

PERAC AUDIT REPORT



Teachers'
Contributory Retirement System



JAN. 1, 2007 - DEC. 31, 2009



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PERAC

COMMONWEALTH OF MASSACHUSETTS | PUBLIC EMPLOYEE RETIREMENT ADMINISTRATION COMMISSION

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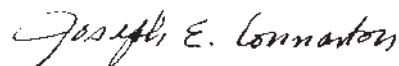
June 21, 2011

The Public Employee Retirement Administration Commission has completed an examination of the Massachusetts Teachers' Retirement System (MTRS) pursuant to G.L. c. 32, § 21. The examination covered the period from January 1, 2007 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 Tivnan, James Ryan, Carol Niemira, and John Shea 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. Annuity Savings Fund/Supplemental Membership Schedule

The Annuity Savings Fund general ledger balance as of 12/31/09 is greater than the balance accumulated in the Supplemental Membership Schedule database file. During the course of the previous audit, an adjusting journal entry was made to increase the general ledger Annuity Savings Fund balance. PERAC requires that each Annual Statement contain a Supplemental Membership Schedule that lists the activity and balance of each member's account. This schedule must agree with the Annuity Savings Fund Account balance carried on the general ledger. The variance between the general ledger balance and the Supplemental Membership Schedule balance is due to the Supplemental Membership Schedule not being consistently updated and reconciled to the general ledger balance. This database of membership activity is the most significant automated record of membership that a retirement system manages. The failure to manage the data on a timely basis may compromise the accuracy of membership data within the general ledger.

Recommendation: As part of the data migration and conversion process during implementation of the new Vitech MyTRS software system, it is critical that an analysis be made of each member's account by MTRS and any necessary adjustments be made to the Supplemental Membership Schedule balances. Once an accurate balance is determined, MTRS must reconcile the data to the general ledger. Any unexplained variances should either be adjusted on the general ledger or within the new MyTRS software system. Going forward, a comprehensive monthly process must be established to reconcile the general ledger to the Supplemental Membership Schedule.

Board Response:

The MTRS, as part of the data migration and conversion process for our new pension management and reporting system (MyTRS) established a dedicated data cleansing and conversion team in order to minimize the merging of inconsistent or inaccurate data from our legacy system to MyTRS. Once the final conversion and analysis has been completed, the MTRS will reconcile the data to the general ledger. Going forward, the MTRS will establish a timely reconciliation process of the general ledger to the Supplemental Membership Schedule.

2. Membership

The auditor sampled active members' contributions from the 415 MTRS school districts to determine that the correct rates are being assigned and withheld, and that the additional 2% deduction is withheld from those members who make over \$30,000, who were hired after January 1, 1979 but before July 1, 2001, and have not elected to participate in *RetirementPlus*. The majority of members' deductions reviewed appeared to be accurate. Deductions for four percent of the members sampled were found to be incorrect, and the MTRS database was in error in two cases where deductions were proven to be taken at the correct rate. Additionally, the latest deductions posted for seven percent of districts dated to December 2009, meaning later attempts at submission may contain unresolved errors.

Most of the deduction errors (11 out of 14) involved withholding at an 11% rate when a lower rate was correct, usually pertaining a member who transferred into MTRS with prior service and did not choose *RetirementPlus*. Transfer information used to determine the proper deduction rate may not be received until months after MTRS creditable service begins. In such cases, schools were

EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

observed to have correctly initiated deductions at the mandatory 11%, but then failed to adjust to a lower rate.

In three cases, an incorrect deduction rate was applied to service transferred. This rate was too high. The incorrect rate was applied to a non-Retirement*Plus* member's initial school employment. It also continued to apply to the member who subsequently was employed in other districts.

Recommendation: The daunting task of monitoring the deductions of some 83,000 active members requires constant attention and communication. Employee turnover of payroll officers may require frequent retraining and review. Rate errors must be swiftly and routinely identified by payroll officers and, if not identified before submission, then by MTRS with the schools being promptly notified. The new MyTRS system being implemented transfers the burden of accuracy to the payroll officers. The extensive backlog of acceptable deduction reports should be resolved as schools learn the new system, which identifies most errors immediately and requires their correction before reports can be submitted. MTRS representatives are actively working with school districts to resolve errors holding up the submission of the oldest deduction reports. This should facilitate the accurate submission of these reports and all those generated subsequently.

Because MTRS, not the school districts, obtains authoritative data concerning transfers, immediate communication to payroll officers upon rate validation would no doubt be helpful in reducing the most frequent cause of errors discovered in this audit. A member's rate status, including "Hold" while the Retirement*Plus* option is being considered by incoming transfers, is now visible in MyTRS, and a confirming message will be sent to schools. Prompt notification to schools and/or payroll officer's discovery via MyTRS error reporting will help ensure accurate reporting of member deductions.

The next audit should be able to determine the efficacy of the MyTRS system and enable PERAC auditors to comment more definitively.

Board Response:

The MTRS continues to present annual and ad hoc training sessions for the school business and payroll officers, as well as town finance officials for our 415 employer units. Additionally we post training and guided practice guides on line for easy access for our employers. We also partner with several of our stakeholder groups (e.g. the Massachusetts Association of School Business Officials, the Massachusetts Association of School Personnel Administrators and the Massachusetts Association of School Superintendents) for additional trainings and MTRS updates.

As noted in the audit the MTRS has recently rolled out phase 2 of the MyTRS system, which requires our employer units to submit their deduction reports electronically. MyTRS will detect most payroll errors immediately and require the employers to correct those errors before they submit the data to MTRS. The implementation of this phase of MyTRS is a priority for the MTRS, and once employers become more familiar with the new reporting and additional system validations, it will help to ensure accurate reporting and reduce processing delays.

EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

3. Annuity Reserve Fund (ARF) Interest

A stale beginning balance was inadvertently inserted into the spreadsheet used to calculate all three years' ARF interest, causing annual shortfalls in the interest posted to that fund.

Recommendation: An adjusting journal entry of \$29,578,500 must be posted to the general ledger in 2010 to add the required interest (debit #3297 Pension Reserve Fund, credit #3294 Annuity Reserve Fund). The resulting total of the 2009 ARF balance as reported on the MTRS Annual Statement plus the adjustment should then be used as the beginning balance for the 2010 ARF interest calculation.

Board Response:

The recommended adjusting journal entry of \$29,578,500 was posted to the general ledger to add the required interest resulting in a correct beginning fund balance for the 2010 ARF interest calculation.

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	2007
Net Assets Available For Benefits:			
Cash	\$193,604,890	\$46,137,409	\$57,998,633
PRIT Cash Fund	17,922,988	29,070,558	35,723,938
PRIT Core Fund	19,311,587,953	17,177,957,406	25,280,320,141
Interest Due and Accrued	0	0	0
Prepaid Expenses	180,668	0	0
Accounts Receivable	65,249,310	55,911,350	44,949,570
Software Acquisition & Development Costs, Net	7,868,871	5,154,047	0
Accounts Payable	(127,194,712)	(178,919)	(100,278,390)
Total	\$19,469,219,967	\$17,314,051,851	\$25,318,713,892
Fund Balances:			
Annuity Savings Fund	\$4,928,039,833	\$4,688,917,206	\$4,467,312,578
Annuity Reserve Fund	2,444,390,289	2,373,445,172	2,262,133,578
Pension Fund	0	0	0
Military Service Fund	319,019	290,954	262,450
Expense Fund	0	0	0
Pension Reserve Fund	12,096,470,826	10,251,398,519	18,589,005,286
Total	\$19,469,219,967	\$17,314,051,851	\$25,318,713,892

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)	\$4,307,882,175	\$2,108,945,790	\$0	\$221,230	\$0	\$16,770,946,127	\$23,187,995,322
Receipts	575,732,117	56,645,248	834,962,384	41,220	143,720,370	2,529,248,361	4,140,349,700
Interfund Transfers	(382,466,604)	382,466,660	711,189,146	0	0	(711,189,202)	0
Disbursements	(33,835,110)	(285,924,120)	(1,546,151,530)	0	(143,720,370)	0	(2,009,631,130)
Ending Balance (2007)	4,467,312,578	2,262,133,578	0	262,450	0	18,589,005,286	25,318,713,892
Receipts	620,281,844	58,777,549	820,578,404	28,504	151,702,713	(7,554,831,921)	(5,903,462,907)
Interfund Transfers	(365,935,516)	365,935,516	782,774,846	0	0	(782,774,846)	0
Disbursements	(32,741,700)	(313,401,471)	(1,603,353,250)	0	(151,702,713)	0	(2,101,199,134)
Ending Balance (2008)	4,688,917,206	2,373,445,172	0	290,954	0	10,251,398,519	17,314,051,851
Receipts	623,582,965	58,302,355	812,884,577	28,065	137,466,261	2,751,567,155	4,383,831,378
Interfund Transfers	(354,715,402)	354,715,402	906,494,849	0	0	(906,494,849)	0
Disbursements	(29,744,936)	(342,072,640)	(1,719,379,426)	0	(137,466,261)	0	(2,228,663,263)
Ending Balance (2009)	<u>\$4,928,039,833</u>	<u>\$2,444,390,289</u>	<u>\$0</u>	<u>\$319,019</u>	<u>\$0</u>	<u>\$12,096,470,826</u>	<u>\$19,469,219,967</u>

STATEMENT OF RECEIPTS

	FOR THE PERIOD ENDING DECEMBER 31,		
	2009	2008	2007
Annuity Savings Fund:			
Members Deductions	\$574,838,042	\$559,291,000	\$523,133,382
Transfers from Other Systems	13,039,856	19,548,080	11,957,140
Member Make Up Payments and Re-deposits	9,052,502	9,819,500	12,075,210
Member Payments from Rollovers	5,136,403	7,321,660	7,865,380
Investment Income Credited to Member Accounts	<u>21,516,163</u>	<u>24,301,604</u>	<u>20,701,005</u>
Sub Total	<u>623,582,965</u>	<u>620,281,844</u>	<u>575,732,117</u>
Annuity Reserve Fund:			
Investment Income Credited to the Annuity Reserve Fund	<u>58,302,355</u>	<u>58,777,549</u>	<u>56,645,248</u>
Pension Fund:			
3 (8) (c) Reimbursements from Other Systems Received from Commonwealth for COLA and Survivor Benefits	13,307,848	8,648,710	9,462,384
Pension Fund Appropriation	125,774,730	112,414,934	91,015,360
Pension Fund Appropriation	673,557,199	699,514,760	734,484,640
Settlement of Workers' Compensation Claims	<u>244,800</u>	<u>0</u>	<u>0</u>
Sub Total	<u>812,884,577</u>	<u>820,578,404</u>	<u>834,962,384</u>
Military Service Fund:			
Contribution Received from Employer on Account of Military Service	26,736	26,955	39,898
Investment Income Credited to the Military Service Fund	<u>1,329</u>	<u>1,549</u>	<u>1,322</u>
Sub Total	<u>28,065</u>	<u>28,504</u>	<u>41,220</u>
Expense Fund:			
Expense Fund Appropriation	0	0	0
Investment Income Credited to the Expense Fund	<u>137,466,261</u>	<u>151,702,713</u>	<u>143,720,370</u>
Sub Total	<u>137,466,261</u>	<u>151,702,713</u>	<u>143,720,370</u>
Pension Reserve Fund:			
Federal Grant Reimbursement	4,234,811	4,428,360	3,283,790
Pension Reserve Appropriation	0	0	0
Interest Not Refunded	496,302	631,914	743,360
Section 91 Recovery	24,551	0	0
Excess Investment Income (Loss)	<u>2,746,811,490</u>	<u>(7,559,892,196)</u>	<u>2,525,221,211</u>
Sub Total	<u>2,751,567,155</u>	<u>(7,554,831,921)</u>	<u>2,529,248,361</u>
Total Receipts, Net	<u>\$4,383,831,378</u>	<u>(\$5,903,462,907)</u>	<u>\$4,140,349,700</u>

STATEMENT OF DISBURSEMENTS

	FOR THE PERIOD ENDING DECEMBER 31,		
	2009	2008	2007
Annuity Savings Fund:			
Refunds to Members	\$23,982,434	\$26,363,190	\$28,318,850
Transfers to Other Systems	<u>5,762,501</u>	<u>6,378,510</u>	<u>5,516,260</u>
Sub Total	<u>29,744,936</u>	<u>32,741,700</u>	<u>33,835,110</u>
Annuity Reserve Fund:			
Annuities Paid	339,663,857	312,264,830	284,007,480
Option B Refunds	<u>2,408,783</u>	<u>1,136,641</u>	<u>1,916,640</u>
Sub Total	<u>342,072,640</u>	<u>313,401,471</u>	<u>285,924,120</u>
Pension Fund:			
Pensions Paid	1,464,456,507	1,364,371,566	1,354,966,080
3(8)(c) Reimbursements to Other Systems	129,148,190	126,566,750	100,170,090
State Reimbursable COLA's Paid	125,774,730	112,414,934	91,015,360
Chapter 389 Beneficiary Increase Paid	<u>0</u>	<u>0</u>	<u>0</u>
Sub Total	<u>1,719,379,426</u>	<u>1,603,353,250</u>	<u>1,546,151,530</u>
Military Service Fund:			
Return to Employer for Members Who Withdrew Their Funds	<u>0</u>	<u>0</u>	<u>0</u>
Expense Fund:			
Board Member Stipend	0	0	0
Salaries	6,437,102	4,243,623	5,966,610
Legal Expenses	23,770	52,450	48,690
Reimbursement of ERI and 3(8)(c) Receipts to the Commonwealth's General Fund	17,319,256	28,997,660	0
Travel Expenses	11,685	59,290	54,210
Administrative Expenses	385,446	749,890	876,680
PERAC Expenses	3,692,207	3,348,390	3,535,970
Education and Training	4,684	0	0
Furniture and Equipment	486,536	129,830	25,140
Management Fees	102,960,350	106,786,186	129,157,210
Federal Grants Distributed	4,234,811	4,428,360	3,283,790
Consultant Fees	0	0	0
Rent Expenses	765,668	743,253	772,070
Service Contracts	1,144,746	2,163,780	0
Fiduciary Insurance	<u>0</u>	<u>0</u>	<u>0</u>
Sub Total	<u>137,466,261</u>	<u>151,702,713</u>	<u>143,720,370</u>
Total Disbursements	<u>\$2,228,663,263</u>	<u>\$2,101,199,134</u>	<u>\$2,009,631,130</u>

INVESTMENT INCOME

	FOR THE PERIOD ENDING DECEMBER 31,		
	2009	2008	2007
Investment Income Received From:			
Cash	\$0	\$0	\$0
Pooled or Mutual Funds	528,791,117	755,860,900	802,760,507
Commission Recapture	0	0	0
Total Investment Income	<u>528,791,117</u>	<u>755,860,900</u>	<u>802,760,507</u>
Plus:			
Realized Gains	394,602,842	283,037,300	1,956,092,364
Unrealized Gains	4,685,061,004	1,221,480,440	1,943,251,992
Interest Due and Accrued - Current Year	0	0	0
Sub Total	<u>5,079,663,846</u>	<u>1,504,517,740</u>	<u>3,899,344,356</u>
Less:			
Paid Accrued Interest on Fixed Income Securities	0	0	0
Realized Loss	(1,273,684,478)	(4,008,321,580)	0
Unrealized Loss	(1,370,672,887)	(5,577,165,840)	(1,955,815,707)
Interest Due and Accrued - Prior Year	0	0	0
Sub Total	<u>(2,644,357,365)</u>	<u>(9,585,487,420)</u>	<u>(1,955,815,707)</u>
Net Investment Income (Loss)	<u>2,964,097,598</u>	<u>(7,325,108,780)</u>	<u>2,746,289,156</u>
Income Required:			
Annuity Savings Fund	21,516,163	24,301,604	20,701,005
Annuity Reserve Fund	58,302,355	58,777,549	56,645,248
Military Service Fund	1,329	1,549	1,322
Expense Fund	<u>137,466,261</u>	<u>151,702,713</u>	<u>143,720,370</u>
Total Income Required	<u>217,286,108</u>	<u>234,783,416</u>	<u>221,067,945</u>
Net Investment Income (Loss)	<u>2,964,097,598</u>	<u>(7,325,108,780)</u>	<u>2,746,289,156</u>
Less: Total Income Required	<u>217,286,108</u>	<u>234,783,416</u>	<u>221,067,945</u>
Excess Income (Loss) To The Pension Reserve Fund	<u>\$2,746,811,490</u>	<u>(\$7,559,892,196)</u>	<u>\$2,525,221,211</u>

SCHEDULE OF ALLOCATION OF INVESTMENTS OWNED

(percentages by category)

AS OF DECEMBER 31, 2009		
	MARKET VALUE	PERCENTAGE OF TOTAL ASSETS
Cash	\$193,604,890	1.0%
PRIT Cash Fund	17,922,988	0.1%
PRIT Core Fund	19,311,587,953	98.9%
Grand Total	\$19,523,115,831	100.0%

For the year ending December 31, 2009, the rate of return for the investments of the Massachusetts Teachers' Retirement System was 17.86%. For the five-year period ending December 31, 2009, the rate of return for the investments of the Massachusetts Teachers' Retirement System averaged 4.17%. For the twenty-five-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 Massachusetts Teachers' Retirement System was 9.60%.

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 twenty-five-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 Massachusetts Teachers' Retirement System is invested 100% in the PRIT Fund and therefore has no supplementary investment regulations.

NOTES TO FINANCIAL STATEMENTS

NOTE I – SUMMARY OF PLAN PROVISIONS

The plan is a contributory defined benefit plan covering all Massachusetts Teachers' Retirement System member unit employees deemed eligible by the retirement board, as well as State-Boston Retirement System school department employees who serve in a teaching, administrative, or other capacity deemed eligible by the retirement board.

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 Systems, however all teachers are classified in Group I.

Group I:

General employees, including clerical, administrative, technical, and all other employees not otherwise classified. All Massachusetts Teachers' Retirement System members are classified in Group I.

NOTES TO FINANCIAL STATEMENTS (Continued)

MEMBER CONTRIBUTIONS

Member contributions vary depending on the most recent date of membership and whether the member has accepted the provisions of Chapter 114 of the Acts of 2000, thereby enrolling in *RetirementPlus*. This term includes the Teachers' Alternate Retirement Program (TARP) of the State-Boston Retirement System.

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

If the member's most recent date of membership was prior to July 1, 2001 and the member has enrolled in *RetirementPlus*, and any member beginning service on or after July 1, 2001:

7/1/01 to present: 11% of regular compensation

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

There is no mandatory retirement age for employees in Group I.

SUPERANNUATION RETIREMENT

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

- completion of 20 years of service (30 years for *RetirementPlus*), or
- attainment of age 55 if hired prior to 1978, or
- attainment of age 55 with 10 years of service, if hired after 1978

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 years of service at retirement. 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 traditional benefit rate coincides with the member's years of service applied to a group classification rate based upon age at retirement. The highest rate of 2.5% applies to Group I employees who retire at or after age 65. A .1% reduction is applied for each year of age under the maximum age for the member's group.
- An enhanced benefit rate termed *RetirementPlus* requires larger annuity contributions by the member. As a result, a *RetirementPlus* member's benefit rate is increased by an additional percentage added to the traditional benefit rate. The additional percentage begins at 12% upon completion of 30 years' service and increases 2% for each additional full year of service to a maximum of 32%. The increased benefit rate is capped at 80% to conform to the maximum retiree benefit limit applied against average salary.

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.

NOTES TO FINANCIAL STATEMENTS (Continued)

WITHDRAWAL OF CONTRIBUTIONS

Member contributions may be withdrawn upon termination of employment. Employees who first become members on or after January 1, 1984 and voluntarily terminate their service after less than 10 years receive 3% interest. All others receive all interest credited. Both groups accrue no additional interest two years after becoming inactive.

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.

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 \$729.84 per year, 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 \$729.84 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.

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.

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

Investments are reported at their fair value. Mutual, commingled and pooled funds are valued based on the net asset or unit value at year end. 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. Investment income is recorded as earned on an accrual basis. 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 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 relies upon the investment strategy of the PRIM Board to maintain progress toward full funding of the system. That strategy seeks to balance the exposure to common deposit and investment risks related to custody, credit concentrations, interest rate and foreign currency fluctuations.

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

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.

NOTES TO FINANCIAL STATEMENTS (Continued)

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 Massachusetts Teachers' Retirement System submitted the following supplementary membership regulations, which have been approved by the Public Employee Retirement Administration Commission. The complete text of all regulations can be viewed on the MTRS website: www.mass.gov/mtrs.

807 CMR 2.00: Rules of Election

807 CMR 3.00: Retirement and Credit for Service

807 CMR 4.00: Eligibility for Membership

807 CMR 5.00: Employer Reporting Requirements

807 CMR 6.00: Regular Compensation

807 CMR 7.00: Documentation to be obtained for Ordinary or Accidental Disability

807 CMR 9.00: Elective Payroll Deductions for Retirement*Plus* Accelerated Contributions Under M.G.L. c. 32, § 5

807 CMR 10.00: Maternity Service Purchases

807 CMR 12.00: Rollover Distributions and Trust to Trust Transfers

807 CMR 13.00: Transfer of Membership of Retirement*Plus* Members

807 CMR 14.00: Purchase of Creditable Service for Prior Vocational Work Experience

807 CMR 15.00: Confidentiality of Information

807 CMR 16.00: Qualified Excess Benefit Arrangement

807 CMR 17.00: Workers' Compensation Benefit Offset and Verification

807 CMR 18.00: Mandatory Direct Deposit

807 CMR 19.00: Eligibility for Out of State Service Purchase

Travel Regulations:

The MTRS Board adopted a travel policy May 24, 2001, amended most recently on July 20, 2010.

NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 4 - ADMINISTRATION OF THE SYSTEM

The System is administered by a seven-person Board of Retirement consisting of the Commissioner of Education or his designee who shall be a member ex-officio and serve as chairman, a second member appointed by the Governor and who shall be a retired former public school teacher within the Commonwealth, a third and fourth member who shall be elected by the members in or retired from the service of such system, the State Treasurer and the State Auditor or one designee of each, and a seventh member appointed by the other six board members.

Ex-officio Member's Designee: Jeff Wulfson

Appointed Member: Ellen T. Hargraves Term Expired: 4/18/10
Serving until reappointed or replaced

Elected Member: John A.M. Dow, Jr. Term Expires: 12/31/11

Elected Member: Karen Ann Mitchell Term Expires: 12/31/11

Appointed Member: Linda M. Ruberto Term Expires: 1/31/12

Treasurer's Designee: Nicola Favorito

Auditor's Designee: John Parsons

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 PRIM Board. All retirement allowances must be approved by the Retirement Board. The annual budget for expenses estimated to be incurred by the System must be approved by a majority vote of the Board. Payments shall be made only upon vouchers signed by a designee of 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:

Ex-officio Member:)	ERISA Bond
Elected Members:)	in the amount of \$500,000
Appointed Members:)	issued through the Hartford Casualty
Staff Employees:)	Insurance Company

NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 5 - ACTUARIAL VALUATION AND ASSUMPTIONS

The most recent actuarial valuation of the System was prepared by the Public Employee Retirement Administration Commission as of January 1, 2010.

\$000's omitted	
The actuarial liability for active members was	\$14,703,294
The actuarial liability for retired and inactive members was	<u>19,035,672</u>
The total actuarial liability was	33,738,966
System assets as of that date were	<u>21,262,462</u>
The unfunded actuarial liability was	<u>\$12,476,504</u>
The ratio of system's assets to total actuarial liability was	63.0%
As of that date the total covered employee payroll was	\$5,509,698

The normal cost for employees on that date was 9.74% of payroll
 The normal cost for the employer was 1.88% of payroll

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

Investment Return: 8.25% per annum
 Rate of Salary Increase: Varies by length of service

GASB STATEMENT NO. 25, DISCLOSURE INFORMATION AS OF JANUARY 1, 2010

\$000's omitted

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)
1/1/2010	\$21,262,462	\$33,738,966	\$12,476,504	63.0%	\$5,509,698	226.4%
1/1/2009	\$18,927,731	\$32,543,782	\$13,616,051	58.2%	\$5,389,895	252.6%
1/1/2008	\$22,883,553	\$30,955,504	\$8,071,951	73.9%	\$5,163,498	156.3%
1/1/2007	\$20,820,392	\$29,320,714	\$8,500,322	71.0%	\$4,969,092	171.1%
1/1/2006	\$18,683,295	\$27,787,716	\$9,104,421	67.2%	\$4,819,325	188.9%
1/1/2005	\$17,683,368	\$26,166,675	\$8,483,307	67.6%	\$4,642,765	182.7%

NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 6 - MEMBERSHIP EXHIBIT

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Retirement in Past Years										
Superannuation	2,348	1,437	1,359	1,352	3,788	3,444	4,327	3,362	3,085	2,756
Ordinary Disability	27	5	24	12	20	19	17	13	12	16
Accidental Disability	16	5	9	6	8	7	16	2	3	5
Total Retirements	2,391	1,447	1,392	1,370	3,816	3,470	4,360	3,377	3,100	2,777
Total Retirees, Beneficiaries and Survivors	33,063	34,897	37,443	39,755	42,532	44,871	48,050	50,491	52,615	54,465
Total Active Members	80,592	83,692	80,191	84,255	84,117	83,723	85,847	86,134	86,421	82,779
Pension Payments										
Pension Benefits Paid	\$524,067,215	\$593,647,040	\$683,104,926	\$779,131,002	\$898,472,290	\$1,006,661,500	\$1,124,799,860	\$1,354,966,080	\$1,364,371,566	\$1,464,456,507
Other	27,648,698	118,532,180	99,637,668	116,768,109	140,170,680	162,484,460	181,382,560	191,185,450	238,981,684	254,922,920
Total Payments for Year	<u>\$551,715,913</u>	<u>\$712,179,220</u>	<u>\$782,742,594</u>	<u>\$895,899,111</u>	<u>\$1,038,642,970</u>	<u>\$1,169,145,960</u>	<u>\$1,306,182,420</u>	<u>\$1,546,151,530</u>	<u>\$1,603,353,250</u>	<u>\$1,719,379,427</u>

NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 7 – LEASED PREMISES

The Massachusetts Teachers' Retirement System leases approximately 17,800 square feet of space for its offices in the One Charles Park office building at Cambridgeport Plaza, in Cambridge. They signed an initial five year lease term (\$43.50 per square foot) and are in the last year of that initial term; the lease term expires March 14, 2011. The landlord is a property management company, Charles Park One, LLC. As of the date of this audit an extension of this lease had not been finalized.

There is also an office in Western Massachusetts located at 1414 Main Street in Springfield. subject to a new lease agreement. The office contains 2,661 square feet at a cost of \$21.95 per square foot. The term is five years expiring November 30, 2015. The landlord is the Picknelly Family Limited Partnership.

The following schedule displays the minimum lease obligations on non-cancelable operating leases as of December 31, 2009:

For the year ending:

2010	\$ 800,620.89
2011	\$ 219,715.27
2012	\$ 58,408.92
2013	\$ 58,408.92
2014	\$ 58,408.92
Later years	<u>\$ 53,541.51</u>
Total future minimum lease payments required	<u>\$ 1,249,104.43</u>

NOTE 8 – SOFTWARE ACQUISITION AND DEVELOPMENT COSTS

The Massachusetts Teachers' Retirement System is investing in new technology to improve service to its members and retirees. During 2008, the system approved a significant initiative involving a major upgrade to its technology platform. It is designed to improve the accuracy of reporting from the multiple units that provide payroll data to the system. Additional applications and upgrades will continue to be added to the platform as necessary. The estimated total project cost is \$32.3 million with an estimated completion date of March 2017. The project team is now focused on testing and integration of the initial phase of this project.

The system will allow for wage and contribution reporting; generate benefit estimates; issue refunds; accurately determine the cost of purchased service; process retirements; payroll tax reporting; Form 1099R processing; and issue annual statements of members contributions. The system will allow for compliance with state and federal law. It is expected to improve efficiency by streamlining the current business processes. It will provide for browser-based access to data and applications for members, users, employers, and managers. It will provide for Internet based self-service functions. It will improve access to imaged documents and minimize the collection of paper documents.

NOTES TO FINANCIAL STATEMENTS (Continued)

The data conversion will result in additional functionality for the users; provides more accurate data to improve the counseling and decision options for potential retirees. It will provide additional security to prevent the disclosure of confidential information to unauthorized persons. The upgrade expected in the training and use of the system will enhance the operations and functions of the Massachusetts Teachers Retirement System.

Capitalized costs consisted of the following components as of December 31, 2009:

Asset Classification:	Acquisition Cost	Service Life:
Software	\$2,851,676	3-7 years
Hardware	\$584,320	3-7 years
Project Management	\$1,613,640	3-7 years
Other	\$2,819,235	3-7 years

Commitments in future periods for agreements currently in place consist of the following:

2010	\$2,112,049
2011	\$3,692,380
2012	\$3,864,064
2013	\$4,399,964
2014	\$1,674,952
Thereafter	\$2,766,145

NOTE 9 – BOSTON RETIREMENT SYSTEM FUNDING OBLIGATIONS

Prior to May 22, 2010, the obligation for teachers who are members of the Boston Retirement System had been funded on a pay-as-you-go basis. Ch 112, Acts of 2010 §§ 7 through 18 mandated the apportioning of the assets related to Boston teachers' from the remainder of the Boston Retirement System's investments. The statute required those assets be transferred into PRIM for the benefit of Boston teachers, and continue to be reported as part of the Boston Retirement System financials. The major change is that MTRS will no longer fund any shortfall between the actual cost of Boston teachers' benefits and the appropriation funded by the Commonwealth of Massachusetts.

As of July 1, 2010 (FY 2011), the Commonwealth of Massachusetts took over as a contributing employer for Boston teachers. The Comptroller of the Commonwealth retains considerable discretion in timing the funding of the appropriations associated with both the MTRS and the portion attributed to the Boston teachers' assets transferred into PRIM. This discretion is directed by the normal budgetary considerations inherent within the Commonwealth's legislative process. As a practical matter, it was determined to use MTRS as a conduit to fund the portion directly to the City of Boston to be used for the exclusive benefit of their teachers.

MTRS received, as part of its FY10 appropriation, \$115,986,000 for the Boston teachers. That exact amount was forwarded to the City of Boston on June 17, 2010. The FY 2011 appropriation for Boston teachers of \$121,290,000 was received by MTRS in December and paid to Boston on January 10, 2011. Going forward, the Boston teachers' appropriation received from the Commonwealth will be forwarded promptly upon receipt by MTRS.

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