REPORT DIGEST

STATE UNIVERSITIES RETIREMENT SYSTEM
COMPLIANCE AUDIT
FOR THE TWO YEARS ENDED JUNE 30, 1994

{Selected Financial Information and Activity Measures are summarized on the reverse page.}

INTRODUCTION

This digest covers our State compliance audit of the System for the two years ended June 30, 1994. A financial audit covering the year ending June 30, 1994 was previously issued.

FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS

NEED TO ESTABLISH GUIDELINES FOR AUTOMOBILE REIMBURSEMENTS AND ALLOWANCES

The Executive Director received reimbursements for business mileage at the rate of $.25 per mile in addition to receiving an annual $7,000 car allowance.

The SURS Board authorized the Executive Director to receive an annual car allowance of $7,000 in September, 1991. The Board minutes state that the allowance "would be in addition to the salary approved each year. The Executive Director would purchase or lease a car at his discretion, and be responsible for all maintenance and operating costs."

Including the $7,000 car allowance, the Executive Director received a total of $10,200 and $10,525 for auto-related expenses in FY 93 and FY 94, respectively.

We recommended that SURS determine the actual automobile costs incurred by the Executive Director and establish appropriate methods and guidelines that ensure payments made to the Executive Director for automobile purposes take into consideration actual costs incurred. (Finding 1, page 8)

SURS officials stated, in part, that in setting the Executive Director's compensation, the System's Board of Trustees determined that in addition to the salary as set forth by the board, the Executive Director was to be provided with $7,000 from which to obtain an automobile. The System's current Executive Director uses this car allowance to lease an automobile. Further, the Board states the current methods and guidelines for reimbursement of the business use of personal automobiles is based on sound and legal principles.

Auditor's Comment: We believe that it is neither sound nor common practice to both reimburse for business mileage and provide a car allowance of $7,000 per year. Either method alone is designed to provide adequate reimbursement for all reasonable costs of operating an automobile for business purposes. However, the practice of both methods provides excessive reimbursement and appears simply to be a means of additional compensation for the Executive Director.

NEED TO REEVALUATE THE USE OF SYSTEM FUNDS FOR COUNTRY CLUB MEMBERSHIPS, DUES AND EXPENSES

SURS used System funds to pay for initiation fees, monthly dues and dining/business meeting charges to two private country clubs on behalf of its Executive Director. These payments totaled in excess of $11,000 for the two years ended June 30, 1994.

The SURS Board of Trustees approved the purchase of a social membership to the Urbana Country Club for the Executive Director in December, 1991. SURS paid a $1,500 one-time initiation fee directly to the Urbana Country Club for this membership and also paid a dues allowance of $125 a month directly to the Executive Director.

In FY94, the Executive Director joined the Champaign Country Club and discontinued the Urbana Country Club membership. Fiscal year 1994 payments made by SURS directly to the Champaign Country Club totaled $5,250 for the initiation fee and $1,980 for monthly dues. Additional charges for dining and business meetings were paid by SURS through reimbursement to the Executive Director. Although the Urbana Country Club membership was discontinued in FY94, SURS continued to pay directly to the Executive Director the $125 monthly allowance for dues to the Urbana Country Club.

We recommended that SURS reevaluate the appropriateness of using System funds to pay for country club memberships, monthly club dues and related dining/business meeting expenses. Further, Board approval of any country club memberships, dues and related expenses should be documented in Board minutes. We also recommended that SURS discontinue paying the Executive Director the $125 per month that was previously approved to pay dues at a country club where membership has been discontinued. (Finding 2, page 11)

System officials stated, in part, that the fund membership and the public's trust must be upheld. To maintain that trust and to reflect the Board's continued sensitivity to the stewardship of the fund, the membership was terminated December 31, 1994.

Auditor's comment: During the audit exit conference on February 21, 1995, the $125 monthly dues allowance authorized by the Board for the Urbana Country Club was discussed. SURS officials indicated that although the Urbana Country Club membership was terminated in FY 94, a $125 per month amount continues to be paid to the Executive Director as a general business allowance.

NEED TO ESTABLISH APPROPRIATE GUIDELINES AND CONTROLS FOR PAYMENTS MADE ON SURS CREDIT CARDS

Certain expenditures incurred by employees using SURS-provided credit cards do not appear to be reasonable and necessary, and some are not supported by adequate documentation.

We noted seven instances totaling $3,625 where goods purchased by a SURS employee did not appear, from the documentation provided, to be reasonable and necessary expenditures of the System.

Further, we noted 24 instances totaling approximately $4,572 where meals charged by a SURS employee while on travel status exceeded $40 per person. In part, these charges also included expenditures for meals of other SURS employees, SURS consultants, and executives of other organizations. In these instances, it appears the meal expenses were unreasonable and significantly exceeded the out-of-town per diem rate for meals of $24 per day as established by the Higher Education Travel Control Board.

Additionally, we noted 14 instances totaling approximately $2,162 where meals charged by a SURS employee included companions (i.e. spouses, dining companion's spouses or both). In these instances, there is an apparent lack of specific documentation as to why these expenditures were necessary.

Although travel vouchers were completed for other expenses incurred while on travel status, meals billed directly to a SURS credit card were not documented on travel vouchers and thus were not properly certified expenses.

Ninety charges for out-of-town lodging billed directly to a SURS credit card were reviewed, noting 30 instances where the daily rate charged for accommodations exceeded the maximum allowable rates as established by the Higher Education Travel Control Board. These 30 instances were in excess of the allowable $60 per night in the Chicago Metro Area, $50 per night in areas outside the Chicago Metro Area, and $90 for out-of-State lodging per night. Actual charges in the Chicago Metro Area ranged from $85 to $220 per night. Actual charges for areas outside the Chicago Metro Area ranged from over $50 to $234 per night.

The Administrative Code addresses specific instances where exceeding the rate is allowable, but requires documentation of these occurrences on the individual travel voucher. Thirty instances were noted where the travel voucher did not contain adequate documentation to substantiate the rate.

We recommended that SURS establish appropriate guidelines and controls to ensure payments made on SURS credit cards are for reasonable and necessary expenditures of the System. Further, all travel expenses including meals and lodging paid by a SURS credit card should be adequately documented on the respective travel voucher. (Finding 3, page 13)

System officials stated that SURS has enhanced its written policies for expense documentation of all System expenses. In addition, SURS has placed responsibility for payment of expenses made on SURS credit cards on the employee, requiring the employee to ask for reimbursement item by item, providing the required documentation.

NEED TO CLARIFY AUTHORITY FOR BONUS PAYMENTS AND SEVERANCE AGREEMENTS

The Board is authorized under the Pension Code "to employ and fix the rate of pay" of System employees. However, certain personal services practices in FY 94 were not carried out consistent with that authority.

The Board established a pool of bonus money for distribution to the System's five exempt employees. The actual amount received by an eligible employee was determined by the Board's Executive Committee and any of the Board's past presidents who are still Board members, but not by the full Board. The bonuses were not included in the receiving employee's base pay and were given in addition to annual raises. During FY94, the System paid a total of $28,000 in bonuses to the five exempt employees.

In FY94, the System entered into severance agreements with its five exempt employees to provide post-termination benefits under specified circumstances. The draft agreement was approved by the Board in December, 1993 and was contained in the Board minutes. However, the agreement that was ultimately executed by the System differ in some details. Further, the agreement that was executed contains bracketed areas where additional terms and conditions were to be inserted but were not in fact inserted before the agreement was signed by the parties. Because of these omissions, aspects of the agreement are unclear.

We recommended that the Board clarify its authority to grant add-ons to rates of pay, such as bonuses, and to enter into agreements to provide post termination benefits. We further recommended that the Board allocate salary and other emoluments to System employees consistent with statute. We also recommended that the terms and conditions of contractual agreements be finalized before the contract is signed by the parties. (Finding 4, page 16)

System officials stated, in part, that their actions are consistent with the statutes applicable to the System and such statutes do not prohibit the Board from authorizing the discretionary income and agreements referred to above. The Board has simply retained the flexibility to adjust the discretionary income component of compensation to reflect performance and has chosen to pay the discretionary income portion of total compensation in biannual lump sums rather than every pay period to enhance retention.

The severance agreements involve payments to be made in the event of the termination of certain key executives employed by the System under certain circumstances outlined in the agreements. The agreements also serve to retain these key executives during adverse conditions. The forms of severance agreements that were executed had not been finalized due to a clerical error. This oversight has been corrected, and the contracts have been re-executed.

Auditor's comment: The re-executed severance agreements have not been provided to the external auditors. These documents will be requested for examination in our next regularly scheduled audit of the System.

OTHER FINDING

The remaining finding is less significant and the System is addressing it. We will review the System's progress in implementing our recommendations in our next audit.

Mr. Bryan Bloom, Assistant Executive Director at the System provided responses to our recommendations. All responses were received on March 3, 1995.

DERIVATIVES

The System periodically invests in derivative securities. A derivative security is an investment whose payoff depends upon the value of other assets such as commodity prices, bond and stock prices, or a market index. The System's investments in derivatives are not leveraged. In the case of an obligation to purchase (long a financial future or a call option), the full value of the obligation is held in cash or cash equivalents. For obligations to sell (short a financial future or a put option), the reference security or cash is held in the portfolio. All of the

System's trades are done through a clearinghouse which guarantees delivery and accepts the risk of default by either party. As of June 30, 1994, the System held both financial futures and financial options.

Financial futures are an agreement to buy or sell a specific amount at a specified delivery or maturity date for an agreed-upon price. As the market value of the futures contract varies from the original contract price, a gain or loss is recognized and paid to the clearinghouse. Financial futures represent an off-balance sheet obligation. The cash or securities to fulfill these obligations are held in the investment portfolio. As of June 30, 1994, the System was long 2,161 Treasury Bond and Note financial futures contracts with a book value of $227,437,469 and a market value of $221,727,594. The System also held Canadian, French, Japanese and United Kingdom stock index futures reflected in the listing of assets, with a total book value of $64,352,147 and a market value of $63,244,626.

Financial options are an agreement that gives one party the right, but not the obligation, to buy or sell a specific amount of an asset for a specified price, called the strike price, on or before a specified expiration date. The gains or losses arising from financial options are recognized at the time the options are exercised or when they expire. As of June 30, 1994, SURS had 12,300 options contracts outstanding, a balance sheet liability. The liability is the result of a net short position. The book value of ($3,676,969) represents the excess of premiums collected over premiums paid. The market value of ($4,395,132) represents the amount needed to close all positions as of June 30, 1994.

WILLIAM G. HOLLAND, Auditor General

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SUMMARY OF AUDIT FINDINGS

Number of	This Audit	Prior Audit
Audit Findings	5	3
Repeated audit findings	0	0
Recommendations implemented or not repeated	3	0

SPECIAL ASSISTANT AUDITORS

KPMG Peat Marwick, LLP were our special assistant auditors for these audits.

STATE UNIVERSITIES RETIREMENT SYSTEM
INFORMATION FROM FINANCIAL AND COMPLIANCE AUDITS
Two Years Ended June 30, 1994

FINANCIAL OPERATIONS	**FY 1994**	**FY 1993**
Revenues		
Contributions		
Participants	$183,070,148	$175,700,619
Federal, trust funds, other	31,520,427	22,823,652
State of Illinois	102,015,800	104,728,100
Other	246,584	255,071
Total Contributions	$316,852,959	$303,507,442
Net investment income	214,097,427	194,805,603
Gain on sale of investments	62,848,253	84,922,022
Total Revenues	$593,798,639	$583,235,067
Expenses		
Total benefits	$304,034,754	$265,140,179
Other expenses	31,357,219	31,006,505
Total Expenses	$335,391,973	$296,146,684
Revenues in excess of Expenses	$258,406,666	$287,088,383
INVESTMENT PORTFOLIO ANALYSIS (Book Value)	**JUNE 30, 1994**	**JUNE 30, 1993**
Total common stock	$2,037,992,225	$1,908,438,004
Preferred stock	46,784,931	17,250,000
Total fixed income securities	1,651,080,168	1,636,089,883
Short-term investments	299,635,484	169,871,919
Real estate investments	392,788,636	432,918,113
Total Investments at Book Value	$4,428,281,444	$4,164,567,919
Total Investments at Market Value	$5,156,627,224	$5,132,202,991
ADMINISTRATIVE EXPENSES	**FY 1994**	**FY 1993**
Personal services	$2,837,792	$2,574,200
Other professional services	1,893,925	2,398,335
Depreciation	1,452,455	1,005,461
Postage, freight, and expenses	266,951	284,604
Equipment repair and rental	260,379	185,898
Printing and copying services	238,575	272,295
Building operations expenses	234,326	194,937
Other expenses	581,726	649,413
	$7,766,129	$7,565,143
SELECTED ACCOUNT BALANCES	**JUNE 30, 1994**	**JUNE 30, 1993**
Contributions receivable	$ 12,766,206	$ 19,738,752
Prepaid expenses	21,299	36,032
Accrued investment income receivable	15,466,835	15,379,251
Investments, at cost	4,428,281,444	4,164,567,919
Property and equipment	10,075,858	9,780,343
Total Assets	$4,466,611,642	$4,209,502,297
Total Liabilities	$ 19,669,887	$ 20,967,208
Fund balance (reserved):		
Participant contributions	2,362,661,861	2,196,593,367
Benefits from employee and employer contributions		
Unfunded accrued actuarial liability	6,222,850,139	5,641,592,633
Total Fund Balance	(4,138,570,245)	(3,649,650,911)
Total Liabilities and Fund Balance	$4,446,941,755	$4,188,535,089
	$4,466,611,642	$4,209,502,297
SUPPLEMENTARY INFORMATION	**FY 1994**	**FY 1993**

Total investment manager fees	$11,296,326	$10,568,554
Return on investments	.8%	11.2%
Average number of employees	79	78
Number of active members	80,350	78,605
Number of inactive members	17,756	13,890
Number of retirement benefit recipients	17,400	16,200
Number of survivors benefit recipients	4,100	4,000
Number of disabilities benefit recipients	1,100	1,100

EXECUTIVE DIRECTOR(S)

During Audit Period: Dennis Spice
Currently: Dennis Spice