MISSOURI LOCAL GOVERNMENT EMPLOYEES RETIREMENT SYSTEM
THREE YEARS ENDED JUNE 30, 2000

From The Office Of State Auditor
Claire McCaskill

AUDIT REPORT

Report No. 2001-31
April 12, 2001
www.auditor.state.mo.us

Office Of The
State Auditor Of Missouri
Claire McCaskill

April 2001

www.auditor.state.mo.us

YELLOW SHEET

The following report is our review of the Missouri Local Government Employees Retirement System.

The State Auditor is required by state law to review the audits of the Missouri Local Government Employees Retirement System. The system's Board of Trustees has contracted with a certified public accounting firm to perform annual financial audits of the system. The scope of this review included, but was not necessarily limited to, the period of July 1, 1997 to June 30, 2000.

During our review, we noted that the system's Board of Trustees has not formally solicited proposals for the auditing service, actuarial consulting service, investment consulting service, or medical consulting service contracts in recent years. The Board spends approximately $24,000, $300,000, $135,000, and $19,000, respectively, for these services annually. The Board has not solicited proposals for some of these services for over twenty years. Without requesting proposals for such services periodically, the Board of Trustees has not ensured it will receive these services at a fair price.

We recommended that the Missouri Local Government Employees Retirement System Board of Trustees periodically solicit proposals for all professional services.

The Missouri Local Government Employees Retirement System was created under an act of the 74th General Assembly, commenced actual operations on April 1, 1968, and is governed by state law. The Missouri Local Government Employees Retirement System is an agent multiple-employer, statewide public employee retirement plan for units of local government. The system is a defined benefit plan providing retirement, death, and disability benefits to its members.

Any political subdivision (unit of local government such as a city, county, or special district) of Missouri is eligible to join the system. Once a political subdivision elects membership in Missouri Local Government Employees Retirement System, all current and future eligible employees are legally required to become members of the system. A summary of the retirement, death, and disability benefits provided to members is included in our report.

<u>Copies of this audit are available upon request.</u>

MISSOURI LOCAL GOVERNMENT EMPLOYEES
RETIREMENT SYSTEM

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CLAIRE C. McCASKILL
Missouri State Auditor

Honorable Bob Holden, Governor
and
Board of Trustees
and
William R. Schwartz, Executive Secretary
Missouri Local Government Employees Retirement System
Jefferson City, Missouri 65102

The State Auditor is required by Section 70.605.18, RSMo 2000, to review the audits of the records and accounts of the Missouri Local Government Employees Retirement System. The Board had engaged KPMG, LLP, Certified Public Accountants (CPA) to perform the annual financial audits of the system for the years ended June 30, 2000, 1999, and 1998. We reviewed the reports and substantiating workpapers of the CPA firm. The scope of our review included, but was not necessarily limited to, the period of July 1, 1997 to June 30, 2000. The objectives of this review were to:

1. Review certain financial activity and related procedures, and examine compliance with certain constitutional provisions, statutes, administrative rules, and attorney general's opinions.

2. Examine certain management practices.

Our review was made in accordance with applicable generally accepted government auditing standards and included such procedures as we considered necessary in the circumstances. In this regard, we reviewed the system's board minutes, various contracts, and other pertinent policies, and discussed various system procedures with applicable personnel.

As a part of our review, we assessed the system's management controls to the extent we determined necessary to evaluate the specific matters described above and not to provide assurance on those controls. With respect to management controls, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation.

Our review was limited to the specific matters described above and was based on selective tests and procedures considered appropriate in the circumstances. Had we performed

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additional procedures, other information might have come to our attention, which would have been included in this report.

The accompanying Statistical Section is presented for informational purposes. This background information was obtained from the system's management and was not subjected to the procedures applied in our review of the Missouri Local Government Employees Retirement System.

The accompanying Management Advisory Report presents our findings arising from our review of the Missouri Local Government Employees Retirement System.

Claire McCaskill
State Auditor

February 9, 2001 (fieldwork completion date)

The following auditors participated in the preparation of this report:

Director of Audits:	Kenneth W. Kuster, CPA
Audit Manager:	Douglas J. Porting, CPA
In-Charge Auditor:	Heather M. Thompson

MANAGEMENT ADVISORY REPORT SECTION

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MISSOURI LOCAL GOVERNMENT EMPLOYEES RETIREMENT SYSTEM
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In addition to our review of the reports and substantiating working papers of KPMG, LLP, we included those procedures which we considered necessary in the circumstances.

We reviewed probable compliance with certain constitutional provisions, statutes, administrative rules, and attorney general's opinions, as we deemed necessary or appropriate. This review was not intended to provide assurance of full compliance with all regulatory provisions and, thus, did not include all regulatory provisions which may apply. Nevertheless, our review disclosed no conditions that represent significant violations.

During our review, we identified a certain management practice which we believe could be improved. Our review was not designed or intended to be a detailed study of every system, procedure, and transaction. Accordingly, the finding presented in our report should not be considered as all-inclusive of areas where improvements may be needed.

Professional Services Contracts

The Missouri Local Government Employees Retirement System (LAGERS) Board of Trustees has not formally solicited proposals for the auditing service, actuarial consulting service, investment consulting service, or medical consulting service contracts in recent years. The Board spends approximately $24,000, $300,000, $135,000, and $19,000, respectively, for these services annually. The Board has not solicited proposals for some of these services for over twenty years. Without requesting proposals for such services periodically, the LAGERS Board of Trustees has not ensured it will receive these services at a fair price.

WE RECOMMEND the LAGERS Board of Trustees periodically solicit proposals for all professional services.

AUDITEE'S RESPONSE

The Board Chairperson responded as follows:

In our most recent selection of outside counsel, the LAGERS Board of Trustees went through a very detailed review of proposals from numerous law firms before making a selection. A similar process is used in the selection of new investment management firms. We work in conjunction with our investment consultant and review numerous firms before deciding on those to be interviewed. In addition, we retain consultants to review and recommend various carriers and brokers for all of our risk management activities. Thus, we feel we are complying with your recommendation for all new professional service providers.

You did cite specifically in your report those professional service providers that provide auditing, actuarial, investment consulting, and medical consulting services for the system. These four firms are retained by the Board of Trustees and serve at the pleasure of the Board. The Board has delegated to the Executive Secretary the ability to negotiate fees with these firms and we are satisfied that the fees that have been negotiated are not only competitive but substantially below those fees being paid by other retirement systems of similar size. We feel that as long as we are confident and satisfied with the services being provided and the current fee arrangement with these firms, that there would be little, if any, advantage in requesting proposals from other firms for these services. In fact, requesting proposals from other firms may, in fact, cause the cost of current services to go up considerably.

This report is intended for the information of the system's management and other applicable government officials. However, this report is a matter of public record and its distribution is not limited.

STATISTICAL SECTION

History, Organization, and
Statistical Information

MISSOURI LOCAL GOVERNMENT EMPLOYEES RETIREMENT SYSTEM
HISTORY, ORGANIZATION, AND STATISITICAL INFORMATION

The Missouri Local Government Employees Retirement System (LAGERS) was created under an act of the 74th General Assembly, commenced actual operations on April 1, 1968, and is governed by Sections 70.600 to 70.755 of the Revised Statutes of Missouri. The LAGERS is an agent multiple-employer, statewide public employee retirement plan for units of local government. The LAGERS is a defined benefit plan providing retirement, death, and disability benefits to its members.

The responsibility for the operation and administration of the retirement system is vested in the LAGERS Board of Trustees, consisting of three elected LAGERS members, three employer trustees who are not members of LAGERS and are elected or appointed by the governing bodies of employers, and one trustee appointed by the governor, who is neither covered by LAGERS nor a member of a governing body of any participating political subdivision. All members serve four year terms. As of June 30, 2000, the members of the Board of Trustees were:

Name	Position	Membership	Term Expires
Jeffrey D. Moreland	Chairperson	Member Trustee	December 31, 2002
J. Robert Ashcroft	Vice Chairperson	Employer Trustee	December 31, 2001
Dr. Donald E. Clark*	Member	Employer Trustee	December 31, 2000
Victor Gragg	Member	Employer Trustee	December 31, 2002
Nancy Yendes*	Member	Member Trustee	December 31, 2000
Gary Findlay**	Member	Citizen Trustee	December 31, 1999

* These members were re-elected for another term expiring in December 2004.

** Although term had expired, continued to serve until a new Citizen Trustee was appointed by the Governor in October 2000. Claire West currently fills the position of the Citizen Trustee. The term expires December 31, 2003.

As of June 30, 2000, one Member Trustee position was vacant due to the resignation of Steve Ellsworth during June 2000. The position was filled by Tara Calvin in October 2000.

William R. Schwartz serves as the Executive Secretary to the board. The Executive Secretary acts as advisor to the board on all matters pertaining to the system and, with the approval of the board, contracts for professional services and employs the remaining staff needed to operate the system. At June 30, 2000, the retirement system had twelve employees, including the Executive Secretary.

The Board of Trustees has appointed Gabriel, Roeder, Smith and Company, of Southfield, Michigan as actuarial consultants. As of June 30, 2000 the following investment managers held investments for the LAGERS: Barclays Global Investors, of San Francisco, California; Chartwell Investment Partners, of Berwyn, Pennsylvania; Dimensional Fund Advisors, of Santa Monica, California; Hansberger Global Investors, of Fort Lauderdale, Florida; Hoisington Investment Management, of Austin, Texas; INVESCO Capital Management, of Atlanta, Georgia; Nicholas-Applegate Capital Management, of San Diego, California; Pacific Investment Management Company, of Newport Beach, California; Rockwood Capital Advisors, of St. Louis, Missouri; Wachovia Bank of Georgia Timberland Investment Management, of Atlanta, Georgia; AEW Real Estate Advisors, of Boston, Massachusetts; and Westmark Realty Advisors, of Los Angeles, California. Northern Trust Company, of Chicago, Illinois serves as the system's master custodian. Summit Strategies Group, of St. Louis, Missouri serves as the system's investment consultant. Armstrong Teasdale, LLP, of Jefferson City, Missouri serves as the system's legal counsel.

As of June 30, 2000, there were 449 participating political subdivisions in the system which included 28,491 active members, 249 inactive members, and 8,789 retirees and beneficiaries.

Membership, required contributions, and benefits provided under LAGERS are generally as follows:

Eligibility

Any political subdivision (unit of local government such as a city, county, or special district) of Missouri is eligible to join LAGERS. Once a political subdivision elects membership in LAGERS, all current and future eligible employees are legally required to become members of the system. Participation in LAGERS is considered to be a condition of employment with a member subdivision.

Employee Contributions

Political subdivisions may participate in LAGERS under either a contributory or non-contributory plan. If the subdivision participates under the contributory plan, each member contributes four percent of gross salary after completion of six months of service with the subdivision. If a member terminates LAGERS covered employment before any benefits are payable, the employee's own contributions, plus interest, are fully refundable upon request. If a member is reemployed in a position covered by the system within four years from the time membership last terminated, the member has the option to repay to the system the amount refunded, plus any regular interest, and reinstate the service previously forfeited.

Employer Contributions

The political subdivisions served by LAGERS are required to contribute the remaining amount above that contributed by their members to finance the benefits that the political subdivision has promised their employees through their participation in LAGERS. These employer contributions are determined annually by the system's retained actuary and are based upon level-percent-of-payroll funding principles so that the contribution rates do not have to increase over decades of time.

Age and Service Allowance

This is the normal retirement benefit and is payable monthly for the lifetime of a member. The age and service allowance retirement benefits are based on a formula which multiplies final average salary, by the applicable benefit factor, by the years of creditable service and, in the case of early retirement, by an age reduction factor. Each employer elects the benefit factor percentage applicable to its members from nine available programs. Final average salary is the average of a member's monthly pay during the period of sixty consecutive months of credited service producing the highest monthly average, which is contained within the 120 consecutive months of credited service immediately preceding retirement. A participating LAGERS subdivision may, by majority vote of the governing body, elect to have their future retirants' benefits calculated using a thirty-six month final average salary period.

NORMAL RETIREMENT

A member may retire with an age and service allowance after completing at least five years of credited service, and attaining age sixty for a general employee and age fifty-five for law enforcement or fire personnel. Employers may, by majority vote of the governing body, select an alternative unreduced retirement for employees whose age and service total eighty or more years, with at least five years of credited service.

EARLY RETIREMENT

A member may retire with an early retirement allowance after completing five years of credited service, and attaining age fifty-five for a general employee or age fifty for a law enforcement or fire member. The early allowance amount is computed in the same manner as an age and service allowance, but reduced to reflect the fact that the age when payments begin is younger than the minimum service retirement age. The amount of the reduction is ½ percent of 1 percent (.005) for each month the retirant is younger than the minimum service retirement age.

PAYMENT OPTIONS

A member may elect to receive the benefits payable under one of four options. The Life Option provides a full monthly benefit to the retirant until his death. Two other options provide a reduced benefit to the retirant and a survivor benefit in varying degrees after the retirant's death. The fourth option provides a reduced monthly benefit for the lifetime of the retirant, but additionally guarantees at least 120 monthly payments will be made either to the retirant or his beneficiary.

Cost-of Living Adjustments

All retired members are eligible for an annual post-retirement cost-of-living adjustment beginning the October 1st at least twelve months after the effective date of their allowance. The adjustment, determined annually by the Board of Trustees, is based on the lower of the increase in the Consumer Price Index or four percent per year. These increases are contingent upon the financial solvency of the system.

Deferred Retirement

If a member leaves LAGERS covered employment before attaining early retirement age, but after completing five or more years of service, he becomes eligible for a deferred allowance; provided he lives to his early retirement age and does not withdraw his accumulated contributions, if applicable. Certain deferred members may be eligible for a limited lump-sum payment. Any deferred benefits paid prior to the member attaining his minimum service requirement age will be reduced ½ of 1 percent for each month the retirant is younger than his minimum service age requirement.

Disability Benefits

There are two categories of disability benefits:

> **Non-Duty Disability:** A member with five or more years of credited service who becomes totally and permanently disabled from performing his job, from other than duty connected causes, is eligible for a non-duty disability benefit computed in the same manner as an age and service allowance, based upon length of service and salary to time of disability with no reduction for age.
>
> **Duty Disability:** A member who becomes totally and permanently disabled from performing his job, from a duty related injury or disease, is eligible for a duty disability benefit computed in the same manner as an age and service allowance, but based upon the years of service the member would have completed had he continued in LAGERS covered employment to age sixty.

In the case of both non-duty and duty disability benefits, there is a limitation on total compensation from all sources received by a disability retirant of 100 percent of final average salary. Continuing medical examinations are required to confirm the disability once per year for the first five years and once every three years thereafter until reaching the minimum service retirement age.

Survivor Benefits

There are two categories of survivor benefits:

> **Non-Duty Death:** Upon the death of a member who had completed at least five years of credited service, his eligible surviving dependents receive the following benefits: 1.) the surviving spouse receives an allowance equal to the Option A allowance (joint and 75 percent survivor benefits) computed upon the deceased member's service and salary to time of death. If the surviving spouse is less than age forty, the benefit is payable for no more than ten years; if over age forty, the

benefit is payable for life; 2.) when no spouse benefit is payable, the dependent children under age eighteen (twenty-three if they are full-time students) each receive an equal share of sixty percent of an age and service allowance computed upon the deceased member's service and salary to time of death.

Duty Death: If a member's death was the natural and proximate result of a personal injury or disease arising out of and in the course of his actual performance of duty as an employee, the spouse is eligible for a duty death benefit computed in the same manner as an age and service allowance, but based upon the years of service the member would have completed had he continued in LAGERS covered employment to age sixty. The surviving spouse receives an allowance equal to the Option A allowance (joint and 75 percent survivor benefits). If the surviving spouse is less then age forty, the benefit is payable for no more than ten years; if over forty, the benefit is payable for life. When no spouse benefit is payable, the dependent children under age eighteen (twenty-three if they are full-time students) each receive an equal share of sixty percent of the life allowance computed for the deceased member.

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