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Missouri State Auditor

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# Missouri Department of Transportation and Highway Patrol Employees' Retirement System

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Missouri State Auditor

## YELLOW SHEET

### Findings in the audit of the Missouri Department of Transportation and Highway Patrol Employees' Retirement System

#### Investment Manager Hiring

The Missouri Department of Transportation and Highway Patrol Employees' Retirement System Board of Trustees (Board) did not follow its investment policy when hiring an investment manager. In November 2008, the Board voted to invest \$15 million with a new private equity fund manager although the Executive Director, Chief Investment Officer, and investment consultant all opposed the investment. As required by the Board's investment policy, investment manager hiring decisions are typically made by the Chief Investment Officer and investment consultant with approval of the Executive Director, and supported by a detailed hiring report provided to the Board. However, this investment manager was hired directly by the Board, a hiring report was not prepared, and the related Board meeting minutes contained no documentation of the Board's decision process or rationale for its decision. In addition, the Board did not comply with state law when holding the closed meeting at which the investment manager was hired.

#### Travel Expenditures

As noted in our prior audit report, the Board has not established limits for travel expenses such as lodging and meals, or sufficient procedures for ensuring these costs are reasonable. Travel expenses are incurred for various purposes including Board meetings, Board member and employee training, conferences, member and retiree seminars, and due diligence trips to monitor the system's external service providers. Travel expenditures totaled approximately \$241,000 during the 3 years ended June 30, 2009. Our review noted instances where lodging and meal reimbursements appeared excessive and/or exceeded federal employee per diem maximums established by the federal government.

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**SUSAN MONTEE, JD, CPA**  
**Missouri State Auditor**

Honorable Jeremiah W. (Jay) Nixon, Governor  
and  
Board of Trustees  
and  
Susie Dahl, Executive Director  
Missouri Department of Transportation and  
Highway Patrol Employees' Retirement System  
Jefferson City, Missouri

The State Auditor is required under Section 104.190.4, RSMo, to review the audits of the Missouri Department of Transportation and Highway Patrol Employees' Retirement System. The system engaged Williams Keepers LLC, Certified Public Accountants (CPAs), to audit the system's financial statements for the years ended June 30, 2009, 2008, and 2007. We reviewed the reports and substantiating working papers of the CPA firm and performed other procedures that we considered necessary in the circumstances. The scope of our audit included, but was not necessarily limited to, the years ended June 30, 2009, 2008, and 2007. The objectives of our audit were to:

1. Evaluate the system's internal controls over significant management and financial functions.
2. Evaluate the system's compliance with certain legal provisions.
3. Evaluate the economy and efficiency of certain management practices and operations.

Our methodology included reviewing minutes of meetings, written policies and procedures, financial records, and other pertinent documents; interviewing various personnel of the system, as well as certain external parties; testing selected transactions; and analyzing comparative data obtained from the system.

We obtained an understanding of internal controls that are significant within the context of the audit objectives and assessed whether such controls have been properly designed and placed in operation. We also tested certain of those controls to obtain evidence regarding the effectiveness of their design and operation. However, providing an opinion on the effectiveness of internal controls was not an objective of our audit and accordingly, we do not express such an opinion.

We obtained an understanding of legal provisions that are significant within the context of the audit objectives, and we assessed the risk that illegal acts, including fraud, and violations of contract or other legal provisions could occur. Based on that risk assessment, we designed and performed procedures to provide reasonable assurance of detecting instances of noncompliance significant to those provisions. However, providing an opinion on compliance with those provisions was not an objective of our audit and accordingly, we do not express such an opinion. Abuse, which refers to behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary given the facts and circumstances, does not necessarily involve noncompliance with legal provisions. Because the determination of abuse is subjective, our audit is not required to provide reasonable assurance of detecting abuse.

We conducted our audit in accordance with the standards applicable to performance audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform our audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides such a basis.

The accompanying Organization and Statistical Information is presented for informational purposes. This information was obtained from the system's management and was not subjected to the procedures applied in our audit of the system.

The accompanying Management Advisory Report presents our findings arising from our audit of the Missouri Department of Transportation and Highway Patrol Employees' Retirement System.



Susan Montee, JD, CPA  
State Auditor

The following auditors participated in the preparation of this report:

|                     |                           |
|---------------------|---------------------------|
| Assistant Director: | Douglas Porting, CPA, CFE |
| Audit Manager:      | Kim Spraggs, CPA          |
| In-Charge Auditor:  | Christina Davis           |
| Audit Staff:        | Jessica Jordan            |

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# Missouri Department of Transportation and Highway Patrol Employees' Retirement System Management Advisory Report - State Auditor's Findings

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## **1. Investment Manager Hiring**

The Missouri Department of Transportation and Highway Patrol Employees' Retirement System (system) Board of Trustees (Board) did not follow its investment policy when hiring an investment manager. In addition, the Board did not comply with state law when holding the closed meeting at which the investment manager was hired.

In November 2008, the Board voted to invest \$15 million with a new private equity fund manager although the Executive Director (ED), Chief Investment Officer (CIO), and investment consultant all opposed the investment. In a report submitted to the Board, the CIO expressed the system staff and investment consultant's opposition and concerns regarding hiring the investment manager. These concerns included violation of the Board's investment policy and CIO's employment contract, duplication of services provided by an existing provider, and risk due to the infancy of the fund.

As required by the Board's investment policy, investment manager hiring decisions are typically made by the CIO and investment consultant with approval of the ED, and supported by a detailed hiring report provided to the Board. However, this investment manager was hired directly by the Board, a hiring report was not prepared, and the related Board meeting minutes contained no documentation of the Board's decision process or rationale for its decision. When we inquired with the CIO regarding the system's compliance with the Board's investment policy, he indicated he could not recall any other instance that the policy was not followed when hiring an investment manager. When we asked several system employees present during that Board meeting for information regarding the Board's rationale for hiring the investment manager, each employee told us they were asked to leave the Board meeting during the time the Board discussed and voted on the hiring of the investment manager. Although it appears a portion of the Board meeting was essentially closed, this action was not disclosed in the open Board meeting minutes.

The Board's investment policy provides, "the Board has delegated to the CIO and general consultant all investment manager hiring and termination decisions, subject to the approval of the ED. In establishing this policy, it is the Board's intent to assure interested parties that actions . . . occur in an environment of full disclosure that is characterized by a competitive process, objective evaluation, and thorough documentation. The overriding consideration with respect to all decisions is that they are made solely in the best interests of plan participants and beneficiaries." The policy also provides that documentation materials prepared by the investment staff and consultant regarding action to hire a manager should include a full description of the reason for the action, the expected benefits resulting from the action, and a full review of the decision making process. By not maintaining documentation supporting its hiring decision, the Board has not



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demonstrated the decision was objective, in the best interests of plan participants and beneficiaries, or in compliance with Board policy.

In addition, the Sunshine Law, Chapter 610, RSMo, provides the specific reasons governmental bodies are allowed to close a public meeting and requires the Board to vote in open session to close a meeting, to announce publicly the reasons for going into closed session, and to maintain sufficiently detailed minutes for all closed meetings.

## Recommendation

The Board of Trustees ensure the decision making process and rationale for hiring investment managers is documented as required by the investment policy. When an investment manager hiring process does not comply with the investment policy, the reasons necessitating such policy deviations should be documented. In addition, the Board should ensure closed meetings are conducted and documented in accordance with the Sunshine Law.

## Auditee's Response

*The Board of Trustees provided the following response:*

*During 2009, the Board of Trustees established a Board Governance Committee and engaged a governance consultant to develop a comprehensive set of board governance policies. These policies were fully implemented in 2010. These include a Board Meeting Protocol policy that addresses the Missouri Sunshine Law requirements for open and closed meetings. The Board will abide by this and all the board governance policies, ensuring that closed meetings are conducted and documented in accordance with the Sunshine Law.*

*The Board will adhere to the Missouri Department of Transportation and Highway Patrol Employees' Retirement System (MPERS) investment policy and ensure the decision-making process and rationale for hiring investment managers is documented as required. If the situation arises where the hiring process presents a deviation from policy, the reasons for the deviation will be fully documented.*

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## 2. Travel Expenditures

As noted in our prior audit report, the Board has not established limits for travel expenses such as lodging and meals, or sufficient procedures for ensuring these costs are reasonable.

Travel expenses are incurred for various purposes including Board meetings, Board member and employee training, conferences, member and retiree seminars, and due diligence monitoring trips. Costs associated with system travel are most commonly paid by Board members or employees and reimbursed, but can also be paid directly to vendors. Travel expenditures totaled approximately \$240,700 during the 3 years ended June 30, 2009. A significant portion of system travel expenditures are related to due diligence



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monitoring trips to monitor the system's external service providers. The CIO and the Senior Investment Officer collectively make approximately 20 due diligence trips per year, which are frequently to large out-of-state cities, with at least one international trip each year. To save travel costs, investment department staff generally coordinate due diligence monitoring trips with other events requiring travel such as investment advisory board meetings and conferences. Some or all travel costs associated with these other events are often paid by third parties.

We reviewed 27 Board member and employee expense reimbursements totaling approximately \$30,200, or 13 percent of travel expenditures, during the 3 years ended June 30, 2009. Approximately \$7,500, or 25 percent, of these travel expenditures were associated with six due diligence monitoring trips. Additional travel expenses were incurred for each of these six due diligence monitoring trips and paid by third parties, including the lodging costs for two of the trips.

Our review noted lodging reimbursements appeared excessive for two of the four due diligence monitoring trips where lodging costs were paid by the system. For both trips, lodging expense reimbursements exceeded Continental United States (CONUS) and foreign per diem rates (federal employee per diem maximums, established by the U.S. General Services Administration and Department of State, frequently used by governmental agencies as travel reimbursement guidelines). For a January 2008 trip to San Francisco, California, to attend training provided by an investment manager and perform due diligence monitoring for another investment manager, the Senior Investment Officer was reimbursed \$255 per night for two nights, when the CONUS rate was \$152 per night. For an October 2007 trip to Boston, Massachusetts, to attend a conference and perform due diligence monitoring of an investment manager, the CIO was reimbursed \$505 for one night, when the CONUS rate was \$220. The CIO indicated travel arrangements for this trip were made too late to stay at the hotel where the conference was held and availability at other hotels was limited because the trip was during the World Series; however, documentation of this situation and justification for staying at the selected hotel was not maintained. The Board's travel policies require that when selecting a hotel the location, quality, and price must be considered and the best value hotel selected; however, the policy does not require that documentation of this analysis be maintained.

We noted meal reimbursements exceeded CONUS rates on 1 of 24 expense reimbursements reviewed that included meal costs. The General Counsel was reimbursed \$37 and \$30 for dinner during a June 2009 trip to a conference in Portland, Oregon, when the CONUS rate was \$24.



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The Board's policies for Board member and employee reimbursement of travel expenses state these expenses " . . . shall be in reasonable relationship to their average cost for the cities where the expenses are incurred." However, the policies provide no limits or guidance for determining what costs would be considered reasonable. Limits for meal and lodging expenses, such as CONUS and foreign per diem rates, could help ensure such payments are reasonable.

## Recommendation

The Board of Trustees establish reasonable maximum rates for all meal and lodging costs. The reasons necessitating rates exceeding those established guidelines should be documented.

## Auditee's Response

*The Board of Trustees provided the following response:*

*Effective July 1, 2010, the MPERS Staff Travel policy was revised to change meal reimbursement from actual cost to a per diem allowance, in accordance with the guidelines established by the Office of Administration. Adopting the state meal per diem rates establishes reasonable maximum rates for all meal costs, as recommended.*

*MPERS will review current hotel rates in cities where MPERS' staff and Board members most frequently travel, along with applicable CONUS rates, to determine reasonable maximum lodging rates. Revisions to the MPERS' Staff Travel policy will be considered, based on this analysis.*

*The Board of Trustees will consider revising the Board Travel policy to be consistent with the Staff Travel policy regarding meal per diem and maximum lodging rates.*

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# Missouri Department of Transportation and Highway Patrol Employees' Retirement System Organization and Statistical Information

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The Missouri Department of Transportation and Highway Patrol Employees' Retirement System (MPERS) was created under an act of the General Assembly, commenced actual operations on September 1, 1955, and is governed by Chapter 104, RSMo.

The system is a single-employer, public employee, defined benefit retirement system for benefit eligible employees of the Missouri Department of Transportation (MoDOT) and the Missouri State Highway Patrol (MSHP). The system provides retirement, survivor, and disability benefits to its members. Within the system are two benefit structures known as the Closed Plan and the Year 2000 Plan. As of June 30, 2009, the system had 8,813 active, 1,737 terminated vested, and 7,480 retired members and beneficiaries. Legislation passed in July 2010 created a new tier within the Year 2000 Plan for employees hired on or after January 1, 2011. These employees will be required to contribute 4 percent of their pay to the system, and will have certain other provisions that differ from those applicable to previously hired employees.

## Board of Trustees

The responsibility for the operation and administration of the system is vested in an 11-member Board of Trustees. This Board consists of three members of the state Highways and Transportation Commission (Highway Commission), elected by the members of the commission; the director of the MoDOT; the superintendent of the MSHP; one member of the Senate, appointed by the President Pro Tem of the Senate; one member of the House of Representatives, appointed by the Speaker of the House; and one active employee and one retired member of each the MoDOT and MSHP, who are elected by a plurality vote of the active and retired members of their respective departments to serve 4-year terms. The members of the Board of Trustees as of June 30, 2009, were as follows:



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| Name and Title                        | Membership                     | Term Expires  |
|---------------------------------------|--------------------------------|---------------|
| Mike Kehoe, Board Chair (1)           | Highway Commissioner           | March 1, 2011 |
| Roger Stottlemeyer, Vice Chair (1)(2) | Elected (Retired MSHP member)  | July 1, 2010  |
| Rudolph E. Farber                     | Highway Commissioner           | March 1, 2013 |
| Duane Michie (3)                      | Highway Commissioner           | March 1, 2009 |
| Sue Cox (1) (2)                       | Elected (Active MoDOT member)  | July 1, 2010  |
| Captain Juan Villanueva (2)           | Elected (Active MSHP member)   | July 1, 2010  |
| Bob Sfreddo (2)                       | Elected (Retired MoDOT member) | July 1, 2010  |
| Colonel Jim Keathley (4)              | Superintendent, MSHP           | (6)           |
| Pete Rahn (5)                         | Director, MoDOT                | (6)           |
| John Griesheimer                      | Senator                        | (6)           |
| Charlie Schlottach                    | Representative                 | (6)           |

- (1) Resigned in July 2009 and replaced by Lloyd J. Carmichael in September 2009. His term expires March 1, 2015. Roger Stottlemeyer and Sue Cox were elected Board Chair and Vice Chair in July 2009 and January 2010, respectively.
- (2) Roger Stottlemeyer, Sue Cox, and Bob Sfreddo were re-elected and Captain Juan Villanueva was replaced by Major Bret Johnson. Their terms expire July 1, 2014.
- (3) Though his term expired March 1, 2009, he served until June 2010. He was replaced by Kenneth Suelthaus in August 2010.
- (4) Succeeded by Colonel Ron Replogle in March 2010.
- (5) Succeeded by Kevin Keith, Interim Director, in April 2010.
- (6) Term expires with office held.

## Executive Staff

Susie Dahl has served as the Executive Director since July 1, 2008, upon the retirement of Norm Robinson. The Executive Director coordinates the daily operation of the system, contracts for professional services with the approval of the Board, and advises the Board on all matters pertaining to the system. At June 30, 2009, the system had 13 employees including the Executive Director. The executive staff and their annual compensation as of June 30, 2009, were as follows:

| Name and Title                              | Annual Compensation |
|---|---------------------|
| Susie Dahl, Executive Director              | \$ 128,316          |
| Pam Henry, Assistant Executive Director     | 92,040              |
| Larry Krummen, Chief Investment Officer (1) | 222,000             |

- (1) Includes incentive payment of \$67,500, earned for fiscal year 2008 investment performance, in addition to his base salary of \$154,500. The Chief Investment Officer's employment contract, effective December 2007, provides for an annual performance incentive payment, not to exceed 60 percent of his salary, if certain investment performance benchmarks are exceeded by preset levels. No incentive payment was earned for fiscal year 2009 investment performance.

Additional information regarding the system's plan provisions and benefits, assets, investments, financial activities, consultants, and actuarial valuations is included in various documents and reports which are available on the system's website ([www.mpers.org](http://www.mpers.org)).