

PERAC AUDIT REPORT



PRIM Contributory
Retirement System



JAN. 1, 2004 - DEC. 31, 2007



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COMMONWEALTH OF MASSACHUSETTS | PUBLIC EMPLOYEE RETIREMENT ADMINISTRATION COMMISSION

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JOSEPH E. CONNARTON, *Executive Director*

April 27, 2009

The Public Employee Retirement Administration Commission has completed an examination of the Massachusetts Pension Reserves Investment Management (PRIM) Board, as Trustee of the Massachusetts Pension Reserves Investment Trust (PRIT) Fund, pursuant to G.L. c. 32, § 21. The examination covered the period from July 1, 2004 to June 30, 2007. This audit was conducted in accordance with the accounting and management standards established by the Public Employee Retirement Administration Commission in regulation 840 CMR 25.00.

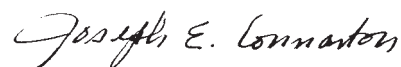
The scope of this audit was to review and analyze the internal controls over administrative and operating costs and to review the Board's internal policies and management functions. Such review was determined by an Attorney General's opinion issued on May 29, 2001, and did not include the investment practices of the Board and therefore expresses no opinion on them. The completion of this audit was conducted in compliance with the 2001 Attorney General's opinion.

In our opinion, the financial records are being maintained and the management functions are being performed in conformity with the standards established by the Public Employee Retirement Administration Commission.

We commend the PRIM Board for its exemplary operation.

In closing, I acknowledge the work of examiners James Tivnan and Carol Niemira who conducted this examination, and express appreciation to the PRIM Board, its Executive Director and staff for their courtesy and cooperation.

Sincerely,



Joseph E. Connarton
Executive Director



STATEMENT OF POOLED NET ASSETS
(000 Omitted)

	AS OF JUNE 30,		
	2007	2006	2005
Assets:			
Cash	\$167,761	\$132,429	\$78,637
Short Term Investments	1,540,446	987,933	908,415
Fixed Income Securities	11,730,829	10,953,340	8,720,414
Equities	23,828,318	19,459,607	18,842,512
Real Estate	4,828,582	5,134,353	4,068,141
Timber	1,637,474	1,502,234	1,330,179
Alternative Investments	3,199,521	2,662,094	2,106,913
Hedge Fund to Fund Investments	4,595,755	2,114,115	1,726,255
Interest and Dividends Receivable	136,695	132,871	124,527
Receivable for Investments Sold	367,723	177,557	180,944
Securities Sold on a When-Issued Basis	948,947	25,575	241,004
Unrealized Gains on Foreign Currency			
Exchange Contracts	6,050	5,046	20,712
Margin Variation Receivable	0	14,889	0
Other Receivable	3,242	3,479	11,374
Total Assets	<u>\$52,991,343</u>	<u>\$43,305,522</u>	<u>\$38,360,027</u>
Liabilities:			
Payable for Investments Purchased	\$387,521	\$338,068	\$258,879
Securities Purchased on a When-Issued Basis	1,591,779	413,308	579,751
Obligations under Securities Lending			
Transactions	451,970	451,872	1,103,887
Unrealized Losses on Foreign Currency			
Exchange Contracts	8,155	9,457	2,944
Margin Variation Payable	1,791	0	1,601
Management Fees Payable to PRIM	151,993	167,766	92,758
Total Liabilities	<u>\$2,593,209</u>	<u>\$1,380,471</u>	<u>\$2,039,820</u>
Net Assets Held in Trust for Pool Participants	<u>\$50,398,134</u>	<u>\$41,925,051</u>	<u>\$36,320,207</u>

NOTES TO FINANCIAL STATEMENTS

PRIM/PRIT FUND OVERVIEW

The Pension Reserves Investment Management (PRIM) Board was created by the state legislature (Chapter 66I of the Acts of 1983). The PRIM Board consists of nine members including statutorily designated appointments of the governor and state treasurer, one member of each of the State Employees' and State Teachers' Retirement Boards, and elected members. The Treasurer serves as its chair. The Board is charged with the general supervision of the Pension Reserves Investment Trust (PRIT) Fund, which was established by the same act of the legislature and is governed by a declaration of trust adopted by the Board and subject to approval of the legislature.

The PRIT Fund was created with a mandate to accumulate assets through investment earnings and other revenue sources in order to reduce the Commonwealth's significant unfunded pension liability, and to assist local participating retirement systems in meeting their future pension obligations. The PRIT Fund merged with the Massachusetts State Teachers' and Employees' Retirement System (MASTERS) Trust on January 1, 1997, in accordance with Chapter 315 of the Acts of 1996.

The PRIT Fund is a pooled investment vehicle which invests not only the assets of the Teachers' and Employees' Retirement Systems, but also the assets of Massachusetts county, authority, district, and municipal retirement systems that choose to or are mandated to invest in the Fund. Chapter 68 of the Acts of 2007 provided that any system which underperforms relative to the PRIT Fund by at least 2% on an annualized basis over 10 years and is less than 65% funded must transfer its assets into the PRIT Fund permanently. If any system deemed underperforming had voluntarily transferred its assets into the Fund by October 1, 2007, that system retains the right to revoke its participation after five years.

Pursuant to G.L. c. 32, § 23(2A)(e), the Board has authority to employ an Executive Director, outside investment managers, custodians, consultants, and other professionals it deems necessary to formulate policies and procedures and to take other actions as deemed necessary and appropriate to manage the assets of the Fund. The Board acts as trustee for each retirement system that invests in the PRIT Fund and is therefore a fiduciary. Accordingly, under G.L. c. 32 § 23 and 840 CMR 1.00, it is required to:

1. Act solely in the interest of the participating retirement systems' members and beneficiaries, for the exclusive purpose of providing benefits and defraying the reasonable costs of managing the systems' pension assets.
2. Act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.

NOTES TO FINANCIAL STATEMENTS (Continued)

3. Diversify the investments of the PRIT Fund in order to minimize the risks of large losses unless under the circumstances it is clearly prudent not to do so.

4. Act in accordance with the PRIT Fund's authorizing statute and governing documents.

Pursuant to G.L. c. 32 § 1, fiduciary standards of conduct also apply to PRIM's staff, investment managers, custodians, investment consultants, and others who exercise discretionary authority or discretionary control over the management or disposition of PRIT Fund assets. The Board is responsible for establishing the policies and guidelines by which the PRIT Fund is managed and PRIM is operated. To assist the Board in carrying out its duties, it has established three standing committees as described below. Pursuant to the By-Laws of the Massachusetts PRIM, Article II, § 8, the role of each committee is to make recommendations to the Board within its stated area of responsibility. Members of the committees shall be appointed by the chairperson after consultation with other Board members and shall be ratified by Board vote. Such committees may include, at the option of the Board, representatives from PRIM's participating or purchasing systems or from the investment or business community.

Administration and Audit Committee. The Committee reviews all issues related to the administration of PRIM. As such, its responsibilities include but are not limited to: recommending amendments to the PRIT Fund's Operating Trust and the By-Laws of PRIM; authorizing and eliminating staff positions; establishing a staff salary structure; conducting Executive Director evaluations; and overseeing the custodian of the PRIT Fund's assets, the PRIM operating budget and financial statements, staff and Board member travel, and office management. The Committee also oversees the annual audits of the PRIT Fund and PRIM, including the selection and hiring of auditors, the review of the completed audits, and the PRIM staff's responses to auditors' findings.

Investment Committee. The Investment Committee reviews all investment-related policy, performance, and management issues. The Investment Committee reviews and recommends the broad asset allocation among various asset classes. For all asset classes other than real estate and timber, the committee also reviews and recommends investment structure, recommends hiring and terminating investment managers and consultants, and monitors investment performance.

Real Estate and Timber Committee. The Real Estate and Timber Committee reviews all policy, performance and management issues related to investment in real estate and timber. The Real Estate and Timber Committee reviews and recommends the structure of the real estate and timber asset class, hiring and terminating real estate and timber investment managers and consultants, and acquiring or disposing of properties where this authority is not delegated to another fiduciary. The Real Estate and Timber Committee also monitors real estate and timber investment results and real estate and timber manager performance and organizational issues.

The Executive Director, with the assistance of PRIM staff, has the responsibility and authority to assist the Board and its committees in establishing investment and administrative policy; to implement the policies and programs established by the Board; and to report to the Board on the status of the PRIT Fund and the operations of PRIM.

NOTES TO FINANCIAL STATEMENTS (Continued)

The Board employs professional investment managers and gives them discretion, consistent with specified objectives and guidelines, to manage the PRIT Fund's assets. The Board and PRIM staff do not directly manage any PRIT Fund portfolios. Each investment manager operates under a formal contract that delineates responsibilities and performance expectations, including formal investment guidelines and administrative requirements for each portfolio. The Board reviews the investment performance of all managers against their stated objectives at least quarterly.

The Board may utilize the services of one or more investment management consultants to assist the Board and PRIM staff in performance review, asset allocation studies, investment structure analyses, manager screening and selection, investment research and other matters of investment policy, procedures, and implementation. The analysis and recommendations of the consultants may be considered by the Board in conjunction with other available information for the purpose of making informed and prudent decisions.

The Board may retain one or more custodian banks or trust institutions to hold the assets of the PRIT Fund. The custodian accounts for and assists in the settlement of all transactions executed by PRIM's investment managers and makes available to the Board and to PRIM staff information with respect to the holdings, transactions, and performance of the PRIT Fund. Currently, custodian services are provided by BNY Mellon Corp.

The Board may utilize the services of independent auditors, appraisers and other third parties, as needed. Currently, the annual audit is provided by KPMG LLP.

PRIM's mission is to maximize the return on investment within acceptable levels of risk by broadly diversifying the PRIT Fund's investment portfolio, capitalizing on economies of scale to achieve cost-effective operations, and providing access to high quality, innovative investment management firms, all under the management of a professional staff and members of the Board.

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