Report Highlights

State Police Pension and Retirement System

January 2005

Louisiana Legislative Auditor

The State Police Pension and Retirement System (STPOL) is a retirement plan created by state law to provide retirement benefits for Louisiana state police officers and their beneficiaries. The system's membership as of June 30, 2004, consisted of 2,128 members of which 1,091 are retired. STPOL's primary goal is to safeguard and manage the funds it holds in trust so that future benefits are guaranteed and protected.

As directed by Senate Concurrent Resolution Number 14 of the 2004 Regular Session, we examined various aspects of STPOL's investment activities, including the system's asset allocation policy, investment return data, investment contractor fees, selection and monitoring of investment advisors, and corrective actions for underperforming investment advisors.

Audit Results

- STPOL's long-term investment returns have exceeded the system's actuarially assumed rate of return (of 7.5%). However, over the long-term, of STPOL's four broad asset classes, only one (international equity) has beaten its comparable benchmark index while the other three (large cap equity, small cap equity, and fixed income) have underperformed their benchmark indices.
- STPOL has developed and implemented an investment policy that allocates system assets by balancing risks with returns. STPOL monitors compliance with the asset allocation component of its investment policy and makes adjustments to its portfolio when needed.
- The fees STPOL is paying to more than half of its investment managers are higher than the averages of similar sized pension plans, according to a fee survey conducted by Greenwich Associates.
- STPOL's consultant's and custodian's fees are lower than average for similarly sized systems, according to a survey conducted by Greenwich Associates. However, estimates we obtained from two Baton Rouge banks indicate that STPOL may be able to lower its fees by conducting a custodian search.
- STPOL uses competitive, objective procedures to select its money managers and consultant. However, the system has no formal, written selection policies which may lead to inconsistency in its selection processes.
- STPOL uses objective procedures to monitor its investment managers and consultant but needs to formalize its monitoring policies.
- STPOL does take corrective action when the performance of its investment managers or consultant is below benchmarks or the system's expectations.
- STPOL does employ some policies and procedures to avoid conflicts of interest. However, in a possible violation of the Louisiana Code of Governmental Ethics, we found instances where gifts, although immaterial, were accepted by STPOL's key staff and consultant from investment managers and the consultant.
- STPOL's trustees have accepted meals from its investment managers and custodian. STPOL trustees are responsible for selecting, monitoring, and evaluating these same investment managers and custodian. Although such meals are allowed by the Code of Ethics, they may give the appearance of a conflict of interest.

Steve J. Theriot, CPA

Legislative Auditor

How Do the Investment Returns for Different Asset Classes of STPOL Compare to Relevant Benchmarks?

- STPOL's investment returns have exceeded the system's actuarially assumed rate of return (7.5%) by 1.61 percentage points over 10 years and 1.14 percentage points since inception (1990).
- Most of the investment returns being reported by STPOL's consultant are "gross of fees," which means that the investment managers' fees have not been subtracted when computing the rate of return. Therefore, we could not precisely determine the degree to which STPOL's overall long-term return, after subtracting investment fees, exceeded the actuarially assumed rate of return.
- Long-term investment returns for STPOL's Large Cap Equity, Small Cap Equity, and Fixed Income asset classes were below their relevant benchmark indices. If STPOL had invested in the benchmark index for each asset class since inception of that class, it would have almost $15.8 million more in assets, as of June 30, 2004.

- STPOL's investment consultant does not summarize and present the system's investment returns by asset classes.

RECOMMENDATIONS

- ✓ STPOL should ensure that future investment return data are presented as "net of fees."
- ✓ STPOL should require its consultant to include investment return data by asset class in the quarterly investment reports.
- ✓ STPOL should determine why its long-term investment returns for the Large Cap Equity, Small Cap Equity, and Fixed Income portfolios were below their respective benchmark indices and take appropriate corrective action.

Has STPOL Developed and Implemented an Investment Policy That Allocates System Assets by Balancing Risks With Returns on Investments and Ensures That Investments Are of Sufficient Quality to Minimize the Risk of Loss of System Assets?

- STPOL has implemented an investment policy that allocates system assets by balancing risks with returns on investments. STPOL's investment policy ensures that investments are of sufficient quality to minimize the risk of loss.
- STPOL has no policies concerning cash management because the system receives more cash annually then it has to pay out. STPOL currently receives $21 million from the state general fund annually to help pay off its original unfunded accrued liability (UAL).

Does STPOL Monitor Compliance With the Asset Allocation Component of the System's Established Investment Policy?

- STPOL officials and the system's consultant review the system's asset allocation at least quarterly and, if necessary, adjust the amount invested in an asset class to rebalance asset amounts toward the established targeted guidelines.

How Do STPOL's Investment Manager, Consultant, and Custodial Fees and Charges Compare to Other Pension Plans?

- The fees STPOL is paying to more than half of its investment managers are higher than the averages of similarly sized pension plans, according to a fee survey conducted by Greenwich Associates. For example, STPOL pays between 20% and 30% higher fees for its two international equity managers than do similar sized systems.

- STPOL's consultant and custodian fees are lower than similarly sized pension plans, according to the Greenwich survey. However, the system may be able to achieve cost savings by conducting a custodian search/evaluation.
- We could not find documentation in STPOL's files and contracts to support the fee structure and amounts of fees being paid to three of STPOL's nine money managers.

RECOMMENDATIONS

- ✓ STPOL should ensure that its contracts with money managers detail the fee structure.
- ✓ STPOL should require all money managers, including commingled trusts, to submit regular statements detailing all fees, expenses, foreign taxes, etc., paid from STPOL's account.
- ✓ STPOL should review all quarterly/monthly statements from money managers to ensure that charges to STPOL accounts are accurate.

Does STPOL Use Competitive, Objective Procedures With Performance Based Criteria to Select Investment Managers, Investment Consultants, and Custodians?

- STPOL uses appropriate, competitive criteria for the selection of money managers and consultants; however, the system has no formal, written investment policies relating to the selection of managers and consultants.

RECOMMENDATION

- ✓ STPOL should include selection criteria for investment professionals (money managers, consultants, and custodians) in its investment policy.

Does STPOL Use Objective Procedures With Performance Based Criteria to Monitor Investment Managers (Including Investment Performance and Churning), Investment Consultants, and Custodians?

- STPOL's consultant, staff, and trustees are in compliance with STPOL monitoring policies, which stipulate that investment manager performance be compared to relevant benchmarks and peer groups.
- STPOL has no policies in place requiring its staff to monitor its custodian or to reconcile the custodian's data. However, every quarter the system's money managers inform STPOL that they have reconciled their balances to those maintained by the custodian. The consultant also reconciles money manager and custodial account balances.
- STPOL has monitored and evaluated the performance of the system's consultant by having the staff and trustees rate the consultant's performance, but STPOL has no policies concerning consultant evaluation.
- STPOL informally reviews an investment manager's trading turnover ratio to monitor whether the manager is churning STPOL's account.

RECOMMENDATIONS

- ✓ STPOL should develop and implement written policies for custodial reviews at least annually.
- ✓ STPOL should develop and implement written policies for consultant reviews (at least annually). These policies should state the frequency of evaluations and the areas to be evaluated.
- ✓ STPOL should review the quarterly reconciliation done by the consultant of the account balances furnished by the custodian and the investment managers.
- ✓ STPOL should develop and implement written policies for the monitoring of churning.

If Performance by Investment Managers, Investment Consultants, or Custodians Is Below Relevant Benchmarks, Does STPOL Take Corrective Action?

- STPOL takes corrective action when its investment managers and consultant under perform, but has not needed corrective action for its custodian.

Does STPOL Employ Adequate Policies and Procedures to Ensure That Primary Decision Makers Avoid Conflicts of Interest as Well as the Appearance of Conflicts of Interests?

- STPOL does have policies and annual training to ensure that key staff members avoid potential conflicts of interest. However, we found instances where members of STPOL's staff possibly violated the Louisiana Code of Governmental Ethics by accepting gifts from investment managers and the custodian.
- During fiscal year 2004, STPOL's Board of Trustees, key staff, and consultant accepted meals paid by investment managers and custodians valued at $2,852. These meals do not violate the Code of Ethics; however, they represent a potential conflict of interest for trustees and key staff.
- STPOL does not employ policies or procedures to ensure disclosure and proper treatment of potential conflicts of interest with the consultant it hires.

RECOMENDATIONS

- ✓ STPOL should obtain an opinion from the Louisiana Board of Ethics concerning whether acceptance of gifts constitutes a violation of the Louisiana Code of Governmental Ethics. If the Louisiana Board of Ethics' opinion states that there are violations, STPOL should strengthen policies and procedures to ensure that all staff adhere to the Louisiana Code of Governmental Ethics. This should include clearly communicating the applicability of the ethics code to STPOL staff and the provisions of the code to all investment managers and custodian.
- ✓ STPOL should strengthen policies and procedures to ensure that all staff avoid conflicts of interest and appearance of conflicts of interest with current and perspective investment managers and custodians.
- ✓ STPOL should establish and implement policies and procedures for the disclosure and treatment of conflicts of interest and the appearance of conflicts of interest with current and prospective investment managers, custodians, and consultants.

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LEGISLATIVE AUDITOR

STATE OF LOUISIANA

STATE POLICE PENSION AND RETIREMENT SYSTEM

PERFORMANCE AUDIT
ISSUED JANUARY 26, 2005

LEGISLATIVE AUDITOR
1600 NORTH THIRD STREET
POST OFFICE BOX 94397
BATON ROUGE, LOUISIANA 70804-9397

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January 26, 2005

The Honorable Donald E. Hines,
President of the Senate
The Honorable Joe R. Salter,
Speaker of the House of Representatives

Dear Senator Hines and Representative Salter:

This report gives the results of our performance audit of the State Police Pension and Retirement System. The audit was conducted under the provisions of Title 24 of the Louisiana Revised Statutes of 1950, as amended. Senate Concurrent Resolution Number 14 of the 2004 Regular Session directed our office to examine each of the four state retirement systems.

The report contains our findings, conclusions, and recommendations. Appendix C contains the agency's response. I hope this report will benefit you in your legislative decision-making process.

Sincerely,

Steve J. Theriot, CPA
Legislative Auditor

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Page

Does STPOL Use Competitive, Objective Procedures With Performance Based Criteria to Select Investment Managers, Investment Consultants, and Custodians?

Does STPOL Use Objective Procedures With Performance Based Criteria to Monitor Investment Managers (Including Investment Performance and Churning), Investment Consultants, and Custodians?

If Performance by Investment Managers, Investment Consultants, or Custodians Is Below Relevant Benchmarks, Does STPOL Take Corrective Action?

Does STPOL Employ Adequate Policies and Procedures to Ensure That Primary Decision Makers (Board Members, Key System Staff, Money Managers, Custodians, and Consultants) Avoid Conflicts of Interest as Well as the Appearance of Conflicts of Interest?

EXECUTIVE SUMMARY

Article X, Section 29 of the Louisiana Constitution of 1974 provides that the legislature shall provide for retirement of teachers, other employees of the public educational system and state employees, and this is to be done by establishment of one or more retirement systems. This performance audit primarily examines two areas of the State Police Pension and Retirement System (STPOL), investments and ethics. Our findings are summarized as follows:

Performance Audit Findings

Investments *(See pages 9 through 31 of the report.)*

How do the investment returns for different asset classes of STPOL compare to relevant benchmarks?

STPOL's long-term investment returns have exceeded the system's actuarially assumed rate of return (of 7.5%). However, over the long-term, of STPOL's four broad asset classes, only one (international equity) has beaten its comparable benchmark index while the other three (large cap equity, small cap equity, and fixed income) have underperformed their benchmark indices. *See pages 13-15.*

Has STPOL developed and implemented an investment policy that allocates system assets by balancing risks with returns on investments and ensures that investments are of sufficient quality to minimize the risk of loss of system assets? Does STPOL monitor compliance with the asset allocation component of the system's established investment policy?

STPOL has developed and implemented an investment policy that allocates system assets by balancing risks with returns. STPOL monitors compliance with the asset allocation component of its investment policy and makes adjustments to its portfolio when needed. *See pages 17-21.*

How do STPOL money manager, consultant, and custodial fees and charges compare to other pension plans?

The fees STPOL is paying to more than half of its investment managers are higher than averages of similarly sized pension plans, according to a fee survey conducted by Greenwich Associates. For example, STPOL pays between 20% and 30 % higher fees for its international equity investments than do similar sized systems. *See pages 23-24.*

STPOL pays its consultant $70,000 annually, which is 15% lower than average for similarly sized systems, according to a survey conducted by Greenwich Associates. *See page 26.*

STPOL paid its custodian $73,317 during fiscal year 2004. STPOL's fees are lower than average for similarly sized systems, according to a survey conducted by Greenwich Associates. However, estimates we obtained from Baton Rouge banks indicate that STPOL may be able to lower its fees by conducting a custodian search. *See pages 26-27.*

We could not find documentation in STPOL's files to support the amounts of fees being paid to three of its nine money managers. *See pages 25-26.*

Does STPOL use competitive, objective procedures with performance based criteria to select investment managers, investment consultants, and custodians?

STPOL uses competitive, objective procedures to select its money managers and consultant. However, the system has no formal, written selection policies which may lead to inconsistency in its selection processes. *See page 29.*

Does STPOL use objective procedures with performance based criteria to monitor investment managers (including investment performance and churning), investment consultants, and custodians?

STPOL uses objective procedures to monitor its investment managers and consultant but needs to formalize its monitoring policies. Although individual managers are properly monitored, STPOL was unaware that three of its four asset classes had performed below their respective benchmarks. *See page 31.*

If performance by investment managers, investment consultants, or custodians is below relevant benchmarks, does STPOL take corrective action?

STPOL does take corrective action when the performance of its investment managers or consultant is below benchmarks or the system's expectations. *See page 35.*

Ethics *(See pages 33 through 34 of the report.)*

Does STPOL employ adequate policies and procedures to ensure that primary decision makers (board members, key system staff, money managers, custodians, and consultants) avoid conflicts of interest as well as the appearance of conflicts of interest?

STPOL does employ some policies and procedures to avoid conflicts of interest. However, in a possible violation of the Louisiana Code of Governmental Ethics, we found instances where gifts, although immaterial, were accepted by STPOL's key staff and consultant from investment managers and the custodian. *See pages 37-38.*

STPOL's trustees have accepted meals from its investment managers and custodian. STPOL trustees are responsible for selecting, monitoring, and evaluating these same investment managers and custodians. Although such meals are allowed by the Code of Ethics, they may give the appearance of a conflict of interest. *See page 38.*

STPOL does not employ policies and procedures to ensure disclosure and proper treatment of potential conflicts of interest with the consultants it hires. During fiscal year 2004, we found that the consultant received gifts from the investment managers and custodian. *See page 39.*

AUDIT INITIATION AND BACKGROUND

Audit Initiation and Objectives

We conducted this performance audit under the provisions of Title 24 of the Louisiana Revised Statutes of 1950, as amended. Louisiana Revised Statute 24:522 requires, in part, that the legislative auditor establish a schedule of performance audits to ensure that at least one performance audit is completed and published for each executive department within a seven-year period beginning with fiscal year 1998. In accordance with this requirement, the Office of Legislative Auditor developed a plan scheduling a performance audit of the four state retirement systems:

- State Police Pension and Retirement System (STPOL)
- Teachers Retirement System of Louisiana
- Louisiana School Employees Retirement System
- Louisiana State Employees Retirement System

The Legislative Audit Advisory Council approved this audit on March 5, 2004. In addition, Senate Concurrent Resolution Number 14 of the 2004 Regular Session directed our office to examine the four state retirement systems. The resolution specified that we focus on "the relationships between the state public retirement systems' boards and the investment advisors, consultants and managers." Appendix A contains our audit scope and methodology.

The objectives of this audit are:

- How do the investment returns for different asset classes of STPOL compare to relevant benchmarks?
- Has STPOL developed and implemented an investment policy that allocates system assets by balancing risks with returns on investments and ensures that investments are of sufficient quality to minimize the risk of loss of system assets?
- Does STPOL monitor compliance with the asset allocation component of the system's established investment policy?
- How do STPOL money manager, consultant, and custodial fees and charges compare to other pension plans?
- Does STPOL use competitive, objective procedures with performance based criteria to select investment managers, investment consultants, and custodians?

- Does STPOL use objective procedures with performance based criteria to monitor investment managers (including investment performance and churning), investment consultants, and custodians?

- If performance by investment managers, investment consultants, or custodians is below relevant benchmarks, does STPOL take corrective action?

- Does STPOL employ adequate processes and procedures to ensure that primary decision makers (board members, key system staff, money managers, custodians, and consultants) avoid conflicts of interest as well as the appearance of conflicts of interest?

Overview of STPOL

Purpose and Statutory Authority: Article X, Section 29 of the Louisiana Constitution of 1974 provides that the legislature shall provide for retirement of teachers, other employees of the public educational system and state employees, and this is to be done by establishment of one or more retirement systems. There are four state systems:

- State Police Pension and Retirement System (STPOL)

- Teachers Retirement System of Louisiana

- Louisiana School Employees Retirement System

- Louisiana State Employees Retirement System

The Louisiana Legislature established STPOL in 1938 by Act No. 293. STPOL is a qualified pension and retirement plan under Section 401(a) of the Internal Revenue Code created to provide retirement benefits for Louisiana state police officers and their beneficiaries. STPOL's primary goal is to safeguard and manage the funds it holds in trust so that future benefits are guaranteed and protected.

Background Information: A retirement system's financial health is primarily measured by its funded ratio, which is the extent to which a system's assets are sufficient to pay for present and future liabilities. As of June 30, 2003, STPOL's funded ratio was 60.6%, and it remained at 60.6%, as of June 30, 2004. Another measure of a system's financial health is the amount of its unfunded accrued liability (UAL). UAL is defined as that portion of the actuarially calculated liability not funded by the actuarial value of the system assets. STPOL's UAL was \$177 million and \$188 million, as of June 30, 2003 and 2004, respectively. If a system achieves a long-term rate of return on its investments greater than the assumed actuarial rate (of 7.5%), the system's funding status will improve, assuming all other factors remain equal. The following two exhibits provide background information concerning STPOL's budget and funding:

Exhibit 1 State Police Retirement System Statistics as of June 30, 2003 and 2004					
As of June 30	Fiscal Year Investment Income	Net Assets	Unfunded Actuarial Accrued Liability	Percentage Funded	Fiscal Year Administrative Expenses
2003	$13.8 million	$267 million	$177 million	60.6 %	$366,353
2004	$32.5 million	$304 million	$188 million	60.6%	$416,304
Source: Prepared by legislative auditor's staff using STPOL's fiscal year 2004 audited financial statement and STPOL's Actuarial Valuation as of June 30, 2004, prepared by Hall Actuarial Associates.					

As shown in Exhibit 2 on page 10, STPOL's primary source of funding in fiscal year 2004 was investment income of approximately $32.5 million. The retirement system also received $21 million from the state general fund for an amortization payment of the system's initial UAL. Our state constitution guarantees an annual employer payment that is sufficient to pay for the system's normal cost as well as amortize the UAL. For STPOL, the initial UAL was established as of June 30, 1988, and is being amortized over a 20-year period. Thus, the initial UAL should be paid off by 2009. Funding sources in addition to investment income and the state general fund include the following:

- an insurance premium tax resulting from 2001 legislation
- member purchases of system credit (if the member was in the military or if credit was not given due to administrative error)
- employer and employee contributions

Exhibit 2 also details the system's budgeted sources and uses of funds for fiscal year 2005 and actual figures from fiscal year 2004. This exhibit also contains a variance calculation for these two years.

Exhibit 2
Sources and Uses of Funds
Comparison of Fiscal Years 2004 and 2005

	Fiscal Year 2005 Proposed Budget	Fiscal Year 2004 Actual	Difference Between 2004 and 2005	Percentage Change From 2004 to 2005
Investment Income[1]	n/a[1]	$ 32,509,295	($32,509,295)	n/a
General Fund Contributions	$21,000,174	$21,000,174	0	0%
Insurance Premium Tax	$1,500,000	$1,500,000	0	0%
Employee Contributions	$4,105,000	$4,090,079	+ $14,921	0%
Employer Contributions	$3,100,000	$2,911,875	$188,125	6%
Member Purchases[2]	$300,000[2]	$815,945	- $515,945	-63%
Total Funding Sources (excluding investment income):	$30,005,174	$30,318,073	($312,899)	-1%
Benefits Paid and Refund of Contributions	$24,350,000	$24,188,394	+ $161,606	1%
Salaries - Regular	$195,520	$178,277	+ $17,243	10%
Salaries - Related Benefits	$42,854	$47,624	- $4,770	-10%
Accounting Services	$36,000	$36,000	0	0%
Actuarial Fees	$16,800	$16,800	0	0%
Auditing Fees	$8,300	$8,300	0	0%
Investment Manager Fees	$872,000	$845,666	+ $26,334	3%
Investment Consultant	$70,000	$70,000	0	0%
Computer Consultant Fees	$4,800	$4,800	0	0%
Custodial Fees	$65,000	$73,317	- $8,317	-11%
Legal Fees	$30,000	$38,628	- $8,628	-22%
Office Lease	$30,000	$28,391	+$1,609	6%
Board Per Diem	$2,500	$2,190	+ $310	14%
Travel and Seminars[3]	$8,000[3]	$2,167	+ $5,833	269%
Major Acquisitions	$5,000	$3,229	+ $1,771	55%
Miscellaneous/Other	$50,175	$49,781	+ $394	1%
Total Fund Uses	$25,786,949	$25,593,564	$193,385	1%
Net Funding Sources (Excluding Investment Income)	$4,218,225	$4,724,509	($506,284)	-11%
Net Funding Sources (Including Investment Income)	$4,218,225	$37,233,804	($33,015,579)	-89%

Notes: [1] Investment income is unpredictable and for this reason STPOL does not budget it.
[2] Member purchases are contributions by members transferring into the system (employee and employer portion from the member's prior retirement system), by members in the military, or by members purchasing system credit. This figure varies widely from year to year.
[3] STPOL's budgeted amounts for travel have decreased from $10,000 in 2004 to $8,000 for fiscal year 2005.

Source: Prepared by legislative auditor's staff using information furnished by STPOL.

STPOL members are vested after 10 years of service, meaning that after this time they are eligible for a retirement benefit once a certain age is reached. Members with 25 or more years of service may retire and draw benefits at any age. Benefits are generally calculated by multiplying 3.33 % times years of service times the member's average annual salary. Average annual salary is computed using the three consecutive, active years of employment with the highest salary. Exhibit 3 provides information concerning the membership of the STPOL system.

Exhibit 3
State Police Retirement System Membership Components
Fiscal Years 2002, 2003 and 2004

Membership Categories	As of June 30, 2002	As of June 30, 2003	As of June 30, 2004
Active Members	961	948	979
Terminated Vested Members	20	21	22
Retired Members	1,060	1,074	1,091
DROP Participants	43	45	36
Total Membership	**2,084**	**2,088**	**2,128**

Source: Prepared by legislative auditor's staff using fiscal year 2003 and 2004 audited financial statements of STPOL.

HOW DO THE INVESTMENT RETURNS FOR DIFFERENT ASSET CLASSES OF STPOL COMPARE TO RELEVANT BENCHMARKS?

STPOL's long-term investment returns have exceeded the actuarially assumed rate of return of 7.5%. However, three of STPOL's four broad asset classes have performed below their respective benchmark indices, on a long-term basis. Only the performance of the international equity funds has exceeded its benchmark since STPOL began investing in this class of asset approximately eight years ago.

STPOL's Total Long-Term Investment Returns Have Exceeded the System's Actuarially Assumed Rate of Return

STPOL's investment returns, as reported, have exceeded the system's actuarially assumed rate of return by 1.61 percentage points over 10 years and by 1.14 percentage points since inception (1990). These numbers are primarily "gross of fees," which means that the money managers' fees have not been subtracted when computing the rate of return. The actuarial rate is the rate of return that the system's actuary assumes the system will earn when he computes its funding ratio. If a system's investment performance exceeds this actuarial assumed rate, such performance helps improve its funding ratio. A system with investment returns less than this rate worsens its funding ratio, all other factors (such as benefits and contributions) remaining equal.

STPOL's consultant reports all of STPOL's investment returns "net of fees," although most of the returns being reported are actually "gross of fees." Therefore, we could not precisely determine the degree to which STPOL's overall long-term return, net of fees, exceeded the actuarially assumed rate of return. However, to estimate the investment return "net of fees," we calculated the average fee paid by STPOL at the end of fiscal year 2004 for all managers for whom returns have been reported "gross of fees." This average fee was almost 33 basis points (0.33 of 1 percent, as 1 percent = 100 basis points). We subtracted this fee amount from the investment return reported for STPOL to obtain the amount shown in the middle column of Exhibit 4 on the following page. Therefore, we conclude that STPOL has exceeded its actuarially assumed rate over the long term, although we can only estimate by how much. Exhibit 4 also shows STPOL's investment returns over different time periods.

Exhibit 4 State Police Pension and Retirement System Total Investment Returns as of June 30, 2004				
Time Period	**STPOL's Investment Return (Gross of Fees)**	**Estimated Investment Return (Net of Fees)***	**Actuarially Assumed Rate of Return**	**Excess Return (Gross of Fees)**
1 Year	11.54 %	11.21 %	7.5 %	4.04 %
3 Years	4.83 %	4.50 %	7.5%	-3.00 %
5 Years	3.85 %	3.52 %	7.5 %	-3.65 %
10 Years	9.11 %	8.78 %	7.5 %	1.61 %
Since Inception (11/30/1990)	8.64 %	8.31 %	7.5 %	1.14 %

Source: Prepared by legislative auditor's staff from information provided by UBS Financial Services, Inc., STPOL's consultant.
*We calculated the average fee paid by STPOL at the end of fiscal year 2004 for managers whose returns are reported "gross of fees." We subtracted this amount from the investment returns reported "gross of fees" in the second column of this exhibit.

We discussed the discrepancy concerning the reporting of fees with both the Executive Director of STPOL and the system's consultant. According to both officials, the system is taking corrective action so that in the future all investment returns will be reported "net of fees."

Recommendation 1: STPOL should ensure that future investment return data are presented as "net of fees."

Management's Response: STPOL agrees with this recommendation and is taking steps to implement it. STPOL notes that the last column on Exhibits 4 and 5 should be labeled Estimated Excess Return and Estimated Dollar Impact, respectively, since the figures are based on estimated investment returns. (See Appendix C for the system's full response.)

Three of STPOL's Four Broad Asset Classes Have Yielded Long-Term Investment Returns Below Their Benchmark Indices

Over the long-term (i.e., since inception), STPOL's investment returns (gross of fees) for three of four broad asset classes were below relevant benchmark indices, as illustrated in Exhibit 5 on the following page. The dollar impact of returns being below the relevant benchmarks is approximately ($15.8 million). In other words, had STPOL invested in the benchmark index for each asset class since inception of that class, it would have almost $15.8 million more in assets, as of June 30, 2004. Benchmark indices are statistical indicators against which investment performance is measured. A typical index is composed of many securities of a similar class, such as securities of companies valued over a certain dollar amount (large capitalization companies), or securities of all international companies. Examples of indices are the S&P 500 and the Russell 2000. The relevant benchmark indices for STPOL's asset classes are listed in Appendix B. STPOL's large cap equity, small cap equity, and fixed income investment returns were all below their respective benchmark indices. The return on STPOL's international investments, net of fees, exceeded the benchmark index. The last column of Exhibit 5 shows the dollar impact of the difference, since inception, between the rates of return and the benchmark indices for each of the four asset classes.

Exhibit 5
State Police Pension and Retirement System
Investment Returns as of June 30, 2004 Since Inception
Gross of Fees [3]

Asset Class [2]	State Police Return Since Inception	Comparable Index[1] Return Since Inception	STPOL Above or Below Index?	Dollar Impact ($000)
Large Cap Equity	10.21 %	12.06 %	Below	-12,040
Small Cap Equity	8.41 %	10.39 %	Below	-4,758
Total International [3]	8.04 %	4.49 %	Above	+3,800
Total Fixed Income	7.42 %	7.65 %	Below	-2,797
Total				($15,795)

Notes: [1] See Appendix B for index information.
[2] Large Cap returns include approximately 13.6 years of data, Small Cap 9 years, International 8 years and Fixed Income 13.6 years of investment return data.
[3] International returns are net of fees. Returns of the other three asset classes are "gross of fees."
Source: Prepared by legislative auditor's staff using information furnished by UBS Financial Services, Inc., the system's consultant.

STPOL Should Formally Evaluate Its Investment Performance by Asset Class

Each month, STPOL's consultant presents the system's board with a report on STPOL's investments containing useful performance data for evaluating individual investment managers and the overall system. However, these reports do not summarize the system's investment returns by asset class (large cap equity, international equity, fixed income, etc.).

Exhibit 5 above illustrates the type of data that should be presented to STPOL. STPOL's decision makers (the board and management staff) were not fully aware that three of the system's four asset classes have underperformed their benchmarks over the long term. Summarizing investment performance data by asset class would provide the system's management, board, and consultant with another valuable tool in detecting and then correcting sub-par investment performance.

Recommendation 2: STPOL should require its consultant to include investment return data by asset class in the quarterly investment reports.

Management's Response: STPOL agrees with this recommendation and agrees that asset class reports will assist the board in its evaluation process. Although its board has not been reviewing the asset class data, it has accomplished the task of determining why there was under-performance in certain areas. This was accomplished by evaluating the individual money managers. (See Appendix C for the system's full response.)

Recommendation 3: STPOL should determine why its long-term investment returns for the Large Cap Equity, Small Cap Equity, and Fixed Income portfolios were below their respective benchmark indices and take appropriate corrective action.

Management's Response: STPOL disagrees with this recommendation. It has been aware of the underperformance of these three asset classes. The reasons for the under-performance are (1) Large Cap replaced Large Cap Value Manager in 2003; (2) Small Cap replaced both Small Cap Managers in 2002; and (3) Fixed Income - STPOL restricts managers to lower risk tolerance than is allowed by benchmarks. All of this is documented in Investment Committee minutes and was discussed with the auditors. (See Appendix C for the system's full response.)

HAS STPOL DEVELOPED AND IMPLEMENTED AN INVESTMENT POLICY THAT ALLOCATES SYSTEM ASSETS BY BALANCING RISKS WITH RETURNS ON INVESTMENTS AND ENSURES THAT INVESTMENTS ARE OF SUFFICIENT QUALITY TO MINIMIZE THE RISK OF LOSS OF SYSTEM ASSETS?

STPOL has implemented an investment policy that allocates system assets by balancing risks with returns on investment. STPOL's investment policy conforms with seven of eight criteria that we developed. While the investment policy does not conform to one of our criteria, we found that STPOL does follow this criterion in practice but has not yet incorporated it formally into its investment policy. STPOL's investment policy ensures that investments are of sufficient quality to minimize the risk of loss.

STPOL Has Developed and Implemented an Appropriate Investment Policy That Balances Risks With Returns

Asset allocation is the single largest determinant of investment returns according to the Government Finance Officers' Association (GFOA), accounting for 94 % of the variation in returns. We evaluated STPOL's asset allocation based on a list of eight criteria that a system's investment and asset allocation policies should contain. These criteria (Exhibit 6 on page 19), if adhered to, will mitigate investment risks while maximizing returns. STPOL's investment policy satisfied seven of these eight criteria.

The criterion not met requires STPOL's investment policy to ensure that the use of index funds is formally and regularly evaluated as an alternative to active management of investments. We observed instances of this discussion in STPOL's investment committee meetings, but the system's policies do not require it. This criterion is recommended by the GFOA.

State law [R. S. 11:263(E)] provides that 10 % of STPOL's equity portfolio must be invested in indexed funds if more than 55% of its total portfolio is invested in equities. STPOL is subject to the 10 % requirement because it had 56 % of its portfolio invested in equities as of June 30, 2004. However, we did not use this requirement as a criterion because the system only recently became subject to this law as a result of Act 850 of the 2004 Regular Session. In practice, STPOL complies with the requirement because 27% of its assets are invested in indexed funds, as of June 30, 2004. We recommended to STPOL management that it adds this new legal requirement to its investment policy, and management agreed with this recommendation.

Recommendation 4: STPOL's written investment policy should ensure that the use of index funds as an alternative to active management is "formally and regularly" evaluated.

Management's Response: STPOL agrees with this recommendation and thinks the use of index funds should be formally added to its investment policy. The STPOL board disagrees with the use of the eight GFOA criteria as the basis for an investment performance evaluation. (See Appendix C for the system's full response.)

Having an asset allocation policy and adhering to it is one way STPOL ensures that its investments are of sufficient quality to minimize the risk of loss. Asset allocation is the process of dividing a system's investments into different kinds of assets (stocks, bonds, etc.) and setting a projected rate of return as well as a level of risk associated with each asset class. Diversification of investments helps control the risk of loss. STPOL's consultant conducts an asset allocation study at least annually, which results in a recommended level of investment in different asset classes. As subsequently discussed (see page 17), STPOL monitors the targets set in its asset allocation policy and rebalances its portfolio as needed.

Another method used by STPOL to ensure the quality of its portfolio is that its investment policy prohibits certain types of riskier investments. For example, investment managers cannot sell securities short, invest in commodities, futures, or in unregistered securities or private placements. Investment managers certify monthly that they are in compliance with the system's investment policy.

A third method used by STPOL to ensure the quality of its portfolio is investment limitations placed on two of its fixed income portfolio managers. One can only invest in debt issues with a credit risk of "A" or better. The manager must inform STPOL and its consultant immediately if a security is downgraded below an "A" credit rating. The other manager must maintain its portfolio at an average rating of "A" or higher, although it can invest in debt that is rated below investment grade (rated "BBB" by Standard & Poors). However, this manager is limited to investing only 10% of its portfolio in below investment grade securities.

Exhibit 6 Evaluation of STPOL's Compliance With Criteria for Asset Allocation and Investment Policy	
Criteria	**Met by STPOL's Policies?**
1. Investment policies should contain a provision that prohibits and prevents more than 65% of the systems' portfolios from being invested in equity securities.	√
2. The asset allocation of a system should be specifically tailored to the "unique circumstances of the individual system" through an asset-liability study.	√
3. Asset allocation ranges should be set that include minimum, maximum, and target allocation percentages for asset classes.	√
4. The asset allocation set in the investment policy should contain two or more asset classes (domestic stocks, foreign stocks, domestic bonds, etc.) that have low correlation with one another (i.e., when one is up the other is down) to reduce volatility and therefore risk.	√
5. Portfolios should be rebalanced to stay in line with the established asset allocation ranges and to reduce volatility. The portfolio should be reviewed at least annually by the appropriate system official for rebalancing purposes.	√
6. Investment guidelines should identify permissible and non-permissible investments. They should also set maximum percentages of system assets allowed to be invested in a single issuer, asset class, economic sector, and nation.	√
7. The investment policy should ensure that the use of index funds as an alternative to active management is "formally and regularly" evaluated.	**X**
8. Private equity and real estate investments should be constrained so that the system's portfolio does not become dominated by these non-liquid investments.	√
Source: Criteria developed by legislative auditor's staff based on the GFOA and Louisiana Revised Statutes of 1950, as amended.	

STPOL's Cash Inflow Presently Exceeds Its Cash Needs

The system periodically does an asset-liability study. This study uses future liabilities for the system that are projected in an Experience Study. The Experience Study is conducted by the system's actuary. The asset-liability study helps determine how STPOL's assets should be structured to meet the future cash needs of STPOL.

STPOL does not have any policies concerning cash management. The reason that STPOL presently has no policies concerning cash management is that the system receives more cash annually than it has to pay out. The system receives approximately $21 million from the state general fund each August to pay off the system's original UAL. In addition, the system receives investment income, which was approximately $32.5 million in fiscal year 2004. STPOL pays benefit amounts of approximately $2 million monthly, or $24 million annually. If STPOL does need cash, it uses rebalancing of its portfolio to redeem funds from an asset class that exceeds its asset allocation target.

The State of Louisiana should repay STPOL's original UAL by 2009 at which time STPOL should no longer receive $21 million every August. At that time, STPOL will need to plan more for its cash needs.

DOES STPOL MONITOR COMPLIANCE WITH THE ASSET ALLOCATION COMPONENT OF THE SYSTEM'S ESTABLISHED INVESTMENT POLICY?

STPOL effectively monitors compliance with the asset allocation set forth in the system's investment policy and adopted by the system's investment committee and board of trustees. STPOL officials and the system's consultant review the system's asset allocation at least quarterly and, if necessary, adjust the amount invested in an asset class to rebalance asset amounts toward the established targeted guidelines.

STPOL Properly Monitors Compliance With Its Asset Allocation Policy

STPOL's investment policy provides that at the end of each quarter, the system's director and its consultant will examine the portfolio and rebalance any asset class that is over or under its specified range. However, the policy contains little specific methodology concerning rebalancing. STPOL's consultant recommends target ranges for each class of assets, and the investment committee and board of trustees approve these targets.

Our review of STPOL's board of trustees and investment committee meeting minutes found that STPOL is complying with this policy. In fact, officials review the allocation at most investment committee meetings. As of June 30, 2004, none of STPOL's asset classes were over or under the ranges established in its asset allocation policy. Exhibit 7 shows the targets and ranges for each asset class.

Exhibit 7
STPOL Asset Allocation Policy
(Different Asset Classes as a Percentage of the Total Portfolio)
(June 30, 2004)

Asset Class	Minimum	Target	Maximum
Domestic Large Cap	27.5 %	32.5 %	37.5 %
Domestic Small Cap	7.5 %	10.0 %	12.5 %
International	7.5 %	10.0 %	12.5 %
Total Equities	**45%**	**52.5 %**	**55.0 %**
Fixed Income	40.0 %	45.0 %	55.0 %
Cash and Equivalents	0.0 %	2.5 %	5.0 %
TOTAL		**100.0%**	

Source: Prepared by legislative auditor's staff using STPOL's Investment Policy and a report prepared by STPOL's consultant, UBS Financial Services, Inc.

Exhibit 8 shows the asset classes in STPOL's investment portfolio, the investment managers, and amount of funds invested by each manager. This exhibit also shows whether the asset class is in compliance with STPOL's asset allocation targets.

Exhibit 8
STPOL's Investment Managers and Amounts Invested
(As of June 30, 2004)

Asset Class	Investment Managers	Amount Invested (in millions)	Percentage of STPOL's Portfolio	Complies With Asset Allocation Targets?
Large Cap Growth	Fayez Sarofim & Co.	$33.9	11.2%	Yes
Large Cap Value	Aronson+Johnson+ Ortiz	$35.2	11.6	Yes
S&P 500 Index (Passive)	State Street Global Advisors	$35.7	11.7	Yes
International Equity	Templeton Institutional	$15.5	5.1	Yes
International Equity	Julius Baer Investment Management	$14.8	4.8	Yes
Small Cap Value	State Street Research & Management	$18.7	6.1	Yes
Small Cap Growth	Waddell & Reed Investment Management Company	$16.6	5.4	Yes
Fixed Income Index (Passive)	State Street Global Advisors	$46.5	15.3	Yes
Active Fixed Income	Loomis, Sayles & Company	$41.8	13.7	Yes
Active Fixed Income	Orleans Capital Management	$42.7	14.0	Yes
Cash Equivalents	Bank One	$3.0	1.0	Yes
Total		**$304.3**	**100.0%**	

Source: Prepared by legislative auditor's staff using information prepared by UBS Financial Services, Inc., STPOL's investment consultant.

Periodically rebalancing a retirement system's portfolio reduces risk and increases investment return and should be done at least annually according to the GFOA. By ensuring that its asset allocation policy is complied with and by reviewing it on a regular basis, STPOL is minimizing its investment risk.

HOW DO STPOL MONEY MANAGER, CONSULTANT, AND CUSTODIAL FEES AND CHARGES COMPARE TO OTHER PENSION PLANS?

The fees STPOL is paying to more than half of its investment professionals are higher than averages of similarly sized pension plans, according to a fee survey conducted by Greenwich Associates of Greenwich, Connecticut (Greenwich). In fact, the fees paid to two international investment managers, two domestic equity managers, and one fixed income manager are much higher than the averages in the Greenwich survey. These findings were supported by a second survey that was conducted by the Independent Consultants Cooperative (ICC). In that survey, half of the fees paid to managers were higher than the survey averages. We could not find documentation in STPOL's files to support the fees paid to three of its nine money managers.

Consultant and custodian fees are lower than averages we obtained from the Greenwich survey of similarly sized pension plans. However, STPOL may be able to achieve cost savings by conducting a custodian search/evaluation, as we obtained custodian fee estimates lower than what STPOL is currently paying.

STPOL's Money Management Fees Are Higher Than Average When Compared to Similar Sized Pension Plans

To determine whether the fees paid to STPOL's money managers were in line with averages paid by other retirement systems, we compared them to two fee surveys: a survey conducted by Greenwich that STPOL participated in dated July 2004, and an ICC study dated December 2003. The Greenwich survey included 191 institutional investors and was prepared on behalf of a leading investment consultant firm during January and February 2004. The ICC is a consortium of independent investment consulting firms and its study was based upon an extensive survey of management fees paid by clients of consulting firms that belong to the ICC.

Using the Greenwich survey and comparing to similar sized public pension plans, the fees STPOL pays for five of its nine investment managers are higher, as illustrated in Exhibit 9 on the following page. The fees for the international equity portfolios are higher than average by 20% for one manager and 30% for the other. Also, the fees for one active fixed income manager are 29% higher than the survey's average. Finally, fees for two of the domestic equity managers are 53% and 80% higher than the survey average. Both of these managers are small cap equity managers. On average, small cap managers have higher fees than large cap equity managers. Therefore, the fees of these two small cap managers being above the active domestic equity category average is not surprising. The fees STPOL pays for two of its domestic equity managers, its passive domestic equity manager, and one active fixed income manager are in line with or below the averages as shown in Exhibit 9. Fees for the passive domestic equity portfolio are particularly low--60% below average.

Using the ICC survey, when compared to the average public plan (not taking into account the size of the plan), STPOL's fees for one large cap manager and one fixed income manager are higher than survey averages. Also, as with the Greenwich survey, the fees paid for the international portfolio managers are much higher than average, with one international manager receiving an 88% higher than average fee and the other receiving a 73 % higher than average fee. According to STPOL's consultant, the relatively high fees paid to the international money managers are due in part to STPOL's small size--the system has only $30 million invested in international investments. As a result, STPOL does not have as much fee bargaining power with a manager as would a system with larger amounts to invest. Exhibit 10 on the next page shows the results of the comparison of STPOL to the ICC study.

Exhibit 9
Comparison of STPOL Fees to Greenwich Survey of Money Managers' Fees
(Public Pension Plans Under $500 million)

Asset Class	Average Fees Per Survey (in basis points**)	Fiscal Year 2004 STPOL Money Managers' Fees (in basis points)	Percentage that STPOL Is Above or Below Fee Study	Difference (in basis points)	Estimated Value of Difference in Fees***
Active Domestic Equity	48.9	47 (Fayez) 52 (Aronson) 88 (Waddell) 75 (State Street)	Below 3.9 % Above 6.3 % Above 80.0 % Above 53.3 %	-1.9 +3.1 +39.1 +26.1	-$6,448 10,921 64,832 48,735
Passive Domestic Equity	10.1	4 (SSGA*)	Below 60.4 %	-6.1	-$21,772
Active International Equity	69.1	83 (Templeton) 90 (Julius Baer)	Above 20.1 % Above 30.3 %	+13.9 +20.9	21,499 30,840
Active Fixed Income	27.1	35 (Loomis) 17 (Orleans)	Above 29.2 % Below 37.3 %	+7.9 -10.1	33,024 -43,123

Notes: *SSGA is an abbreviation for State Street Global Advisors, manager of an S&P 500 Index Fund.
**Basis points: 100 basis points = 1 percent.
***Calculated by taking the amount of assets under management as of June 30, 2004, multiplied by the difference between the actual fee paid compared to the average fee in the confidential survey. For the full names of STPOL's money managers, refer to Exhibit 8 on page 22.
Source: Prepared by legislative auditor's staff using a survey conducted by Greenwich Associates dated July 2004, STPOL contracts with managers, and manager invoices to STPOL for the 4th quarter of fiscal year 2004.

Exhibit 10 Comparison of STPOL Fees to ICC Survey of Money Managers' Fees (Public Defined Benefit Plans)					
Asset Class	Average Fees Per Survey (in basis points*)	Fiscal Year 2004 STPOL Money Managers' Fees (in basis points)	Percentage That STPOL Is Above or Below Fee Study	Difference (in basis points)	Estimated Value of Difference in Fees**
Large Cap	46	47 (Fayez) 52 (Aronson)	Above 2.2 % Above 13.0 %	+1 +6	$3,394 21,138
Small Cap	87	75 (State Street) 88 (Waddell)	Below 13.8 % Above 1.2 %	-12 +1	-22,407 1,658
International	48	83 (Templeton) 90 (Julius Baer)	Above 73.0 % Above 88.0 %	+35 +42	54,133 61,974
Fixed Income	31	35 (Loomis) 17 (Orleans)	Above 13.0 % Below 45.2 %	+4 -14	16,721 -59,775

Notes: *Basis points: 100 basis points = 1 percent.
**Calculated by taking the amount of assets under management as of June 30, 2004, multiplied by the difference between the actual fee paid compared to the average fee in the confidential survey. For the full names of STPOL's money managers, refer to Exhibit 8 on page 22.
Source: Prepared by legislative auditor's staff using an Independent Consultants Cooperative Fee Survey (dated December 2003), STPOL's contracts with money managers, and manager invoices to STPOL for the 4th quarter of fiscal year 2004.

Exhibit 11 below shows the fees that STPOL paid its investment managers, consultant, and custodian during fiscal year 2004.

Exhibit 11 Fees Paid by STPOL to Investment Professionals Fiscal Year 2004		
Type of Professional	Amount of Fees	As Percentage of Total Assets (in Basis Points)
Investment Managers	$845,666	26
Investment Consultant	$70,000	2
Custodian Bank	$73,317	2

Notes: Total assets were $320,069,465, as of June 30, 2004.
Basis points: 100 basis points = 1 percent.
Source: Prepared by legislative auditor's staff using STPOL's audited financial statement for fiscal year 2004.

STPOL Does Not Document Fee Arrangements in All Contracts

From reviewing STPOL's files and contracts, we could not find documentation to support the fee structure and amounts of fees being paid to three of the nine money managers. In response to our questions, STPOL's Executive Director obtained documentation and more detailed information from these three managers during our audit. STPOL should implement a system to receive billing information regularly from its money managers, and, as a good business practice, promptly review this information to ensure that it is paying the appropriate amounts of expenses.

Recommendation 5: STPOL should ensure that its contracts with money managers detail the fee structure.

Management's Response: STPOL agrees with this recommendation. All new contracts or prospectus have fee disclosure. STPOL plans to develop a standard contract for managers that will include a fee schedule. (See Appendix C for the system's full response.)

Recommendation 6: STPOL should require all money managers, including commingled trusts, to submit regular statements (either quarterly or monthly depending on when fees are paid) detailing all fees, expenses, foreign taxes, etc., paid from STPOL's account.

Management's Response: STPOL agrees with this recommendation. All managers, including commingled trusts, are submitting monthly or quarterly statements of their fees, expenses and foreign taxes. (See Appendix C for the system's full response.)

Recommendation 7: STPOL should review all quarterly/monthly statements from money managers to ensure that charges to STPOL accounts are accurate.

Management's Response: STPOL agrees with this recommendation. All quarterly or monthly statements from money managers are reviewed to ensure that statements are correct before fees are paid. The process for the commingled trusts was established after the performance review. (See Appendix C for the system's full response.)

STPOL's Consultant Fees Are Lower Than Average

STPOL pays its consultant $70,000 annually. The term of the current contract is from February 19, 2004, through February 18, 2005. Similarly sized public pension plans (under $500 million in size) paid their consultant an average of $82,000 in 2003, according to the Greenwich survey we obtained from STPOL. Thus, STPOL pays 15 % less in consultant fees than the average paid by similar sized public retirement systems. STPOL conducted a formal evaluation of its consultant in 2001, which resulted in a fee reduction.

STPOL's Custodian Fees Are Lower Than Average But Are Higher Than Estimates We Obtained

STPOL paid its custodian bank $73,317 during fiscal year 2004. The fee is 2.5 basis points of the fair market value of assets held by the bank. This fee is lower than the average for similar sized public pension plans, which is 3.2 basis points, according to the Greenwich study we obtained from STPOL. However, we obtained fee estimates from two Baton Rouge area banks that were lower than the 2.5 basis points presently being paid by STPOL.

STPOL has used the same custodian for over 15 years and its contract with this bank is 5.5 years old. STPOL has not formally reviewed and evaluated its custodial services. The assets under STPOL's management as well as applicable technologies have grown significantly over the past few years, which should decrease custodian fees. Based on this data we obtained from a phone survey of Baton Rouge banks, the fee structure in STPOL's custodian contract may be outdated. STPOL may be able to achieve cost savings by conducting a custodian search/evaluation.

Recommendation 8: STPOL should conduct a custodian search/evaluation to determine if a more favorable fee structure can be obtained.

Management's Response: STPOL disagrees with this recommendation. The system believes that the quality of service received from its custodian is far more important than the fee structure. Fees are just one component of the overall evaluation process for a custodian. The performance review does indicate that the system's custodian fees are lower than the average for similar sized pension plans. Also, the custodian has scored extremely well on the system's evaluation form. STPOL's Executive Director states that the system has experienced no significant problem with its custodian in three and one-half years. The STPOL Investment Committee will consider this custodial issue at its next meeting in February. (See Appendix C for the system's full response.)

DOES STPOL USE COMPETITIVE, OBJECTIVE PROCEDURES WITH PERFORMANCE BASED CRITERIA TO SELECT INVESTMENT MANAGERS, INVESTMENT CONSULTANTS, AND CUSTODIANS?

STPOL uses competitive, objective procedures with performance based criteria to select investment managers and its investment consultant. However, we were unable to evaluate the selection process for the system's custodian, because of the length of time (15 years) that has elapsed since this bank was selected. Overall, STPOL's selection methodologies are in line with industry standard criteria recommended by the GFOA, but are often unwritten and informal.

STPOL Lacks Formal Policies for Selecting Investment Managers, Consultants, and Custodians

We found that STPOL uses appropriate criteria for the selection of money managers and consultants, including:

- Key personnel--experience and education
- Clients--the number and size of clients under management
- Assets under management
- History of investment performance versus appropriate benchmarks
- Number of years a firm has been in business
- Fee structure

However, STPOL's investment policy does not contain these criteria. According to staff, STPOL has no formal investment policies relating to the selection of investment managers and consultants because the system has only four staff members. Therefore, they do not use the conventional RFP (Request For Proposal) process used by the larger retirement systems. We also found that STPOL has no written policies for selection of its custodian bank. The GFOA recomends that retirement systems include in their investment policy the criteria used to select money managers and other professionals. The absence of formal policies at STPOL increases the risk that inconsistent means will be used to select investment professionals, which may result in the best professionals not being selected.

We reviewed investment committee minutes for three money manager searches and found that STPOL's selection methodologies varied among different searches. For one search, the system's consultant and internal staff presented the investment committee with a list of 10 semi-finalists, from which the committee picked five finalists to be interviewed. In the other two searches, the consultant and staff selected the finalists to be interviewed by the committee and no list of semifinalists was ever submitted to the committee. Such inconsistencies illustrate the need for STPOL to develop and adopt formal selection policies so that the same selection process is consistently used.

Recommendation 9: STPOL should include selection criteria for investment professionals (money managers, consultants, and custodians) in its investment policy.

Management's Response: STPOL agrees with this recommendation. The system will formalize its general criteria for the selection of consultants, custodian, and money managers into its Investment Policy. (See Appendix C for the system's full response.)

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DOES STPOL USE OBJECTIVE PROCEDURES WITH PERFORMANCE BASED CRITERIA TO MONITOR INVESTMENT MANAGERS (INCLUDING INVESTMENT PERFORMANCE AND CHURNING), INVESTMENT CONSULTANTS, AND CUSTODIANS?

STPOL uses objective procedures to monitor its investment managers and consultant, although its monitoring policies are not fully documented. Although individual managers are properly monitored, STPOL was unaware that three of its four asset classes had performed below their respective benchmarks since inception of the STPOL's investment in these asset classes. We found that money managers' rates of return on investment are presented inconsistently (most managers' rates of return were reported "gross of fees," but two managers' fees were reported as "net of fees.").

STPOL Complies With Its Monitoring Policies for Investment Managers

The system's consultant, staff, and trustees are in compliance with STPOL monitoring policies, which stipulate that investment manager performance be compared to relevant benchmarks and peer groups. STPOL policies also require that investment managers be monitored for changes in investment style, key personnel changes, and management approach. During our audit, we observed STPOL applying these policies at investment committee and board meetings, as well as during daily operations.

GFOA states that retirement systems should continually monitor the work of money managers and that systems do the following:

- Compare performance to relevant benchmarks and peer groups
- Determine if the firm's investment team is still in place
- Determine if the firm uses a consistent management approach (does not change style frequently)

STPOL has complied with the last two of the above GFOA criteria. However, STPOL has not monitored performance by asset class by comparing to relevant benchmarks, although it has effectively monitored specific investment managers' performance. In addition, the details about how the comparisons and evaluations required by STPOL's policies are to be made and who will perform them are not in writing. GFOA criteria provide that specific agreed-upon procedures for performance analysis, time frames to be used, who will verify investment return data, and who will do in-depth analysis of the data are the types of monitoring details that should be spelled out in the investment policy. STPOL has an informal agreement with its consultant to perform these duties. However, if key members of STPOL's management or the consultant were no longer with STPOL, since these details are not contained in the investment policy, there could be a lapse in the thorough monitoring of STPOL's investments.

STPOL Performs Monitoring of Its Custodial Bank

STPOL has no policies in place requiring its own staff to monitor its custodian or to reconcile the custodian's data. However, when STPOL's investment managers submit their quarterly invoices, they verify in writing to STPOL that they have verified or reconciled their balances to those maintained by the custodian. Also, on a quarterly basis, the system's consultant reconciles investment manager account balances received from the custodian to account balances provided by the investment managers. STPOL does not review the consultant's reconciliation.

The National Association of State Retirement Administrators (NASRA) states that "the accuracy of holdings and transactions is usually assured through monthly reconciliations of the data by the external manager and custodian or by the pension system from data provided by the external manager and custodian." NASRA also states that each investment manager and custodian should be required to reconcile account positions on a monthly basis. This reconciliation process recommended by NASRA helps to assure that any breakdown in the custodial system between annual audits will be identified on a timely basis. It also helps to ensure the integrity and timeliness of the data used by a retirement system during the monitoring of investment managers.

STPOL Monitors Its Consultant But Does Not Have a Formalized Monitoring Policy

STPOL has monitored and evaluated the performance of the system's consultant by having staff and trustees rate the consultant's performance in areas such as:

- Independence
- Investment Research and Education
- Asset Allocation Analysis
- Manager Search and Selection Process
- Asset Allocation Monitoring
- Monitoring of Manager Performance
- Overall Communications

However, STPOL has no policies stating that the consultant is to be formally reviewed on a regular basis. STPOL's handbook for its trustees provides that the board of trustees shall select, hire, and terminate the consultant, and monitor the consultant's performance. There is no further guidance on how often the consultant should be evaluated or what factors should be used in an evaluation.

STPOL does not know if its consultant has properly reconciled the account balances furnished by the custodian and investment managers. As a result, STPOL cannot be certain that the consultant's reports are accurate. For instance, rates of return reported by the consultant for some investment managers were incorrect.

The GFOA recommends that consultants be evaluated based on how well they monitor money managers' performance and whether the consultants' reports are accurate, timely, and relevant. STPOL's criteria for informally monitoring and evaluating its consultant include these GFOA criteria and should be formally incorporated into STPOL's investment policy. Written policies will help ensure that there is continuity and consistency of consultant monitoring if key members of STPOL's management, board of trustees or the consultant were no longer employed by STPOL.

Recommendation 10: STPOL should develop and implement written policies for custodial reviews at least annually.

Management's Response: STPOL agrees with this recommendation. It will formalize its general policies for custodial reviews to conduct these evaluations at least annually. (See Appendix C for the system's full response.)

Recommendation 11: STPOL should develop and implement written policies for consultant reviews (at least annually). These policies should state the frequency of evaluations and the areas to be evaluated.

Management's Response: STPOL agrees with this recommendation. The system has formally evaluated its consultant, annually, for the past three years. The system will include written policies in its Investment Policy. (See Appendix C for the system's full response.)

Recommendation 12: STPOL should review the quarterly reconciliation done by the consultant of the account balances furnished by the custodian and the investment managers.

Management's Response: STPOL agrees with this recommendation. The system has been reviewing the reconciliation done by its money managers before paying their fees. The system will begin reviewing the reconiliation done by its consultant. (See Appendix C for the system's full response.)

STPOL Monitors the Churning of Assets by Its Investment Managers But Does Not Have a Formalized Monitoring Policy

STPOL reviews an investment manager's trading turnover ratio to monitor whether the manager is churning STPOL's account, according to the Executive Director of STPOL. Churning is the practice of excessive trading in an account, which increases the commissions earned by the broker handling the trades. Before hiring a manager, STPOL reviews its turnover ratio and asks for an explanation if the turnover appears high. STPOL then takes this turnover history of the investment manager and uses it as a benchmark to compare the manager's future turnover ratios.

Investment managers earn their fees based on the amount of assets under management, which obviously provides an incentive for them to increase the value of the account being managed. In practice, since churning increases the commissions that must be paid to a broker, churning would reduce the value of the account and thus lower the fee earned by the manager. Therefore, churning would probably only occur if the manager and broker were affiliated in the same financial services company to result in the broker's churning commissions exceeding the manager's associated loss of fees, or if the manager were getting some financial incentive from the broker as a result of churning. We reviewed the trading history of two of STPOL's managers and found no evidence of churning.

Although STPOL informally monitors managers for churning, STPOL has no formal, written policy. Items that STPOL could implement to ensure that churning of its accounts does not occur would be to:

- Require investment managers to disclose to STPOL at least annually any financial or other relationships they have with the brokers they are using
- Provide in contracts executed with managers that affiliated brokers will not be used by the manager
- Provide specific methods that STPOL will periodically use to monitor for churning

Recommendation 13: STPOL should develop and implement written policies for the monitoring of churning.

Management's Response: STPOL disagrees with this recommendation. The system presently monitors investment managers for churning and has found no evidence of it. The performance audit agrees with STPOL on this point. The system will formalize its current monitoring procedures for churning into its investment policies. (See Appendix C for the system's full response.)

IF PERFORMANCE BY INVESTMENT MANAGERS, INVESTMENT CONSULTANTS, OR CUSTODIANS IS BELOW RELEVANT BENCHMARKS, DOES STPOL TAKE CORRECTIVE ACTION?

STPOL does take corrective action for poorly performing money managers and the system's consultant. The system has taken no corrective action with its custodian bank because STPOL's management stated that it has not experienced any significant custodial problems.

STPOL Takes Corrective Action When Investment Managers Underperform

Since October 2001, STPOL has placed five money managers on its "watch list" for reasons such as poor performance, personnel changes, style issues and fees/cost issues. STPOL terminated three of these five managers. By creating and following policies for corrective action, STPOL has ensured that poorly performing money managers receive prompt corrective action and are held accountable for their performance.

GFOA recommends that systems develop a process for placing money managers on a watch list or terminating them for reasons such as the following: key personnel changes, portfolio characteristics, underperformance, and style deviations. STPOL's investment policy provides that underperforming money managers be placed on a "watch list" in these circumstances:

- A material change in the money manager's organization - such as ownership or key personnel changes
- Poor relative performance vs. benchmarks - investment returns are lower than comparable benchmarks
- Drifting from assigned style - investing in assets other than what the manager was hired to invest in

STPOL Takes Corrective Action When Its Consultant Underperforms

GFOA states that retirement systems should require that their consultants be both objective and independent. In 2001, STPOL staff became aware of a possible independence issue with their consultant's firm related to fees the consultant may have received from money managers. STPOL conducted a search to compare its consultant with other candidates. Ultimately, STPOL decided to keep its consultant but only after reducing its fees and shortening its contract term. By taking these actions, STPOL has held its consultant accountable for its performance.

STPOL Has Not Needed Corrective Action for Its Custodian

STPOL officials informed us that they have not experienced any significant problems with the custodian. Our review of STPOL's meeting minutes also revealed no mention of any issues or problems with the custodian.

DOES STPOL EMPLOY ADEQUATE POLICIES AND PROCEDURES TO ENSURE THAT PRIMARY DECISION MAKERS (BOARD MEMBERS, KEY SYSTEM STAFF, MONEY MANAGERS, CUSTODIANS, AND CONSULTANTS) AVOID CONFLICTS OF INTEREST AS WELL AS THE APPEARANCE OF CONFLICTS OF INTEREST?

The policies and procedures of STPOL may not always ensure that primary decision makers avoid conflicts of interest as well as the appearance of conflicts of interest. We found instances where gifts were accepted by STPOL's key staff and consultant from investment managers and the custodian, a possible violation of the Louisiana Code of Governmental Ethics. In addition, STPOL's trustees accepted meals from its investment managers and custodian. Furthermore, the consultant and investment managers are not required to disclose the nature of their relationship regarding potential conflicts of interest.

STPOL Could Strengthen Controls to Prevent Conflicts of Interest by Its Key Staff

STPOL does have policies and annual training to ensure that key staff members avoid potential conflicts of interest. However, we found what appeared to be instances where members of STPOL's staff may have violated the Louisiana Code of Governmental Ethics by accepting gifts from investment managers and the custodian hired by STPOL.

We asked STPOL's investment managers, custodian, and consultant to identify any things provided to key staff at STPOL during the period from July 1, 2003, through September 15, 2004 (14 ½ months). We also asked key staff members for a list of anything received from these investment professionals during the same time period. Based on the responses we received, STPOL staff received holiday gift baskets and investment-related books from some investment managers and the custodian. Although these gifts had an estimated total value of about $290, the Ethics Code (R. S. 42:1115) specifically provides that no public servant shall accept any thing of economic value as a gift from any person, if the public servant knows, or should know, that the person is seeking to obtain contractual or other business or financial relationships with the public servant's agency. A "thing of economic value" is defined as money or any other thing having economic value, except promotional items having no substantial resale value, according to R. S. 42:1102(22)(a).

In addition, we asked STPOL investment managers, custodian, consultant, key staff, and trusteees to disclose any economic interests trustees, STPOL staff, or their immediate family members have with any of the investment managers, custodian, or consultant. Based on the responses we received, we did not find any trustees, staff, or their immediate family members with any economic interests in the investment professionals hired by STPOL.

The key staff at STPOL are involved in screening, selecting, monitoring, and evaluating the investment managers and custodians hired by STPOL. Therefore, any gifts received by STPOL's key staff from the investment managers or custodians could be viewed as attempts to influence STPOL's oversight decisions. To avoid this potential conflict of interest, the Louisiana Code of Governmental Ethics prohibits public employees from accepting anything of economic value as a gift from anyone with a contractual or other business relationship with the public employee's agency. This code also prohibits STPOL from contracting with any investment manager, consultant, or custodian with whom a trustee or key staff member or a member of their immediate family have a substantial economic interest (R.S. 42:1113).

Recommendation 14: STPOL should obtain an opinion from the Louisiana Board of Ethics concerning whether acceptance of these gifts constitutes a violation of the Louisiana Code of Governmental Ethics. If the Louisiana Board of Ethics' opinion states that these are violations, STPOL should strengthen policies and procedures to ensure that all staff adhere to the Louisiana Code of Governmental Ethics. This process should include clearly communicating the applicability of the ethics code to STPOL staff and the provisions of the code to all investment managers and custodians.

Management's Response: STPOL agrees with this recommendation. The system's attorney is seeking an opinion from the Louisiana Board of Ethics. STPOL's Executive Director is recommending a no tolerance policy for the system in regard to prohibited gifts from money managers, custodians, and consultants. The Director and Assistant Director will sign a statement each year concerning complying with ethics laws. (See Appendix C for the system's full response.)

Recommendation 15: STPOL should strengthen policies and procedures to ensure that all staff avoid conflicts of interest and the appearance of conflicts of interest with current and prospective investment managers and custodians.

Management's Response: STPOL agrees with this recommendation. The Board of Trustees adopted the Louisiana Code of Ethics in December 2000, and will continue to conduct its business in compliance with these guidelines, which do not indicate that meals present any violation of the Code of Ethics. (See Appendix C for the system's full response.)

STPOL Personnel and Trustees Also Received Meals

Senate Concurrent Resolution (SCR) No. 14 of the 2004 Regular Session provides that the legislature is concerned about any impropriety which may occur between investment consultants, advisors, managers, and the board members of the state public retirement systems. SCR No. 14 therefore directed the legislative auditor to examine and audit all facets of the relationship between investment consultants, advisors, managers, and board members of the systems. Accordingly, we asked trustees, key STPOL staff, and all of STPOL's investment advisors to inform us of meals paid for by investment advisors from July 1, 2003, through September 15, 2004.

The prohibition against accepting any thing of economic value as a gift in the Louisiana Code of Governmental Ethics has exceptions. One exception is for food, drink, or refreshments consumed by a public servant while the personal guest of some person [R. S. 42:1102(22)(a)]. During fiscal year 2004, trustees and key staff accepted meals with investment managers and the custodian valued at approximately $2,852. This amount also includes the amounts paid for representative(s) of the providers. These meals do not violate the Code of Ethics; however, they represent a potential conflict of interest for trustees and key staff. By addressing such situations, we are complying with the intention of SCR No. 14. The providers, recipients, total cost, and dates of the meals are shown below in Exhibit 12.

Exhibit 12
Meals Received by STPOL Personnel, Trustees and Consultant
Fiscal Year 2004

Provider	Recipients	Value	Date
Waddell & Reed	Executive Director, STPOL	$44	February 10, 2004
Franklin Templeton	Mr. Walter Smith (Trustee)	70	September 15, 2003
Bank One	STPOL key staff, trustees, and consultant	984	September 15, 2003
Bank One	STPOL key staff and trustees	1,754	December 8, 2003
Total		**$2,852**	

Source: Prepared by legislative auditor's staff based on information received from STPOL's trustees, key staff, investment managers, custodian, and consultant.

STPOL Could Strengthen Controls on Disclosure and Treatment of Potential Conflicts of Interest by Its Consultant

STPOL does not employ policies or procedures to ensure disclosure and proper treatment of potential conflicts of interest with the consultants it hires. We found that the consultant has received gifts from STPOL's investment managers and custodian. During fiscal year 2004, these gifts of investment-related books and holiday gift baskets had an estimated total value of $250.

STPOL has put some controls in place regarding potential conflicts of interest by its consultant. In STPOL's current consultant contract, there is a provision prohibiting the consultant from recommending any investment managers owned by the consultant's parent company. In addition, the contract prohibits the consultant from receiving additional compensation for the services it provides to STPOL. Such provisions prohibit the consultant from receiving referral fees.

In a ruling dated January 8, 2004, the Louisiana Board of Ethics determined that the consultant for another state retirement system was a "public employee" of the retirement system as defined in the Louisiana Code of Governmental Ethics (Docket No. 2002-556). The Ethics Code prohibits public employees from accepting gifts from anyone with a contractual or other business relationship with the public employee's agency. Recent legislation (Act 686 of the 2004 Regular Session) requires investment managers and consultants to disclose conflicts of interest to public retirement systems.

Recommendation 16: STPOL should establish and implement policies and procedures for the disclosure and treatment of conflicts of interest and the appearance of conflicts of interest with current and prospective investment managers, custodians, and consultants.

Management's Response: STPOL agrees with this recommendation. It will inform its consultant of its "no tolerance" policy concerning prohibited gifts from money managers or custodians. The system will require an annual statement from the consultant indicating his activities in this regard. (See Appendix C for the system's full response.)

APPENDIX A: SCOPE AND METHODOLOGY

We conducted this performance audit under the provisions of Title 24 of the Louisiana Revised Statutes of 1950, as amended. We followed the applicable generally accepted government auditing standards as promulgated by the Comptroller General of the United States. Preliminary work on this audit began in April of 2004.

Scope

This audit focused on STPOL's investment activities from fiscal year 2002 thru August 2004. For certain parts of our investment work, we reviewed documents and information for years prior to fiscal year 2002. We obtained investment return data for different classes of assets and determined if the system had instituted an asset allocation plan in its investment policy. We evaluated whether STPOL staff, its consultant, and the board monitored compliance with the allocation plan and made adjustment to asset levels when appropriate. We reviewed the fees the system is paying to its contractors and how the fees compare with averages obtained from two surveys. We examined how STPOL and its board of trustees selected and monitored investment managers, their consultant, and custodian. In addition, we examined how the system and its board took corrective action for any poorly performing contractor.

This audit also focused on certain ethics-related activities for the time period from July 1, 2003, through September 15, 2004. We examined relationships among the STPOL's board and key employees and the investment consultant, managers, and custodian of this system. We also reviewed the steps that the system takes to ensure compliance with the state's ethics laws.

Methodology

We performed several tasks, which include the following:

- Conducted background research, including reviewing laws and information concerning the four state retirement systems
- Held an entrance conference with STPOL on July 27, 2004
- Obtained investment return information from STPOL's investment consultant and interviewed the consultant concerning this information
- Reviewed STPOL's asset allocation study prepared by its consultant
- Obtained two surveys of pension plans that provided data on fees and obtained custodial fee estimates from local banks

- Determined the fees STPOL currently pays by reviewing the contracts and invoices for money managers, the consultant, and the custodian

- Compared the survey and custodial fee estimate data to the fees currently paid by STPOL

- Gathered criteria on selecting, monitoring, and taking corrective action for money managers, consultants, and custodians; most of our criteria came from the GFOA, the Association for Investment Management and Research (AIMR), and state laws

- Met with STPOL's management to discuss criteria and interviewed STPOL management and reviewed STPOL policies to determine how investment professionals are selected and monitored and how corrective action is taken for a poorly performing contractor

- Attended meetings of the system's investment committee and board of trustees and reviewed minutes of meetings of the committee and board

- Reviewed state ethics law and all of STPOL's written policies for ethics work

- Developed criteria using the GFOA, the AIMR, and state laws

- Drafted and sent representation letters to STPOL staff, trustees, money managers, consultant, and custodian asking them to:

    - List things of value given or received to one another

    - Disclose relationships that could be a conflict of interest, such as those involving family members, business associates, ownership interests, financial interests, et cetera

APPENDIX B: COMPARABLE BENCHMARK INDICES FOR STPOL'S ASSET CLASSES

STPOL Asset Classes and Comparable Benchmark Indices	
Asset Class	**Comparable Benchmark Index**
Large Cap Equity	**S&P 500 -** Composed of 500 widely held U.S. stocks, both mid cap and large cap. Used to judge overall U.S. market performance.
Small Cap Equity	**Russell 2000 -** Measures the performance of the smallest 2,000 companies in the Russell 3000 Index (the Russell 3000 is composed of 3,000 of the largest U.S. companies).
Total International	**MSCI EAFE -** (Morgan Stanly Capital International, Europe, Australia, and the Far East) Composed of 21 MSCI Country Indices picked to represent the developed markets outside of North America.
Total Fixed Income	**Lehman Aggregate Bond -** Composed of the Lehman Brothers Government/Corporate Bond Index, Mortgage-Backed Securities Index, and Asset-Backed Securities Index, including securities that are investment-grade quality or better, have at least one year to maturity, and have an outstanding par value of at least $100 million.
Sources: www.trading-glossary.com, www.investorwords.com, www.msci.com	

APPENDIX C: MANAGEMENT'S RESPONSE

Louisiana State Police Retirement System

January 5, 2005

Mr. Steve J. Theriot, C.P.A.
Louisiana Legislative Auditor
P.O. Box 94397
Baton Rouge, LA 70804-9397

Dear Mr. Theriot:

In response to your letter concerning the performance review of the LSPRS, I was pleased both with how the review was handled and the results of the review. In terms of the scope and methodology of their review, all of the appropriate communication with the system representatives was handled very effectively. The actual review process was performed very efficiently and with a minimal about of complications for our staff. Finally, the results are documented well and presented in a fair manner.

It is our intent to use the recommendations to strengthen the processes used by our system in the management of its assets. In several instances, our board was already aware of the issues presented by the auditors and had taken action to remedy the situation. As a fiduciary to our system, I believe the recommendations can help us to bring greater focus and attention to our responsibilities.

With this response to the performance review, I am including comments relative to each individual recommendation.

In closing, I would like to compliment you and your staff for the professional and courteous manner in which this review was conducted. It was a very positive experience for me and our staff.

Sincerely,

Irwin L. Felps, Jr.

Irwin L. Felps, Jr.
Executive Director

3100 BRENTWOOD DRIVE, SUITE B – BATON ROUGE, LOUISIANA 70809 – PHONE 225-925-4878 – FAX 225-925-3797–1-800-256-5210

Legislative Auditor's Recommendations

1. **Agree -** Have coordinated with consultant, custodian and C.P.A to report investment returns "net of fees". It should be noted that on Exhibits 4 and 5 the last column should be labeled Estimated Excess Return and Estimated Dollar Impact, since the figures are based on estimated investment returns.

2. **Agree -** Although our board has not been reviewing the asset class data, it has accomplished the task of determining why there was under-performance in certain areas. This was accomplished by evaluating the individual money managers. We do agree that the asset class reports will assist our board in its evaluation process.

3. **Disagree -** Our board is aware of the under-performance in the Large Cap Equity, Small Cap Equity and Fixed Income portfolios. The reasons for the under-performance are: 1) Large Cap - replaced Large Cap Value Manager in 2003, 2) Small Cap - replaced both Small Cap Managers in 2002, and 3) Fixed Income - restrict our managers to lower risk tolerance than allowed by benchmarks. All of this is documented in our Investment Committee minutes and was discussed with auditors.

4. **Agree -** Although our board disagrees with the use of the GFOA eight criteria as the basis for an investment performance evaluation, we agree that the use of index funds should be formally added to our investment policy. We are currently monitoring and evaluating our index funds on a monthly basis.

5. **Agree -** All new contracts or prospectus have fee disclosure. We will develop a standard contract for our managers that will include fee schedule.

6. **Agree -** All managers, including commingled trusts, are submitting monthly or quarterly statements of their fees, expenses and foreign taxes. In the case of our commingled trusts, this has necessitated that our managers set up special procedures for our account that are not offered to all accounts in the trust.

7. **Agree -** All quarterly or monthly statements from money managers are reviewed to ensure that statements are correct before fees are paid. This process for the commingled trusts was established after the performance review.

8. **Disagree -** Fees are just one component of the overall evaluation process for a custodian. In fact, we believe that the quality of service from our custodian is far more important than the fees. The performance review does indicate that our custodian fees are <u>lower</u> than the average for similar sized public pension plans. Our custodian has scored extremely well on our custodial evaluation form. In

addition, we have not had one significant problem in 3 ½ years. Our Investment Committee will consider this custodial issue at its next meeting in February.

9. **Agree -** We will formalize our general criteria for the selection of consultants, custodian banks and money managers in our Investment Policy.

10. **Agree -** We will formalize our general policies for custodial reviews to conduct these evaluations at least annually.

11. **Agree -** We have formally evaluated our consultant, annually, for the past three years. This evaluation is performed in December, and it is documented in the minutes of our Investment Committee. We will include this process in our Investment Policy.

12. **Agree -** We have been reviewing the reconciliation done by our money managers, before we pay their fees. We will begin reviewing the reconciliation done by our consultant.

13. **Disagree -** Although we monitor our investment managers for churning their portfolios, we have not found any evidence of such activity. In fact, the performance review agrees with us on this point. We will formalize our current monitoring procedures for churning into our investment policies.

14. **Agree -** Our Attorney, Randy Zinna, is seeking an opinion from the Louisiana Board of Ethics. I am recommending a no tolerance policy for the LSPRS in regards to prohibited gifts from money managers, custodians and consultants. Director and Assistant Director will sign a statement to this effect each year.

15. **Agree -** Our board adopted the Louisiana Code of Ethics in December 2000. We will continue to conduct our business in compliance with these guidelines, which do not indicate that meals present any violation of the Code of Ethics.

16. **Agree -** We will inform our consultant of our “no tolerance” policy concerning prohibited gifts from money managers or custodians. We will require his statement annually indicating his activities in this regard.