

PERAC AUDIT REPORT



Somerville

Contributory Retirement System



JAN. 1, 2008 - DEC. 31, 2009



TABLE OF CONTENTS

| | |
|--|----|
| Letter from the Executive Director | 1 |
| Explanation of Findings and Recommendations..... | 2 |
| Statement of Ledger Assets and Liabilities..... | 6 |
| Statement of Changes in Fund Balances | 7 |
| Statement of Receipts..... | 8 |
| Statement of Disbursements..... | 9 |
| Investment Income | 10 |
| Schedule of Allocation of Investments Owned..... | 11 |
| Supplementary Investment Regulations | 12 |
| Notes to Financial Statements: | |
| Note 1 - Summary of Plan Provisions | 13 |
| Note 2 - Significant Accounting Policies | 20 |
| Note 3 - Supplementary Membership Regulations..... | 22 |
| Note 4 - Administration of the System | 24 |
| Note 5 - Actuarial Valuation and Assumptions..... | 25 |
| Note 6 - Membership Exhibit..... | 26 |

PERAC

COMMONWEALTH OF MASSACHUSETTS | PUBLIC EMPLOYEE RETIREMENT ADMINISTRATION COMMISSION

DOMENIC J. F. RUSSO, *Chairman* | A. JOSEPH DeNUCCI, *Vice Chairman*
PAUL V. DOANE | JAMES M. MACHADO | DONALD R. MARQUIS | ROBERT B. McCARTHY | GREGORY R. MENNIS

JOSEPH E. CONNARTON, *Executive Director*

August 18, 2011

The Public Employee Retirement Administration Commission has completed an examination of the Somerville Retirement System pursuant to G.L. c. 32, § 21. The examination covered the period from January 1, 2008 to December 31, 2009. 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. Additionally, all supplementary regulations approved by PERAC and on file at PERAC are listed in this report.

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 with the exception of those noted in the findings presented in this report.

In closing, I acknowledge the work of examiners James Sweeney, Martin Feeney and James Tivnan who conducted this examination, and express appreciation to the Board of Retirement and staff for their courtesy and cooperation.

Sincerely,



Joseph E. Connarton
Executive Director



EXPLANATION OF FINDINGS AND RECOMMENDATIONS

I. System Expenses

During a review of the expenses of the system, it was observed that the purchasing process in effect during the audit period did not conform to the best practices of retirement systems subject to Chapter 32 of Massachusetts General Law. The Somerville Board regularly reimbursed a staff employee personally for the purchase of office supplies charged to that employee's personal credit card. We noted the vendor listed the invoice in the name of the Somerville Retirement System. Many purchases were initiated on-line that involved the use of coupons and discounts based on the total value of the order. The process involved the procurement of items that did not appear to have a legitimate business purpose. These items were obtained at no additional cost. They were distributed either within the system or among the staff for personal use. The staff asserts that the net cost of office supplies ordered in this manner is competitive with similar vendor pricing available to the system.

Our inspection of supporting invoices noted that a vendor included sales tax on many purchases during the audit period. The Somerville Retirement System should be exempt from sales tax.

Recommendation: A purchasing system that includes free or promotional items made available to the staff and system must not compromise the most economical pricing mechanism. All property acquired by the system must remain the property of the system. Direct reimbursement to an individual for routine purchases of office supplies does not provide an adequate audit trail from requisition to purchase through vendor payment. We understand a new policy is now in effect since the end of the audit period involving only vendors approved by the City of Somerville and direct payments to them from the Somerville Retirement System.

The Board must design a formal approval process from requisition to purchase of any item for use by the system through delivery; inventory and payment. The current system relies too heavily on the ratification of purchases already acquired and disclosed at the monthly Board meeting on the warrant. This process does not allow for an orderly review of the sequence for acquiring items and verification of invoice charges and items delivered.

Board Response:

Prior to this current PERAC audit, the Somerville Retirement Board (SRB) audited its internal procurement system as part of a comprehensive review of the operations and functions within the Somerville Retirement System (SRS). A new policy was implemented whereby the Procurement Officer (also serves as the Systems Accountant) will purchase office supplies from vendors approved by the SRB with a total limit of \$300.00. Purchase invoices are then reviewed by the SRB before being approved for payment. Competitive quotes from vendors are required for most office supplies. Any individual purchase above \$300.00 must be approved prior to purchase by the SRB and use of a personal credit card to purchase office supplies has been discontinued.

EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

2. Board Travel Expenses

Travel expenses are not submitted on an official expense reimbursement form. Itemized charges and receipts are required to substantiate the dates and purpose for the expense, unless the per diem policy applies. The established Board policy provides for two levels of per diem; \$50 daily for travel within the state and \$75 daily for travel to out-of-state locations. The per diem policy is designed to alleviate the collection of specific receipts. However, general documentation relating to the date and purpose for the reimbursement must be retained. PERAC auditors were unable to determine if the per diem policy applied to events when meals were supplied by a sponsor. The charges reimbursed for the event attended did not reference the meal options available. In the absence of actual receipts or appropriate documentation, the legitimacy of the per diem reimbursements could not be substantiated. In several instances, inquiries designed to clarify the travel expenses were directed to the Board member. This confirms that disclosures relating to travel reimbursement remain largely within the discretion of Board members and are not subject to staff or full Board scrutiny.

Recommendation: The Board must conform to PERAC's travel regulations as detailed in 840 CMR 2.00. The Board may adopt additional supplemental regulations to expand upon these regulations. Such regulations must be submitted to PERAC for review and approval as required by the provisions of G.L. c. 7, § 50 and c. 32, § 21 (4).

Board members must submit travel vouchers with detailed receipts, so that dates, amounts and the business purpose can be validated. The System is required to closely review requests for travel reimbursement. The Board must ensure that all vouchers are supported by detailed invoices before approving payment. A more comprehensive reimbursement form must be adopted. This new form should disclose the potential benefit or business purpose of the travel, which must be approved by the Board in advance and be supported with adequate documentation for all reimbursements. The person requesting reimbursement must certify the submission under the pains and penalties of perjury.

The per diem reimbursement policy should be reevaluated. Most restaurants can provide itemized bills with payment receipt. Such detail will ensure that only meals consumed are reimbursed and prohibited items are eliminated. PERAC will not authorize per diem reimbursement if meals are included in the cost of an event.

Board Response:

The SRB's existing policy of reviewing all travel expenses will be modified to require receipts for meals and per diem reimbursements up to \$50 per day for in-State conferences and \$75 per day for out-of-State conferences where meals are not provided by the host of the conferences. This finding is duly noted.

EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

3. Bank Reconciliations

All three bank accounts (Checking; Retiree Payroll and Money Market) have been reconciled on a regular basis using a consistent process for the audit period. However, the reconciliation only confirms the transaction activity recorded on the bank statement. We noted the general ledger cash account balance did not agree with the cash balance used to reconcile with the bank balance noted on the reconciliation forms. The auditors noted unexplained variances between the adjusted bank balance and the general ledger of \$57,780.20 for the Money Market account and \$503.43 for the Checking account. The staff cited transactions posted to the general ledger that were not apparent until inquiries related to these differences were made by the auditors.

Recommendation: Incorrect and unreliable bank reconciliations are a serious internal control weakness. All differences between the transactions recorded in the general ledger and those noted in the bank statement must be identified and disclosed in the reconciliation process. In order to strengthen internal controls, the bank reconciliations must include the general ledger cash balances. These numbers must be accurate, reliable and communicated directly to the person completing the formal reconciliation. The Board must inspect and review the reconciliations on a monthly basis and all timing differences noted on these records must be thoroughly described.

Board Response:

An information technology (IT) issue existed with Tyler Technologies' RET32 accounting software. While the SRS Systems Accountant continued to work with Tyler on the issue, the audit ended and this finding was issued. The matter has since been resolved and a letter from Tyler Technologies to the SRB affirms the Systems Accountant's position on this issue.

4. Annuity Reserve Fund

The 2009 Annuity Reserve Fund interest calculation was understated by \$27,273.26. As a result, the 12/31/09 ending balance of the Annuity Reserve Fund, which was reported as \$16,612,995.05, was understated. The actual balance should have been \$16,640,268.81. These differences resulted primarily from the timing of the actual posting of retirement transactions as recorded in the general ledger and the transactions used in the formula supporting the calculation of the interest applied to the Annuity Reserve Fund.

Recommendation: An adjusting entry of \$27,273.26 is required to correct the January 1, 2010 Annuity Reserve Fund balance by the amount of understated interest recorded to the Annuity Reserve Fund for the year 2009. The beginning balance of the Annuity Reserve Fund on January 1, 2010 should be \$16,640,268.81. The staff should ensure that this amount is used as the beginning balance when calculating the current year's (2010's) Annuity Reserve Fund interest so that both the 2010 Annuity Reserve Interest and the 2010 ending balance of the Annuity Reserve Fund are correct.

Board Response:

The SRS Systems Accountant has made the required adjustments and implemented this correction immediately to the 2010 cashbooks. This finding is duly noted.

EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

5. Appropriations

The total of the 12/31/09 General Ledger Appropriation balance of \$10,197,346.80 and the 2009 Accounts Receivable balance of \$2,871,946.83 are understated by \$848,696.20. The 12/31/09 General Ledger Appropriation balance should be \$11,046,043. A journal entry of \$2,434,140.80 made on 12/30/09 to the Appropriation and Accounts Receivable Accounts was not correct. The journal entry should have been \$3,282,837. On 1/7/10 a cash receipt for Fiscal Year 2010 in the amount of \$3,352,352 was received from the City of Somerville. \$2,434,140.80 was credited to Accounts Receivable and the balance was credited to the Appropriation Account. This resulted in the general ledger reporting overpayments from the governmental units in Fiscal Year 2010 and underpayments for Fiscal Year 2011.

Recommendation: Prior to the close of each year and prior to the booking of any journal entry, the activity in the Appropriation Account and the actual cash receipts related to Appropriations should be reviewed. The total of the cash receipts shown in the Appropriations Account and the journal entry to be made for anticipated receipts in the accounts receivable ledger account should equal the amount disclosed in the Appropriations letter issued by PERAC. This will ensure that appropriations reported in the General Ledger are accurate.

Board Response:

The SRS Systems Accountant detailed this issue to the SRB in May 2010 and made the necessary corrections, ensuring the entire transaction would be transparent to PERAC auditors. This finding is duly noted.

6. System Administration

Our review of the administration by the Board identified the established contractual and statutory obligations that are unique to the Somerville Retirement System. The staffing structure operates under the provisions of G.L. c. 150E, Collective Bargaining and G.L. c.31, Civil Service. These provide for union representation of civil service positions as well as for one non-civil service position. This is in contrast to most all other public retirement systems throughout the Commonwealth where the staff is under the direct control and subject to Board decisions based upon the fiscal autonomy granted under G.L. c. 32.

Another distinct factor in the administration of the Board can be found in the current board membership make-up. Staff members are not excluded by law from serving as elected Board members. The Somerville Board Administrator also serves on the Board in an elected position and appears to accept both roles with due diligence. The dual responsibilities inherent in these related but converse positions could result in a weakness in the existing system of internal controls if not conducted with discretion. A recent Board election for this position was contested by another staff member. The ultimate result of that election appears to have created certain internal disruption to the administration of the Board. Since the end of the audit period, the staff accountant position held by a candidate in recent election has been reorganized to report directly to the Board. The current organization is administered by a structure not based upon clear lines of authority and

EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

responsibility. The results of this current audit are in part a repudiation of the current structure. These circumstances call for a reevaluation of the system administration.

Recommendation: The Board must establish a formal management chart and a written manual that explicitly identifies the rules, rights, responsibilities and functions of the Somerville Retirement System staff. Specific duties, supervisory lines of organization and how the staff interacts with the Board must be clarified. The process of documenting the existing system of internal control over financial transactions must be included in this procedure. We informed Board members in the past that specific case law has determined that G.L. c. 32 provides to retirement boards the authority that precludes the City from being a G.L. c.150E employer of retirement board employees (Labor Relations Commission – City of Brockton and Brockton City Administrative Services Association and Brockton Retirement Board 1992). Our intent is to eliminate confusion among the staff; the administrator and the Board members. The system must develop its operating policies while maintaining its autonomy from existing city departments.

Board Response:

The SRB will examine model management structures in other Retirement Systems and consider necessary changes. As recommended, the SRB will establish a formal management chart and a written manual that explicitly identifies the rules, rights, responsibilities and functions of the SRS staff. As recommended, the manual will document the specific duties, supervisory lines of organization and how the staff should interact with the SRB. The SRB has already begun the process of changing the flow of financial transactions to ensure greater accountability. The SRB recognizes the need to document the system of internal controls over financial transactions.

FINAL DETERMINATION:

PERAC Audit staff will follow up in six (6) months to ensure appropriate actions have been taken regarding all findings.

STATEMENT OF LEDGER ASSETS AND LIABILITIES

| | AS OF DECEMBER 31, | |
|---|----------------------|----------------------|
| | 2009 | 2008 |
| Net Assets Available For Benefits: | | |
| Cash | \$1,240,508 | \$1,193,092 |
| Fixed Income Securities | 7,339,001 | 7,347,820 |
| Equities | 73,922,588 | 55,199,404 |
| Pooled Domestic Equity Funds | 5,484,427 | 6,705,492 |
| Pooled International Equity Funds | 9,976,815 | 7,640,887 |
| Pooled Domestic Fixed Income Funds | 49,560,407 | 36,482,998 |
| Pooled Real Estate Funds | 12,699,327 | 17,896,989 |
| PRIT Cash Fund | 0 | 0 |
| PRIT Core Fund | 0 | 0 |
| Interest Due and Accrued | 84,355 | 109,929 |
| Accounts Receivable | 3,720,643 | 5,491,211 |
| Accounts Payable | (68,410) | (10,365) |
| Total | <u>\$163,959,660</u> | <u>\$138,057,458</u> |
| Fund Balances: | | |
| Annuity Savings Fund | \$56,127,842 | \$53,511,231 |
| Annuity Reserve Fund | 16,640,268 | 16,706,406 |
| Pension Fund | 2,401,546 | 4,480,561 |
| Military Service Fund | 44,280 | 38,230 |
| Expense Fund | 0 | 0 |
| Pension Reserve Fund | 88,745,725 | 63,321,030 |
| Total | <u>\$163,959,660</u> | <u>\$138,057,458</u> |

STATEMENT OF CHANGES IN FUND BALANCES

| | Annuity Savings Fund | Annuity Reserve Fund | Pension Fund | Military Service Fund | Expense Fund | Pension Reserve Fund | Total All Funds |
|--------------------------|----------------------|----------------------|--------------------|-----------------------|--------------|----------------------|----------------------|
| Beginning Balance (2008) | \$50,601,299 | \$16,582,249 | \$4,542,183 | \$38,650 | \$0 | \$118,471,204 | \$190,235,585 |
| Receipts | 5,715,784 | 491,608 | 13,454,357 | 199 | 1,045,852 | (51,415,967) | (30,708,167) |
| Interfund Transfers | (1,953,937) | 1,927,510 | 3,761,253 | (619) | 0 | (3,734,208) | 0 |
| Disbursements | (851,915) | (2,294,961) | (17,277,232) | 0 | (1,045,852) | 0 | (21,469,960) |
| Ending Balance (2008) | 53,511,231 | 16,706,406 | 4,480,561 | 38,230 | 0 | 63,321,030 | 138,057,458 |
| Receipts | 5,665,892 | 466,037 | 11,916,187 | 191 | 999,858 | 29,201,445 | 48,249,610 |
| Interfund Transfers | (2,045,745) | 2,045,745 | 3,770,892 | 5,858 | 0 | (3,776,750) | 0 |
| Disbursements | (1,003,535) | (2,577,921) | (17,766,094) | 0 | (999,858) | 0 | (22,347,408) |
| Ending Balance (2009) | <u>\$56,127,842</u> | <u>\$16,640,268</u> | <u>\$1,552,849</u> | <u>\$44,280</u> | <u>\$0</u> | <u>\$88,772,998</u> | <u>\$163,959,660</u> |

STATEMENT OF RECEIPTS

| | FOR THE PERIOD ENDING DECEMBER 31, | |
|---|---------------------------------------|------------------------------|
| | 2009 | 2008 |
| Annuity Savings Fund: | | |
| Members Deductions | \$5,275,092 | \$5,075,213 |
| Transfers from Other Systems | 96,431 | 332,682 |
| Member Make Up Payments and Re-deposits | 30,708 | 15,952 |
| Member Payments from Rollovers | 5,349 | 0 |
| Investment Income Credited to Member Accounts | <u>258,312</u> | <u>291,937</u> |
| Sub Total | <u>5,665,892</u> | <u>5,715,784</u> |
| Annuity Reserve Fund: | | |
| Investment Income Credited to the Annuity Reserve Fund | <u>466,037</u> | <u>491,608</u> |
| Pension Fund: | | |
| 3 (8) (c) Reimbursements from Other Systems Received from Commonwealth for COLA and Survivor Benefits | 242,479 | 261,258 |
| | 596,556 | 667,362 |
| Pension Fund Appropriation | 11,046,043 | 12,488,135 |
| Settlement of Workers' Compensation Claims | <u>31,109</u> | <u>37,602</u> |
| Sub Total | <u>11,916,187</u> | <u>13,454,357</u> |
| Military Service Fund: | | |
| Contribution Received from Municipality on Account of Military Service | 0 | 0 |
| Investment Income Credited to the Military Service Fund | <u>191</u> | <u>199</u> |
| Sub Total | <u>191</u> | <u>199</u> |
| Expense Fund: | | |
| Expense Fund Appropriation | 0 | 0 |
| Investment Income Credited to the Expense Fund | <u>999,858</u> | <u>1,045,852</u> |
| Sub Total | <u>999,858</u> | <u>1,045,852</u> |
| Pension Reserve Fund: | | |
| Federal Grant Reimbursement | 132,837 | 92,481 |
| Pension Reserve Appropriation | 0 | 0 |
| Interest Not Refunded | 2,006 | 3,661 |
| Miscellaneous Income | 126 | 0 |
| Excess Investment Income (Loss) | <u>29,066,476</u> | <u>(51,512,109)</u> |
| Sub Total | <u>29,201,445</u> | <u>(51,415,967)</u> |
| Total Receipts, Net | <u>\$48,249,610</u> | <u>(\$30,708,167)</u> |

STATEMENT OF DISBURSEMENTS

| | FOR THE PERIOD ENDING DECEMBER 31, | |
|--|---------------------------------------|---------------------|
| | 2009 | 2008 |
| Annuity Savings Fund: | | |
| Refunds to Members | \$555,285 | \$455,443 |
| Transfers to Other Systems | <u>448,251</u> | <u>396,473</u> |
| Sub Total | <u>1,003,535</u> | <u>851,915</u> |
| Annuity Reserve Fund: | | |
| Annuities Paid | 2,395,813 | 2,280,881 |
| Option B Refunds | <u>182,108</u> | <u>14,080</u> |
| Sub Total | <u>2,577,921</u> | <u>2,294,961</u> |
| Pension Fund: | | |
| Pensions Paid: | | |
| Regular Pension Payments | 11,465,761 | 11,217,422 |
| Survivorship Payments | 581,401 | 602,779 |
| Ordinary Disability Payments | 102,320 | 109,726 |
| Accidental Disability Payments | 2,962,429 | 2,731,715 |
| Accidental Death Payments | 1,300,176 | 1,376,453 |
| Section 101 Benefits | 31,500 | 33,925 |
| 3 (8) (c) Reimbursements to Other Systems | 626,888 | 0460,034 |
| State Reimbursable COLA's Paid | 621,032 | 666,486 |
| Section 90 A, C, D Paid | <u>74,587</u> | <u>78,691</u> |
| Sub Total | <u>17,766,094</u> | <u>17,277,232</u> |
| Military Service Fund: | | |
| Return to Municipality for Members Who Withdrew Their Funds | <u>0</u> | <u>0</u> |
| Expense Fund: | | |
| Board Member Stipend | 18,000 | 18,000 |
| Salaries | 233,939 | 237,596 |
| Legal Expenses | 5,828 | 14,713 |
| Medical Expenses | 201 | 0 |
| Travel Expenses | 5,353 | 9,139 |
| Administrative Expenses | 46,227 | 27,357 |
| Professional Services | 0 | 0 |
| Education and Training | 0 | 0 |
| Furniture and Equipment | 608 | 103 |
| Management Fees | 657,639 | 706,578 |
| Custodial Fees | 31,247 | 31,550 |
| Consultant Fees | 0 | 0 |
| Rent Expenses | 0 | 0 |
| Service Contracts | 490 | 490 |
| Fiduciary Insurance | <u>326</u> | <u>326</u> |
| Sub Total | <u>999,858</u> | <u>1,045,852</u> |
| Total Disbursements | <u>\$22,347,408</u> | <u>\$21,469,960</u> |

INVESTMENT INCOME

| | FOR THE PERIOD ENDING DECEMBER 31, | |
|---|---------------------------------------|-----------------------|
| | 2009 | 2008 |
| Investment Income Received From: | | |
| Cash | \$41,313 | \$99,851 |
| Short Term Investments | 0 | 442 |
| Fixed Income | 543,915 | 514,435 |
| Equities | 921,812 | 1,011,650 |
| Pooled or Mutual Funds | 3,641,738 | 4,902,656 |
| Commission Recapture | 0 | 0 |
| Total Investment Income | <u>5,148,778</u> | <u>6,529,033</u> |
| Plus: | | |
| Realized Gains | 1,117,539 | 1,700,795 |
| Unrealized Gains | 36,954,256 | 1,072,570 |
| Interest Due and Accrued - Current Year | 84,355 | 109,929 |
| Sub Total | <u>38,156,150</u> | <u>2,883,293</u> |
| Less: | | |
| Paid Accrued Interest on Fixed Income Securities | (20,300) | (38,421) |
| Realized Loss | (2,520,407) | (9,207,990) |
| Unrealized Loss | (9,863,418) | (49,751,790) |
| Interest Due and Accrued - Prior Year | (109,929) | (96,637) |
| Sub Total | <u>(12,514,054)</u> | <u>(59,094,839)</u> |
| Net Investment Income (Loss) | <u>30,790,875</u> | <u>(49,682,513)</u> |
| Income Required: | | |
| Annuity Savings Fund | 258,312 | 291,937 |
| Annuity Reserve Fund | 466,037 | 491,608 |
| Military Service Fund | 191 | 199 |
| Expense Fund | 999,858 | 1,045,852 |
| Total Income Required | <u>1,724,399</u> | <u>1,829,596</u> |
| Net Investment Income (Loss) | <u>30,790,875</u> | <u>(49,682,513)</u> |
| Less: Total Income Required | 1,724,399 | 1,829,596 |
| Excess Income (Loss) To The Pension Reserve Fund | <u>\$29,066,476</u> | <u>(\$51,512,109)</u> |

SCHEDULE OF ALLOCATION OF INVESTMENTS OWNED

(percentages by category)

| AS OF DECEMBER 31, 2009 | | |
|------------------------------------|-----------------------------|----------------------------------|
| | MARKET VALUE | PERCENTAGE OF TOTAL ASSETS |
| Cash | \$1,240,508 | 0.8% |
| Fixed Income | 7,339,001 | 4.6% |
| Equities | 73,922,588 | 46.1% |
| Pooled Domestic Equity Funds | 5,484,427 | 3.4% |
| Pooled International Equity Funds | 9,976,815 | 6.2% |
| Pooled Domestic Fixed Income Funds | 49,560,407 | 30.9% |
| Pooled Real Estate Funds | 12,699,327 | 7.9% |
| PRIT Cash Fund | 0 | 0.0% |
| PRIT Core Fund | 0 | 0.0% |
| Grand Total | <u>\$160,223,072</u> | <u>100.0%</u> |

For the year ending December 31, 2009, the rate of return for the investments of the Somerville Retirement System was 22.63%. For the five-year period ending December 31, 2009, the rate of return for the investments of the Somerville Retirement System averaged 3.93%. For the 25-year period ending December 31, 2009, since PERAC began evaluating the returns of the retirement systems, the rate of return on the investments of the Somerville Retirement System was 8.75%.

The composite rate of return for all retirement systems for the year ending December 31, 2009 was 18.22%. For the five-year period ending December 31, 2009, the composite rate of return for the investments of all retirement systems averaged 3.97%. For the 25-year period ending December 31, 2009, since PERAC began evaluating the returns of the retirement systems, the composite rate of return on the investments of all retirement systems averaged 9.30%.

SUPPLEMENTARY INVESTMENT REGULATIONS

The Somerville Retirement System has not submitted supplementary investment regulations to the Public Employee Retirement Administration Commission.

NOTES TO FINANCIAL STATEMENTS

NOTE I – SUMMARY OF PLAN PROVISIONS

The plan is a contributory defined benefit plan covering all Somerville Retirement System member unit employees deemed eligible by the retirement board, with the exception of school department employees who serve in a teaching capacity. The Teachers' Retirement Board administers the pensions of such school employees.

ADMINISTRATION

There are 105 contributory Retirement Systems for public employees in Massachusetts. Each system is governed by a retirement board, and all boards, although operating independently, are governed by Chapter 32 of the Massachusetts General Laws. This law in general provides uniform benefits, uniform contribution requirements, and a uniform accounting and funds structure for all systems.

PARTICIPATION

Participation is mandatory for all full-time employees. Eligibility with respect to part-time, provisional, temporary, seasonal, or intermittent employment is governed by regulations promulgated by the retirement board, and approved by PERAC. Membership is optional for certain elected officials.

There are 3 classes of membership in the Retirement System:

Group 1:

General employees, including clerical, administrative, technical, and all other employees not otherwise classified.

Group 2:

Certain specified hazardous duty positions.

Group 4:

Police officers, firefighters, and other specified hazardous positions.

NOTES TO FINANCIAL STATEMENTS (Continued)

MEMBER CONTRIBUTIONS

Member contributions vary depending on the most recent date of membership:

| | |
|--------------------|---|
| Prior to 1975: | 5% of regular compensation |
| 1975 - 1983: | 7% of regular compensation |
| 1984 to 6/30/96: | 8% of regular compensation |
| 7/1/96 to present: | 9% of regular compensation |
| 1979 to present: | an additional 2% of regular compensation in excess of \$30,000. |

RATE OF INTEREST

Interest on regular deductions made after January 1, 1984 is a rate established by PERAC in consultation with the Commissioner of Banks. The rate is obtained from the average rates paid on individual savings accounts by a representative sample of at least 10 financial institutions.

RETIREMENT AGE

The mandatory retirement age for some Group 2 and Group 4 employees is age 65. Most Group 2 and Group 4 members may remain in service after reaching age 65. Group 4 members who are employed in certain public safety positions are required to retire no later than the end of month they attain age 65. There is no mandatory retirement age for employees in Group 1.

SUPERANNUATION RETIREMENT

A member is eligible for a superannuation retirement allowance (service retirement) upon meeting the following conditions:

- completion of 20 years of service, or
- attainment of age 55 if hired prior to 1978, or if classified in Group 4, or
- attainment of age 55 with 10 years of service, if hired after 1978, and if classified in Group 1 or 2

NOTES TO FINANCIAL STATEMENTS (Continued)

AMOUNT OF BENEFIT

A member's annual allowance is determined by multiplying average salary by a benefit rate related to the member's age and job classification at retirement, and the resulting product by his creditable service. The amount determined by the benefit formula cannot exceed 80% of the member's highest three year average salary. For veterans as defined in G.L. c. 32, § 1, there is an additional benefit of \$15 per year for each year of creditable service, up to a maximum of \$300.

- Salary is defined as gross regular compensation.
- Average Salary is the average annual rate of regular compensation received during the 3 consecutive years that produce the highest average, or, if greater, during the last three years (whether or not consecutive) preceding retirement.
- The Benefit Rate varies with the member's retirement age, but the highest rate of 2.5% applies to Group 1 employees who retire at or after age 65, Group 2 employees who retire at or after age 60, and to Group 4 employees who retire at or after age 55. A .1% reduction is applied for each year of age under the maximum age for the member's group. For Group 2 employees who terminate from service under age 55, the benefit rate for a Group 1 employee shall be used.

DEFERRED VESTED BENEFIT

A participant who has completed 10 or more years of creditable service is eligible for a deferred vested retirement benefit.

The participant's accrued benefit is payable commencing at age 55, or the completion of 20 years, or may be deferred until later at the participant's option.

WITHDRAWAL OF CONTRIBUTIONS

Member contributions may be withdrawn upon termination of employment. Employees who first become members on or after January 1, 1984, may receive only limited interest on their contributions if they voluntarily terminate their service. Those who leave service with less than 5 years receive no interest; those who leave service with greater than 5 but less than 10 years receive 50% of the interest credited.

NOTES TO FINANCIAL STATEMENTS (Continued)

DISABILITY RETIREMENT

The Massachusetts Retirement Plan provides 2 types of disability retirement benefits:

ORDINARY DISABILITY

Eligibility: Non-veterans who become totally and permanently disabled by reason of a non-job related condition with at least 10 years of creditable service (or 15 years creditable service in systems in which the local option contained in G.L. c. 32, § 6(1) has not been adopted).

Veterans with ten years of creditable service who become totally and permanently disabled by reason of a non-job related condition prior to reaching “maximum age”.

Retirement Allowance: Equal to the accrued superannuation retirement benefit as if the member was age 55. If the member is a veteran, the benefit is 50% of the member’s final rate of salary during the preceding 12 months, plus an annuity based upon accumulated member contributions plus credited interest. If the member is over age 55, he or she will receive not less than the superannuation allowance to which he or she is entitled.

ACCIDENTAL DISABILITY

Eligibility: Applies to members who become permanently and totally unable to perform the essential duties of the position as a result of a personal injury sustained or hazard undergone while in the performance of duties. There are no minimum age or service requirements.

Retirement Allowance: 72% of salary plus an annuity based on accumulated member contributions, with interest. Any member injured while working out of title retiring after July 1, 2009, has such allowance based on the salary of the permanent title held on the date of injury. This amount is not to exceed 100% of pay. For those who became members in service after January 1, 1988 or who have not been members in service continually since that date, the amount is limited to 75% of pay. There is an additional pension of \$729.84 per year (or \$312.00 per year in systems in which the local option contained in G.L. c. 32, § 7(2)(a)(iii) has not been adopted), per child who is under 18 at the time of the member’s retirement, with no age limitation if the child is mentally or physically incapacitated from earning. The additional pension may continue up to age 22 for any child who is a full time student at an accredited educational institution. An additional \$15.00 per year of service, not to exceed \$300 annually may be added to the benefit in systems in which the local option contained in G.L. 32, §. 7(2)(e) has been adopted.

NOTES TO FINANCIAL STATEMENTS (Continued)

ACCIDENTAL DEATH

Eligibility: Applies to members who die as a result of a work-related injury or if the member was retired for accidental disability and the death was the natural and proximate result of the injury or hazard undergone on account of which such member was retired.

Allowance: An immediate payment to a named beneficiary equal to the accumulated deductions at the time of death, plus a pension equal to 72% of current salary and payable to the surviving spouse, dependent children or the dependent parent, plus a supplement of \$729.84 per year, per child (or \$312.00 per year in systems in which the local option contained in G.L. c. 32, §. 9(2)(d)(ii) has not been adopted) payable to the spouse or legal guardian until all dependent children reach age 18 or 22 if a full time student, unless mentally or physically incapacitated.

The surviving spouse of a member of a police or fire department or any corrections officer who, under specific and limited circumstances detailed in the statute, suffers an accident and is killed or sustains injuries resulting in his death, may receive a pension equal to the maximum salary for the position held by the member upon his death.

In addition, an eligible family member may receive a one time payment of \$100,000 from the State Retirement Board.

DEATH AFTER ACCIDENTAL DISABILITY RETIREMENT

Effective November 7, 1996, Accidental Disability retirees were allowed to select Option C at retirement and provide a benefit for an eligible survivor. For Accidental Disability retirees prior to November 7, 1996, who could not select Option C, if the member's death is from a cause unrelated to the condition for which the member received accidental disability benefits, a surviving spouse will receive an annual allowance of \$6,000.

DEATH IN ACTIVE SERVICE

Allowance: An immediate allowance equal to that which would have been payable had the member retired and elected Option C on the day before his or her death. For death occurring prior to the member's superannuation retirement age, the age 55 benefit rate is used. The minimum annual allowance payable to the surviving spouse of a member in service who dies with at least two years of creditable service is \$3,000, provided that the member and the spouse were married for at least one year and living together on the member's date of death.

NOTES TO FINANCIAL STATEMENTS (Continued)

The surviving spouse of such a member in service receives an additional allowance equal to the sum of \$1,440 per year for the first child, and \$1,080 per year for each additional child until all dependent children reach age 18 or 22 if a full time student, unless mentally or physically incapacitated.

COST OF LIVING

If a system has accepted Chapter 17 of the Acts of 1997, and the Retirement Board votes to pay a cost of living increase for that year, the percentage is determined based on the increase in the Consumer Price Index used for indexing Social Security benefits, but cannot exceed 3.0%. Section 51 of Chapter 127 of the Acts of 1999, if accepted, allows boards to grant COLA increases greater than that determined by CPI but not to exceed 3.0%. The first \$12,000 of a retiree's total allowance is subject to a cost-of-living adjustment. The total Cost-of-Living adjustment for periods from 1981 through 1996 is paid for by the Commonwealth of Massachusetts.

METHODS OF PAYMENT

A member may elect to receive his or her retirement allowance in one of 3 forms of payment.

Option A: Total annual allowance, payable in monthly installments, commencing at retirement and terminating at the member's death.

Option B: A reduced annual allowance, payable in monthly installments, commencing at retirement and terminating at the death of the member, provided, however, that if the total amount of the annuity portion received by the member is less than the amount of his or her accumulated deductions, including interest, the difference or balance of his accumulated deductions will be paid in a lump sum to the retiree's beneficiary or beneficiaries of choice.

Option C: A reduced annual allowance, payable in monthly installments, commencing at retirement. At the death of the retired employee, 2/3 of the allowance is payable to the member's designated beneficiary (who may be the spouse, or former spouse who remains unmarried for a member whose retirement becomes effective on or after February 2, 1992, child, parent, sister, or brother of the employee) for the life of the beneficiary. For members who retired on or after January 12, 1988, if the beneficiary pre-deceases the retiree, the benefit payable increases (or "pops up") based on the factor used to determine the Option C benefit at retirement. For members who retired prior to January 12, 1988, if the System has accepted Section 288 of Chapter 194 of the Acts of 1998 and the beneficiary pre-deceases the retiree, the benefit payable "pops up" in the same fashion. The Option C became available to accidental disability retirees on November 7, 1996.

NOTES TO FINANCIAL STATEMENTS (Continued)

ALLOCATION OF PENSION COSTS

If a member's total creditable service was partly earned by employment in more than one retirement system, the cost of the "pension portion" is allocated between the different systems pro rata based on the member's service within each retirement system.

NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES

The accounting records of the System are maintained on a calendar year basis in accordance with the standards and procedures established by the Public Employee Retirement Administration Commission.

Cash is considered to be funds on deposit with banks and are available upon demand.

Short Term Investments are highly liquid investments that will mature within twelve months from the date of acquisition.

Investments are reported at their fair value. Securities traded on recognized exchanges are valued at the most recent sales price at year end. If no sale was reported, the mean of the bid and asked price is used when available, or the most recent bid price. Mutual, commingled and pooled funds are valued based on the net asset or unit value at year end. Real estate and alternative investments are valued based on estimates provided by the managers of those respective investments. Purchases and sales of securities are reflected on the date the trade is initiated. Realized gain or loss is largely based on the difference between the cost or the value at the prior year end and the funds realized upon liquidation. Dividend income is generally recorded when received. Interest income is recorded as earned on an accrual basis. Income from alternative investments is recorded as reported by the managing partner. Appreciation or depreciation in the value of investments consists of the unrealized gains and losses reported as the difference between the previous period and the current value.

The system makes estimates and assumptions that affect the reported values of assets and liabilities and the reported amounts added and deducted during the reporting periods. The fair value of real estate and alternative investment holdings are generally estimated in the absence of reliable exchange values. The actual funds realized upon liquidation may differ from these estimates.

The provisions of Massachusetts General Laws Chapter 32, § 23 (2) generally govern the investment practices of the system. The Board does not retain an investment consultant to closely monitor the implementation and performance of their investment strategy and advise them of the progress toward full funding of the system.

Operating expenses include the ordinary and necessary cost of investment and professional services and the other miscellaneous administrative expenses of the system.

NOTES TO FINANCIAL STATEMENTS (Continued)

The Annuity Savings Fund is the fund in which members' contributions are deposited. Voluntary contributions, re-deposits, and transfers to and from other systems, are also accounted for in this fund. Members' contributions to the fund earn interest at a rate determined by PERAC. Interest for some members who withdraw with less than ten years of service is transferred to the Pension Reserve Fund. Upon retirement, members' contributions and interest are transferred to the Annuity Reserve Fund. Dormant account balances must be transferred to the Pension Reserve Fund after a period of ten years of inactivity.

The Annuity Reserve Fund is the fund to which a member's account is transferred upon retirement from the Annuity Savings Fund and Special Military Service Credit Fund. The annuity portion of the retirement allowance is paid from this fund. Interest is credited monthly to this fund at the rate of 3% annually on the previous month's balance.

The Special Military Service Credit Fund contains contributions and interest for members while on a military leave for service in the Armed Forces who will receive creditable service for the period of that leave.

The Expense Fund contains amounts transferred from investment income for the purposes of administering the retirement system.

The Pension Fund contains the amounts appropriated by the governmental units as established by PERAC to pay the pension portion of each retirement allowance.

The Pension Reserve Fund contains amounts appropriated by the governmental units for the purposes of funding future retirement benefits. Any profit or loss realized on the sale or maturity of any investment or on the unrealized gain of a market valued investment as of the valuation date is credited to the Pension Reserve Fund. Additionally, any investment income in excess of the amount required to credit interest to the Annuity Savings Fund, Annuity Reserve Fund, and Special Military Service Credit Fund is credited to this Reserve account.

The Investment Income Account is credited with all income derived from interest and dividends of invested funds. At year-end the interest credited to the Annuity Savings Fund, Annuity Reserve Fund, Expense Fund, and Special Military Service Credit Fund is distributed from this account and the remaining balance is transferred to the Pension Reserve Fund.

NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 3 - SUPPLEMENTARY MEMBERSHIP REGULATIONS

The Somerville Retirement System submitted the following supplementary membership regulations, which were approved by the Public Employee Retirement Administration Commission on:

May 19, 1998

Creditable Service:

- 1). That persons employed by the Election Department for working on the "census" may not pay a makeup for this time.
- 2). That draftsman (interns) hired by the Department of Public Works on a temporary basis will not join the Somerville Retirement System.

August 16, 1995

Monies Paid:

Hazardous Duty Material monies paid to Somerville Fire Department employees shall be considered regular compensation.

November 29, 1994

Membership:

To allow full-time, including provisional and temporary, employees to join the Somerville Retirement System immediately upon employment.

August 19, 1994

Creditable Service:

All members of the Somerville Retirement System whether they be full-time or part-time shall be granted 12 months creditable service for each full year of membership.

March 28, 1988

Membership:

Persons who were employed by the City of Somerville prior to January 1, 1984 and are being paid out of Federal Funds will become members of the Somerville Retirement System at an annual contribution rate of 7% due to the fact that they had been denied membership prior to that date.

April 24, 1985

Classification:

To classify licensed electricians employed by the Somerville Housing Authority in Group 2 as of March 14, 1985.

December 26, 1984

Rules & Regulations:

Regularly employed part-time employees working a minimum of twenty (20) hours per week must join the retirement system upon first date of employment;

NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 3 - SUPPLEMENTARY MEMBERSHIP REGULATIONS (Continued)

Provisional or temporary part-time employees working a minimum of twenty (20) hours per week must join the retirement system after working for six (6) consecutive months;

No employees may join the retirement system unless they work a minimum of twenty (20) hours per week;

All non-elected board members must join the retirement system upon the first date of employment;

Election department employees paid by name for census are not eligible for membership in the retirement system;

All new employees shall be examined by a physician and a written report shall be filed in the retirement system prior to their acceptance in the retirement system;

Board members shall receive one (1) year of service for each year of service;

Part-time employees who work at least twenty (20) hours per week shall receive one (1) year of service for each year of service;

Seasonal part-time employees who work at least twenty hours per week for seven (7) months or for the full season whichever is larger shall receive one (1) year of service of each year of service;

The following formula shall be used for all hourly persons working for less than twenty (20) hours per week and for those seasonal employees who do not work for at least seven (7) months or the full season whichever is longer:

- number of hours worked per year divided by twenty (20)
- divided by the normal working period of the position
- multiplied by 12 months = creditable service granted. (AMENDED November 29, 1994).

NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 5 - ACTUARIAL VALUATION AND ASSUMPTIONS

The most recent actuarial valuation of the System was prepared by Buck Consultants as of January 1, 2008.

| | |
|---|---------------------|
| The actuarial liability for active members was | \$139,000,113 |
| The actuarial liability for retired and inactive members was | <u>141,399,786</u> |
| The total actuarial liability was | 280,399,899 |
| System assets as of that date were | <u>183,769,256</u> |
| | |
| The unfunded actuarial liability was | <u>\$96,630,643</u> |
| The ratio of system's assets to total actuarial liability was | 65.5% |
| As of that date the total covered employee payroll was | \$54,546,918 |

The normal cost for employees on that date was 8.3% of payroll

The normal cost for the employer was (including administrative expenses) 5.1% of payroll

The principal actuarial assumptions used in the valuation are as follows:

Investment Return: 8.25% per annum
 Rate of Salary Increase: 4.25% per annum

GASB STATEMENT NO. 25, DISCLOSURE INFORMATION AS OF JANUARY 1, 2008

| Actuarial Valuation Date | Actuarial Value of Assets (a) | Actuarial Accrued Liability (b) | Unfunded AAL (UAAL) (b-a) | Funded Ratio (a/b) | Covered Payroll (c) | UAAL as a % of Cov. Payroll ((b-a)/c) |
|--------------------------------|--|--|--------------------------------------|----------------------------|-----------------------------|--|
| 1/1/2008 | \$183,769,256 | \$280,399,899 | \$96,630,643 | 65.5% | \$54,546,918 | 177.2% |
| 1/1/2007 | \$167,527,653 | \$226,454,022 | \$98,926,369 | 62.9% | \$48,837,222 | 202.6% |
| 1/1/2004 | \$145,850,905 | \$246,797,910 | \$100,947,005 | 59.1% | \$43,875,838 | 230.1% |

NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 6 - MEMBERSHIP EXHIBIT

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| Retirement in Past Years | | | | | | | | | | |
| Superannuation | 10 | 29 | 74 | 53 | 13 | 9 | 9 | 20 | 22 | 22 |
| Ordinary Disability | 0 | 0 | 1 | 1 | 0 | 0 | 0 | 0 | 0 | 0 |
| Accidental Disability | 0 | 1 | 6 | 4 | 8 | 5 | 2 | 2 | 9 | 3 |
| Total Retirements | 10 | 30 | 81 | 58 | 21 | 14 | 11 | 22 | 31 | 25 |
| Total Retirees, Beneficiaries and Survivors | 896 | 935 | 976 | 995 | 985 | 949 | 908 | 926 | 922 | 920 |
| Total Active Members | 1,232 | 1,252 | 1,185 | 1,068 | 1,107 | 1,129 | 1,128 | 1,156 | 1,207 | 1,166 |
| Pension Payments | | | | | | | | | | |
| Superannuation | \$5,935,567 | \$6,287,989 | \$7,033,415 | \$8,082,387 | \$8,618,967 | 8,568,783 | 8,692,410 | 8,894,800 | \$11,677,456 | \$11,465,761 |
| Survivor/Beneficiary Payments | 286,560 | 279,909 | 422,269 | 444,318 | 510,919 | 506,824 | 550,109 | 588,712 | 602,779 | 581,401 |
| Ordinary Disability | 167,586 | 126,367 | 124,925 | 116,944 | 126,493 | 109,049 | 102,610 | 117,266 | 109,726 | 102,320 |
| Accidental Disability | 2,392,735 | 2,319,227 | 2,364,287 | 2,443,731 | 2,539,200 | 2,676,037 | 2,968,452 | 2,675,200 | 2,731,715 | 2,962,429 |
| Other | 2,991,905 | 3,152,144 | 3,495,355 | 3,375,237 | 4,150,195 | 4,000,050 | 4,188,442 | 4,460,118 | 2,155,555 | 2,654,183 |
| Total Payments for Year | <u>\$11,774,353</u> | <u>\$12,165,636</u> | <u>\$13,440,251</u> | <u>\$14,462,617</u> | <u>\$15,945,774</u> | <u>\$15,860,743</u> | <u>\$16,502,023</u> | <u>\$16,736,096</u> | <u>\$17,277,231</u> | <u>\$17,766,094</u> |

PERAC

Five Middlesex Avenue | Third Floor
Somerville, MA | 02145

Ph: 617.666.4446 | Fax: 617.628.4002

TTY: 617.591.8917 | Web: www.mass.gov/perac