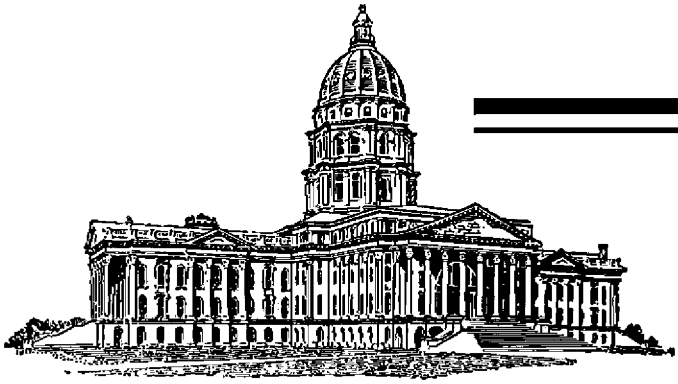

PERFORMANCE AUDIT REPORT

Reviewing Benefits Provided by the Kansas Public Employees Retirement System:

A K-GOAL Audit

Executive Summary

with Conclusions and Recommendations

A Report to the Legislative Post Audit Committee
By the Legislative Division of Post Audit
State of Kansas
October 1996

97-38

Legislative Post Audit Committee

Legislative Division of Post Audit

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LEGISLATURE OF KANSAS
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October 29, 1996

To: Members of the Kansas Legislature

This executive summary contains the findings and conclusions from our completed performance audit, *Reviewing Benefits Provided by the Kansas Public Employees Retirement System: A K-GOAL Audit.* The report also contains an appendix showing comparative information on the retirement plans and benefits provided by Kansas and most of the other states.

If you would like a copy of the full audit report, please call our office and we will send you one right away. We would be happy to discuss the findings presented in this report with you at your convenience.

Barbara J Hinton

Barbara J. Hinton
Legislative Post Auditor

Question 1: How Does The Kansas Public Employees Retirement System Compare To Other Public And Private Pension Systems With Respect To Contributions, Vesting Provisions, and Benefit Levels?

The Retirement System's cash benefits generally compared favorably with other states, but health insurance and cost-of-living provisions were somewhat less generous than many other states provide. *The Retirement System pays an annual retirement benefit of $15,750 to an employee who worked 30 years and had a final average salary of $30,000. This benefit ranked 20th of the 37 states we reviewed for this measure, and was slightly below the average of $16,197. Paid health insurance and cost-of-living increases can enhance retirement benefits greatly. Thirteen states, including Kansas, pay all or part of the cost of retirees' health insurance premiums. Of those states, Kansas provided the smallest subsidy—15%. Four states provide health insurance at no cost to retirees. Nearly two-thirds of the states we reviewed gave automatic annual cost-of-living increases. Kansas was one of nine states that granted occasional increases. Kansas' vesting period is 10 years, while many other states allow their employees to become vested in five years or less. The Retirement System generally offered the same types of non-cash benefits other systems offered.* .... page 5

Employee contribution rates in Kansas were about average, and employer contribution rates were among the lowest of the states we reviewed. *State employees generally pay for a portion of their retirement benefits during the years they work by contributing a certain percentage of their salaries. In Kansas, employees contribute 4% of their salaries, which was about average. Employee contributions in other states ranged from 0% to 8.7% of salary. Kansas' employer contribution rate was the second lowest of all the states we reviewed. In fiscal year 1994, Kansas contributed 3.1% of employee salaries to fund the retirement system. Retirement System officials point to good investment performance as the main reason for Kansas' low rate. The contribution rate also is held artificially low to some extent because of a law passed in 1993, which spreads out employer contribution increases needed to fund benefit increases given that year.* .... page 8

The Retirement System wasn't as well funded as many of the other state retirement systems we reviewed. *How well-funded a retirement system is has to do with the assets it has available to invest so that it can pay retirement benefits to employees who are currently retired, or who will retire in the future. If a retirement system is 100% funded, that means that it has enough assets to cover all its current and future liabilities for retirement benefits. Our comparisons showed that for fiscal year 1994, the Retirement System was about 78% funded, compared with an average of about 88% for the other systems we reviewed. Officials from the Government Finance Officers Association told us the Retirement System's funding level shouldn't be of particular concern as long as the* .... page 9

employer contributions are actuarially determined and the Legislature appropriates enough money to make those contributions. Kansas is doing both those things.

Private pension systems may provide greater benefits than public systems. *There are two major types of retirement plans, defined-benefit plans, and defined-contribution plans. Defined-benefit plans offer a set retirement benefit based on years of service and final average salary. (Nearly all state retirement plans are defined-benefit plans.) Defined-contribution plans don't offer a set retirement benefit. The employer, and sometimes the employee, put money into an account for the employee, and the employee controls how the money is invested. The final benefit amount depends on how well those investments perform. Large private employers generally offer employees combined defined-benefit and defined-contribution plans. We gathered information from four large Kansas corporations—Blue Cross Blue Shield of Kansas, Goodyear Tire and Rubber Company, Security Benefit Life, and Cessna Aircraft Company. We found that each company provides both a defined-benefit plan and a defined-contribution plan for their employees. Two companies offer better defined-benefit plans than the State does. They also provide this benefit at no cost to the employee. All the companies also provide a defined-contribution plan with an employer match. It's difficult to estimate a benefit that would result from these defined-contribution plans. However, they are benefits the State doesn't offer.* .... page 11

Question 2: How Can Kansas Provide More Flexibility and Options For State Employees To Invest Their Retirement Moneys?

Defined-Benefit retirement plans, like the Retirement System's, lack portability and tend to penalize workers who change jobs. *Defined-benefit plans generally don't allow workers to take any of the employer contributions with them when they change jobs. This has become an important problem given todays less stable job market. When vested employees change jobs, they can leave their money in their retirement plans and receive a retirement benefit from each employer when they reach retirement age. However, they end up with a lower total annual retirement benefit than employees with similar salary histories who work for one employer their entire career. In contrast, defined-contribution plans—the other major type of retirement plan—generally are very portable. These plans usually allow employees to take some or all of the employer contributions with them, and benefits aren't affected by how often employees change jobs. In addition, they allow employees to choose how their retirement money is invested. The main disadvantages of these plans are that they shift the investment risk to the employee, they require employees to have investment knowledge, and they won't necessarily provide a larger benefit at retirement.* .... page 13

A few states have taken steps to make it easier for employees to take their retirement benefits with them when they change jobs, or to have more control over investment decisions. *Colorado and South Dakota have adopted retirement plans that give employees some of the employer contributions when they change jobs. For example, Colorado lets employees take the contributions they made plus interest, and then* .... page 16

matches 50% of that amount with state money. Nebraska offers a non-traditional defined-contribution plan that lets employees invest their retirement funds, but doesn't let them take employer contributions with them if they leave. Washington offers a combined defined-benefit and defined-contribution plan that provides employees with a retirement benefit even if they change jobs and withdraw their employee contributions. Four states have added features to their defined-benefit retirement plans that give employees more flexibility in how their final retirement benefits are determined. Many states, including Kansas, provide a portable defined-contribution plan for unclassified university employees. All of these alternatives have some actual or potential costs to the State or the employee.

Although defined-contribution plans can create more portability and investment choices for employees, these plans don't necessarily guarantee a larger retirement benefit. *Two scenarios we constructed to compare defined-contribution plans with defined-benefit plans showed that the portability of the defined-contribution plans may come at the cost of lower retirement benefits. One scenario that kept employer and employee contribution rates about the same as they are now failed to provide a retirement benefit as good as the current defined-benefit plan, even for the employees who changed jobs. It's only when contribution rates are increased substantially that the defined-contribution plan begins to provide a better benefit than the current defined-benefit plan.* .... page 19

Question 2 Conclusion: *It is clear that defined-benefit retirement plans aren't as beneficial to short term employees as they are to long-term employees. This report mentions a number of ways to increase portability or flexibility for State employees. However, most of the alternatives have some actual or potential cost to the State or to the employee. For example, allowing employees to take employer contributions with them when they change jobs would likely increase the employer contribution rate needed to fund the system in the future. Likewise, having a shorter vesting period would increase the number of employees who are eligible for retirement, thus increasing the costs of the System. Converting to a defined-contribution plan might give more portability and choices, but could result in smaller benefits for many employees. Also, the Retirement System would have to continue to administer the defined benefit plan for those employees who didn't choose to transfer to the defined-contribution plan. 20* .... page 20

The Kansas Public Employees Retirement System concurred with the findings in this report. It also noted that the audit findings mirrored the results of a study they presented to the House Appropriations and Senate Ways and Means Committees last year.

This audit was conducted by Allan Foster. If you need any additional information about the audit's findings, please contact Mr. Foster at **the Division's offices. Our address is: Legislative Division of Post Audit, 800 SW Jackson Street, Suite 1200, Topeka, Kansas 66612.** You also may call (913) 296-3792, or contact us via the Internet at **LPA@postaudit.ksleg.state.ks.us.**