

PERAC AUDIT REPORT



Swampscott
Contributory Retirement System



JAN. 1, 2007 - DEC. 31, 2008



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PERAC

COMMONWEALTH OF MASSACHUSETTS | PUBLIC EMPLOYEE RETIREMENT ADMINISTRATION COMMISSION

DOMENIC J. F. RUSSO, *Chairman* | A. JOSEPH DeNUCCI, *Vice Chairman*

JOSEPH E. CONNARTON, *Executive Director*

MARY ANN BRADLEY | PAUL V. DOANE | JAMES M. MACHADO | DONALD R. MARQUIS | ROBERT B. McCARTHY

December 18, 2009

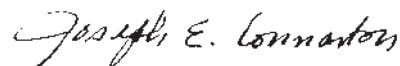
The Public Employee Retirement Administration Commission has completed an examination of the Swampscott Retirement System pursuant to G.L. c. 32, § 21. The examination covered the period from January 1, 2007 to December 31, 2008. This audit was conducted in accordance with the accounting and management 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.

It should be noted that the findings determined in this audit report were based on the Laws and Regulations in effect during the time the audit was conducted for the period referenced in this report. These findings do not reflect the changes made to Chapter 32 after passage of Chapter 21 of the Acts of 2009.

In closing, I acknowledge the work of examiner 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. Board Member Attendance:

The Board members are required to meet at least once a month. A review of meeting attendance by Board members revealed a significant level of absenteeism. Two members missed more than 40% of the meetings held in 2007; while one member missed more than 30% of the meetings held that year. In 2008, two members missed more than 30% of the meetings held. Of the thirty meetings held between 2007 and through May of 2009, the full Board was present at only three of those meetings, or 10% of the time. The result is an attendance rate for several Board members well below the seventy-five percent minimum considered acceptable for each of the years evaluated. Such a level of absenteeism is considered to be excessive.

Recommendation: Attendance at Board meetings is an obligation that must be fulfilled by all Board members. It is the Board's responsibility to counsel members who do not regularly attend meetings that they jeopardize their fiduciary duty to the retirement system. The Board should consider adjusting the schedule of Board meetings in order to better accommodate its members. In extreme conditions, it may be necessary for the Board to take appropriate action with members who fail to maintain minimum attendance requirements.

Board Response:

The Board Members will make a concerted effort to attend all Boards Meetings forthwith.

2. System Administration: Expenses of Operations:

The Board must annually submit to the appropriate authority an estimate of the expenses of administration and cost of operation of the system. The Swampscott Retirement System has a high expense ratio when compared to other similar local retirement systems for the 2008 calendar reporting period. This can be attributed to some extent to liabilities assessed by the Internal Revenue Service during both the 2007 and 2008 calendar years. The system incurred penalties for late payment of taxes withheld from retirees during the 2006 calendar year; and a penalty imposed for inaccurate totals in filing of Form 1099-R that relates to benefits paid to retirees during 2007. Retirement Administrators are expected to be knowledgeable about the deposit and filing requirements for contributory retirement systems in Massachusetts. The disbursements mentioned above are not an appropriate use of retirement funds.

The auditor determined that the system was remitting its withholding tax obligations on a timely basis during the audit period. However, the annual information return filed with the IRS (Form 945) had not been completed accurately. The specific date the tax liability was incurred was not precisely disclosed. As a result, the IRS would presume the system was not remitting its tax deposits on a timely basis. The records essential to resolving this discrepancy had to be reconstructed since they initially could not be located during the field work conducted on the premises. The system recently relocated to Town Hall. Some records have not been identified in completion of the relocation process. It was noted the system did recover the penalties and interest assessed for the overpayment identified for the 2007 tax period.

EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

Recommendation: The Board must continue to conform to all laws and regulations related to filing requirements for benefits paid to retirees and funds held in trust for taxes. This is a basic requirement for the operation of a retirement system. A more comprehensive reconciliation process must be initiated to ensure that accurate information is provided to the IRS in all required filings. All funds disbursed as benefits by the retirement system must be properly categorized and accurately reported to the tax authority. It is essential that refunds paid to members as taxable distributions be included on these respective filings.

Board Response:

With respect to any penalties that were paid to the Internal Revenue Service during this period, it should be noted that the System questioned all penalties that were paid for the audit period upon demand and was refunded most, if not all of the amount. All Federal Tax deposits for payrolls and refunds were submitted to the IRS in a timely manner and all deductions for 2008 were subsequently verified as correct. Due to a calculation error, the amount listed on the System's tax return understated the actual taxes that were paid. The System subsequently filed an amended 945 return restating the correct amounts that were already paid, listing the dates of deposits in chronological order. Additionally, the office has relocated to Town Hall, thus significantly reducing expenditures for rent, internet fees and other associated costs.

3. System Administration: Expenses of Operations Charged to Credit Card:

The Swampscott Contributory Retirement System uses a credit card to charge ordinary and necessary business expenses of the system. A review of these expenses disclosed that the system receives multiple statements that reflect different activity for the same period. This creates a level of confusion relating to the affirmation of charged transactions. We observed that source invoices, consisting of the specific charges that support the warrant, were not consistently attached to the credit card voucher. This practice made it difficult to confirm the legitimate business purpose of the transaction. The result is that payments are approved without a formal reconciliation process that confirms all charges listed on the multiple statements. During the two-year audit period, finance charges were incurred for late payments and late payment penalty fees were assessed. There were occasions when payment was authorized to resolve prior balance due amounts without identifying the specific charges associated with that balance due. Overall, the process reflects weak internal financial control over the operations of the system. The disbursements for late payments and late payment penalty fees are not an appropriate use of retirement funds.

Recommendation: The Board must ensure that all vouchers are fully supported by detailed invoices before approving payment. Receipts for transactions charged to the system credit card must be retained and matched to activity on the periodic statement provided by the issuer. Only transactions determined to be valid should be authorized for payment. The original receipts should be the primary source for posting the activity to the general ledger. The account number should be prominent on the source document. A more formal reconciliation process should be initiated to prevent authorizing payment for previous unpaid balances and confirming the validity of all fees for late payment, cash advances, finance charges and similar activity. Such fees should be avoided under

EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

all circumstances contemplated by this kind of financial tool. The issuer should be notified that a single comprehensive statement of charges for the period must be the sole basis for expected remuneration.

Board Response:

In 2007, the System's credit card was serviced by a new financial institution. At that time, the new bank issued two credit cards, one of which was never used by the System but for which interest charges accrued. Upon advice from the Commission, the System immediately notified the bank and requested that the unused card be canceled. The System subsequently received written confirmation from the financial institution that the unused card has been canceled. Additionally, the Board has instituted a policy wherein the credit card will no longer be used for the purchase of supplies and will order directly from vendors. The Commission has also furnished the System with a voucher template that is to be attached to all expense invoices that will enable a more expeditious reconciliation process late payment, cash advances, finance charges and similar activity.

4. Accounting: Annual Statement:

The board must annually file a financial statement of condition for the system with the Executive Director of PERAC. PERAC requires an annual statement to be filed pursuant to G.L. c.32, § 20 (5)(1) and G. L. c. 32, § 23 (1) states that each board shall submit annually on or before May 1st a sworn statement of the financial condition as of December 31st of the previous year. A review of transactions posted to the general ledger disclosed discrepancies that resulted in variances from the normal operations of the Swampscott Contributory Retirement System. These are similar and consistent with findings disclosed in the previous audit report. The Annual Statement filed by the Swampscott Retirement Board for the 2008 calendar period did not meet PERAC standards.

Recommendation: As a sole source of information to third parties, the Annual Statement and supporting schedules must be prepared accurately to allow readers to make an informed assessment of the system's financial condition without having to reference the general ledger. Prior to submission of the Annual Statement, a review process must be established to ensure all entries on the Annual Statement agree with the detailed supporting schedules and conform to the guidelines specified in the PERAC Annual Statement Guide. The importance of providing financial information that can be used as a reasonable basis for comparison with other systems is a basic tenet of financial disclosure for public trusts.

Board Response:

The financial data listed on the Annual Statement was verified as having been correct prior to its issuance. The schedules provided by the custodian were inadvertently not included on the package that was submitted to the Commission.

EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

5. Regular Compensation:

The inspection of a payroll register disclosed that weekly payments for being assigned as LT Inspector, Detective and Identification Officer (Payroll Code #132 – Investigation) are excluded from retirement deductions. The members are paid fixed amounts per week. These amounts are regular, recurring payments, not in the nature of a reimbursement. These assignments are of an indefinite duration and should be classified as regular earnings for retirement purposes.

Recommendation:

These payments must be considered regular compensation pursuant to 840 CMR 15.03 (1) (a) which states in pertinent parts:

To be considered regular compensation, any compensation to an employee must:

- 1) be ordinary, normal, recurrent, repeated, and of indefinite duration;
- 2) be made pursuant to an official written policy of the employer or to a collective bargaining agreement;

The Board must formally instruct the payroll officers of the Police Department and the Town of Swampscott to begin withholding retirement deductions from this compensation paid to members. The rate of deduction must be the same as the member's other compensation plus the additional 2% if total compensation exceeds \$30,000 on an annualized basis for any pay period.

Board Response:

This issue has been rectified by the Treasurer's Office and Chief of Police.

6. Membership: Active Members Over Seventy Years Old:

We observed the files of 13 active members who were age seventy or older. An inspection of their files revealed that none of the members had made an election on whether or not to continue contributing to the retirement system as required under G.L. c. 32, § 90(G)(3/4). At least 180 days before the last day of the month in which a member attains age seventy, the retirement office should contact the member about benefits, options and procedures for continuing in service beyond age seventy. There was no indication in the files that these members had been notified or counseled relative to the implications of this irrevocable election. There did not appear to be a reliable process for notifying the system of similar events in the future.

Recommendation: The System must comply with G.L. c. 32, § 90(G)(3/4). A procedure must be developed to initiate contact with members who are approaching the age of seventy. These members should be counseled on the relative merit of the benefits, options and procedures for continuing in service beyond age seventy. The PERAC Form "Application by Member Requesting to Continue Retirement Contributions Beyond the Age of 70 Pursuant to G.L. c. 32, § 90(G)(3/4)" is the evidentiary source document that supports this election. The form must be completed and maintained in the member's permanent file.

EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

Board Response:

The System identified four active Members currently over the age of seventy. Each Member was notified in writing whether they wish to continue to have retirement deductions and provided with PERAC's established form. Three of the Members responded affirmatively while one indicated that she wanted to have her deductions stopped. The Treasurer's office was notified accordingly.

7. System Administration: Section 91A:

The Swampscott Contributory Retirement System has not adequately addressed its responsibilities in conforming to G.L. c. 32, § 91 A. Retired persons who receive benefits based on accidental and ordinary disability status are restricted in the amount of income they can earn and must annually complete and file a statement disclosing their earnings from sources other than retirement. PERAC annually requires each retirement system to provide information related to the position from which a disability retiree was previously employed, as well as a request to contact those who have not provided a current statement to PERAC. No evidence of related correspondence was located in any of the files inspected, no current compensation information had been provided, no hearings had been scheduled, no pension benefits had been terminated, and PERAC had not been contacted regarding the status of any of the six retirees involved in compliance actions.

Recommendation: The administrator should respond to all PERAC Fraud Unit requests promptly, even if the Board is unable to provide complete information or requires additional time to comply. All copies of PERAC correspondence and Board actions should be inserted into members' files. Recovery of excess earnings must be fully documented. A formal financial agreement should be initiated for any periodic payment arrangements agreed to by the Board. If termination of benefits is required, copies of Board motions and votes should be retained in the members' file.

Board Response:

The System has contacted the Fire and Police Chiefs as well as the DPW Director to obtain the current salaries and will create a spreadsheet in accord with PERAC's recommendation for Section 91A reporting requirements. Upon receipt of same, the System will furnish the Commission's Disability Unit with all current salaries to be used for all of the System's disability retirees.

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, | |
|---|----------------------------|----------------------------|
| | 2008 | 2007 |
| Net Assets Available For Benefits: | | |
| Cash | \$1,400,979 | \$329,215 |
| Short Term Investments | 184,987 | 310,167 |
| Equities | 4,016,928 | 7,432,389 |
| Pooled Domestic Equity Funds | 5,076,614 | 8,191,108 |
| Pooled International Equity Funds | 3,362,520 | 6,139,295 |
| Pooled Domestic Fixed Income Funds | 6,324,199 | 6,156,522 |
| Pooled Alternative Investment Funds | 2,015,801 | 2,125,757 |
| Pooled Real Estate Funds | 2,831,858 | 2,797,697 |
| PRIT Cash Fund | 0 | 0 |
| PRIT Core Fund | 0 | 0 |
| Interest Due and Accrued | 157 | 157 |
| Accounts Receivable | 86,468 | 26,763 |
| Accounts Payable | (129,108) | (9,074) |
| Total | <u>\$25,171,402</u> | <u>\$33,499,996</u> |
| Fund Balances: | | |
| Annuity Savings Fund | \$9,183,264 | \$8,592,666 |
| Annuity Reserve Fund | 3,488,377 | 3,628,310 |
| Pension Fund | 0 | 0 |
| Military Service Fund | 326 | 324 |
| Expense Fund | 0 | 0 |
| Pension Reserve Fund | 12,499,435 | 21,278,696 |
| Total | <u>\$25,171,402</u> | <u>\$33,499,996</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 (2007) | \$8,121,459 | \$3,612,613 | \$0 | \$322 | \$0 | \$19,478,633 | \$31,213,028 |
| Receipts | 1,001,512 | 106,995 | 3,140,864 | 2 | 390,974 | 2,548,324 | 7,188,671 |
| Interfund Transfers | (432,182) | 432,775 | 747,668 | 0 | 0 | (748,261) | (0) |
| Disbursements | (98,124) | (524,073) | (3,888,532) | 0 | (390,974) | 0 | (4,901,703) |
| Ending Balance (2007) | 8,592,666 | 3,628,310 | (0) | 324 | 0 | 21,278,696 | 33,499,996 |
| Receipts | 1,071,182 | 106,355 | 3,213,396 | 2 | 448,271 | (7,947,350) | (3,108,144) |
| Interfund Transfers | (295,062) | 295,062 | 831,912 | 0 | 0 | (831,912) | 0 |
| Disbursements | (185,522) | (541,349) | (4,045,307) | 0 | (448,271) | 0 | (5,220,450) |
| Ending Balance (2008) | <u>\$9,183,264</u> | <u>\$3,488,377</u> | <u>\$0</u> | <u>\$326</u> | <u>\$0</u> | <u>\$12,499,435</u> | <u>\$25,171,402</u> |

STATEMENT OF RECEIPTS

| | FOR THE PERIOD ENDING | |
|---|-----------------------|--------------------|
| | 2008 | 2007 |
| Annuity Savings Fund: | | |
| Members Deductions | \$957,993 | \$951,963 |
| Transfers from Other Systems | 56,869 | 85 |
| Member Make Up Payments and Re-deposits | 4,765 | 2,510 |
| Member Payments from Rollovers | 0 | 0 |
| Investment Income Credited to Member Accounts | <u>51,556</u> | <u>46,954</u> |
| Sub Total | <u>1,071,182</u> | <u>1,001,512</u> |
| Annuity Reserve Fund: | | |
| Investment Income Credited to the Annuity Reserve Fund | <u>106,355</u> | <u>106,995</u> |
| Pension Fund: | | |
| 3 (8) (c) Reimbursements from Other Systems Received from Commonwealth for COLA and Survivor Benefits | 21,241 | 17,276 |
| Pension Fund Appropriation | <u>163,739</u> | <u>218,193</u> |
| Sub Total | <u>3,028,416</u> | <u>2,905,395</u> |
| Military Service Fund: | | |
| Contribution Received from Municipality on Account of Military Service | 0 | 0 |
| Investment Income Credited to the Military Service Fund | <u>2</u> | <u>2</u> |
| Sub Total | <u>2</u> | <u>2</u> |
| Expense Fund: | | |
| Expense Fund Appropriation | 0 | 0 |
| Investment Income Credited to the Expense Fund | <u>448,271</u> | <u>390,974</u> |
| Sub Total | <u>448,271</u> | <u>390,974</u> |
| Pension Reserve Fund: | | |
| Federal Grant Reimbursement | 0 | 0 |
| Pension Reserve Appropriation | 0 | 0 |
| Interest Not Refunded | 323 | 1,043 |
| Miscellaneous Income | 0 | 0 |
| Excess Investment Income (Loss) | <u>(7,947,673)</u> | <u>2,547,281</u> |
| Sub Total | <u>(7,947,350)</u> | <u>2,548,324</u> |
| Total Receipts | <u>(\$3,108,144)</u> | <u>\$7,188,671</u> |

STATEMENT OF DISBURSEMENTS

| | FOR THE PERIOD ENDING DECEMBER 31, | |
|--|---------------------------------------|--------------------|
| | 2008 | 2007 |
| Annuity Savings Fund: | | |
| Refunds to Members | \$68,746 | \$73,378 |
| Transfers to Other Systems | <u>116,776</u> | <u>24,745</u> |
| Sub Total | <u>185,522</u> | <u>98,124</u> |
| Annuity Reserve Fund: | | |
| Annuities Paid | 535,316 | 513,226 |
| Option B Refunds | <u>6,033</u> | <u>10,847</u> |
| Sub Total | <u>541,349</u> | <u>524,073</u> |
| Pension Fund: | | |
| Pensions Paid: | | |
| Regular Pension Payments | 2,715,845 | 2,641,423 |
| Survivorship Payments | 92,896 | 83,871 |
| Ordinary Disability Payments | 16,793 | 16,433 |
| Accidental Disability Payments | 796,070 | 759,299 |
| Accidental Death Payments | 166,209 | 163,382 |
| Section 101 Benefits | 15,846 | 23,498 |
| 3 (8) (c) Reimbursements to Other Systems | 207,271 | 166,370 |
| State Reimbursable COLA's Paid | 30,987 | 26,035 |
| Chapter 389 Beneficiary Increase Paid | <u>3,390</u> | <u>8,222</u> |
| Sub Total | <u>4,045,307</u> | <u>3,888,532</u> |
| Military Service Fund: | | |
| Return to Municipality for Members Who Withdrew Their Funds | <u>0</u> | <u>0</u> |
| Expense Fund: | | |
| Board Member Stipend | 0 | 0 |
| Salaries | 86,490 | 80,537 |
| Legal Expenses | 4,793 | 4,371 |
| Medical Expenses | 0 | 0 |
| Travel Expenses | 1,416 | 1,868 |
| Administrative Expenses | 87,181 | 21,816 |
| Furniture and Equipment | 1,532 | 5,746 |
| Management Fees | 177,591 | 164,523 |
| Custodial Fees | 14,266 | 11,611 |
| Consultant Fees | 27,500 | 29,000 |
| Rent Expenses | 19,141 | 17,198 |
| Service Contracts | 20,374 | 46,403 |
| Fiduciary Insurance | <u>7,988</u> | <u>7,902</u> |
| Sub Total | <u>448,271</u> | <u>390,974</u> |
| Total Disbursements | <u>\$5,220,450</u> | <u>\$4,901,703</u> |

INVESTMENT INCOME

| | FOR THE PERIOD ENDING DECEMBER 31, | |
|---|---------------------------------------|--------------------|
| | 2008 | 2007 |
| Investment Income Received From: | | |
| Cash | \$22,407 | \$28,085 |
| Short Term Investments | 5,621 | 11,989 |
| Fixed Income | 0 | 0 |
| Equities | 76,503 | 82,197 |
| Pooled or Mutual Funds | 158,063 | 24,799 |
| Commission Recapture | <u>1,211</u> | <u>1,582</u> |
| Total Investment Income | <u>263,805</u> | <u>148,652</u> |
| Plus: | | |
| Realized Gains | 267,846 | 533,872 |
| Unrealized Gains | 1,581,968 | 3,662,992 |
| Interest Due and Accrued - Current Year | <u>157</u> | <u>157</u> |
| Sub Total | <u>1,849,970</u> | <u>4,197,021</u> |
| Less: | | |
| Paid Accrued Interest on Fixed Income Securities | 0 | 0 |
| Realized Loss | (1,946,526) | (345,181) |
| Unrealized Loss | (7,508,581) | (901,282) |
| Interest Due and Accrued - Prior Year | <u>(157)</u> | <u>(7,003)</u> |
| Sub Total | <u>(9,455,264)</u> | <u>(1,253,467)</u> |
| Net Investment Income (Loss) | <u>(7,341,489)</u> | <u>3,092,206</u> |
| Income Required: | | |
| Annuity Savings Fund | 51,556 | 46,954 |
| Annuity Reserve Fund | 106,355 | 106,995 |
| Military Service Fund | 2 | 2 |
| Expense Fund | <u>448,271</u> | <u>390,974</u> |
| Total Income Required | <u>606,184</u> | <u>544,925</u> |
| Net Investment Income (Loss) | <u>(7,341,489)</u> | <u>3,092,206</u> |
| Less: Total Income Required | <u>606,184</u> | <u>544,925</u> |
| Excess Income (Loss) To The Pension Reserve Fund | <u>(\$7,947,673)</u> | <u>\$2,547,281</u> |

SCHEDULE OF ALLOCATION OF INVESTMENTS OWNED

(percentages by category)

| AS OF DECEMBER 31, 2008 | | |
|-------------------------------------|----------------------------|----------------------------------|
| | MARKET VALUE | PERCENTAGE OF TOTAL ASSETS |
| Cash | \$1,400,979 | 5.6% |
| Short Term | 184,987 | 0.7% |
| Equities | 4,016,928 | 15.9% |
| Pooled Domestic Equity Funds | 5,076,614 | 20.1% |
| Pooled International Equity Funds | 3,362,520 | 13.3% |
| Pooled Domestic Fixed Income Funds | 6,324,199 | 25.1% |
| Pooled Alternative Investment Funds | 2,015,801 | 8.0% |
| Pooled Real Estate Funds | 2,831,858 | 11.2% |
| PRIT Cash Fund | 0 | 0.0% |
| PRIT Core Fund | 0 | 0.0% |
| Grand Total | <u>\$25,213,885</u> | <u>100.0%</u> |

For the year ending December 31, 2008, the rate of return for the investments of the Swampscott Retirement System was -23.19%. For the five-year period ending December 31, 2008, the rate of return for the investments of the Swampscott Retirement System averaged 3.04%. For the twenty-four year period ending December 31, 2008, since PERAC began evaluating the returns of the retirement systems, the rate of return on the investments of the Swampscott Retirement System was 9.00%.

SUPPLEMENTARY INVESTMENT REGULATIONS

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

December 11, 2007

17.03 Notwithstanding the provisions of the Public Employee Retirement Administration Commission regulations, the Swampscott Retirement Board may invest funds of the Retirement System (the "System") in the fund known as the Institutional Retirement Trust (IRT) International Equity Trust (the "Fund"), and effective as of the date of the initial investment by the System of any of its assets in the Fund, while the assets of the System are so invested, the activities and investments of the Fund, directly or indirectly, shall be deemed to satisfy the prohibited transaction rules set forth in 840 CMR 16.00 et seq. and 840 CMR 17.03 to the extent such activities satisfy the prohibited transaction rules set forth in Section 406 of the U.S. Employee Retirement Income Security Act of 1974, as amended ("ERISA"), taking into account ERISA Section 408(b)(8) as well as other statutory exemptions under ERISA, and Prohibited Transaction Class Exemption 84-14, as amended, Prohibited Transaction Class Exemption 91-38, and other available class exemptions.

August 31, 2001

16.08 In accordance with PERAC Investment Guideline 99-2, the Swampscott Retirement System is modifying its international growth equity mandate with State Street Global Advisors to allow for securities lending. There is no change in the fund's investment strategy, investment universe, or benchmark. The Board understands and is comfortable with the practice of securities lending and is satisfied with State Street Bank's capabilities in this area.

NOTES TO FINANCIAL STATEMENTS

NOTE I – SUMMARY OF PLAN PROVISIONS

The plan is a contributory defined benefit plan covering all Swampscott 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 106 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. Elected officials and others who were hired prior to 1978 may be vested after 6 years in accordance with G.L. c. 32, § 10.

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. 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 \$708.60 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.

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 \$312 per year, per child, 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.

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.

NOTES TO FINANCIAL STATEMENTS (Continued)

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.

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

May 21, 1998

Creditable Service

Any employee of the Town of Swampscott who served as an auxiliary or special police officer in any governmental unit or political subdivision of the Commonwealth prior to becoming a member of the Swampscott Retirement System shall be considered a temporary employee as set forth in G.L. c. 32, § 4(2)(c) and may receive credit for actual service rendered in this capacity, based on the actual compensation received while rendering such service and upon making payment to the System, with interest, prior to the member's actual retirement.

May 20, 1998

Cost of Living Adjustments Guidelines

In making determination of whether a cost-of-living adjustment should be granted in any particular year and whether said cost-of-living adjustment would substantially impair the funding scheduled of the Swampscott Retirement System, The Swampscott Retirement Board hereby adopts the following guidelines:

1. A cost-of-living adjustment for eligible retirees and beneficiaries shall not be granted unless the average rate of return on the Swampscott Retirement System's investments for the three-year period immediately preceding the current calendar year is eight percent.
2. Any cost-of-living adjustment will be an amount equal to the Consumer Price Index as calculated by PERAC or three percent, whichever is less.
3. The Swampscott Retirement Board is under no obligation to grant cost-of living adjustments in any particular year.

December 17, 1996

Buy-backs

An eligible member may not receive additional creditable service until the member has paid into the annuity savings fund of the retirement system "in one lump sum or in installments" the amount required by c. 71 of the acts of 1996. This allows the member to choose his/her own method or option of payment, thereby eliminating payroll deduction. The total veterans' buyback payment would be payable in full prior to the member's effective date of retirement.

NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 3 - SUPPLEMENTARY MEMBERSHIP REGULATIONS (Continued)

June 20, 1995

Buy-backs

Repeal of Supplementary Rule:

A member of the Swampscott Retirement system shall be allowed to buy back time which they earned during their status as a less than half-time employee and ineligible for membership, provided that the creditable service shall be granted based upon the actual service rendered.

January 6, 1995

Rules & Regulations

Membership:

- Every employee who becomes a member of the Swampscott Retirement System must complete the necessary forms as furnished by the Retirement Board and name a beneficiary. At the time of enrollment he/she must also furnish the Board with a birth certificate, and if a veteran, a copy of his/her Discharge of Military Service or equivalent which shall be kept on file with the board.
- Full-time permanent employees who work at least 30 hours per week and are under age 65 must join the Retirement System as of the date of their employment.
- Part-time permanent employees who work at least 20 but less than 30 hours per week and are under the age of 65 must join the retirement system as of their date of employment.
- Elected officials who receive compensation may join the Retirement System within ninety (90) days after the date of the assuming office, if under age 65 on the date of election.
- Temporary employees, employees who are normally scheduled to work less than 20 hour per week are not eligible for membership in the retirement system. **AMENDED 5/21/98.**
- The Retirement Board shall have full jurisdiction to determine the eligibility of employees for membership involving part-time, provisional, temporary, temporary provisional, seasonal or intermittent employment service.

Creditable Service:

- Full-time permanent employees will receive full credit except in instances where full-time employees also had part-time service.
- Any part-time employee who qualifies for membership, shall receive one (1) year of creditable service provided they work the hours required for their position and provided their entire service is on a part-time basis;
- Subject to verification as specified by the agency any full-time employee who becomes part-time shall receive credit for their part-time service on a pro-rated basis as it relates to a full-time position;

NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 3 - SUPPLEMENTARY MEMBERSHIP REGULATIONS (Continued)

- Members who work at least seven continuous months per year will be credited with one year of service for each year worked provided they work the hours required by their position and provided their entire service is on the same basis;
- The Board will not accept service credit liability of less than 13 consecutive weeks (minimum 20 hours per week) for former Swampscott governmental employees who were ineligible at the time of their employment in the Swampscott Retirement System;

Buy-backs:

- Members seeking to buy back time must submit, in writing, dates and places of previous employment. The Retirement Board will request all pertinent information from the appropriate agencies;

Changes in employee status:

- Members agencies must notify the Retirement Board within ninety (90) days of any changes in employee status including workers compensation, position held and hours in work week. (Note: G.L. c.32, s. 3 (2) (g) requires department heads to notify the board within thirty (30) days of any change in the title, address, rate of compensation, duties or service of any employee in the department);

Injuries:

- All major injuries incurred due to employment must be reported in writing to the Swampscott Retirement Board within 90 days of the accident.

October 8, 2002

The Board has adopted Supplemental Travel Regulations under the provisions of G.L. c.7, § 50 and G.L. c.32, § 21(4). These regulations are available upon written request and are also available on the PERAC website (<http://www.mass.gov/perac>).

NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 4 - ADMINISTRATION OF THE SYSTEM

The System is administered by a five-person Board of Retirement consisting of the Town Accountant who shall be a member ex-officio, a second member appointed by the governing authority, a third and fourth member who shall be elected by the members in or retired from the service of such system, and a fifth member appointed by the other four board members.

Ex-officio Member: David Castellarin

Appointed Member: Thomas H. Driscoll, Jr. Term Expires: 06/30/2011

Elected Member: Francis E. Delano, Jr., Term Expires: 08/11/2010
Chairman

Elected Member: John F. Behan, Jr. Term Expires: 12/11/2011

Appointed Member: John T. Kiely, Jr. Term Expires: 01/07/2012

The Board members are required to meet at least once a month. The Board must keep a record of all of its proceedings. The Board must annually submit to the appropriate authority an estimate of the expenses of administration and cost of operation of the system. The board must annually file a financial statement of condition for the system with the Executive Director of PERAC.

The investment of the system's funds is the responsibility of the Board. All retirement allowances must be approved by the Retirement Board. All expenses incurred by the System must be approved by a majority vote of the Board. Payments shall be made only upon vouchers signed by two persons designated by the Board.

The following retirement board members and employees are bonded by an authorized agent representing a company licensed to do business in Massachusetts as follows:

| | | |
|------------------------|---|--|
| Treasurer - Custodian: |) | |
| Ex-officio Member: |) | \$1,000,000 Fiduciary Liability policy |
| Elected Members: |) | National Union Fire Insurance Co. |
| Appointed Members: |) | \$1,000,000 Commercial Crime policy |
| Staff Employee: |) | National Union Fire Insurance Co. |

NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 5 - ACTUARIAL VALUATION AND ASSUMPTIONS

The most recent actuarial valuation of the System was prepared by The Segal Group, Inc. as of January 1, 2008.

| | |
|---|---------------------|
| The actuarial liability for active members was | \$27,010,856 |
| The actuarial liability for inactive members was | 1,225,840 |
| The actuarial liability for retired members was | <u>37,400,757</u> |
| The total actuarial liability was | 65,637,453 |
| System assets as of that date were | <u>33,845,690</u> |
| | |
| The unfunded actuarial liability was | <u>\$31,791,763</u> |
| The ratio of system's assets to total actuarial liability was | 51.6% |
| As of that date the total covered employee payroll was | \$10,841,912 |

The normal cost for employees on that date was 8.9% of payroll

The normal cost for the employer, including administrative expenses, was 8.6% of payroll

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

Investment Return: 8.00% per annum
 Rate of Salary Increase: 4.5% for 2008 and 5% per annum for Group 1,
 5% per annum for Group 4

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 | \$33,845,690 | \$65,637,453 | \$31,791,763 | 51.6% | \$10,841,912 | 293.2% |
| 1/1/2006 | \$30,492,424 | \$58,082,162 | \$27,589,738 | 52.5% | \$10,011,387 | 275.6% |
| 1/1/2004 | \$28,721,832 | \$52,826,739 | \$24,104,907 | 54.4% | \$9,044,330 | 266.5% |
| 1/1/2002 | \$29,429,260 | \$47,842,001 | \$18,412,741 | 61.5% | \$8,337,379 | 220.8% |
| 1/1/2000 | \$27,150,564 | \$40,926,782 | \$13,776,218 | 66.3% | \$7,516,008 | 183.3% |

NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 6 - MEMBERSHIP EXHIBIT

| | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 |
|---|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|
| Retirement in Past Years | | | | | | | | | | |
| Superannuation | 3 | 13 | 10 | 25 | 7 | 2 | 1 | 2 | 7 | 5 |
| Ordinary Disability | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Accidental Disability | 0 | 1 | 1 | 1 | 0 | 2 | 0 | 0 | 0 | 1 |
| Total Retirements | 3 | 14 | 11 | 26 | 7 | 4 | 1 | 2 | 7 | 6 |
| Total Retirees, Beneficiaries and Survivors | 207 | 213 | 227 | 214 | 227 | 227 | 224 | 223 | 222 | 221 |
| Total Active Members | 292 | 274 | 264 | 282 | 309 | 287 | 272 | 282 | 252 | 241 |
| Pension Payments | | | | | | | | | | |
| Superannuation | \$1,311,186 | \$1,393,388 | \$1,554,098 | \$1,683,852 | \$2,169,481 | \$2,345,744 | \$2,498,776 | \$2,603,919 | \$2,641,423 | \$2,715,845 |
| Survivor/Beneficiary Payments | 97,295 | 109,722 | 102,989 | 96,533 | 91,246 | 91,851 | 95,308 | 82,083 | 83,871 | 92,896 |
| Ordinary Disability | 27,326 | 27,686 | 37,511 | 31,873 | 22,468 | 15,353 | 15,713 | 16,073 | 16,433 | 16,793 |
| Accidental Disability | 600,347 | 591,311 | 647,571 | 721,145 | 726,263 | 727,746 | 772,879 | 798,985 | 759,299 | 796,070 |
| Other | 297,960 | 343,794 | 306,606 | 283,907 | 293,759 | 413,171 | 389,003 | 365,902 | 387,506 | 423,703 |
| Total Payments for Year | <u>\$2,334,114</u> | <u>\$2,465,901</u> | <u>\$2,648,775</u> | <u>\$2,817,310</u> | <u>\$3,303,217</u> | <u>\$3,593,865</u> | <u>\$3,771,679</u> | <u>\$3,866,962</u> | <u>\$3,888,532</u> | <u>\$4,045,307</u> |

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