EXECUTIVE DIGEST

BUREAU OF INVESTMENTS

INTRODUCTION	This report contains the results of our performance audit of the Bureau of Investments, Department of Treasury, for the period October 1, 1990 through September 30, 1994.
AUDIT PURPOSE	This performance audit was conducted as part of the constitutional responsibility of the Office of the Auditor General. Performance audits are conducted on a priority basis related to the potential for improving effectiveness and efficiency.
BACKGROUND	The major responsibility of the bureau is to invest, manage, account for, and safekeep the State's retirement funds, trust funds, and other funds comprising the State Treasurer's common cash fund. For example, the bureau invests funds for the Children's Trust Fund, deferred lottery prizes subfund, Michigan Education Trust, Michigan Higher Education Assistance Authority, and Michigan Veterans' Trust Fund. The bureau manages the State cash flow and ensures that sufficient money is on hand to meet the cash disbursement needs of the State.

For summary reporting of asset allocation, the bureau combines the Judges, Public School Employees, State Employees, and State Police Retirement Systems into one unit called the State of Michigan Retirement Systems (SMRS). The bureau compares investment performance with a group of similar state retirement systems.

At September 30, 1994, the market value of the investments for the retirement systems and the common cash fund was approximately $27.4 billion including $916 million, or 3.3% of their holdings, in derivatives.

As of September 30, 1994, the bureau had 75 employees. Total operating expenses for fiscal year 1993-94 were approximately $6 million which were from appropriated funds.

AUDIT OBJECTIVES AND CONCLUSIONS

Audit Objective: To assess whether the return on SMRS assets has met or exceeded the median rate of return of comparable pension systems.

Conclusion: As of September 30, 1994, the rate of return on SMRS assets was approximately 1.4% below the median rate of return of similar state pension funds for the last five completed fiscal years. However, it should be noted that the rates of return for the one, two, and three years ended September 30, 1994 had improved to the point where they equaled or exceeded the median of the other state pension plans.

SMRS rates of return for its two largest investment categories, equities and fixed income, were below the rates of return for comparable state and public pension plans for the last five completed fiscal years. The bureau stated that 4 factors negatively impacted the rate of return: (1) the South African divestiture restrictions had a large impact in fiscal years 1989-90 and 1990-91, (2) value investing was out of favor, (3) SMRS had a larger percentage of cash equivalent investments than its peer group, and (4) poor real estate returns.

Audit Objective: To assess whether the bureau has developed meaningful overall performance indicators and maintained accurate data to measure the performance of the divisions within the bureau and the individual analysts.

Conclusion: We concluded that the bureau was reasonably effective in developing meaningful performance goals, objectives, and benchmarks for measuring and evaluating investment performance. We also concluded that the bureau maintained accurate data for measuring performance within the bureau. However, we identified deficiencies in the bureau's measurement, evaluation, and monitoring of investment performance. The bureau established specific performance benchmarks that were based on average rather than superior performance. Also, the bureau did not consistently develop measurable goals and objectives for all levels within the organization. In addition, the bureau did not have a system to document the evaluation and monitoring of its performance. (Finding 1)

Audit Objective: To assess the efficiency of the bureau's administration of the investment function.

Conclusion: We concluded that the bureau was efficiently administering the investment function. We did, however, note that the department did not periodically evaluate whether it was using the most cost-effective method for paying for banking services. The department used the compensating balance method rather than the direct charge method, which could result in increased cost in a low interest rate environment (Finding 2). Also, the department did not obtain its central banking services through a competitive bid process (Finding 3). In addition, the department had not developed formal operating procedures for all investment activities (Finding 4).

AUDIT SCOPE AND METHODOLOGY

Our audit scope was to examine the program and other records of the Bureau of Investments for the period October 1, 1990 through September 30, 1994. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Our audit methodology included a review of agency records, interviews with agency staff, and comparisons of investment performance data compiled by other agencies.

AGENCY RESPONSES AND PRIOR AUDIT FOLLOW-UP

Our audit report contains 4 findings and 6 corresponding recommendations. The department's preliminary response indicated that it agreed with 4 of our recommendations and would take steps to implement them.

The department complied with 7 of our 9 prior audit recommendations.