

STATE OF LOUISIANA LEGISLATIVE AUDITOR

Firefighters' Retirement System
Baton Rouge, Louisiana

November 20, 2002



Daniel G. Kyle, Ph.D., CPA, CFE
Legislative Auditor

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FIREFIGHTERS' RETIREMENT SYSTEM

Baton Rouge, Louisiana

Dated November 6, 2002

Under the provisions of state law, this report is a public document. A copy of this report has been submitted to the Governor, to the Attorney General, and to other public officials as required by state law. A copy of this report has been made available for public inspection at the Baton Rouge office of the Legislative Auditor.

November 20, 2002

FIREFIGHTERS' RETIREMENT SYSTEM
Baton Rouge, Louisiana

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November 6, 2002

**MR. BILL DESORMEAUX, ACTING CHAIRMAN,
AND MEMBERS OF THE BOARD OF TRUSTEES
FIREFIGHTERS' RETIREMENT SYSTEM**
Baton Rouge, Louisiana

We have performed a limited examination of the Firefighters' Retirement System (System). Our examination was conducted in accordance with Title 24 of the Louisiana Revised Statutes and was performed to determine the propriety of certain allegations received by this office.

A limited examination is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

The accompanying report presents the background, methodology, and our findings and recommendations, as well responses from management of the System. We will continue to monitor the findings until you resolve them. Copies of this report have been delivered to the Honorable Doug Moreau, District Attorney for the Nineteenth Judicial District of Louisiana; the Louisiana Board of Ethics; the Internal Revenue Service; and other authorities as required by state law.

Respectfully submitted,

A handwritten signature in cursive script that reads "Daniel G. Kyle".

Daniel G. Kyle, CPA, CFE
Legislative Auditor

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[FIRERET02]

LEGISLATIVE AUDITOR

FIREFIGHTERS' RETIREMENT SYSTEM

Baton Rouge, Louisiana

BACKGROUND

The Firefighters' Retirement System (System) is a statewide retirement system that was established January 1, 1980. It is a multiple-employer defined benefit pension plan that covers firemen employed by municipalities, parishes, and fire protection districts within the State of Louisiana. At June 30, 2002, there are 3,322 active members contributing to the System and 145 participants in the Deferred Retirement Option Plan. Also, there are 1,278 retired members or beneficiaries receiving retirement benefits.

Louisiana Attorney General Opinion 93-676 provides, in part, that a statewide retirement system can be considered a state agency, or at a minimum, an entity or instrumentality of the state. For the years ended June 30, 2002, and June 30, 2001, state contributions (insurance premium tax) totaled \$15,115,035, and \$19,865,996, respectively. Also, on June 30, 2002, the state appropriated an additional \$4,500,000 for the purpose of subsidizing the increase in the employer contribution rate (from 9.00% to 18.25%) that was recommended by the Public Retirement Systems' Actuarial Committee for fiscal year ending June 30, 2003.

The market value of net assets of the System's retirement fund decreased \$21,069,235 (3%) from \$641,929,807 at June 30, 2001, to \$620,860,572 at June 30, 2002. In addition, the unfunded actuarial accrued liability increased \$74,407,227 (43%) from \$171,609,212 at June 30, 2001, to \$246,016,439 at June 30, 2002.

The System contracts with eleven investment managers to invest the retirement funds and pays an investment consultant (Becker Burke Associates) \$52,000 a year to primarily monitor/evaluate the performance of the investment managers. Although the investment managers invest and manage System funds, we found that the System realized substantial net losses on sales during the period from April 2001, through July 2002 (sixteen-month period). The following is a list of those sales of investment securities that exceeded \$1 million in realized net losses for the sixteen-month period.

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FIREFIGHTERS' RETIREMENT SYSTEM

Baton Rouge, Louisiana
Background (Continued)

<u>Company</u>	<u>Net Losses*</u> <u>(In Thousands)</u>
EMC	\$4,562
Oracle	3,016
WorldCom	2,427
Xilinx	2,379
Corning	2,137
Cisco	2,068
AOL Time Warner	1,931
SBC Communications	1,557
ADC Telecommunications	1,538
Solectron	1,533
Veritas Software	1,457
Computer Sciences	1,353
Perkinelmer	1,099
Emerson Electric	1,043
Conseco	1,034
Schlumberger	1,001
Total	<u>\$30,135</u>

*Does not include net losses of investment securities less than \$1,000,000

The board of trustees that administers the System is composed of eight members as follows:

- Two members of the Professional Firefighters Association (association), elected by officers of the association
- A fire chief, elected by fire chiefs of fire departments participating in the System
- The executive director of the Louisiana Municipal Association
- A mayor, appointed by the Louisiana Municipal Association
- The chairman of the Retirement Committee of the House of Representatives of the Louisiana Legislature, or their designee
- The chairman of the Retirement Committee of the Senate of the Louisiana Legislature, or their designee
- Retired System member, elected by System board members

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FIREFIGHTERS' RETIREMENT SYSTEM

Baton Rouge, Louisiana
Background (Concluded)

The following individuals have served as chairman and vice-chairman of the board since January 1986:

Name	Title	Dates of Term
Bill Desormeaux	Acting Chairman	November 1, 2002 - present
Donald Nugent**	Chairman	May 28, 2002 - October 31, 2002
Michael Hemphill***	Chairman	January 1, 1986 - May 28, 2002
Bill Desormeaux	Vice-Chairman	January 1, 1986 - October 31, 2002

**Mr. Nugent no longer serves on the board.

***Mr. Hemphill presently serves as a board member.

The System operated without a director for 15 years of Mr. Hemphill's approximately 16½-year tenure as board chairman. As the System's de-facto director, Mr. Hemphill was involved in System operations and was a signatory on the System's bank accounts. Current employees of the System include a director, administrator, administrative assistant, retirement benefit analyst, and receptionist.

METHODOLOGY

The legislative auditor received information relating to travel, credit cards, payroll, tapes of board meetings, litigation, and policies. We visited the System to determine the accuracy of this information.

Our procedures consisted of the following: (1) examining selected System records; (2) interviewing certain employees and board members of the System; (3) reviewing applicable Louisiana laws, Attorney General opinions, and Board of Ethics opinions; and (4) making inquiries of other persons to the extent we considered necessary to achieve our purpose.

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FIREFIGHTERS' RETIREMENT SYSTEM
Baton Rouge, Louisiana

CONCLUSIONS

The following summarizes the findings that resulted from this limited examination of the System. The Findings and Recommendations section of this report provides details for these findings. Management's responses are included in Attachment 1.

1. System officials received duplicate travel reimbursements for which they were not entitled to keep. (See page 8.)
2. The System does not follow the State of Louisiana's travel regulations as required by the Division of Administration. Also, board members did not always comply with the travel policy that was adopted by the System. (See page 11.)
3. There is no documentation for the necessity of Mr. Hemphill's travel outside of the continental United States and this travel may have violated the terms and spirit of a Louisiana House Resolution. (See page 17.)
4. System funds were commingled by paying Mr. Hemphill's personal credit card company. Also, System funds were used to pay for purchases that lack a public purpose. (See page 20.)
5. Board members may have violated the Code of Ethics by accepting complimentary gifts and/or golf outings from investment managers doing business with the System. (See page 22.)
6. We found no documentation of the board's consideration of the impact on the System of legislation relating to members' purchase of military service credit or members' repayment of refunds to receive credit in the System. In addition, the board of trustees did not exercise its fiduciary responsibility when it allowed the purchase of military service credit by retirees that returned to work for one day. (See page 24.)
7. Annual leave paid to System employees was not made in accordance with state law. Also, the System did not obtain authorization from the Louisiana Department of Civil Service (Civil Service) to place its employees in the unclassified service and also failed to provide Civil Service with employee information. (See page 26.)
8. The System has not maintained all tapes of its board meetings in accordance with state law. (See page 27.)
9. The System's written policies and procedures are not complete. (See page 27.)

LEGISLATIVE AUDITOR

FIREFIGHTERS' RETIREMENT SYSTEM

Baton Rouge, Louisiana
Conclusions (Concluded)

10. Mr. Hemphill's participation in the Deferred Retirement Option Plan (DROP) program for retirees may violate state law. Also, the System did not obtain guidance from the Internal Revenue Service for the tax reporting changes made for the retirement benefits of Mr. Hemphill or for the participants in the Disability Conversion program. (See page 29.)
11. The System did not enter into written contracts for legal services provided by attorneys. (See page 30.)
12. The System administers the retirement plan as a nonqualified plan rather than as a qualified plan. (See page 31.)

LEGISLATIVE AUDITOR

FIREFIGHTERS' RETIREMENT SYSTEM
Baton Rouge, Louisiana

FINDINGS AND RECOMMENDATIONS

Duplicate Travel Reimbursements

System officials received duplicate travel reimbursements for which they were not entitled to keep. Louisiana Revised Statute (R.S.) 42:1461(A) provides, in part, that officials, whether elected or appointed and whether compensated or not, by the act of accepting such office assume a personal obligation not to misappropriate, misapply, convert, misuse, or otherwise wrongfully take any funds, property, or other thing of value belonging to or under the custody or control of the public entity in which they hold office.

Former Chairman Hemphill

Mr. Hemphill filed for and received \$2,224 in duplicate travel reimbursement for which he was not entitled to keep.

Mr. Hemphill is an executive board member of the National Conference on Public Employee Retirement Systems (NCPERS), a nonprofit organization with offices located in Washington D.C., and serves on its Budget and Insurance committees. NCPERS reimburses Mr. Hemphill for his travel to attend meetings that are held in various locations throughout the United States. Also, on May 14, 1993, the board (Desormeaux, Broussard, Pasqua, Fredieu, and Douglas) unanimously approved the System reimbursing Mr. Hemphill for those travel costs not reimbursed by NCPERS. However, our review of NCPERS records that were provided to us for 2000 and 2001, revealed that Mr. Hemphill filed for and received \$2,224 in duplicate travel reimbursements for seven of his nine trips as follows:

- The System paid Mr. Hemphill's personal credit card company (American Express) for certain travel and travel related charges made to attend NCPERS meetings. Mr. Hemphill also filed for and received travel reimbursements from NCPERS for \$2,082 of the travel costs paid by the System.
- Mr. Hemphill filed two expense reports with the System for travel reimbursements that included meals and mileage expenditures for which he also included on his expense reports submitted to NCPERS. As a result, Mr. Hemphill received duplicate travel reimbursements of \$142.

A summary of the duplicate travel reimbursements for 2000 and 2001 is as follows:

	<u>Amounts</u>
Airfare	\$894
Lodging	770
Parking	194
Vehicle rental	160
Meals	116
Mileage	<u>90</u>
Total	<u><u>\$2,224</u></u>

LEGISLATIVE AUDITOR

FIREFIGHTERS' RETIREMENT SYSTEM

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Findings and Recommendations (Continued)

Mr. Hemphill told us he agrees duplicate payments were made and that he did not reimburse the System; however, he said that he was not aware that the duplicate payments were made until recently when he did his own audit. Mr. Hemphill said he sent his credit card receipts (with travel expense forms) to NCPERS for reimbursement and that the System should not have paid these charges on his American Express card. Mr. Hemphill told us the System's staff was instructed not to pay charges without receipts. Mr. Hemphill said he signed the System checks paying his monthly credit card bill, but that it has been a couple of years since he reviewed the monthly billing statements. He said he did not review the statements unless the staff had a question.

The current and former administrator and two other System employees, who were involved in processing Mr. Hemphill's credit card bill for payment, informed us they were not instructed nor were they aware of a policy that prohibited the payment of credit card charges without receipts. We were informed that as a matter of procedure, all charges on Mr. Hemphill's credit card were paid unless he instructed them not to pay it with System funds.

Although Mr. Hemphill did not review his monthly credit card statement, he had full knowledge of the credit card charges made because he possessed the card, made all the charges, and signed the System check paying the credit card bill. Therefore, Mr. Hemphill did not exercise proper or reasonable care in allowing the System to pay for travel and travel related expenses reimbursed him by another organization.

Former Chairman Nugent

Mr. Nugent received mileage reimbursements from the System totaling \$8,464 from January 11, 1996, through September 12, 2002, for attending board meetings although his employer (Ouachita Parish Police Jury) provided/paid his transportation costs. Therefore, Mr. Nugent received mileage reimbursements for which he was not entitled to keep.

We were advised that Mr. Nugent reimbursed the Ouachita Parish Police Jury the \$8,464 on October 29, 2002. Presently, our investigative audit division is reviewing Mr. Nugent's travel in connection with its investigative audit of the Ouachita Parish Police Jury.

Former Contract General Counsel

The System paid \$1,399 for five nights of lodging for the System's former contract general counsel (Randy Roche) that was not related to System business. In addition, Mr. Roche's employer paid \$729 for three of the five nights lodging.

Mr. Roche informed us that he was in Anchorage, Alaska, attending a conference (August 13-15, 2001) that was paid for by his employer, the Louisiana School Employees' Retirement System (LSERS). Mr. Roche told us that he and his wife and children occupied two hotel rooms for five nights and that LSERS paid \$729 for three nights of lodging (for one room) at the conference room rates.

LEGISLATIVE AUDITOR

FIREFIGHTERS' RETIREMENT SYSTEM

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Findings and Recommendations (Continued)

In addition to LSERS paying for Mr. Roche's lodging, Mr. Hemphill paid for five nights of Mr. Roche's lodging by charging \$1,399 on his personal credit card. The administrator informed us that upon Mr. Hemphill's request, the System paid his (Mr. Hemphill's) personal credit card company for these lodging charges on September 20, 2001.

Mr. Roche informed us that while he was in Anchorage, he attended a 1½-hour meeting on August 17 relating to the System's Conseco securities litigation. Mr. Roche said that he only attended the meeting because he was already in Anchorage (see finding, *Former Chairman's Travel Outside Continental United States - Anchorage, Alaska Trip*). Mr. Roche told us he knew Mr. Hemphill paid for one of his rooms (five nights) with a credit card, but he did not know that the System paid for this lodging until we told him.

After we questioned Mr. Roche about the System's payment for his lodging costs in Anchorage, he reimbursed the System \$1,399 on July 15, 2002 (almost one year after his trip) for the five nights of lodging. Mr. Roche stated, "In my opinion, this wasn't a System expense." Also, although Mr. Roche reimbursed the System, he did not include an amount for interest to compensate the System for the time period that the funds were not available for investment purposes.

These duplicate reimbursements indicate the System needs to strengthen controls over payments/disbursements made to board members and other System officials. As part of the System's Code of Ethics policy (see finding, *Written Policies and Procedures Are Not Complete*), the System should:

- Develop and implement a system/program that would highlight possible duplicate reimbursements made to board members and other System officials. As part of the program, the System should require board members and other System officials to disclose the names of their employers and other affiliated organizations, including certifying to the System that they have not received any payments that would violate the System's Code of Ethics policy.
 - Consider reviewing reimbursements made to all board members and System officials in prior years, including the reimbursements made to Mr. Hemphill, Mr. Nugent, and Mr. Roche.
 - Recover all duplicate reimbursements made for which board members and other System officials are not entitled to keep.
-

FIREFIGHTERS' RETIREMENT SYSTEM

Baton Rouge, Louisiana

Findings and Recommendations (Continued)

Noncompliance With Travel Policy

The System does not follow the State of Louisiana's travel regulations as required by the Division of Administration. Also, board members did not always comply with the travel policy that was adopted by the System. Division of Administration Policy and Procedure Memorandum (PPM) 49 Section 1501(A) provides that the State of Louisiana's travel regulations apply to the System.

Because the System did not follow the state's travel regulations, we used the travel policy adopted by the System in evaluating travel. Our findings are confined to that travel policy, unless the state's travel regulations are more restrictive.

During the 4¼-year period from January 1998 through March 2002, approximately \$98,000 was paid for former Chairman Hemphill and board members' conference travel. Our review of available travel records revealed the following noncompliance with the System's travel policy:

1. Authorization to Travel

The System's travel policy authorizes the chairman to attend a maximum of three conferences per year and board members to attend a maximum of two conferences per year. The policy states, "Anything above this number would have to be brought before the board for approval at the time the matter arises."

System records reflect that Mr. Hemphill attended 34 conferences/meetings (30 out-of-state and 4 in-state) during the 4¼-year period. We found board approval documented in the board minutes for 12 conferences attended by Mr. Hemphill. Considering the policy allows Mr. Hemphill to attend three conferences each year without board approval, we found that he attended ten conferences that were not approved in accordance with the travel policy.

Also, two board members attended more than two conferences in one year. Vice-Chairman Bill Desormeaux and former Board Member Brady Broussard each attended 11 conferences (8 out-of-state and 3 in-state) during the 4¼-year period. We found board approval documented in the board minutes for two conferences attended by Mr. Desormeaux and one conference attended by Mr. Broussard. Considering the policy allows board members to attend two conferences each year without board approval, we found that Mr. Desormeaux attended three conferences and Mr. Broussard attended two conferences that were not approved in accordance with the travel policy.

2. Expense Reports and Receipts Required

The travel policy states, "Travel expenses incurred by authorized travelers shall be accounted for, in writing, by submitting a signed expense report to the retirement office within 30 days of departure." Also, the policy states, "Appropriate receipts must be attached to the expense report."

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FIREFIGHTERS' RETIREMENT SYSTEM
 Baton Rouge, Louisiana
 Findings and Recommendations (Continued)

Mr. Hemphill charged approximately \$72,000 on his personal credit card for travel and travel related expenses that were paid by the System for which he did not complete required expense reports and for which there are detailed receipts missing for charges totaling \$44,747. Mr. Hemphill informed us that he also used his credit card to pay for airfares and lodgings for other board members and that the board members were responsible for turning in their own receipts. Because of the lack of supporting documentation, we could not determine whether all of the payments by the System were for business purposes. A summary of the travel and travel related charges/payments for which detailed receipts were not provided is as follows:

<u>Types of Charges</u>	<u>Total Charges for the 4 1/4-Year Period</u>	<u>Total Charges Not Supported by Receipts</u>	<u>Number of Missing Paid Charge Receipts</u>
Lodging	\$50,350	\$27,539	87
Airfare	10,357	8,082	26
Restaurants	6,291	5,158	79
Vehicle rentals	3,147	1,974	7
Parking	1,513	1,537	34
Gasoline	577	457	29
Total	\$72,235	\$44,747	262

Also, the System reimbursed airfare costs to Vice-Chairman Desormeaux on two occasions in 2001, totaling \$488, for which detailed airfare receipts were missing.

3. Documentation Required to Support Necessity to Travel Early

The policy states, "In the event the cost to travel by air is less expensive to the retirement system because the traveler stays over a Saturday night, such early travel is permitted provided the total cost, including extra lodging and meals, does not exceed the cost if travel had not begun earlier. Documentation shall be provided by the traveler to substantiate the necessity for early travel."

Mr. Hemphill informed us that documentation to substantiate the necessity for early travel (Saturday night stay over) was not prepared for every conference because the savings and the costs to the System were a "wash." He said that it was a board decision to stay over on a Saturday night and should be in the board minutes. However, we found no such documentation in the minutes. Also, we found no documentation to substantiate the cost benefit to the System or the necessity of Mr. Hemphill and board members' early travel to conferences/meetings as follows:

- During the fifteen-month period from January 1, 2001, through March 31, 2002, Mr. Hemphill went on 11 out-of-state trips to attend conferences/meetings.

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FIREFIGHTERS' RETIREMENT SYSTEM
 Baton Rouge, Louisiana
 Findings and Recommendations (Continued)

According to available travel records, Mr. Hemphill traveled early to six conferences/meetings for which we estimate the System paid additional lodgings and meal costs, totaling \$2,568, as follows:

<u>Destinations</u>	<u>Actual Meeting Dates</u>	<u>Arrival Dates</u>	<u>Number of Early Days</u>	<u>Estimated Additional Costs Paid by System</u>
1. Ft. Lauderdale, FL	Mar. 11-13, 2002	Mar. 9, 2002	1	\$293
2. Washington, D.C.	Feb. 5-6, 2002	Feb. 2, 2002	2	525
3. Palm Springs, CA	Oct. 22-24, 2001	Oct. 19, 2001	2	410
4. Anchorage, AK	Aug. 17, 2001	Aug. 14, 2001	2	597
5. Las Vegas, NV	Apr. 9-12, 2001	Apr. 6, 2001	2	331
6. Washington, D.C.	Jan. 30-31, 2001	Jan. 27, 2001	2	412
Total				\$2,568

- Also, during the same time period, we estimate the System paid additional lodgings and meal costs, totaling \$1,961, associated with other board members' early travel to conferences as follows:

<u>Board Members</u>	<u>Destinations</u>	<u>Actual Meeting Dates</u>	<u>Arrival Dates</u>	<u>Number of Early Days</u>	<u>Estimated Additional Costs Paid by System</u>
Desormeaux	Washington, D.C.	Feb. 5-6, 2002	Feb. 2, 2002	2	\$401
Desormeaux	Palm Springs, CA	Oct. 22-24, 2001	Oct. 20, 2001	1	144
Desormeaux	Washington, D.C.	Jan. 30-31, 2001	Jan. 28, 2001	1	223
Broussard	Washington, D.C.	Feb. 5-6, 2002	Feb. 2, 2002	2	451
McCoy	Washington, D.C.	Jan. 30-31, 2001	Jan. 27, 2001	2	441
Nugent	Las Vegas, NV	Apr. 9-12, 2001	Apr. 6, 2001	2	301
Total					\$1,961

Mr. Desormeaux informed us that he disagreed with the actual meeting dates we used above for conferences he attended.

FIREFIGHTERS' RETIREMENT SYSTEM

Baton Rouge, Louisiana

Findings and Recommendations (Continued)

4. Alcohol and Meals

The System reimbursed Mr. Hemphill and the System's former contract general counsel (Mr. Roche) for extravagant meals, including alcohol in violation of the State of Louisiana's travel regulations. The state's travel regulations provide for the reimbursement of meals at established rates and specifically prohibits the reimbursement for alcohol. State travel regulations allow \$26 per day for in-state meals (\$6 for breakfast, \$8 for lunch, and \$12 for dinner) and \$29 per day for out-of-state meals.

The following System payments were not made in accordance with the state's travel regulations and are clearly extravagant and unreasonable for overseeing and safekeeping retirement funds that belong to System members:

The System paid Mr. Hemphill's \$484 credit card charge of May 7, 2001, from Ruth's Chris Steakhouse (Baton Rouge) that included \$114 of alcohol purchases. The paid receipt reflects this was for a dinner meeting with the Louisiana Senate Retirement Committee and includes the names of the attendees. The following are examples of food and alcohol consumed at Ruth's Chris Steakhouse:

- Two bottles of Chateau Saint Michelle (wine) costing \$92 (\$46 each)
- One lamb chop with crab costing \$40
- One lamb chop costing \$30
- One ribeye costing \$27
- One Chivas (liquor) and water costing \$6
- One petite filet costing \$23
- One fresh catch (fish) costing \$20
- One Heineken (beer) costing \$4

On July 25, 2001, the System paid/reimbursed Mr. Roche \$1,415 for "legislative expenses," which included \$284 for alcohol purchases. The System's payment represented one-third of the total costs of five restaurant bills (\$4,246) that included alcohol purchases totaling \$851. Three of the bills were from Ruth's Chris Steakhouse totaling \$3,831; one was from Dinardo's Restaurant for \$275; and one was from T.J. Ribs Restaurant for \$140. Although Mr. Roche provided the names of persons attending the five meals, his billing to the System did not provide the specific business purposes of the meals or how he arrived at assessing one-third of all charges to the System. The following are examples of food and alcohol consumed at Ruth's Chris Steakhouse on the three occasions in June 2001 (June 11, 13, and 18):

- One three-pound lobster costing \$60
- Three ribeyes, each with crab, costing \$126 (\$42 each)

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Findings and Recommendations (Continued)

- Four bottles of Sequoia Grove Cabernet (wine) costing \$180 (\$45 per bottle)
- One large filet with crab costing \$36
- Two lamb chops, each with crab, costing \$78 (\$39 each)
- One T-bone steak costing \$35
- Seven Miller Lite (beer) costing \$21
- Four bottles of Rutherford Hill (wine) costing \$172 (\$43 per bottle)
- One porterhouse steak - for two, costing \$63
- Three ribeyes, each with crab, costing \$108 (\$36 each)
- One three-pound lobster costing \$59
- One petite filet with crab costing \$32
- One bottle of Stags Leap Chardonnay (wine) costing \$49
- Six Crown Royal (liquor) drinks costing \$36 (\$6 each)
- Two fresh catch (fish), each with crab, costing \$54 (\$27 each)
- Three bottles of St. Francis (wine) costing \$162 (\$54 per bottle)
- Three lobsters, weighing 2¾ pounds each, costing \$165 (\$55 each)
- Two Chivas (liquor) and waters costing \$12 (\$6 each)
- One bottle of Moet Chandon White Star (champagne) costing \$75

Also, during the 4¼-year period, the System paid for restaurant charges, totaling \$6,291, on Mr. Hemphill's credit card for which itemized receipts were missing for \$5,158 (82%) of the charges. Because there were missing itemized receipts for the majority of restaurant charges, we could not determine the nature of the items purchased. For those meal receipts that were available, they did not always contain the Internal Revenue Service required documentation of the business purpose of the meals and the names of persons attending.

The following is an example of restaurant charges that were charged on Mr. Hemphill's personal credit card and paid by the System for which itemized receipts were missing, including documentation of the business purpose of the meals and names of persons attending:

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FIREFIGHTERS' RETIREMENT SYSTEM

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Findings and Recommendations (Continued)

<u>Dates</u>	<u>Restaurants</u>	<u>Amounts</u>
June 26, 2001	Gino's (Baton Rouge, LA)	\$211
May 31, 2001	Ruth's Chris Steakhouse (Baton Rouge, LA)	\$139
March 3, 2001	Mortons of Miami (Miami, FL)	\$470
May 8, 2000	Giamanco's (Baton Rouge, LA)	\$118
October 17, 1999	Ristorante Mamma (Newport Beach, CA)	\$143
February 28, 1999	Outback Steakhouse (Ft. Lauderdale, FL)	\$114
February 28, 1999	Bobby Rubinos Place (Ft. Lauderdale, FL)	\$150
August 8, 1998	Ruth's Chris Steakhouse (Baton Rouge, LA)	\$158
June 2, 1998	Ruth's Chris Steakhouse (Baton Rouge, LA)	\$126
March 23, 1998	Gino's (Baton Rouge, LA)	\$151

5. Air Transportation

The travel policy states, "Reimbursement of airfare will be based on the best price available on an advanced ticket purchase of at least 14 days prior to departure, to be determined by retirement office staff."

Although our review revealed that airfare was purchased more than 14 days prior to departure, there was no documentation to support that the airfare purchased by Mr. Hemphill and board members during the period, totaling approximately \$17,000, was the best price available. The administrator informed us that Mr. Hemphill and board members routinely made their own flight arrangements, were reimbursed for the actual cost of their airfares, and that airfare costs were not reviewed by staff to determine whether they were the best price available.

6. Lodging for Board Meetings

The travel policy limits lodging reimbursements to \$50 per day (plus tax) for regular board meetings and/or meetings related to the System. However, on November 29, 2000, Mr. Hemphill signed a contract with a Baton Rouge area hotel for a rate of \$85 per night plus tax that also exceeds State of Louisiana travel regulations (\$65 per night plus tax for lodging in Baton Rouge). During the one-year period from March 29, 2001, through April 9, 2002, the System paid the hotel \$4,774.

7. Vehicle Rentals

The state's travel regulations allow rental of vehicles only when it can be documented that vehicle rental is the only or the most economical means by which the purpose of the trip can be accomplished. The System's travel policy is less restrictive and allows for reimbursement of vehicle rentals "when necessary and approved in advance by the chairman of the board."

During the 4¼-year period, the System paid \$4,153 for 16 vehicle rentals by Mr. Hemphill and \$503 for two vehicle rentals by other board members. Mr. Hemphill told us that he verbally informed board members about his vehicle rentals and that he

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verbally approved the rental of vehicles by board members. However, we found no documentation to support the necessity of vehicle rentals at conferences.

The System should:

1. Strictly adhere to the State of Louisiana travel regulations.
2. Require that all System officials receive board approval in advance of traveling and that the approval be documented in the minutes. Also, the business purpose and benefit to the System should be documented in the approval process.
3. Require staff to ensure that detailed receipts supporting the business nature of the expenditures are received before reimbursement is made.
4. Require that the business purpose for meals and the names of individuals participating be documented.

Former Chairman's Travel Outside Continental United States

There is no documentation for the necessity for Mr. Hemphill's travel outside of the continental United States and this travel may have violated the terms and spirit of a Louisiana House Resolution. In an effort to hold public retirement systems accountable for their spending practices, Louisiana House of Representatives Resolution No. 8 (HR No. 8) of the Third Extraordinary Session of 1994 directed the Teachers Retirement System of Louisiana to refrain from traveling to London unless the board of trustees scheduled a special board meeting in a public forum resolving that it was necessary to travel to review the system's investments abroad. Also, Louisiana House of Representatives Study Request No. 2 of the Regular Session of 2000 directed the House Committee on Retirement to study the remedial actions that may be taken if there is a violation of the terms and spirit of HR No. 8, and specifically mentioned the National Conference on Public Employee Retirement Systems (NCPERS) conference being held in Honolulu, Hawaii, in April 2000. The House Committee on Retirement was requested to report its findings to the House of Representatives during the 2000 Regular Session; however, no report was made. Also, Article VII, Section 14(A) of the Louisiana Constitution of 1974 provides that the funds, credit, property, or things of value of the state or any political subdivision shall not be loaned, pledged, or donated to or for any person, association, or corporation.

During 2000 and 2001, System records reflect that former Chairman Hemphill traveled outside of the continental United States three times for which there is no documentation for the necessity for this travel. Also, the System paid for Mr. Hemphill's following travel expenses that may be in violation of the terms and spirit of HR No. 8:

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Findings and Recommendations (Continued)

1. Honolulu, Hawaii Trip

Mr. Hemphill, accompanied by his wife, traveled to Honolulu, Hawaii, on April 28, 2000, to attend the six-day National Conference on Public Employee Retirement Systems (NCPERS) conference. There was no documentation of board approval or the necessity of Mr. Hemphill's travel outside the continental United States. Mr. Hemphill informed us that, prior to his trip, he consulted with the Louisiana House Representative that authored the House Study Request No. 2 of the Regular Session of 2000.

The System paid/reimbursed Mr. Hemphill for \$2,277 of his travel expenses, which covered the period from April 28, 2000, to May 7, 2000, as follows:

	<u>Amount</u>
Airfare	\$695
Vehicle rental and gasoline	719
Registration fees	350
Mileage, meals, and tips	278
Hotel and parking	<u>235</u>
Total	<u><u>\$2,277</u></u>

2. Dublin, Ireland Trip

Mr. Hemphill, accompanied by his wife, traveled to Dublin, Ireland, on June 7, 2001, to attend the four-day Bank of Ireland's 8th International Investment Conference to do "due diligence" on the Bank of Ireland, a newly hired international equity investment manager. The System paid/reimbursed Mr. Hemphill for \$1,476 of his travel expenses, which covered the period from June 7, 2001, to June 13, 2001.

Although the board (Desormeaux, Nugent, Broussard, and McCoy) unanimously approved Mr. Hemphill's travel to Ireland, there was no documentation of the reasons supporting the necessity for this travel. Mr. Hemphill informed us that he "did not know anything" about international investing; therefore, he asked the board if he could go to the conference. Also, there was no evidence that Mr. Hemphill reported back to the board on his findings/conclusions of his "due diligence" assignment nor is there evidence he shared conference information learned with appropriate board members and staff. Mr. Hemphill told us that he could not remember whether he made a presentation to the board, but he said that he brought back literature and made it available to members.

3. Anchorage, Alaska Trip

Mr. Hemphill, accompanied by his wife, traveled to Anchorage, Alaska, on August 14, 2001, to attend an approximate one-half day meeting on August 17, 2001. The meeting related to the *Conseco* securities litigation for which the System was co-lead plaintiffs

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with the Anchorage Police and Fire Retirement System (Anchorage). The meeting was held at Anchorage's office and other participants was the System's former contract general counsel (Randy Roche), Anchorage's director and attorney, and an attorney with the lead counsel firm.

Mr. Hemphill informed us that he and Randy Roche had board approval to travel "anywhere they had to go" pertaining to the *Conseco* case. The board (Hemphill, Desormeaux, Nugent, Broussard, and McCoy) at its June 21, 2000, meeting, unanimously approved participation in the lawsuit. Also, the minutes reflect Mr. Hemphill stating there would not be any cost to the System for this litigation and that any cost related to travel for litigation hearings would be reimbursed upon settlement of the case. However, we found no specific board approval for the travel to Alaska for the one-half day meeting (in accordance with the System's travel policy) nor did we find documentation of the reasons supporting the necessity for this travel.

The System paid/reimbursed \$3,250 of Mr. Hemphill's travel expenses, which covered the period from August 14, 2001, to August 18, 2001, and included airfare for his wife and five nights of lodging for the one-half day meeting as follows:

	<u>Amount</u>
Airfare - Mr. Hemphill	\$795
Airfare - Mrs. Hemphill	795
Lodging - 5 nights	1,416
Mileage, meals, tips	<u>244</u>
Total	<u><u>\$3,250</u></u>

Mr. Hemphill said the meeting lasted one-half day (approximately 4 hours) and was held to review paperwork and make a decision on the hiring of a company to evaluate *Conseco's* assets. He said that Randy Roche felt it was necessary to have the meeting to "eyeball" each other. Mr. Roche informed us that the meeting lasted approximately 1½ hours and said he thought the meeting could have been conducted over the telephone as was done previously on numerous occasions. Mr. Roche said that he only attended the meeting because he was in Anchorage already for an unrelated conference. The attorney with the lead counsel firm informed us that the meeting lasted 2-3 hours and that there were other discussions held over the course of dinner on a couple of days. Anchorage's director informed us that the meeting lasted "the better part of an afternoon" and that they also discussed the case when he drove them to Prince William Sound to sail around the harbor. The director said that he invited the parties to come to Anchorage for the meeting because it is a beautiful place and he doesn't like to travel.

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Mr. Hemphill reimbursed the System for his wife's round trip airfare cost (\$795) on April 2, 2002, approximately one year after the System paid for the airfare (see finding, *Commingling of Personal Expenses and Expenditures Lacking Public Purpose*). Mr. Hemphill's reimbursement did not include an amount for interest to compensate the System for the time period that the funds were not available for investment.

Also, the System paid \$1,399 for five nights of lodging for Mr. Roche in Anchorage. After we questioned Mr. Roche about the System's payment for his lodging costs, he reimbursed the System \$1,399 on July 15, 2002, eleven months after the trip (see finding, *Duplicate Travel Reimbursements - Former Contract General Counsel*).

In addition, on August 1, 2002, an attorney with the lead counsel firm informed us that they submitted the costs of Mr. Hemphill's airfare and only two nights of his lodging and expenses, totaling \$1,605, to the court for approval of reimbursement relating to the litigation meeting in Alaska. Also, he said that none of the cost of Mr. Roche's lodging was submitted to the court for approval for reimbursement to the System because Mr. Roche was already in Anchorage for another conference. However, subsequent to our inquiry, the lead counsel firm reimbursed the System for all expenses paid by the System for Mr. Hemphill's trip to Anchorage, totaling \$2,455 (\$3,250 - \$795 cost of wife's airfare). In addition, the lead counsel firm also reimbursed the System for the cost of Mr. Roche's five nights of lodging (\$1,399) in Anchorage.

Although the System was reimbursed for all of the travel costs, this effectively reduces the amount of monies available for the System and other class action participants to recover from the lawsuit. Traveling from Bogalusa, Louisiana, to Anchorage, Alaska, and spending five nights to attend a "half-day" meeting that could have been accomplished with a conference telephone call is not reasonable or necessary.

The board of trustees has a fiduciary responsibility to manage the System by exercising good faith, trust, confidence, and candor. Travel that is not reasonable or is unnecessary is a violation of that fiduciary responsibility and should not be tolerated. In the future, the board in a public meeting should approve all travel where the purpose and necessity of such travel is documented.

Commingling of Personal Expenses and Expenditures Lacking Public Purpose

System funds were commingled by paying Mr. Hemphill's personal credit card company. Also, System funds were used to pay for purchases that lack a public purpose. Article VII, Section 14(A) of the Louisiana Constitution of 1974 provides that the funds, credit, property, or things of value of the state or any political subdivision shall not be loaned, pledged, or donated to or for any person, association, or corporation.

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Commingling of Personal Expenses

System funds, totaling approximately \$85,000 over a 4¼-year period from January 1998 through March 2002, were used to pay Mr. Hemphill's personal American Express credit card bill. Although Mr. Hemphill used his personal credit card to charge business expenses, he also used it to charge personal expenses. Instead of Mr. Hemphill submitting expense reports (see finding, *Noncompliance With Travel Policy*) and being reimbursed by the System for business related expenses, he had the System pay the business related charges on his credit card bill directly to the credit card company.

For personal credit card charges, the administrator said that Mr. Hemphill instructed her or a staff employee to prepare one of his personal checks (maintained at the System's office) made payable to the credit card company for his signature. Mr. Hemphill's personal check along with the System check was then mailed to the credit card company by System staff.

Expenditures Lacking Public Purpose

During the 4¼-year period from January 1998 through March 2002, System funds were used to purchase airfare and pay for conference registration fees for board members' spouses. In addition, System funds were used to pay for flowers/gifts and credit card membership fees. All of these expenditures lack a public purpose.

Airfare

The System paid \$795 for round trip airfare to Anchorage, Alaska, for Mr. Hemphill's spouse that was charged on his personal American Express credit card on March 17, 2001 (see finding, *Former Chairman's Travel Outside Continental United States*). The administrator informed us that approximately one year later she was preparing a report on board travel expenditures and found that the \$795 personal airfare charge was not reimbursed to the System. The administrator said Mr. Hemphill was notified and one of his personal checks was prepared on April 2, 2002, to reimburse the System.

Conference Registration Fees

System funds, totaling \$350, were used to pay for conference registration fees for the spouses of board members. The System paid registration fees totaling \$125 for Mr. Hemphill's spouse for two conferences (Honolulu and New Orleans). Also, registration fees totaling \$125 were paid for former Board Member Broussard's spouse for two conferences (Denver and New Orleans), and a \$100 registration fee was paid for Vice-Chairman Desormeaux's spouse for a conference held in Denver. We found no reimbursements to the System for these registration fees paid on behalf of board members' spouses.

Flowers/Gifts

The System paid for Mr. Hemphill's credit card charges, totaling \$697, for the purchase of Christmas wreaths/decorations, Secretary's Day corsages/plants given employees (\$579), and a Secretary's Day meal (\$118).

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Also, the System paid for Mr. Hemphill's credit card charges, totaling \$384, for purchases made at various florist shops. We were informed that these purchases were related to hospitalizations and funerals.

Credit Card Membership Fees

System funds, totaling \$300, were used to pay for the annual membership fees (\$75 per year) assessed to Mr. Hemphill on his personal American Express credit card.

The System should:

- Discontinue paying personal credit card companies and personal bills for board members.
- Discontinue paying for purchases that lack a public purpose.
- Recover from board members all personal expenses paid by the System on their behalf.
- Implement accounting procedures and controls over disbursements to reduce the risk of payment of personal expenses and to ensure that payments are made only in accordance with System policies.
- Require that the business reasons/purposes be documented for all expenditures.

Failure to Comply With Code of Ethics

Board members may have violated the Code of Ethics by accepting complimentary gifts and/or golf outings from investment managers doing business with the System. R.S. 42:1115(A)(1) states that no public servant shall solicit or accept, directly or indirectly, any thing of economic value as a gift or gratuity from any person if the public servant knows or reasonably should know that such person has or is seeking to obtain contractual or other business or financial relationships with the public servant's agency. Also, R.S. 42:1111(A)(1) provides that no public servant shall receive anything of economic value, other than compensation and benefits from the governmental entity to which he is duly entitled, for the performance of the duties and responsibilities of his office or position. In addition, in a situation where a public servant received complimentary rounds of golf, Louisiana Board of Ethics opined (No. 2001-473), in part, that R.S. 1111(A) was violated.

Golf and Gifts Provided by Investment Manager

In July 2002, we requested that certain information be provided to us from various firms/institutions that did business with the System during the three-year period from July 1, 1999, through June 30, 2002. Information provided to us reflects that System board members may have violated the Code of Ethics by receiving/accepting complimentary (free) golf and/or gifts from an investment manager that does business with the System as follows:

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Findings and Recommendations (Continued)

Freeman Associates, one of the System's equity investment portfolio managers, informed us of the following costs incurred for Christmas gifts sent to board members and for golfing with board members during the three-year period:

- In December 2001, six *Ansel Adams* coffee table books and coffeecake, costing \$630, were sent to the System's office for six board members as Christmas gifts. Two board members informed us they received the book, and we found that two of the books were on the System's premises in unopened boxes.
- In October 2001, during the Public Safety Employees Pension and Benefits (PSEP&B) Conference in Palm Springs, California, \$150 was paid for golfing for Vice-Chairman Desormeaux, Board Member Broussard, and a Freeman Associates representative.
- Mr. Desormeaux informed us that he played golf at the PSEP&B Conference with a Freeman Associates representative. Mr. Broussard told us that he is not a golfer and did not play golf in Palm Springs, but that he did ride (in golf cart) with people who were playing golf. Mr. Broussard stated, "I may have hit a ball, but I did not play a round (of golf)."
- In April 2001, during the National Conference on Public Employee Retirement Systems (NCPERS) Conference in Las Vegas, Nevada, \$155 was paid for golf and lunch for Vice-Chairman Desormeaux and a Freeman Associates representative (Freeman Associates did not provide the specific amount paid for the lunch meal). Mr. Desormeaux told us that he played golf at the Las Vegas conference with a Freeman Associates representative.
- In December 2000, six leather bound desk calendars and coffeecake, costing \$240, were sent to the System's office for six board members as Christmas gifts. However, from the System's office, we do not know where the leather bound calendars went or who accepted them.

Also, we were informed that Hibernia National Bank (Hibernia), one of the System's bond investment portfolio managers, and Bank One, the System's custodian bank, co-sponsored an annual Christmas dinner for the Firefighters' Retirement System during the three-year period. Costs of the 1999, 2000, and 2001, Christmas dinner parties, including gifts, reported to us by Hibernia and Bank One totaled \$3,172, \$1,700, and \$2,354, respectively. We were informed that representatives from Hibernia and Bank One were present and that the dinners were "a large affair with not only board members but also many other related guests." Although R.S. 42:1102(22)(a) allows an exception for food and drink consumed while the personal guest of some person, there is the perception by the public that the board member's and employee's independence is impaired for participating in such dinner parties and accepting gifts paid for by investment managers.

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Findings and Recommendations (Continued)

The System should develop a detailed ethics policy that prohibits board members and employees from accepting anything of value, including gifts, golf outings, meals and dinner parties, and any other specific activity that would give the perception that such gifts compromise their fiduciary responsibility (see finding, *Written Policies and Procedures Are Not Complete*).

No Documentation of Board's Consideration of Impact of Legislation and Military Service Credit Purchased by Retirees That Came Back to Work for One Day

We found no documentation of the board's consideration of the impact on the System of legislation relating to members' purchase of military service credit or members' repayment of refunds to receive credit in the System. In addition, the board of trustees did not exercise its fiduciary responsibility when it allowed the purchase of military service credit by retirees that returned to work for one day. The board of trustees has a fiduciary responsibility to manage the System by exercising good faith, trust, confidence, and candor.

The board (Hemphill, Desormeaux, Nugent, Broussard, and McCoy), at its March 12, 1999, meeting, unanimously approved introducing legislation (in the 1999 Regular Session) that was enacted into law (R.S. 11:2269) that allowed members to purchase a maximum of four years of military service credit for active duty military service performed during the Vietnam War era (January 1, 1960, to December 31, 1975). Also, the board unanimously approved introducing legislation that was enacted into law that allowed for members to repay refunds (R.S. 11:2254.1), that they received from Municipal and Parochial Employees' Retirement Systems, directly to the System to receive service credit in the System. However, the legislature repealed both laws effective January 1, 2002.

Board's Consideration of Legislation

In advance of legislative sessions, the board of trustees meets (at its regular board meetings) and discusses proposed legislation and decides on whether or not to introduce/support the legislation. However, in reviewing board minutes, we generally did not find where the board considered fully the impact of proposed legislation on all of its membership, including the financial stability of the System.

For example, we found no detail of discussions in the minutes relating to the potential impact on the membership or the financial stability of the System of the proposed military service credit legislation or the "repay refund" legislation. In addition, we found no mention of the factors that lead to the board's conclusion to support such legislation. Under the military service credit legislation, the System received approximately \$227,000 from 153 members for the purchase of 357 years of service; however, the System's actuary calculated an additional liability to the System, net of payments received, of approximately \$5.7 million. Also, under the "repay refund" legislation, the System received approximately \$873,000 from 92 members for the purchase of

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392 years of service; however, the System's actuary calculated an additional liability to the System of approximately \$5.2 million.

The board of trustees represents a broad group of interests, including retired members, active members, DROP participants, and employers. Prior to voting to propose or support legislation, it is the board's fiduciary responsibility to have a full understanding of the impact of the legislation on all that it represents as well as the financial stability of the System. As such, documentation is crucial to support the trustees' exercise of their trustee responsibility.

Military Service Credit Purchased by Retirees That Came Back to Work for One Day

On July 27, 1999, the board (Hemphill, Desormeaux, Nugent, Broussard, McCoy, and King) unanimously adopted policies and procedures relating to the purchase of military service credit. The board adopted general counsel's interpretation of the statute that the System was only concerned with whether or not a person is an active contributing member and not with the length of employment of the member. As a result, the board maintained that retirees and DROP participants could return to "active contributing" status for one day and complete purchases of military service credit.

At the December 6, 2001, board meeting (25 days prior to the effective date the law was repealed), the board discussed the System's pending applications from retirees and DROP participants that returned to work for one day to purchase military service credit. The board (Hemphill, Desormeaux, McCoy, and Schneider) unanimously passed a motion that any member coming back to work for one day must meet statutory requirements. As a result of the board's action, five retirees and two DROP participants that returned to work for one day were administratively approved to purchase military service credit. We found that two of the retirees were rehired by their employers for one day as a "Secretary 1," two retirees came back to work for one day as a "Fire Data Entry Clerk," and one retiree was rehired as a "Fire Fighter." The two DROP participants were rehired by their employers in the positions of "Firefighter/Operator Recruit" and "District Chief."

Also, prior to December 6, 2001, we found that the System administratively approved the purchase of military service credit by two retirees that returned to work for one day, one retiree that returned to work for five days, and a DROP participant that returned to work for two weeks. One retiree was rehired for one day as a "Executive Secretary," one retiree was rehired for one day as a "Secretary 1," one retiree came back to work for five days as a "Probational Firefighter First Class," and the DROP participant was rehired in the position of "Provisional Training Officer."

The board of trustees should always exercise its discretion in conduct that protects the funds and assets of the System. Although the law did not require members to wait a certain period of time to be considered an active contributing member of the System, the board should have adopted and enforced a policy prohibiting retirees from returning to work for what appears to be "sham" employment. As a result, the additional liability incurred by the System for the retirees' purchase of the military service credit further eroded the System's financial condition. Allowing

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retirees to return to the System for one day frustrates legislative intent, is bad policy, and violates the board's fiduciary duty to the System.

Lack of Controls Over Payroll

Annual leave paid to System employees was not made in accordance with state law. Also, the System did not obtain authorization from the Louisiana Department of Civil Service (Civil Service) to place its employees in the unclassified service and also failed to provide Civil Service with employee information. R.S. 42:421(B) provides for the payment of accrued annual leave to employees of the state or of any state agency after separation from office or employment if the annual leave was accrued under established leave regulations and an attendance record was maintained for the employee by his supervisor. Also, Executive Order MJF 98-23 (unclassified state employee leave rules) and Civil Service Rule 11.10 (classified state employee leave rules) allow for the payment of accrued annual leave up to a maximum of 300 hours; however, the payment of accrued annual leave is made upon the employee's separation from service. In addition, Article VII, Section 14 of the Louisiana Constitution of 1974 prohibits the payment of bonuses. Article X, Section 1(A) of the Louisiana Constitution of 1974 provides that state civil service includes all persons holding offices and positions of trust or employment in the employ of the state or any instrumentality thereof. Also, Article X, Section 2(B)(7) provides authorization for the System to have only two unclassified positions. In addition, R.S. 42:290 requires each agency, board, commission, or other entity in the executive branch of state government to file certain information about their unclassified employees with Civil Service.

Annual Leave Payments

With Mr. Hemphill's authorization, the System paid \$6,085 to five employees who "cashed in" 420 hours of annual leave during the four-year period ending December 31, 2001. The System's payroll records reflect the annual leave payments as a "bonus." Mr. Hemphill said paying System employees for not using all of their vacation time (annual leave) would solve the problem of employees' work from "piling up." Also, Mr. Hemphill informed us that the System's leave policy is the same as the State of Louisiana's leave policy for state employees. However, these annual leave payments were not made in accordance with state law because these employees were not separated/terminated from service. In addition, although employee leave records were maintained during the four-year period, daily attendance records were not maintained on the employees prior to January 1, 2002.

No Authorization for Unclassified Positions and Employee Information Not Provided

Although Article X, Section 2 authorizes the System to have two unclassified positions, Civil Service informed us that it has not placed any positions at the System as unclassified and that no System employee names have been reported to them.

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Findings and Recommendations (Continued)

Mr. Hemphill informed us that the System's five employees are unclassified employees and that they are not classified under Civil Service. However, this is contrary to Article X, Section 1(A) of the Louisiana Constitution of 1974, which provides that state civil service includes all persons holding offices and positions of trust or employment in the employ of the state, or any instrumentality thereof.

The System should:

1. Cease paying employees for their accrued annual leave, except in accordance with state law.
2. Immediately contact the Department of Civil Service for guidance in resolving the classification of its employees. Civil Service administers a pay plan that regulates the compensation of all classified state employees. Generally, each employee is paid at a rate within the range for the grade of the job to which the position is allocated.

Tapes of Board Meetings Should Be Maintained

The System has not maintained all tapes of its board meetings in accordance with state law. R.S. 11:2260(A)(10) requires the board of trustees to keep a record of all its proceedings that are to be open to public inspection. Also, R.S. 44:36 requires the System to exercise diligence and care in preserving public records. In addition, Louisiana Attorney General Opinion No. 94-376 provides that a tape is a public record, subject to a three-year retention period, and should be available for public inspection or copying upon request.

Tapes are missing for three of the board meetings (October 5, 2000; November 9, 2000; and December 14, 2000) held during the past three years.

The System should maintain all tapes of its board meetings in accordance with state law.

Written Policies and Procedures Are Not Complete

The System's written policies and procedures are not complete. Formal/written policies and procedures are necessary as a clear understanding of what should be done, how, who, and when it should be done, and that the procedures followed meet management's expectations. Written procedures aid in continuity of operation and for cross-training of staff.

Although the System has been operating for approximately 22 years, the System does not maintain a complete policies and procedures manual. There are no detailed, written policies and procedures for the following:

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Findings and Recommendations (Continued)

- Code of Ethics, including annual certification letters from board members and employees attesting to their compliance
- Election of board officers
- Search and selection process for hiring investment managers and investment consultant, including criteria used (historical investment returns, commissions/fees, etc.) and methods for evaluating and grading (e.g., point system) proposals
- Preparing, monitoring, and amending the budget during the fiscal year
- Nature, extent, and frequency of financial reporting information that should be provided to the board
- Computer contingency and recovery plan in the event of a disaster, including procedures to test the plan periodically
- Reviewing edits/changes made to computer critical data
- Processing, reviewing, and approving travel expense reports
- Purchasing/procurement process, including how purchases are initiated and approved, and checks and balances to ensure compliance with bid laws
- Contracting for legal and professional services
- Overtime/compensatory leave, employee pay provisions (salary ranges, merit increases, etc.), employee insurance and retirement benefits, and employee performance evaluations
- Capital assets, including dollar thresholds and types of assets that will be inventoried
- Business and personal use of cellular telephones

We strongly encourage the development, adoption, and implementation of policies and procedures for these matters.

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Findings and Recommendations (Continued)

Former Chairman's Participation in Retiree DROP Program May Violate Law and Guidance Not Obtained From IRS for Changes Made in Tax Reporting

Mr. Hemphill's participation in the Deferred Retirement Option Plan (DROP) program for retirees may violate state law. Also, the System did not obtain guidance from the Internal Revenue Service (IRS) for the tax reporting changes made for the retirement benefits of Mr. Hemphill or for the participants in the Disability Conversion program. R.S. 11:2257(H)(2) provides, in part, that upon termination of employment, whether at the end of the specified period of participation or after a period of reemployment, a member may continue to have his retirement benefits deposited into his DROP account. Also, although obtaining guidance from the IRS is voluntary, it is a sound business practice for the System to request and obtain an IRS ruling prior to making changes to the tax reporting of retirement benefits. Also, it is in the best interest of the System to obtain guidance from the IRS for tax issues that arise when new programs are implemented which may impact compliance with federal tax laws.

Mr. Hemphill's Participation in "Retiree DROP" Program

The Retiree DROP law is not clear as to whether a break in service is allowed; therefore, Mr. Hemphill's participation in the program may violate state law. As of October 21, 2002, Mr. Hemphill is the sole participant in the Retiree DROP program. Mr. Hemphill retired effective January 1, 2001, and applied for enrollment in the Retiree DROP program on October 9, 2001, over nine months after retiring. The System administratively approved Mr. Hemphill's application to participate in the program for ten years effective November 1, 2001.

We recommend that the System seek an attorney general's opinion for clarification of whether a break in service is allowable under the provisions of the Retiree DROP law.

Former Chairman's Retirement Benefits Changed From Taxable to Non-Taxable

In 2001, the System changed its IRS tax reporting of former Chairman Hemphill's retirement benefits from taxable to non-taxable (tax deferred until withdrawn from the DROP account) upon his enrollment in the Retiree DROP program. However, the System made this tax reporting change without obtaining a ruling from the IRS.

Prior to Mr. Hemphill's enrollment into the Retiree DROP program, his retirement benefits were reported as taxable income to the IRS. Upon enrollment into the Retiree DROP program, his monthly retirement benefits were deposited directly into his DROP account and reported to the IRS as non-taxable income. Although Mr. Hemphill's method of receipt changed during his retirement from actual (deposited into personal checking account) to constructive receipt (deposited into DROP account), the taxability of his retirement benefits may not have changed.

Disability Conversion Program Participant's Retirement Benefits Changed From Taxable to Partially Taxable

In 2001, the System changed its tax reporting of retirement benefits of Vice-Chairman Desormeaux and the other three Disability Conversion program participants from fully taxable to

FIREFIGHTERS' RETIREMENT SYSTEM

Baton Rouge, Louisiana

Findings and Recommendations (Continued)

partially taxable (for income tax purposes) upon their enrollment into the program. The System's change in tax reporting was made without obtaining an IRS ruling as to the taxability of such an event that was allowed by state law.

Prior to the participants' enrollment into the Disability Conversion program, the System reported their retirement benefits as taxable income to the IRS. Under the Disability Conversion program, the System is reporting approximately one-third of the participants' retirement benefits as taxable income. The non-taxable portion (approximately two-thirds) of their retirement benefits is calculated using a formula developed by the System. A retiree's conversion from a regular retirement to a service connected disability retirement may not change the nature of the benefits/income from taxable to non-taxable, and the formula/percentage used by the System for calculating the non-taxable portion of the retirement benefits may not be acceptable.

We strongly recommend that the System seek a ruling from the IRS relating to the proper tax reporting of retirement benefits under both the Retiree DROP and Disability Conversion programs.

No Written Contracts With Attorneys

The System did not enter into written contracts for legal services provided by attorneys. It is a sound business practice to enter into a written agreement/contract setting forth the terms and conditions of the legal service arrangement.

During the 4½-year period from January 1998 through July 2002, the System paid approximately \$275,000 for legal services for which formal contracts with attorneys do not exist. The System paid an out-of-state (Florida) attorney approximately \$164,000, for tax research and consulting services and paid its former general counsel (Randy Roche) approximately \$111,000 for various legal services, which included a monthly retainer fee. Former Chairman Hemphill was responsible for reviewing and approving attorney's invoices/billings for payment.

The Florida attorney's hourly rate increased from \$175 to \$250 per hour in December 2001; however, the \$250 rate is not reasonable compared with the State of Louisiana Attorney General's approved maximum hourly fee schedule rate of \$175 per hour for professional legal services. Also, during the 4½-year period, the former general counsel's rate ranged from \$100 to \$120 per hour and his legal retainer ranged from \$1,250 to \$1,500 per month.

FIREFIGHTERS' RETIREMENT SYSTEM

Baton Rouge, Louisiana

Findings and Recommendations (Concluded)

In addition, we were informed that there is no written contract signed by both the System and the lead counsel law firm that represented the System in the multi-million dollar *Conseco, Inc.*, securities class action litigation (\$120 million cash settlement for which attorneys' fees approximate \$17.6 million, or 14.6%). The law firm prosecuted the action on a contingency basis and there is an attorney's fee award/schedule on file; however, such legal representation is not evidenced by a written contract signed by both parties. Also, although the board approved Mr. Roche's participation in the *Conseco* litigation after he resigned as general counsel, we did not find a written contract or documentation of the necessity for his participation.

In the future, the System should enter into written contracts for legal services rendered on its behalf and negotiate hourly rates that are reasonable in comparison with state approved rates. Also, the board should approve hiring of attorneys and be involved in the assigning of legal projects to ensure that private attorneys are extending and/or complimenting the in-house legal counsel's work.

Nonqualified Retirement Plan

The System administers the retirement plan as a nonqualified plan rather than as a qualified plan. Qualified plans have significant tax advantages for participants/employees. Qualified plans provide for the deferral of taxes on employee contributions until the retirement benefits are paid. Also, further tax deferral may be available to employees by rolling over contributions/benefits to and from other qualified retirement plans.

The System's June 30, 2001, annual audit report reported that the System's retirement plan is a nonqualified defined benefit pension plan. The director informed us that, although there is not a formal plan for the System to become qualified, the board directed him to do a study of the merits and demerits of qualified plans and nonqualified plans and to make a presentation at a future board meeting. Also, the director informed us that the System has not submitted a request to the IRS for a determination letter on the qualified status of the plan. If requested, the IRS reviews information presented and determines whether the form of the plan satisfies the technical requirements of the Internal Revenue Code.

We encourage the board of trustees, with assistance from its professional advisors, to fully explore all the issues (advantages and disadvantages) of becoming a qualified plan versus a nonqualified plan and to go on public record as to its position. Also, in conjunction with the board's deliberations, we recommend that the System perform a study to determine whether all participating employers are (1) aware of the System's nonqualified plan tax status, and (2) complying with the rules for withholding taxes on employee contributions.

Attachment I

Management's Response

We received management's written response along with a box containing various information. As the box of information was received beyond the date of our fieldwork, we have no indication and have made no analysis of how this information may impact management's response. The box appeared to contain originals and copies of information that should have been readily available at the System during our limited examination. Therefore, we returned this box of information to the System.

FIREFIGHTERS' RETIREMENT SYSTEM

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BILL DESORMEAUX
VICE-CHAIRMAN

STEVEN STOCKSTILL
DIRECTOR

JOANNA JACOB
ADMINISTRATOR

MAYOR CLARENCE W. HAWKINS
TOM ED MC HUGH
MICHAEL HEMPHILL
PAUL E. SMITH
SEN. LAMBERT BOISSIERE
REP. PETE SCHNEIDER

November 19, 2002

Daniel G. Kyle
Legislative Auditor
Post Office Box 94397
Baton Rouge, LA 70804-9397

Re: **FRS-Limited Examination**

RECEIVED
LEGISLATIVE AUDITOR
02 NOV 19 PM 3:17

Dear Dr. Kyle:

In connection with the captioned matter, as acting chairman (serving in an interim capacity due to the resignation of the former chairman), I hereby acknowledge receipt of the draft report issued by your office. Your examiner informed us regarding the procedures for inclusion of a "management response." The following observations are made pursuant thereto:

First, on behalf of the board of trustees and all members of this system, please accept our heartfelt thanks for the diligent study that preceded your report. Your methodology was sound and the conclusions will provide a roadmap for action. That action will result in the betterment of our system. For that reason, we are all appreciative of your efforts and guidance.

Next, with regard to the recommendations, I have personally discussed each recommendation with the executive director of our system who also serves as our legal counsel. Following our discussions, I dispatched him to review the report with each board member. The director displayed his personal copy of the draft report to each board member as part of his discussion with them. Pursuant to guidance by your office, no copies were made or furnished to board members either in whole or in part. The board members reviewed, analyzed, and provided feedback based on their limited exposure to the draft report. This response attempts to reflect my understanding of their individual opinions and the consensus that resulted from their collective review.

Regarding the findings of the report, although the board members had differing responses to the findings, there was commonality in one respect. There was consensus that your recommendations are sound. There was consensus that the recommendations will strengthen the system and they will be immediately submitted to the board of trustees for discussion and action. As you may already be aware, our board has recently undergone intense scrutiny by the legislature, the system's membership,

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members of the media, and the public at large. The board reacted to that attention by making an ongoing commitment to reform the system in a way that warrants mention in this response, because the reforms are consistent with the recommendations made by your office.

For instance, the report indicates that the system needs to strengthen controls over payments and disbursements made to board members and other system officials. A similar recommendation was also made by our contract-auditor following the regular annual audit of the system's financial statements for fiscal year 2001-02. In response, the board adopted a policy requiring each board member to pay for his own expenses related to service on the board, with certain limited exceptions, and the board member may only be reimbursed if he personally completes an expense voucher including the appropriate receipts. The policy prohibits the staff from completing the voucher on behalf of the member and also prohibits the staff from reimbursing the member if appropriate receipts are not provided in advance of the reimbursement. To further that effort, I have instructed our director to include the report issued by your office on the agenda at the next available board meeting. The board will then have an opportunity to act on the balance of your recommendations regarding the controls over payments and disbursements.

The report indicates that the system should strictly adhere to the state of Louisiana travel regulations. This topic has also been a concern of the board. In April of this year, our staff furnished the board with a report comparing the board-adopted travel policy to the state's travel guidelines, PPM 49. The board received the report and took it under advisement with the intent of acting on the matter at the next month's regularly scheduled board meeting. However, your examiner began his study of the system in the next month. Consequently, the board postponed further action pending the completion of the examiner's work and guidance from your office. On November 14th of this year, the board entertained a motion to adopt PPM 49 and repeal the formerly adopted board travel policy. However, based on advice of counsel, the board agreed to withhold that action until after the publication of the report by your office. His advice was based on knowledge that your report addressed travel from a comprehensive standpoint and his recommendation was that the board also address the topic comprehensively. To further that effort, I have instructed the staff to include the report issued by your office on the agenda at the next available board meeting. The board will then have an opportunity to act on the balance of your recommendations regarding travel and adherence to the state regulations.

The report indicates that, in the future, the board in a public meeting should approve all travel where the purpose and necessity of such travel is documented. Again, your recommendation is certainly consistent with recent board action. In April of this year, the board adopted a policy requiring all board travel to be approved in advance by the board. That same policy was later extended to cover all system staff. To further that effort, I have instructed the staff to include the report issued by your office on the agenda at the next available board meeting. The board will then have an opportunity to act on the balance of your recommendations regarding documentation of the business-need for such travel.

The report includes findings regarding the use of the same credit card for payment of both personal expenses and system expenses and recommends the implementation of certain control procedures. This recommendation is consistent with recent board action. In April of this year, the practice of a board member using a single credit card for both personal and system expenses was discontinued. In May of this year, a credit card was obtained on behalf of the system. A written policy was implemented before its usage. The policy includes control procedures. The card is kept in a locked file cabinet in a secure file room and is only authorized to be used for system related expenses which must be preapproved by the director. A date and purpose log is maintained showing use of the card and receipts must be provided for the system's accounting files. To further that effort, I have instructed the staff to include the report issued by your office on the agenda at the next available board meeting. The board will then have an opportunity to act on the balance of your recommendations regarding the commingling of personal expenses and system funds and all appropriate documentation relative thereto.

The report finds that there was no documentation of the board's consideration of the impact of certain legislation. The particular referenced legislation was the subject of much discussion by the board and was repealed by the legislature last year. The report recommends that the board should always exercise its discretion in a way that protects the funds and assets of the system. This recommendation is consistent with recent board action. In October of this year, the board authorized the system actuary to conduct a forecast valuation as part of a ten-year management plan. The forecast valuation is designed to set certain fiscally conservative guideposts by which all future board action will be measured, especially when the impact of legislation is under consideration.

The report encourages the board of trustees, with assistance from their professional advisors, to explore all the issues of becoming a qualified plan versus a nonqualified plan and to go on public record as to its position. This recommendation is consistent with recent board action. In October of this year, the staff presented the board with a report comparing the features of qualified and nonqualified plans. The board discussed the matter and carried the discussion over to the board meeting held last week. The system's consulting tax attorney made a formal presentation on the topic. The board thoroughly discussed the matter and instructed the staff to disseminate related educational information to the system membership in order to be in compliance with certain federal notice requirements. The board set the month of February as a target date for taking final action regarding whether or not the system will formally apply for qualified status.

The report contained recommendations indicating that: (1) the board should strictly comply with the Louisiana Code of Governmental Ethics, (2) the system should conform with state law regarding the payment for accrued annual leave, (3) the system should maintain the tapes of its public meetings in accordance with state law, (4) the system should develop, adopt, and implement a policies and procedures manual, (5) the system should seek a ruling from the IRS regarding the Retiree-DROP and Disability Conversion programs, and (6) should enter into written contracts for legal

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services and those contracts should be coordinated with work already provided by in-house counsel. Again, there was consensus amongst board members that these recommendations are sound and they will be immediately submitted to the board for discussion and action.

Lastly, to reiterate, in this response I have attempted to reflect my understanding of the board members' opinions regarding the limited examination. However, in order to assure equal access and input by all members, I am attaching an appendix containing individual responses by board members and do hereby reserve the right to supplement this response. In closing, the report shows that there has been a lack of good judgment on the part of some board members and, in some cases, plain bad judgment. For that, we all regret the consequences. We are certainly in accord with your office that changes are needed and some are already being made. With that in mind, your report will be the roadmap that we use in situations requiring sound judgment. Thank you again for the opportunity to respond.

Very truly yours,



William Desormeaux

BD/sss
enclosures