OVERVIEW

Management and Performance Audit of the Employees' Retirement System

Report No. 02-19, December 2002

Summary

During the 2002 legislative session, House Concurrent Resolution No. 130 requested that the State Auditor conduct a management and performance audit of the Employees' Retirement System (ERS). The Legislature was particularly concerned about the ERS' delay in terminating an under-performing investment manager that employs the former administrator of the ERS. To assist in this review, the State Auditor engaged the investment firm of New England Pension Consultants, Inc.

In our examination, we found that the ERS continues to fail in its efforts to provide quality retirement service to its members. The ERS has allowed both processing time and the number of retirees awaiting finalization of benefits to increase significantly. For example, we found that the current average finalization time has now increased to about 18 months. This is three times longer than the average finalization time reported in FY1997-98. In one example, we found that the ERS allowed a retiree's final benefit to languish for 14 years before informing the retiree that he needed to purchase additional service credits for $1,500 and to return $6,200 in ERS overpayments. While this case may be an aberration, having retirees wait an average of 18 months to finalize their retirement benefits is too long and unacceptable by any reasonable standard. Such delays become more acute when you consider that no interest is paid on any underpayment of a retirees' estimated pension. In our test sample, we found one retiree who was underpaid a total of $10,000 over two years. In addition, the number of retirees awaiting final pension calculation increased from 1,100 as of June 30, 1999 to 2,523 as of August 30, 2002—an increase of over 129 percent.

We also found that the ERS' main computer system, a 16-year-old Wang computer, is inefficient and ineffective, hindering the retirement system's ability to fulfill its mission. We found that the ERS management failed to properly manage and control the development and implementation of the Automated Retirement Information Exchange System (ARIES) project, resulting in reciprocal lawsuits between the ERS and its computer contractor. In addition, the computer monitor hired by the ERS to monitor the performance of the computer vendor was unable to manage the progress of the new computer system, resulting in more than $3.5 million in wasted resources. Until this legal conflict is resolved, the ERS' antiquated computer system will continue to be a detriment to its ability to improve operations.

We also found that the Board of Trustees failed to properly manage the beneficiaries' assets. We found that the ERS' investment consultant's objectivity could be suspect, since the consultant disclosed financial relationships with the majority of investment managers it has recommended to the board. These financial relationships can include providing consulting services to money managers on strategy and

marketing/sales implementation, software and database information on money managers' performance, and research findings. It is not uncommon for a consultant to charge a money manager in excess of $200,000 for such advice and services—the same people that pension systems pay the consultant to evaluate.

Finally, we found that the board's investment performance to be poor. Our analysis showed that the ERS' total return on investments over the past five years ranked below the bottom 15 percent nationally when compared with other retirement systems. In addition, the handling of an under-performing investment manager was questionable and may have cost the ERS as much as $128 million. Such questionable performance should compel the board to clearly define its role and that of the investment staff, and to balance its investment advisor's recommendations by considering a competitive selection process for investment managers.

Recommendations and Response

We recommended that the ERS reexamine its management procedures to ensure that it can efficiently and effectively oversee the administration's operations to provide quality services to its beneficiaries. We also recommended that the ERS properly plan and replace its obsolete computer system to better meet the needs of the system. Finally, we recommended that the board review its responsibilities and investment strategy to fulfill its fiduciary duties and improve its management of the ERS' investments.

The ERS did not dispute our recommendations, but noted that the recommendations did not provide sufficient detail and substance to make any improvements. The ERS disagreed with most of our findings but agreed with some of the issues in the report. Specifically, the ERS agreed with some of the issues related to its failure to provide its members with retirement benefits and information in a timely manner. The ERS also acknowledged that the current computer system is obsolete. However, the ERS expressed concerns over our publication of the material on the implementation of the ARIES computer system. However, we have proceeded to publish inasmuch as the material is public information and the ERS would have to contend with the lawsuits regardless of this audit report.

The Board of Trustees responded that it agreed that the long-term relative performance has been under its own benchmarks and accepts responsibility for this performance. However, the board responded that our report does not recognize the positive investment decisions made in the management of the retirement systems' assets.

Finally, the board responded that our report demonstrated some serious faults in its assessments and recommendations on the investment decisions of the retirement system's assets.

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