Case #2	\$7,513	\$22,319	\$11,160	\$910	\$12,070	\$4,557	\$4,557
Case #3	\$10,352	\$26,804	\$11,621	\$1,200	\$12,821	\$2,469	\$2,469
Case #4	\$0	\$25,111	\$10,481	\$2,613	\$13,094	\$13,094	\$10,481
Case #5	\$6,868	\$13,199	\$6,600	\$6,087	\$12,687	\$5,819	\$5,819
Case #6	\$720	\$18,527	\$9,264	\$9,264	\$18,528	\$17,808	\$9,264
Case #7	\$38,480	\$33,367	\$16,684	\$23,727	\$40,411	\$1,931	\$1,931
Case #8	\$0	Un- known	\$3,716	\$27,000	\$30,716	\$30,716	\$3,716
Total							\$44, 328
<p>Sources: <i>The Consolidated Public Retirement Board, and the West Virginia Tax Department.</i></p> <p>* <i>Annual Rate of Compensation at Time of Disability Retirement. This represents the total salary of the last 12 months prior to disability retirement.</i></p> <p>** <i>Final Average Salary at the Time of Disability Retirement. This represents the average of the highest annual compensation during any three consecutive years of his or her credited service contained within his or her last ten years of credited service.</i></p>							

However, this may be a moot point because under the new income restrictions of House Bill 2984, the CPRB is required to terminate the annuities of disability retirees who earn income in excess of the federal Substantial Gainful Activity amount. West Virginia Code §5-10-26(c) as amended, states:

The 2 retirees from Table 1 with W-2 incomes in excess of \$20,000 would have had their annuities, which totaled \$20,400, terminated under the new law if it were in effect during CY 2004.

If a review of the disability retiree's annual statement of earnings or other financial information as required by the Board determines that the disability retiree's earned income for the preceding year exceeds the substantial gainful activity amount as defined by the United States Social Security Administration, the disability retirees annuity shall be terminated by the Board, upon recommendation of the Board's disability review committee, on the first day of the month following the Board's action.

The Legislative Auditor identified 151 pre-retirement age PERS disability retirees whose 2004 federal adjusted gross incomes (AGI) was higher than the sum of their W-2 and 1099R documented incomes by over \$1,000.

According to the Social Security Administration, the Substantial Gainful Activity amount for CY 2004 was \$810 per month or \$9,720 for the year. The 2 retirees from Table 1 with W-2 incomes in excess of \$20,000 would have had their annuities, which totaled \$20,400, terminated under the new law if it were in effect during CY 2004. A total reduction of \$5,647 would have resulted under the old law. The CPRB has begun requesting statements of earnings, and as of the last report, the CPRB had sent requests for information to 10% of PERS disability retirees.

Some Pre-Retirement Age PERS Disability Retirees Had Substantial Amounts of Undocumented Sources of Income

Table 3 shows that sixty-two (62) disability retirees had undocumented sources of income that ranged from \$1,000-\$5,000, while 43 individuals had undocumented sources of income above \$10,000.

The Legislative Auditor identified 151 pre-retirement age PERS disability retirees whose 2004 federal adjusted gross incomes (AGI) was higher than the sum of their W-2 and 1099R documented incomes by over \$1,000. This is shown in Table 3. This meant that there were other sources of income besides W-2 earnings and 1099R income for retirees and their spouses. The undocumented sources of income of a single filer or a married couple could be a variety of sources such as interest income, dividends, rental income, real estate transactions and business income. The federal tax return would identify these sources of income. If the income is from a business or rental property, and the disability retiree is involved in Substantial Gainful Activity, then that person's benefits could be affected. Table 3 shows that sixty-two (62) disability retirees had undocumented sources of income that ranged from \$1,000-\$5,000, while 43 individuals

had undocumented sources of income above \$10,000.

There was a total of 1,904 PERS disability retirees as of July 8, 2005. From that total, the Legislative Auditor's staff obtained 902 state tax returns for 2004. Only 788 of those were usable because the other 114 individuals retired during CY 2004 and their earned incomes for that year would have included pre-retirement earned income.

Table 3
CY 2004 PERS Disability Retirees: PERS Disability Retirees With Adjusted Gross Incomes Larger Than W-2 Form Incomes

	\$1,000- \$5,000	\$5,001- \$10,000	\$10,001- \$15,000	\$15,001- \$20,000	\$20,001- \$80,000
Number of PERS Disability Retirees	62	46	23	10	10
<i>Source: The Consolidated Public Retirement Board and PERD analysis of income tax returns from the West Virginia State Tax Department.</i>					

State Income Tax Returns Were Unavailable for Some PERS Disability Retirees

While the Legislative Auditor's staff was unable to find clear documentation of large numbers of PERS disability retirees who earned income in excess of statutory limits, it is important to point out the data limitations imposed on this performance evaluation. There was a total of 1,904 PERS disability retirees as of July 8, 2005. From that total, the Legislative Auditor's staff obtained 902 state tax returns for 2004. Only 788 of those were usable because the other 114 individuals retired during CY 2004 and their earned incomes for that year would have included pre-retirement earned income. In terms of sample size, this is a large group and is probably representative of the total population of PERS disability retirees. However, it should be noted that tax data for some disability retirees were unavailable from the Tax Department for the following two reasons:

1. Some disability retirees live out of state and no longer file West Virginia tax returns;
2. Some disability retirees may have filed joint returns and failed to include their own Social Security numbers on the tax forms, thereby making it impossible for the Tax Department's data system to identify them.

The CPRB should consider identifying all disability retirees who are living out of state and requesting the retirees' federal income tax returns. This should be done to determine if earnings for out of state disability retirees are similar to those of disability retirees living in West Virginia.

During the 2006 Regular Legislative Session the Legislature passed Senate Bill 362 which granted the CPRB the authority to request and receive tax data on disability retirees. The Legislature passed this bill in response to recommendation 3 of the January 2006 Full Performance Evaluation of the CPRB. Despite this authority, if the CPRB implements a limited income verification system, it may be necessary in some cases to request tax data directly from disability retirees. In addition, the Legislative Auditor recommends that the CPRB conduct a study of the earnings of retirees who are living out of state. The CPRB should consider identifying all disability retirees who are living out of state and requesting the retirees' federal income tax returns. This should be done to determine if earnings for out of state disability retirees are similar to those of disability retirees living in West Virginia.

The CPRB Should Use Statements of Income as a Basis for Scheduling Medical Reexaminations

According to West Virginia Code §5-10-26(a), the CPRB may require a medical reexamination at least once during the first five years and once every three years thereafter. Between FY 2000 and FY 2005, the CPRB scheduled reexaminations for only 26 out of 981 new PERS disability retirees one year after retirement.

Issue 3 of the January 2006 Full Performance Evaluation of the CPRB focused on the fact that the CPRB is not effectively monitoring the disabled status of PERS disability retirees. According to West Virginia Code §5-10-26(a), the CPRB may require a medical reexamination at least once during the first five years and once every three years thereafter. Between FY 2000 and FY 2005, the CPRB scheduled reexaminations for only 26 out of 981 new PERS disability retirees one year after retirement. The CPRB will only order a one-year reexamination if its physician recommends one. According to the CPRB, it has never terminated a PERS disability retirement annuity because the retiree was no longer disabled. While the number of clearly documented cases of PERS disability retirees working and receiving disability annuities appears to be relatively small, there are some who reported unidentified sources of income. This income could involve substantial gainful activity on the part of the disability retiree. This analysis indicates that reexamining a larger number of PERS disability retirees is warranted and using tax information as a means to identify those who should be reexamined should be considered.

Conclusion

The Legislative Auditor's staff reviewed the 2004 West Virginia state tax returns of 788 PERS disability retirees and found 17 of pre-retirement age that had documented earned income. Out of the 17 cases, 8 would have resulted in annuity reductions totaling over \$44,000 under the old law. Two of these cases would have resulted in the termination of the

annuities under the new law. This analysis suggests that the number of individuals with substantial earned income is relatively small and therefore it may not be cost effective to verify earned income for every disability retiree. However, the Legislative Auditor's staff found 151 retirees with AGIS that exceeded their documented income in state tax returns ranging from \$1,000 to over \$75,000. These unidentified sources of income may be identified on the federal tax return. It is possible that retirees with large unidentified sources of income may have been involved in substantial gainful activity which could affect a person's disability annuity. This analysis suggests that while implementing an earnings verification process for all PERS disability retirees may not be cost effective, some form of limited earnings verification is warranted, as well as scheduling a larger number of reexaminations using tax data as a possible indicator of who to reschedule. This is especially true given the passage of HB 2984 which is more restrictive on earnings. The CPRB requested the 2004 income statements from 10% of PERS disability retirees in 2005. This is a viable approach as well as requesting tax data directly from the state Tax Department.

Recommendations

1. *The Legislative Auditor recommends that the Consolidated Public Retirement Board implement a process by which it verifies the earnings of at least a limited number of Public Employees Retirement System disability retirees.*
2. *The Legislative Auditor recommends that the Consolidated Public Retirement Board conduct a study on the earnings of all Public Employees Retirement System disability retirees who are living out of state by requesting federal tax returns from these individuals.*
3. *The Legislative Auditor recommends that the Consolidated Public Retirement Board reexamine a larger number of Public Employees Retirement System disability retirees, and consider using earned income obtained from statements of earnings as an indicator of a retiree's continued disability and therefore, criteria for scheduling reexaminations.*

Unlike PERS disability retirees, the disability retirees of the Teachers Retirement System (TRS) are not subject to earned income limits.

Since the TRS has no earned income limits for disability retirees, the Legislative Auditor's staff compared the incomes of TRS disability retirees to the statutory limits placed on PERS disability retirees. The Legislative Auditor's staff identified one pre-retirement age individual who earned \$8,300 in W-2 Form income and \$15,636 in unidentified sources of income.

Disability Retirees of the Teachers Retirement System Are Permitted by State Law to Earn Unlimited Amounts of Income, Unlike Disability Retirees of the Public Employees Retirement System. There is, However, No Clear Reason For This Difference Between the Two Retirement Systems.

Issue Summary

According to the CPRB's interpretation of West Virginia Code §18-7A-25, once designated as disabled, retired teachers can continue to work provided that they do not return to teaching. Unlike PERS disability retirees, the disability retirees of the Teachers Retirement System (TRS) are not subject to earned income limits. It is not clear why there is such a significant difference between these two retirement systems with respect to the ability of disability retirees to earn income. One possible explanation is that these two systems were created separately before they were consolidated under the CPRB.

The Legislative Auditor's staff took a sample of 90 individuals from the 1,986 TRS disability retirees as of February 14, 2006 and obtained their 2004 state income tax returns. The Legislative Auditor's staff identified a proportion of TRS disability retirees (11 out of 90) who had unidentified sources of income, just as they did with PERS disability retirees. Since the TRS has no earned income limits for disability retirees, the Legislative Auditor's staff compared the incomes of TRS disability retirees to the statutory limits placed on PERS disability retirees. The Legislative Auditor's staff identified one pre-retirement age individual who earned \$8,300 in W-2 Form income and \$15,636 in unidentified sources of income. It is not clear how this individual's annuity would have been affected if he was subject to the earned income limits of the PERS. However, his earnings were close to the Substantial Gainful Activity amount under the new law, and the unidentified sources of income may have involved substantial gainful activity. It is apparent that there were relatively few TRS disability retirees with large amounts of earnings, which was similar to PERS. Nevertheless, there is no logical basis for the distinction made between these two retirement systems with respect to limits on earned income. **Therefore, the Legislative Auditor recommends that the Legislature consider amending the West Virginia Code to place new TRS disability retirees under the same earnings restrictions as established under PERS, and that at least a limited form of earnings verification be implemented by the CPRB.**

Teachers Who Retire Due to Disability Can Earn Unlimited Amounts of Income

According to the CPRB's interpretation of West Virginia Code §18-7A-25, once designated as disabled, retired teachers can continue to work. Unlike PERS disability retirees, disability retirees from the Teachers Retirement System are not subject to earned income limits. The CPRB interprets West Virginia Code §18-7A-25(c) as permitting disability retirees to earn income, provided that they do not return to teaching:

...An examination by a physician or physicians selected by the retirement board must show that the member is at the time mentally or physically incapacitated for service as a teacher, that for such service the disability is total and likely to be permanent, and that he or she should be retired in consequence thereof.

Out of the sample of 90, only one disability retiree reported income on a W-2 form. The amount earned was \$8,300. This individual also had \$15,636 in unidentified sources of income.

PERS Earned Income Limits As Applied to TRS Retirees

The Legislative Auditor requested a complete list of current TRS disability retirees from the CPRB to conduct follow-up research regarding Recommendation 4 of the January 2006 Full Performance Evaluation of the CPRB. Recommendation 4 states:

The Legislature should consider amending the disability retirement provisions of the Teachers Retirement System to conform with the earned income criteria established under the Public Employees Retirement System for new hires.

A sample was taken of 90 individuals from the 1,986 TRS disability retirees as of February 14, 2006 and copies of their 2004 state income tax returns were obtained. The Legislative Auditor used 55 as the age of retirement as specified by West Virginia Code §18-7A-25.

Out of the sample of 90, only one disability retiree reported income on a W-2 form. The amount earned was \$8,300. This individual also had \$15,636 in unidentified sources of income. The amount of W-2 income may not have been enough to affect the individual's annuity under the PERS earned income restrictions for 2004. However, his earnings was close to the Substantial Gainful Activity amount under the new law, and the unidentified sources of income may have involved substantial gainful

The Legislative Auditor's staff identified 11 TRS disability retirees whose total earnings added to the earnings of their spouse was less than their 2004 AGI. As noted with PERS, the difference could have been due to a variety of sources from real estate transactions, interest, dividends, rental income, or business income.

activity. It is likely that a few TRS disability retirees are working. Extrapolating from the fact that one individual out of the sample of 90 had earned income, there may be approximately 22 individuals out of a total of 1,986 who have some form of earned income.

Some TRS Disability Retirees Have Unidentified Sources of Income

The Legislative Auditor's staff identified 11 TRS disability retirees whose total earnings added to the earnings of their spouse was less than their 2004 AGI. As noted with PERS, the difference could have been due to a variety of sources from real estate transactions, interest, dividends, rental income, or business income. Obtaining the federal tax return of each disability retiree would, as with PERS, be the best way to identify the sources of income.

Table 4 shows the frequency of the unidentified sources of income. The unidentified sources of income range from \$1,000-\$20,000. It is possible that substantial gainful activity is involved in some of this income. Overall, the number of individuals who have W-2 earnings or unidentified sources of income is relatively small and may not warrant earning verification for all new TRS disability retirees if they are placed under the same earning restrictions as PERS. **However, the Legislative Auditor recommends that the Legislature consider placing new TRS disability retirees under the same earnings restrictions as under PERS.** In addition, the Consolidated Public Retirement Board should consider implementing earning verification at least for a limited number of new TRS disability retirees if they are placed under the PERS' earned income restrictions.

Table 4			
TRS Disability Retirees With Unidentified Sources of Income			
Tax Year 2004			
	\$1,000-\$5,000	\$5,001-\$10,000	\$10,001-\$20,000
TRS Disability Retirees	5	2	4
<i>Source: The Consolidated Public Retirement Board and PERD analysis of income tax returns from the West Virginia State Tax Department.</i>			

Conclusion

There is no apparent justification for the distinction between PERS and TRS with respect to the ability of disability retirees to earn income. The Legislature, therefore, should consider placing new TRS disability retirees under the same earning limitations as PERS disability retirees, as recommended in the January 2006 Performance Evaluation on the CPRB. This analysis suggests that the number of TRS disability retirees with earned income or unidentified sources of income is relatively small. It may not be cost effective to have earned income verification for all new TRS disability retirees. However, the Legislative Auditor recommends that the CPRB consider earned income verification for at least a limited number of new TRS disability retirees if the Legislature places them under the PERS earning restrictions.

Recommendations

4. *The Legislative Auditor recommends that the Legislature consider amending the West Virginia Code to require the Consolidated Public Retirement Board to place new Teachers Retirement System disability retirees under the same earned income restrictions as Public Employees Retirement System disability retirees.*
5. *If the Legislature places new Teachers Retirement System disability retirees under the same earned income restrictions as the Public Employees Retirement System, the Consolidated Public Retirement Board should consider verification of earned income for at least a limited number of new Teachers Retirement System disability retirees.*

Appendix A: Transmittal Letter

WEST VIRGINIA LEGISLATURE *Performance Evaluation and Research Division*

Building 1, Room W-314
1900 Kanawha Boulevard, East
Charleston, West Virginia 25305-0610
(304) 347-4890
(304) 347-4939 FAX



John Sylvia
Director

May 8, 2006

Teresa L. Miller, Acting Executive Director
Consolidated Public Retirement Board
1900 Kanawha Blvd., E.
Building 5, Room 1000
Charleston, WV 23505

Dear Ms. Miller:

This is to transmit a draft copy of the Full Performance Evaluation of the Consolidated Public Retirement Board. This report is scheduled to be presented during the May 21-23, 2006 interim meeting of the Joint Committee on Government Operations. We will inform you of the exact time and location once the information becomes available. It is expected that a representative from your agency is present at the meeting to orally respond to the report and answer any questions the committee may have.

We need to schedule an exit conference to discuss any concerns you may have with the report. We would like to have the meeting on Friday, May 12, 2006. Please notify us to schedule an exact time. In addition, we need your written response by noon on Wednesday, May 17, 2006 in order for it to be included in the final report. If your agency intends to distribute additional material to committee members at the meeting, please contact the House Government Organization staff at 340-3192 by Friday, May 19, 2006 to make arrangements.

We request that your personnel not disclose the report to anyone not affiliated with your agency. Thank you for your cooperation.

Sincerely,

Handwritten signature of John Sylvia in cursive script.
John Sylvia

Enclosure

Joint Committee on Government and Finance

Appendix B: Agency Response



Board Members

Governor Joe Manchin III
Auditor Glen B. Gainer III, Vice Chairman
Treasurer John D. Perdue
Cabinet Secretary Robert W. Ferguson, Jr.

State of West Virginia
Consolidated Public Retirement Board
Capitol Complex, Building 5, Suite 1000
1900 Kanawha Boulevard, East
Charleston, West Virginia 25305-0720
Telephone: 304-558-3570 or 800-654-4406
Fax: 304-558-6337
email: CPRB@wvretirement.com
www.wvretirement.com

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D. Todd Murray
LTC Stephen C. Tucker
Janet F. Wilson

May 16, 2006

John Sylvia, Director
Performance Evaluation Research Division
Building 1, Room W-314
Charleston, West Virginia 25305

R E C E I V E
MAY 16 2006

PERFORMANCE EVALUATION AND
RESEARCH DIVISION

RE: Consolidated Public Retirement Board Performance Review

Dear Mr. Sylvia:

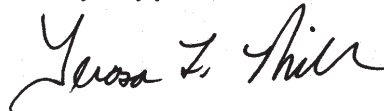
This is to respond to the draft Consolidated Public Retirement Board (CPRB) Full Performance Review as revised at the exit conference Friday, May 12, 2006. I appreciate the time and expertise you and various members of your staff have devoted to this audit over this last year, and I look forward to working with you to follow-up some of our joint concerns.

As we discussed, CPRB is in agreement with your findings with respect to Issue 1 and Issue 2. With respect to Issue 1, CPRB has already commenced the PERS tax information review and expects, on or soon after the effective date of Senate Bill 362, to work directly with the State Tax Department to verify PERS disability retirants' earned income. The Board staff will consider other methods of obtaining accurate tax information for those disability retirants who live outside of the state. With respect to Issue 2, imposition of PERS disability requirements on TRS disability retirants, as recommended by the Auditor, is a policy decision for the Legislature. Because of detrimental reliance issues it is my opinion that any such changes should apply only to new hires, not new disability retirees.

John Sylvia, Director
May 16, 2006
Page 2

Thank you for the opportunity to respond.

Very truly yours,

A handwritten signature in black ink, appearing to read "Terasa L. Miller". The signature is written in a cursive style with a large initial "T".

Terasa L. Miller
Acting Executive Director

TLM/AWL/

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