

# LEGISLATIVE AUDIT DIVISION

Tori Hunthausen, Legislative Auditor  
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors:  
Cindy Jorgenson  
Angie Grove

## MEMORANDUM

**TO:** Legislative Audit Committee Members  
**FROM:** Angus Maciver, Performance Audit Manager  
**CC:** David Senn, Director, Teachers' Retirement System  
Roxanne Minnehan, Director, Montana Public Employee Retirement Administration  
**DATE:** June 2012  
**RE:** Performance Audit Follow-up (12SP-34): *Analysis of Retirement Benefit Inflation in Montana's State Pension Systems* (10P-10)  
**ATTACHMENT:** Original Performance Audit Summary

### Introduction

In December 2010, we presented our performance audit *Analysis of Retirement Benefit Inflation in Montana's State Pension Systems*. The audit included four recommendations. In May 2012, we gathered information from the Teachers' Retirement System and Montana Public Employee Retirement Administration related to progress in implementing the recommendations. This memo summarizes the results of our follow-up work.

### **Overview**

This audit determined that retirement benefit inflation can and does occur within Montana. Retirees have been legally able to increase pension benefits by engaging in several types of actions that coincide with the period used to calculate pension benefits in order to increase retirement benefit amounts. Two recommendations addressed legislative consideration of the conditions which may allow retirement benefit inflation to occur. Two addressed the administrative agencies and concerned improvements related to the efficient collection and retention of member data. Of the recommendations calling for legislative action, one has been implemented while the other remains partially implemented. The other recommendations are being implemented.

### Background

There are eight unique defined benefit retirement systems administered at a state-wide level in Montana. These systems have historically awarded benefits based on the average compensation during a three-year period of a system member's career. Each of the systems is governed by the Public Employees' Retirement Board and administered by the Montana Public Employee Retirement Administration (MPERA) with the exception of the Teachers' Retirement System (TRS) which is governed by its own board and staffed by its own agency, also known as the Teachers' Retirement System. Both TRS and MPERA are administratively attached to the Department of Administration.

One risk associated with defined benefit plans is the possibility that employees or employers may engage in practices that increase the rate of compensation for some members only during the late stages of their

careers. This adversely impacts the financial health of retirement systems because it drives up the amount of retirement benefits that are paid out, but only includes contributions based on high compensation rates for a short period of time. Our audit work found that retirement benefits are usually but not always equitable and based on normal service history and compensation.

Because defined benefit systems guarantee a pension benefit for life, even small increases to a pension benefit can create a significant financial impact. For example, our report discussed eight examples of practices that cumulatively increased lifetime pension payments by approximately \$1.75 million. Types of practices included:

- ▶ Working significant amounts of overtime
- ▶ Receiving bonuses or other discretionary payments
- ▶ Accruing legislative service time prior to other full time public service
- ▶ Earning compensation from dual employment
- ▶ Obtaining other significant late-career compensation increases
- ▶ Seeking exemptions to existing compensation growth limits

Our recommendations called for several types of action to limit the impacts of retirement benefit inflation. Two of the recommendations addressed the methods of calculating retirement benefit amounts and two dealt with improvements to information systems for collecting member compensation and service history data.

### **Follow-Up Audit Findings**

In response to the original audit report, TRS concurred with one recommendation and conditionally concurred with the other addressed to that agency. Of the two recommendations addressed to MPERA, the agency concurred with both.

Two recommendations involved legislative action. One of these has been implemented while the other remains partially implemented. The other recommendations are being implemented. The implementation status of each recommendation is discussed in more detail in the following sections.

### **RECOMMENDATION #1**

**We recommend the Legislature consider whether the elements of compensation used in calculating retirement benefits within Montana Public Employee Retirement Administration-administered systems should be revised.**

#### **Implementation Status – Partially Implemented**

During the 2011 legislative session the Legislature passed HB 122 which increased the number of months used to determine the member's highest average compensation for new hires in the Public Employees' Retirement System, Game Wardens' and Peace Officers System, and the Sheriffs' Retirement System. Effective July 1, 2011, newly-hired members' retirement benefits will be calculated based on a highest average compensation over a period of 60 months instead of 36 months.

This action will reduce the impact on the retirement systems of large late-career increases in compensation. Since it only affects newly-hired employees and covers only some of the systems its effectiveness will not be known for many years. The legislature would have to consider revising the elements of compensation for all employees in order to have a more immediate or widespread impact on the systems.

MPERA reports that it plans to pursue sponsorship of several bills during the 2013 legislative session, including bills with the intent to:

- ▶ Cap the amount of compensation growth that is included in benefit calculations to mitigate inflation of compensation during the highest average compensation period.
- ▶ Increase the highest average compensation (HAC) period for new hires in systems that remain at a 36-month period for calculation of HAC.
- ▶ Address the inclusion of health-care premiums in the compensation definition for retirement plans.

### **RECOMMENDATION #2**

**We recommend the Teachers' Retirement System clarify the exceptions to the compensation growth limit.**

#### **Implementation Status – Implemented**

The statute (§19-20-715, MCA) restricting compensation growth that is counted toward retirement benefit calculations to 10 percent was amended in 2011 to remove all exceptions, except one. This exception is for changes in compensation that result from movement on an employer adopted salary matrix. In addition, §19-20-715, MCA, was amended to remove the Board's authority to grant any exceptions. This legislation was effective July 1, 2011, and applies to the calculation of all benefits effective after July 1, 2011.

### **RECOMMENDATION #3**

**We recommend the Montana Public Employee Retirement Administration develop electronic data storage for compensation and service data to allow for efficient use and analysis of data.**

#### **Implementation Status – Being Implemented**

In its response to our follow-up request, MPERA reported that effective December 2011 it no longer removes compensation and service data from its database when a member retires. To verify this we requested sample data for recent retirees. MPERA IT staff queried the database and provided data that included compensation and service information for the retirees.

Beginning in 2011 MPERA began a multiyear project to replace its existing pension administration software system. The agency has awarded a contract to begin the system redesign. The project is anticipated to officially start in summer 2012 with a projected system implementation date of late summer 2015. Once implemented, the new system will provide MPERA with a more efficient database structure and the ability to efficiently analyze member and retirement plan data.

### **RECOMMENDATION #4**

**We recommend the Montana Public Employee Retirement Administration and the Teachers' Retirement System collect information that is delineated by compensation type where types of reportable compensation are designated in state law.**

#### **Implementation Status – TRS: Not Implemented MPERA: Being Implemented**

The TRS Board conditionally concurred in this recommendation, recognizing that it will take effort and time on the part of the retirement system and participating employers to redesign human resource and compensation reporting systems. TRS is currently working to determine if its current database can successfully be converted to Oracle, which is the first step to expand data collection systems.

Participating employers must also access the information system used to collect data and therefore changes to their human resource and compensation reporting systems may be required. TRS staff members report the agency will continue to enhance information processing systems when possible.

As discussed in the status of Recommendation #3, MPERA is embarking upon a plan to replace its pension administration software system. This is a large, multi-year project. Phase 1 will focus on member enrollment and employer reporting. Beginning in fall 2012, MPERA and contractor staff will begin to design a new employer reporting process that will be capable of collecting compensation types as delineated by state law.

*S:\Admin\Performance\Follow-up\12SP-34-Retirement-Benefit-orig-10P-10-memo.docx/djr*