

Pensions in the Public Sector

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Chapter 14

Pension Governance in the Pennsylvania State Employees' Retirement System

John Brosius

This chapter describes the governance model utilized by the Commonwealth of Pennsylvania State Employees' Retirement System (SERS). The term "governance model" refers to the way in which the public pension plan is managed and key decisions are made. We begin with an overview of the structure of SERS along with the diverse legal authorities that influence its operation; we then go on to show how both the State Employees' Retirement Board ("board") and SERS are governed.

Characteristics of SERS

The Pennsylvania State Employees' Retirement System was established in 1923 by the General Assembly of the Commonwealth of Pennsylvania; the legislation that created and primarily governed SERS was then recodified in 1959 and again in 1974. Today, SERS is charged with administering two retirement plans: (1) a cost-sharing multiple-employer defined benefit plan and (2) an Internal Revenue Code Section 457 deferred compensation plan, which is a defined contribution plan. These two plans serve the employees of the Commonwealth as well as those of certain independent agencies and educational institutions. The agency today employs approximately 190 people, with headquarters in Harrisburg, and it also has seven regional field offices throughout the Commonwealth of Pennsylvania.

The SERS defined benefit (DB) plan serves approximately 198,000 members and has assets in excess of \$24 billion. It was recently ranked 39th in total asset size among all pension funds in the United States (*Pensions & Investments* 1999). Active SERS members (meaning those persons presently making contributions to SERS through their Commonwealth employment)

may also elect to participate in the state's deferred compensation plan, a DC plan with around 38,000 participants and investments valued at approximately \$725 million. A third-party administrator administers the DC plan under contract with the board, with oversight provided by the board and SERS staff.

SERS is subject to regulatory constraint from both the federal and state level.¹ On the federal level, SERS is subject to the U.S. Constitution and to many federal laws including the Internal Revenue Code of 1986, the Bankruptcy Code, the Americans with Disabilities Act of 1990, Title VII of the Civil Rights Act of 1964, and the Family and Medical Leave Act of 1993 (respectively 26 U.S.C. §1 et seq., 11 U.S.C. §101 et seq., 42 U.S.C. §12101 et seq., 42 U.S.C. §2000e et seq., and 29 U.S.C. §2601 et seq. and 5 U.S.C. §6381 et seq.). On the state level, SERS is subject to the Constitution of the Commonwealth of Pennsylvania and to many state laws. These include the Commonwealth Procurement Code, the Right to Know Law, the Sunshine Act, the Civil Service Act, the Human Relations Act, the Commonwealth Attorneys Act, the Administrative Agency Law, and the Administrative Code of 1929 (respectively 1998 Pa. Laws 57, 65 P.S. §66.1 et seq., 65 P.S. §271 et seq., 71 P.S. §741.1 et seq., 43 P.S. §951 et seq., 71 P.S. §732-101 et seq., 2 Pa. C.S. §501 et seq., and 71 P.S. §51 et seq.). The body of common law governing the public pension environment is also very important, and particularly significant are cases addressing the law of trusts and fiduciary responsibility. In addition, SERS is subject to various executive orders and management directives issued through the governor's office, which controls many administrative issues.

In particular, the most important source of governing authority with respect to the state's defined benefit plan is the State Employees' Retirement Code (the "Retirement Code"; see 71 Pa.C.S. §§5101-5956). The primary sources of authority governing the deferred compensation plan include Section 457 of the Internal Revenue Code of 1986; the state statutory provisions authorizing the establishment of the plan (cf. 72 P.S. §§4521, 4521.2, 4521.3); and the DC plan document, entitled "Deferred Compensation Plan for Officers and Employees of the Commonwealth of Pennsylvania" (originally adopted by the board effective as of January 1, 1989, and known as the "Plan Document"). These sources of authority describe the environment in which the defined benefit and defined contribution plans are managed and governed.

SERS Board Structure and Governance

The Retirement Code establishes the SERS board as an "independent administrative board" (cf. 71 Pa.C.S. §5901(a)). Due to this status, the board operates within the executive branch with a greater degree of independence

than many other state agencies. The executive and the legislative branches can influence the actions of the board due to the board's composition, but the board has the authority to make all decisions with respect to the implementation of the Retirement Code and the management of the State Employees' Retirement Fund.

The board's composition is specified in the Retirement Code (71 Pa. C.S. §5901(a)), and must consist of 11 members: the state treasurer *ex officio*,² two state senators or former state senators, two members or former members of the state House of Representatives, and six members appointed by the governor, one of whom must be an annuitant of SERS, subject to confirmation by the state Senate. At least five board members must be active members of SERS, and at least two must have 10 or more years of State service. The Senate members are appointed by the President *pro tempore* of the Senate, and they must be a majority and minority member or former member. The two members from the House of Representatives are appointed by the speaker of the House of Representatives, and also must be a majority and minority member or former member. The Retirement Code provides that the governor shall appoint the board chairman from among the members of the board. At the present time, the SERS board includes three private citizens (two of whom were formerly members of the House or Senate), two senators, two members of the House of Representatives, the state treasurer, the secretary of the budget, the secretary of Administration, and the executive director of the American Federation of State, County, and Municipal Employees (AFSCME), Council 13. The board is chaired by a private citizen, formerly a member of the House of Representatives.

The board is required by the Retirement Code to meet at least six times a year; in practice, it actually meets eight times per year (71 Pa. C.S. §5902(d)). The board chairman runs the meetings. The board has not adopted written policies, such as bylaws, to govern its meetings.

Unlike some other retirement boards, the SERS board does not rely heavily on the use of committees. Currently, the SERS board has only three standing committees: a personnel committee, a deferred compensation committee, and a corporate governance committee. The personnel committee's primary function is to address the compensation of SERS's senior management and investment office staff. The deferred compensation committee recently reviewed proposals to administer the deferred compensation plan submitted by third-party administrators, and it will address other issues associated with the deferred compensation plan as directed by the board chairman. The corporate governance committee addresses the board's position with respect to shareholder class actions. Other *ad hoc* committees have been formed to review responses to requests for proposals for investment consultants. Generally speaking, however, the board prefers to work as a whole.

With respect to the actions of the board members, the Retirement Code provides that members of the SERS board stand in a fiduciary relationship to the members of SERS regarding the investments and disbursements of the monies of the Retirement Fund, and that they are not to profit either directly or indirectly with respect thereto (71 Pa. C.S. §5931(e)). The Retirement Code also requires that new board members take an oath in which they agree to diligently and honestly administer the affairs of the board, and to not knowingly or willingly permit any applicable provisions of law to be violated (71 Pa. C.S. §5901(c)). In addition to these requirements, board members are also subject to the Public Official and Employee Ethics Act (the "Ethics Act"), which addresses conflicts of interest in Commonwealth employment (65 P.S. §§401-13). Pursuant to the Ethics Act, every year board members, like other public officers and employees, are required to file Statements of Financial Interest with the State Ethics Commission (65 P.S. §404). The form requires certain disclosures with respect to investments, business interests, creditors, sources of income, gifts, and expense reimbursements, as mandated by the Ethics Act (65 P.S. §405). Board members are also required to file a comparable disclosure form under the governor's Code of Conduct (Executive Order 1980-18). The State Adverse Interest Act similarly prohibits board members from having adverse interests in contracts entered into by the board (71 P.S. §776.1 et seq.). Finally, board members are subject to Commonwealth-wide policies regarding travel and expense reimbursement.

SERS Board Responsibilities and Agency Governance

The Retirement Code vests the board with responsibility for managing SERS. There are four areas of responsibility: (1) administration, (2) benefit determination, (3) funding, and (4) investment practices. After describing these, the internal controls in place within the agency to ensure compliance with agency policies and procedures are outlined.

Administration. One of the most important duties of the board with respect to the day-to-day administration of SERS is the appointment of the executive director, who is the chief administrative officer of SERS (71 Pa. C.S. §5902(a.1)). The Retirement Board delegates to the executive director responsibility for almost all administrative functions. The agency is organized into several bureaus and offices, as follows: the Bureau of Benefit Determination; the Bureau of Retirement Counseling; the Bureau of Administration; the Bureau of Management Information Systems; the Office of Financial Management; the Investment Office; the Office of Audit, Reporting, and Compliance; and the Legal Office. The head of each department or office, other than the Legal Office, reports to the executive director. The status of the Legal Office is unique in that SERS does not have the authority

to hire its own in-house counsel. The agency's attorneys are instead hired by the governor's Office of General Counsel. Although the chief counsel works closely with the executive director and the board, the chief counsel reports to the General Counsel. The governing law with respect to this area of agency operations is the Commonwealth Attorneys Act (71 P.S. §§732-101-732-506).

Together, the heads of the Bureaus and Offices are referred to as the "executive staff." Each member of the executive staff submits a written report to the executive director on a monthly basis. In addition, meetings between the executive staff and the executive director occur every six weeks, although the executive director will call additional meetings if needed. The purpose of the meetings is to discuss high-level issues, such as the status of strategic planning initiatives, agency performance, and manager and consultant performance. Day-to-day operational issues are generally handled within each Bureau and Office; the executive director becomes involved in operational issues only in exceptional cases.

Many personnel issues, such as the procedures for hiring, promoting and disciplining most employees are governed by the Civil Service Act (71 P.S. §741.1 et seq.). There are employees who are exempted from coverage by the Civil Service Act, the primary examples being the Chief Investment Officer, the Investment Office Directors, and the attorneys in the Legal Office.

Many of the routine administrative issues common to most Commonwealth agencies are addressed through the governor's Directives Management System. The "Management Directives," issued through the governor's office, set forth policies binding on Commonwealth agencies under the governor's jurisdiction. Some of the many topics addressed this way include budget preparation, contract management, accounting processes, payroll, employee training, and supplies. SERS follows the policies established through this state system.

The administration of the deferred compensation plan requires a separate discussion in that, unlike the defined benefit plan, the day-to-day operation of the deferred compensation plan is handled through a third-party administrator under contract with the board (72 P.S. §4521.2(e)(1)). The third-party administrator is supervised by SERS staff within the Office of Financial Management. The head of the Office of Financial Management reports to the executive director regarding deferred compensation issues, with the executive director in turn reporting to the board.

Expenses associated with the administration of SERS are the focus of a yearly budget that is submitted to the General Assembly through the governor's Office, in accordance with the Retirement Code (71 Pa. C.S. §5902(c)). Expenses approved by the General Assembly in an appropriation bill are paid from the investment earnings of the Retirement Fund (71 Pa. C.S. §5902(c)). Expenses associated with both the defined benefit plan and the

deferred compensation plan appear in the same budget. Expenses associated with SERS administration of the deferred compensation plan are initially paid from the investment earnings of the Retirement Fund, and then they are reimbursed to the Retirement Fund from the accounts of the members participating in the deferred compensation plan (72 P.S. §4521.2(g)). The state treasurer acts as the custodian of the assets of both the defined benefit plan and the deferred compensation plan (71 Pa.C.S. §5931(c); 72 P.S. §4521.2(h)).

Benefit determination. The benefit issues associated with the defined benefit plan and the deferred compensation program are very different, and will therefore be addressed separately.

For the DB plan, the Retirement Code sets forth in great detail how the benefit structure works (71 Pa.C.S. §§5701–10). There are five types of benefits available: a normal retirement benefit (called a “superannuation annuity”), an early retirement benefit (called a “withdrawal annuity”), a disability annuity, a death benefit, and a return of the member’s contributions and the interest earned thereon. Rather than fully describe all of the benefit structure, it is useful to highlight key benefit features. For example, the normal retirement age for most members is age 60 or the age at which the member attains 35 years of credited service, whichever occurs first (71 Pa.C.S. §5102; “superannuation age” defined). All members must have at least ten years of credited service to qualify for an early retirement benefit, and most members must have at least 5 years of credited service to qualify for a disability benefit (71 Pa.C.S. §5308). The early retirement benefit is calculated in the same manner as a normal retirement benefit, but a reduction factor is applied for the number of years the member is under normal retirement age (71 Pa.C.S. §5702(a)(1)).

Like many defined benefit plans, the SERS benefit structure focuses on a member’s final average salary and years of credited service. The cornerstone of SERS’s benefit structure is the “standard single life annuity,” which is an annuity equal to 2 percent of the member’s final average salary, multiplied by the total number of years of credited service of the member (71 Pa.C.S. §§5702(a), 5102; see “standard single life annuity” defined)). The term “final average salary” is defined by the Retirement Code to mean the highest average compensation received by a member during any three nonoverlapping periods of four consecutive calendar quarters during which the member was a state employee (71 Pa.C.S. §5102; see “final average salary” defined).

The Retirement Code establishes five different payment options for members receiving superannuation annuities or withdrawal annuities (71 Pa.C.S. §5705). Members who leave Commonwealth employment who either are not eligible for any other benefit, or wish to decline the benefits to which they are otherwise entitled, may elect to withdraw the contributions they have made to the Retirement Fund, and the interest which has accrued

thereon, in lieu of any other benefit available under the Retirement Code (71 Pa.C.S. §5701).

Although the Retirement Code sets forth a very detailed benefit structure, some benefit questions require additional interpretation; to this end, the board issued regulations in 1974 that have not changed much over time (4 Pa. Code §§241.1-250.15). Nevertheless these are currently being reviewed, and they may be updated in the near future.

In addition to the Retirement Code and the regulations already described, two other sources of authority also enter into benefit determination decisions including (1) court and board decisions with respect to benefits issues and (2) SERS staff experience as expressed in SERS policy. For greater clarity, SERS recently compiled a manual that attempts to bring together all these sources of authority into a single text.

SERS occasionally is placed in an adversarial position vis-à-vis its members. For example, many different benefit decisions have to be made by SERS's staff prior to the time a benefit is calculated for any given member. These include decisions with respect to membership eligibility, the ability of members to purchase additional service credit, and whether members qualify for a disability benefit. In some cases, members or their families seek to change the benefit option selected by the member at retirement, a practice allowed by the Retirement Code only under very narrow circumstances. When SERS staff makes a benefit determination that is adverse to a member, the member has the right to appeal that determination. The appeal is first considered by the Appeals Committee, which consists of senior level staff not involved in the original staff determination. If the Appeals Committee determination is still adverse to the member, the member has right to request an administrative hearing before an independent hearing examiner. Upon hearing the case, the hearing examiner makes a recommendation to the board. The board will ultimately issue a decision in the case. If the board does not decide the case in the member's favor, the member may appeal first to the Commonwealth court, and then, if necessary, to the Pennsylvania Supreme Court. The source of authority for much of this procedure is the Administrative Agency Law (2 Pa. C.S. §§501-704). More detailed procedures governing the appeals process are found in the General Rules of Administrative Practice and Procedure (1 Pa. Code §31.1 et seq.), which were made applicable to board proceedings by board regulation (4 Pa. Code §250).

Actual benefit calculations rarely give rise to administrative appeals. The computational procedures used in calculating SERS benefit payments have been approved by the SERS actuary, as required by the Retirement Code (71 Pa. C.S. §5902(h)). To ensure the accuracy of benefit calculations, all calculations are done independently by two different employees. Further, a sub-sample of these calculations is audited by Treasury auditors employed by the

state treasurer but housed at SERS. A subsample of benefit calculations is also audited by the board's independent accountants, in conjunction with the annual agency audit.

In the case of the DC plan, the benefit determination process is fundamentally different. Participants here may elect to defer some of their current compensation into the plan. The deferred funds are then invested at the direction of the participant; several investment vehicles are available under the plan. Amounts paid out from the plan to the participant or the participant's beneficiaries are a function of amounts contributed by the participant and investment income earned with respect to those contributions. The DC plan offers great flexibility in the timing and form of withdrawals as compared to the DB plan; the primary requirements are that DC distributions must comply with Sections 457 and 401 of the Internal Revenue Code of 1986.

The Plan Document gives the board, acting as plan "administrator," the authority to decide all matters under the plan, and it states that the board's determinations are final, binding, and conclusive on all interested persons for all purposes. The Plan Document further provides that any determination shall be uniformly and consistently made according to reasonable procedures established by the Administrator. As of this writing, there have been no challenges by plan participants to determinations made under the plan.

Funding. The SERS deferred compensation plan is financed solely through employee contributions, at levels selected by the employees, and investment earnings on those contributions. As with other DC plans, assets are equal to liabilities at all times so by definition, the DC plan is fully funded.

The SERS DB plan is financed through three sources: (1) employee contributions, (2) employer contributions, and (3) investment earnings. Pursuant to the Retirement Code, most Commonwealth employees contribute to the Retirement Fund at the rate of 5 percent of their gross compensation (71 Pa.C.S. §§5501, 5102; see "regular member contributions" and "basic contribution rate" definitions). These contributions are deducted from each employee's biweekly paycheck. The amounts paid annually to the Retirement Fund as employer contributions are determined each year by the board with the assistance of the SERS actuary, pursuant to the requirements of the Retirement Code (71 Pa.C.S. §5902(k)). The amount of employer contributions is expressed as a percentage of payroll (71 Pa.C.S. §5902(k)). For reasons set forth in the Retirement Code, not all employers contribute to the Retirement Fund at the same rate. The average of all employer contribution rates will be referred to herein as the "composite employer contribution rate."

Every five years the board issues a request for proposals (RFP) for actuarial services. The selected actuary performs several services for the defined

benefit plan during the contract period, including conducting an actuarial experience study once during the five year period; conducting annual actuarial valuations; recommending appropriate employer contribution rates to the board every year; and determining the funded status of the defined benefit plan every year. For the actuarial experience study, the actuary reviews SERS economic and demographic experience over the previous five-year period. That experience is used as a basis for forming actuarial assumptions, which are essentially highly educated predictions about what will occur in the future with respect to salary growth, investment returns, and other demographic factors. The last actuarial experience study covered the period of 1991 to 1995, and concluded that investment earnings could be projected at 8.5 percent per annum, average career salary growth would be 3.5 percent per year, and that salary schedules would rise by 3.3 percent per year. These assumptions were recommended to the board by the actuary and adopted by the board in accordance with the Retirement Code (71 Pa. C.S. §5902(j)).

Armed with these assumptions, the actuary conducts an actuarial valuation of the Retirement Fund each year, as required by the Retirement Code (71 Pa. C.S. §5902(j)), comparing the prior year's actual experience with the actuarial assumptions. Based on this valuation, the actuary develops recommended employer contribution rates, which are presented to the board. The Retirement Code vests the board with the authority to establish the employer contribution rates. The determination of the board is final, and not subject to modification by the Commonwealth's budget secretary (71 Pa. C.S. §5902(k)).

In recent years, required employer contribution rates have declined, mainly because the fund's investment earnings exceeded the actuarially assumed 8.5 percent return. For instance, the composite employer contribution rate for fiscal year 1998–1999 was 6.70 percent of payroll, whereas for fiscal year 1988–1989 it was 13.09 percent of payroll.

The SERS defined benefit plan is currently fully funded, by which we mean that the actuaries have determined that the Retirement Fund has sufficient assets to cover the fund's net liabilities for the accumulated benefits of all active and retired members. SERS first achieved this status in 1992.

Investment practices. The board's investment responsibilities differ for the DB and the DC plan. Turning first to the DB plan, the Retirement Code provides that the members of the board have exclusive control and management of the Retirement Fund, with full power to invest the same:

subject . . . to the exercise of that degree of judgment, skill and care under the circumstances then prevailing which persons of prudence, discretion, and intelligence, who are familiar with such matters, exercise in the management of their own affairs

not in regard to speculation, but in regard to the permanent disposition of the funds, considering the probable income to be derived therefrom as well as the probable safety of their capital. (71 Pa.C.S. §5931(a))

This is commonly known as the "prudent person rule."

Other than the prudent person rule, the Retirement Code contains only a few specific principles with respect to the board's investment authority. First, the board may (when possible and consistent with its fiduciary duties, including the obligation to invest and manage the Retirement Fund for the exclusive benefit of the members of SERS) consider whether an investment promotes the general welfare of the Commonwealth and its citizens, including but not limited to investments that increase and enhance the employment of Commonwealth residents, encourage the construction of adequate housing, and stimulate further investment and economic activity in the Commonwealth (71 Pa.C.S. §5931(e)). The board reports annually to the General Assembly regarding investments made pursuant to this authority (71 Pa.C.S. §5931(e)).

Second, not more than 2 percent of the book value of the total assets of the Retirement Fund can be invested in venture capital investments (71 Pa.C.S. §5931(h)). The Retirement Code further provides that a venture capital investment may only be made if, in the judgment of the board, the investment is reasonably likely to enhance the general welfare of the Commonwealth and its citizens and the investment meets the prudent person standard set forth in the Retirement Code (71 Pa.C.S. §5931(h)). Third, the Retirement Code contains restrictions on investments in Northern Ireland. More particularly, the board is directed to invest the assets of the Retirement Fund in such a manner that the investments in institutions doing business in or with Northern Ireland reflect the advances made by such institutions in eliminating ethnic or religious discrimination (71 Pa.C.S. §5940).

As is apparent, the board's investment authority is quite broad. To help define the exercise of that authority, the board has adopted a Statement of Investment Policy and an Annual Five-Year Investment Plan. This was initially adopted in 1979 but was amended over time, mostly in response to legislative changes. The statement sets forth the board's investment objectives, policies and procedures; defines the duties and responsibilities of the various entities involved in the investment process; and establishes guidelines for the investment of the assets of the Retirement Fund in various investment vehicles. Each year the board also adopts a Five-Year Investment Plan. This plan establishes SERS's asset allocation, and sets specific goals for each asset class in which SERS is investing.

To implement the statement and its five-year investment plan, and to provide advice regarding future policies and plans, the board employs in-house investment professionals and outside consultants, pursuant to au-

thority granted by the Retirement Code (71 Pa. C.S. §5902(b)). The in-house staff consists of a chief investment officer, a director of private equity, a director of real estate, a director of public markets, a director of equities, and a director of fixed income. The directors of private equity, real estate, and public markets report to the chief investment officer. The directors of private equity and fixed income report to the director of public markets. The chief investment officer reports to the executive director.

The board also employs three consultants: one, a general investment consultant, which provides advice regarding the total Retirement Fund portfolio; the second, a private equity consultant, which provides advice regarding the composition of the private equity portfolio and suitable private equity investments for the Retirement Fund; and the third, a real estate consultant, which provides advice regarding the composition of the real estate portfolio and suitable real estate advisors for the Retirement Fund. Working together, the consultants and in-house staff search for managers to fulfill the board's investment policies. Suitable candidates are then interviewed by the board. The board makes all decisions regarding the hiring and termination of managers and consultants.

The managers hired by the board invest the monies of the Retirement Fund. At year-end 1998, the board had 99 external investment managers. The staff and consultants keep the board informed of the performance of the managers through performance reviews. The board is provided with quarterly performance reports for the public market managers and semi-annual performance reports for the private equity and real estate managers. The board is also provided with an annual performance review of all managers upon the conclusion of each calendar year.

The goal of the investment program, of course, is to earn as high a rate of return on the Retirement Fund as possible, with appropriate levels of risk. Attainment of this goal helps to keep the employer contribution rate lower and helps to ease the burden on the Commonwealth's taxpayers. To ensure accountability for its performance, as required by the Retirement Code, each year the board produces a report describing the financial condition of the Retirement Fund during the previous year (71 Pa. C.S. §5902(m), (n)). The financial statements included in the report are audited by an independent accounting firm selected by the board (71 Pa. C.S. §5902(n)). The report is required by the Retirement Code to be submitted to the governor and the head of every department within the Commonwealth for the use of members of the system and the public (71 Pa. C.S. §5902(m)). In actual practice, the report is also forwarded to every member of the state House of Representatives and the state Senate, as well as certain other entities and people who have expressed an interest in receiving the report. The report generally is available to members of the public on request.

Turning next to the DC plan, the board is authorized by statute to contract

with investment managers to invest the assets of the deferred compensation plan (72 P.S. §4521.2(e)(1)). In recent years the board has contracted with external managers to provide seven investment products for plan participants to choose from (1) an S&P 500 index fund, (2) an international index fund, (3) a tactical asset allocation fund, (4) an extended market fund, (5) an aggregate bond fund, (6) a stable value fund, and (7) a money market fund. Only the stable value and the money market funds are actively managed. These seven products were chosen by the board to offer the participants different levels of risk, as well as market diversification and low fees. If the board should seek to offer additional investment products to plan participants, the Office of Financial Management, the Investment Office, and the general investment consultant to the Retirement Fund will work together to find appropriate investment products and managers.

The Office of Financial Management reports the returns earned by each deferred compensation manager to the board every quarter. The financial statements of the deferred compensation plan are audited every year by the board's independent accountants at the same time the financial statements of the Retirement Fund are audited. The audited financial statements are provided to the board, and are generally available to the public upon request.

Internal Controls for SERS

The SERS governance model also includes a series of internal controls. This is because governance largely consists of making policy determinations, but any given policy determination is useful only if it is consistently applied by those responsible for implementing it. The goal of internal controls is therefore to ensure that consistent application.

Historically, SERS has taken a rather decentralized approach toward internal controls, and most believe it has worked well. The head of each bureau and office is responsible for seeing that the staff of that Bureau or Office complies with all agency policies and procedures. The SERS Office of Audit, Reporting and Control provides an oversight function through audits. That is, each year the internal auditors select a certain number of agency processes for audit. Those processes are then tested for accuracy, efficiency, and compliance with policies. The head of the Office of Audit, Reporting and Compliance reports to the executive director but direct access to the board is permitted if deemed necessary.

Recently, SERS has moved toward a more standardized approach toward internal controls through the adoption of an internal control methodology developed by the Committee of Sponsoring Organizations of the Treadway Commission (commonly referred to as COSO; Coopers and Lybrand 1992). This was not in response to any particular problems that had arisen within

the agency, but instead was a reflection of SERS's commitment to proactively find ways to improve its operations. The COSO methodology provides a standard framework for evaluating internal controls over operations. The result is that while each bureau and office within the agency still has primary responsibility for implementing controls, with oversight provided by the Office of Audit, Reporting and Compliance, all the bureaus and offices are now using one methodology to evaluate the internal controls in place. To date, the Office of Audit, Reporting and Compliance has assisted the Office of Management Information Systems and the Investment Office in completing a COSO review of their internal controls. Soon each office and bureau within the agency will undertake similar reviews and this process is anticipated to improve operational efficiency as a result.

Conclusions

As described above, the governance model used by the Commonwealth of Pennsylvania's State Employees' Retirement board and the State Employees' Retirement System is complex. The model addresses responsibility over the four areas of agency operations: plan administration, benefit determination, funding, and investment practices. It also addresses the agency's internal control system. It must be emphasized, however, that what has been presented is but a snapshot of SERS's operations at a particular point in time. An important component of the corporate culture at SERS is openness to change. SERS constantly strives to find new and better ways to do things. As those ways are found, SERS will continue to evolve.

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Notes

1. An overview of sources of authority governing public pension plans appears in Martin (1990).
2. The state treasurer is elected by the citizens of the Commonwealth.

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- Executive Order 1980-18, issued May 16, 1984, revised September 28, 1987.
- Family and Medical Leave Act of 1993, 29 U.S.C. §2601 et seq. and 5 U.S.C. §6381 et seq.
- Internal Revenue Code of 1986, 26 U.S.C. §1 et seq.

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- Administrative Agency Law, 2 Pa. C.S. §501 et seq.
- Administrative Code of 1929, 71 P.S. §51 et seq.
- Civil Service Act, 71 P.S. §741.1 et seq.
- Commonwealth Attorneys Act, 71 P.S. §732-101 et seq.
- Commonwealth Procurement Code, 1998 Pa. Laws 57
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- Right to Know Law, 65 P.S. §66.1 et seq.
- State Adverse Interest Act, 71 P.S. §776.1 et seq.
- State Employees' Retirement Code, 71 Pa. C.S. §5101 et seq.
- Sunshine Act, 65 P.S. §271 et seq.

State Regulations

- General Rules of Administrative Practice and Procedure, 1 Pa. Code §31.1 et seq.
- Regulations of the Commonwealth of Pennsylvania State Employees' Retirement Board, 4 Pa. Code §241.1 et seq.