



# A Legislative Summary Document Regarding Employees Retirement System

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The controls and processes at the Employees Retirement System (ERS) reasonably ensure that it will accomplish its mission, which is to provide retirement and health care benefits for state employees.

State and employee contributions currently do not cover retirement plan costs. If adverse market conditions or actuarial losses cause the plan's assets to fall below liabilities, the Legislature would not be able to increase future retirement benefits without also increasing state and/or employee retirement contribution rates.

We were unable to certify three of the four fiscal year 2001 performance measures we tested at ERS. Reported results for these three measures were found to be inaccurate.

Prepared for the 78th Legislature  
by the State Auditor's Office

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*This is not an audit report and, with the exception of any audit report summaries, the material in this document has not been subjected to all of the tests and confirmations performed in an audit.*

# Employees Retirement System

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## Key Findings from Previous Audits and Reviews

January 1, 2001–December 31, 2002

### ***Ongoing Comparative Investment Performance Report for Major Investing Entities***

The State Auditor's Office will release a report in early 2003 on the investment performance of the Employees Retirement System.

### ***A Review of Selected Controls at the Employees Retirement System***

(Report No. 02-032, March 2002)

The controls and processes at the Employees Retirement System (ERS) reasonably ensure that it will accomplish its mission, which is to provide retirement and health care benefits for state employees. However, ERS needs to address issues related to its administration of the Uniform Group Insurance Program.

Key facts and findings include the following:

- ERS does not ensure that health benefit claims are eligible before it pays them, even though it has the capability to verify claims electronically. As a result, from January to July 2001, ERS reimbursed Blue Cross and Blue Shield of Texas \$395,000 for Health Select claims for employees who were no longer eligible to receive benefits. Even though the payment errors detected were relatively small, the lack of controls creates the potential for much larger errors.
- ERS's contract monitoring program is in development. Also, ERS did not enforce certain contract provisions that could have allowed it to collect a \$270,000 performance penalty.
- ERS has not been funded to maintain the 60-day contingency reserve mandated by the Texas Insurance Code.
- State and employee contributions currently do not cover retirement plan costs. If adverse market conditions or actuarial losses cause the plan's assets to fall below liabilities, the Legislature would not be able to increase future retirement benefits without also increasing state and/or employee retirement contribution rates.

<b>Status of Audit Recommendations as of November 30, 2002 (unaudited)</b>	
ERS has reported the following:	
Implemented	1
Partially implemented	1
Has other explanatory information	4
<b>Total recommendations</b>	<b>6</b>

### ***A Follow-up Report on Two Reviews of Controls Over Investment Practices at State Investing Entities***

(Report No. 01-017, January 2001)

Teacher Retirement System (TRS) and Employees Retirement System (ERS), with combined portfolios of approximately \$110 billion as of August 31, 2000, are the only major investing entities that lack authority to delegate investment decisions to external money managers. Both agencies might be able to better diversify their investment portfolios if permitted to delegate some investment decisions to outside investment professionals. This authority could permit access to additional asset classes that might be highly profitable or that could help control overall portfolio risk but that would be difficult or impossible for internal staff to manage alone.

ERS appears to rely on its external investment advisors to make important investment decisions that determine the performance of some investment portfolios. ERS does not consider its relationships with portfolio advisors to be a delegation of investment decisions. The Office of the Attorney General recently concluded that TRS lacks statutory authority to fully delegate these decisions. Because ERS's current authority to use external managers is identical to TRS's authority at the time of the Office of the Attorney General Opinion, the reasoning and conclusion of that opinion appear to apply to ERS as well.

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Giving ERS explicit authority to delegate might help ERS prudently manage its investments. The extent to which ERS is currently able to rely on these outside parties without such delegation authority suggests that the State would not incur further risk if the Legislature chose to permit ERS to fully delegate these decisions.

A periodic, independent review of the major investing entities' investment practices and performance could provide the Legislature with useful information about the management of these large funds. Currently, only TRS receives a periodic review. An independent firm conducts this review and reports to the Legislative Audit Committee. While the most recent of these reviews in 2002 reported that TRS investments were well managed overall, it contained useful recommendations for improvements. (This review covers specific technical areas beyond the scope of audits conducted by the State Auditor's Office.)

Mandating reviews, such as the one required for TRS, could provide assurance to the Legislature that the other investments are being well managed overall. The reviews could also provide comparative information on performance and staff compensation to assess whether the major investing entities are able to offer adequate salaries to attract and retain highly competent investment professionals.

## Most Recent Performance Measure Certification

Fiscal Year 1998–Fiscal Year 2003

The results included in *An Audit Report on Fiscal Year 2001 Performance Measures at 14 Entities* (Report No. 03-008, November 2002) for this entity are summarized below.

Period	Goal/Strategy		Measure	Certification Results
2001	A	Administer Retirement Program	ERS Annual Operating Expenses per Active and Retired Member	Inaccurate
2001	A.1.1	Retirement Contributions	Number of Member Accounts Serviced	Certified
2001	A.1.1	Retirement Contributions	Average Number of Days to Provide ERS Retirement Packets	Inaccurate
2001	B.1.1	Group Insurance	Average Number of Days to Process Claims	Inaccurate
<b>Total Measures Certified Without Qualification<sup>a</sup></b>				<b>1/4 (25%)</b>
<b>Data Reliability Percentage (Certified and Certified with Qualification)</b>				<b>1/4 (25%)</b>
<sup>a</sup> The percentage of unqualified certifications is presented because it is used in determining an entity's eligibility for performance rewards as established in the General Appropriations Act [77th Legislature, Article IX, Sec. 6.31(d)(2)].				

Category	Definition
Certified	Reported performance is accurate within +/-5 percent, and controls appear adequate to ensure accurate collection and reporting of performance data.
Certified with Qualification	Reported performance is within +/-5 percent, but the controls over data collection and reporting are not adequate to ensure the continued accuracy of performance data.
Factors Prevent Certification	Actual performance cannot be determined because of inadequate controls and insufficient documentation.
Inaccurate	Reported performance is not within +/-5 percent of actual performance, or there is an error rate of at least 5 percent in the supporting documentation.
Not Applicable	A justifiable reason exists for not reporting performance.

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## Quality Assurance Team Reviews

Conducted by the Legislative Budget Board and State Auditor's Office

### Completed Projects

Quality Assurance Team Annual Report – January 2002

The Employees Retirement System (ERS) completed the ERS On-line project at a total cost of \$6,637,582.

## Information System Vulnerability Assessments

The State Auditor's Office (SAO) and/or the Department of Information Resources performed one or more information system vulnerability assessments at the Employees Retirement System between January 2000 and November 2002. Detailed results of this work are confidential under Texas Government Code, Section 2054.077(c). The SAO's Legislative Summary Document titled "Information System Vulnerability Assessments" provides general information about the results of information system vulnerability assessments.

## Travel Expenditures

Travel Expenditures by Appropriation Year (unaudited)			
	2000	2001	2002
In-State Travel	\$ 86,536	\$ 55,831	\$ 59,528
Out-of-State Travel	96,365	114,083	120,395
Foreign Travel	8,449	5,851	12,840
Other Travel Costs	(734)	0	0
<b>Total Travel Expenditures</b>	<b>\$ 190,615</b>	<b>\$ 175,765</b>	<b>\$ 192,763</b>
Limit on Travel Expenditures (Cap)	Exempt <sup>a</sup>	Exempt <sup>a</sup>	Exempt <sup>a</sup>
<b>Expenditures in Excess of Cap</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 0</b>

<sup>a</sup> Travel expenditures are not subject to a travel cap because travel costs are paid from non-appropriated funds. Travel caps apply only to travel expenditures paid by appropriated funds. (General Appropriations Act, 77th Legislature, IX-1, Sec 1.01)

Source: Uniform Statewide Accounting System (USAS) as of November 30, 2002.