

Executive Summary

In summary, we found no evidence of fraud, illegal acts, or data manipulation related to the \$90 billion held in trust by STRS for its members. STRS' organizational structure, control environment and operations are suitably designed and well-monitored, both internally and by independent experts. These experts help assure that STRS follows applicable asset and liability measurement, reporting, investing and cash management laws, professional standards, and best practices. Our conclusions are consistent with the findings of these independent firms.

The Ohio Legislature and the ORSC require STRS to engage most of these firms. Appendix B lists these firms and their duties. They consistently report that STRS is following best practices and sometimes even leading practices in its operations. The checks and balances these experts provide should reassure stakeholders concerning STRS' operations.

In the *Transparency* objective, we addressed allegations related to public records requests and trade secrets and concluded that STRS was within its legal parameters in declaring certain items as trade secrets; however, it is within their discretion to be more transparent by amending the non-disclosure portion of their contracts accordingly.

Our *Investments* objective addressed whether STRS is operating properly regarding:

- Whether staff bonuses follow the Ohio Rev. Code requirement and STRS' policy.
- Whether benchmarks used to measure investment results (and which are part of the bonus formula) are adopted with input from independent benchmarking experts, are comparable to peers, or were subject to manipulation.
- Whether STRS has addressed the risk of paying unapproved PE fund fees.
- How STRS' investment returns, funding levels and deficit compares to those of other Ohio pension systems as well as peer pension systems (approximately 20-25 based on available data) throughout the United States.

Key Conclusions:

- Bonuses were awarded based on approved policies.
- Investment benchmarks are adopted with input from an independent benchmarking firm and are not unusually high or low compared to its peers' benchmarks. There are internal controls that mitigate risks of manipulation.
- STRS' controls over PE fees have been appropriately designed and implemented. While STRS cannot eliminate the risk of paying unapproved PE fees, STRS has appropriately addressed this risk.
- STRS' investment earnings ranked in the top quartile among its peers, based on earnings we summarized from peers' audited Annual Comprehensive Financial Reports (ACFR).
- Because neither Ohio law nor the laws applicable to most peer plans require employer contributions to match actuarially determined contributions, these plans are at risk of accumulating deficits. All the plans not actuarially computing contributions have accumulated significant deficits. STRS' deficit requires careful monitoring and may require amendments to benefits or contributions. STRS should not rely primarily on superior future investment earnings to address the deficit.
- Some of our allegation assessments and conclusions relied, in part, on whether there were appropriate internal controls in place. Internal controls are procedures designed to prevent or detect errors, whether intentional (i.e., fraud) or not. We concluded that controls relevant to these allegations were properly designed and implemented to prevent and/or detect errors and to mitigate the risk of fraud.
- We also recommended specific roles for the investment subcommittee, to support transparency to the Board.

The COLA objective focused on the financial impact of reinstating the COLA and ultimately notes that STRS utilized an expert to assess their data through multiple scenarios regarding ongoing, one-time, or no COLA increases. STRS exercised their statutory authority to determine when/if COLAs should be given. We also noted the School Employees Retirement System of Ohio (SERS) shares the same statutory authority with STRS, while other Ohio pension systems do not, and SERS also eliminated COLAs for several years.

In the *Regional Offices* objective, we reviewed the costs of four regional real estate offices and noted that STRS maintains these offices to implement an internally managed real estate strategy, which differs from the strategy of many peers. We compared STRS' real estate management costs and investment returns with those of its peers. STRS has realized substantial cost savings over their peers by internally managing a larger proportion of real estate assets, as compared to higher-fee external investments. STRS real estate returns, however, underperformed the peer group in recent years, resulting in a negative net effect.

As a result of our special audit, we have management recommendations for the actuarial review requirement, fiduciary audit requirement, and duties of the investment subcommittee. We also issued legislative recommendations regarding the investment manager transparency, frequency of actuarial assumption reviews, the independent auditor requirement for actuarial services and defining the required scope for fiduciary audits, the reduction of the amortization period for unfunded pension liabilities, a stress-test framework for pension oversight, whether bonuses should be allowable, and restrictions on allowable PE investments for pensions. The full details of these recommendations are in Appendix A.