

The Audit Process

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Mandate

M.G.L. c. 7 § 50(a),
c. 32 § 21(1)(a),
and
840 CMR 25.00

An “in depth field examination” of each retirement system is mandated at least every three years, conducted “in accordance with generally accepted auditing standards to determine the system’s financial condition, to monitor performance under the terms of its legal, contractual and fiduciary requirements, and to examine the system’s effectiveness in achieving the intended results established by M.G.L. c. 32.”

**But we have an outside audit done!
Won't that suffice?**

**Follow the protocol in
PERAC Memo #20/2008**

If you have an outside audit performed, follow the protocol specified in PERAC Memo #20/2008. Note that the selection of the auditor must be made through a procurement process and the contractual arrangement must exist between the retirement board and the CPA firm.

Item #4 of the memo states that "... review (by PERAC) of the audit report and audit work papers will be conducted to determine whether any additional audit work must be performed by the PERAC audit staff in order to ensure that the audit is completed in conformance with the requirements of Chapter 32."

MEMORANDUM #20, 2008

Commonwealth of Massachusetts | Public Employee Retirement Administration Commission
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Mary Ann Bradley | Paul V. Doane | Kenneth J. Donnelly | James M. Machado | Donald R. Marquis
Joseph E. Connarton, *Executive Director*

MEMORANDUM

TO: All Retirement Boards

FROM: Joseph E. Connarton, Executive Director

RE: Procedures for Retirement System Audits Performed by Certified Public Accounting Firms
Authorized Under Chapter 32, Section 21(1)(a)

DATE: May 28, 2008

The following sets forth the procedures for those retirement systems that elect to have audits performed by Certified Public Accounting firms in lieu or in conjunction with the tri-annual audits performed by the Public Employee Retirement Administration Commission (PERAC), as authorized under Chapter 32, Section 21(1)(a).

The selection of the vendor, by the board must be made through a procurement process. The retirement board must issue an RFP and advertise to obtain services to perform a financial and managerial audit of the system. Such RFP should contain the requirements and conditions of PERAC listed below, including a requirement for the submission of the completed Internal Control Questionnaire (“ICQ”). The contractual relationship must exist between the retirement board and the CPA firm. Upon the completion of the RFP process the following events must take place after the contract is awarded;

1. Written notification is made to PERAC stating the name and address of the vendor selected, the period to be covered by the audit and the expected completion date of the audit.
2. The vendor may request a meeting with PERAC prior to commencing such audit to discuss any issues relating to the audit, including a review of the prior audit, the ICQ and the generally accepted audit standards applied under the audits conducted in accordance with the procedures established by the Commission.
3. Once the vendor has completed the audit and has presented the audit to the retirement system; the vendor, within ten days, must submit a copy of the written audit report to PERAC which will include financial statements of the system for each of the years audited and any management letter relating to such audit, a completed ICQ, as well as a statement related to responses included in the

ICQ.

4. Within 30 days after the submission of the audit report and ICQ to PERAC, the vendor must meet with a designated PERAC auditor. At such time, review of the audit report and audit work papers will be conducted to determine whether any additional audit work must be performed by the PERAC audit staff in order to insure that the audit is completed in conformance with the requirements of c. 32. PERAC reserves the right to conduct a separate audit notwithstanding the completion of a private audit.
5. PERAC will notify the retirement board and vendor that the audit is accepted or requires a supplemental examination in accordance with Chapter 32, Section 21(1)(a). An electronic copy of such accepted audit report should be sent to PERAC for posting on the PERAC website.

Enclosed is the recently updated ICQ that is referenced above, PERAC will maintain the latest version on our website at www.mass.gov/perac/.

If you have any further questions regarding this matter, do not hesitate to contact me.

Enclosure

PERAC Audit Unit

- Reports to PERAC Deputy Director
Frank E. Valeri
- Chief Auditor Harry Chadwick
- 4 regions
- 9 field auditors

PERAC Auditors

- **Western**
Western Chief Auditor Bob Madison and (open)
- **Central**
Dick Ackerson
- **Northeast**
Jim Sweeney, Jim Ryan, Jim Tivnan, and Carol Niemira
- **South**
Marty Feeney and John Shea

When will you come?

Every 3 years or sooner, as mandated

A member of our audit team will contact you approximately 2 to 3 weeks in advance to schedule your audit. Once a target date is established, you will receive a formal letter of engagement from PERAC with a list of documents required for audit examination and a copy of the Internal Control Questionnaire (recently updated).

How long will the audit last?

That depends on:

- Number of years audited
- Size of your system
- Number of contributing units
- Number of auditors

PERAC's
Program for Statutory Audits
of Retirement Systems

8 general areas for audit examination

1. Audit Administration
2. Cash & Annual Statements
3. Accounting
4. Membership
5. System Administration
6. Fiduciary Bonding
7. Investments
8. Contracts

Section 1

Audit Administration

Set-up and wrap-up

During this step, PERAC auditors set up computer files for your audit and begin assembling and organizing their own paperwork.

Toward the end of the audit, this Section is revisited to complete the audit by producing an exit document and a draft audit document, and by finalizing workpapers and documents which are to be placed on file at PERAC.

Section 2

Certified List of Assets
as of
December 31st of the audit ending year

The auditors will require a certified listing of assets from your custodian for December 31 of the audit ending year (may differ from the last statement you received that year due to restatements, errors or omissions.)

Section 2

- Other custodial statements
- All bank accounts
- Managers' reports
- Petty cash

Section 2

- Completeness
- Internal consistency
- Agreement with General Ledger
- Agreement with custodial report
- Agreement with active and pooled fund managers' reports

PERAC has a checklist used by auditors to check for internal consistency. A copy is available to you upon request for your own use as a proofing tool before submission.

Section 3 Accounting

- Receipts/disbursements
- Appropriations
- Expenses
- Pooled funds
- Pre-close through post-close
- Changes in fund balances
- Annuity Savings Fund (ASF), Military Service Fund (MSF), and Annuity Reserve Fund (ARF) interest

PERAC appropriation letters include amounts that you may transfer from the Pension Reserve Fund to the Pension Fund in order to keep the latter from a debit (overdrawn) status. If you require additional transfers, check appropriation letters for previously approved but unused transfer amounts or contact the PERAC actuary.

Section 4 Membership

- Active members
- Refunds/transfers out
- 10-year inactive transfers to ARF
- Superannuation retirees
- Disability retirees
- Benefit verifications

Auditors choose a *representative*, as opposed to a completely *random*, sample of a significant percentage of your database. We randomly select many names from within each category; however, auditors are careful to include a good representation across all factors which might not be provided by a truly random sample.

What do auditors look for?

- Deduction rates
- 2% over \$30,000
- Buyback calculations
- Interest refunded/not refunded
- Federal withholding tax
- Deduction election for members aged 70
- Categories of regular compensation

What do auditors look for?

- Retirement calculations
- 2 birth certificates and marriage certificate for Option C retirees
- Workers' Compensation offsets
- ASF balance/creditable service
- Remands and 91A non-responders
- And more!

Section 5 System Administration

- Minutes through the present
- Executive Session minutes
- Board member attendance
- Best practices
- Internal controls

Open Meeting Law guidelines may be found on the Attorney General's website <http://www.mass.gov/Cago/docs/Government/openmtgguide.pdf>. Legal requirements pertaining to Minutes and Executive Sessions are discussed in this document.

Section 6 Fiduciary Bonding

840 CMR 17.01
10% or \$500,000 minimum
Liability vs. employee dishonesty

PERAC regulation 840 CMR 17.01 requires board members and system staff be bonded against losses due to fraud and dishonesty, with minimum coverage of 10% of fund assets or \$500,000.

Section 7 Investments

- Coordinate with Investment Unit
- Custodian, consultants and managers
- Quarterly and annual reporting
- RFP process
- Prohibited investments

After January 13, 1998, the investment in companies that derive more than 15% of their income from tobacco is prohibited. Systems that hold these investments prior to January 13, 1998 are not required to divest. However, if the investment was made after January 13, 1998, the system must divest.

Section 8 Contracts

- Investment managers
- Consultant
- Custodian
- Software/hardware/support vendors
- Other vendors

The auditors will check that you have signed copies of all contracts on file.



An audit requires a good deal of time and large number of documents and files to review. The audit process should be a helpful exercise for you.

Auditors will bring you their questions and concerns for clarification as they proceed. You will be kept informed as the audit proceeds.

The Exit Conference

- Auditors present draft findings
- Attendees: board chairperson, administrator, other board members
- If quorum, public meeting
- Full and free discussion

At the conference, auditors present their findings and comments, which can be freely discussed by all present. Findings may be modified as a result of this discussion. The resulting findings will be published in the draft audit document.

“Comments and other observations” within the exit document do not reach the level of a finding but are nonetheless significant and should, like findings, be addressed.

Circulation of the Draft Audit Report

- Circulated among all PERAC units
- Final draft provided to the board
- Board discusses at next board meeting
- Responses due 2 weeks later
- Board's written responses included verbatim

Final Audit Report

- Issued to the board
- Published on PERAC's website

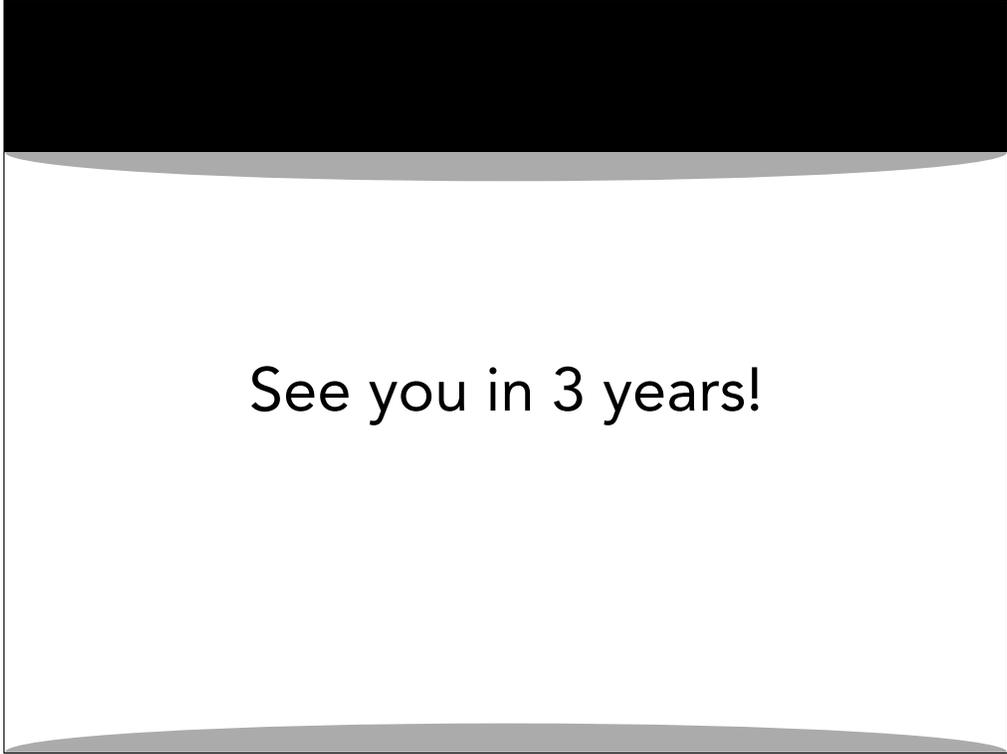
If no issues/concerns, the audit process ends.

If, however, there are findings in your report...



6 Month Follow-up

6 months after publication of your final audit report, your audit team will conduct a follow-up visit during which the auditors will examine your findings to see what corrective actions have been taken. PERAC will send a letter to your board summarizing each issue and whether each has been resolved.



See you in 3 years!