



Commonwealth of Massachusetts
Office of the State Auditor
Suzanne M. Bump

Making government work better

Official Audit Report – Issued June 28, 2018

Public Employee Retirement Administration Commission

For the period July 1, 2015 through June 30, 2017





Commonwealth of Massachusetts
Office of the State Auditor
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Making government work better

June 28, 2018

Mr. Joseph E. Connarton, Executive Director
Public Employee Retirement Administration Commission
5 Middlesex Avenue, Suite 304
Somerville, MA 02145

Dear Mr. Connarton:

I am pleased to provide this performance audit of the Public Employee Retirement Administration Commission. This report details the audit objectives, scope, methodology, finding, and recommendations for the audit period, July 1, 2015 through June 30, 2017. My audit staff discussed the contents of this report with management of the agency, whose comments are reflected in this report.

I would also like to express my appreciation to the Public Employee Retirement Administration Commission for the cooperation and assistance provided to my staff during the audit.

Sincerely,

A handwritten signature in blue ink, appearing to read "SMBump".

Suzanne M. Bump
Auditor of the Commonwealth

cc: Philip Y. Brown, Esq., Chair, Public Employee Retirement Administration Commission

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EXECUTIVE SUMMARY

In accordance with Section 12 of Chapter 11 of the Massachusetts General Laws, the Office of the State Auditor has conducted an audit of certain activities of the Public Employee Retirement Administration Commission (PERAC) for the period July 1, 2015 through June 30, 2017. This audit was undertaken to determine whether PERAC effectively administered various aspects of the disability retirement process for public employees and conducted its oversight activities in compliance with applicable laws and regulations.

Below is a summary of our finding and recommendations, with links to each page listed.

Finding 1 Page 9	PERAC did not always approve disability retirement benefits calculated by retirement boards.
Recommendations Page 10	<ol style="list-style-type: none">1. PERAC should perform reviews to identify all disability retirement benefits for which benefit calculations have not been approved.2. PERAC should develop and implement monitoring controls to ensure that retirement boards follow its existing regulations. These controls should ensure that all required disability retirement benefit calculations and necessary documentation are submitted to PERAC for approval before the board makes the first payment to the applicant. The controls could include communication between PERAC's Legal and Actuarial Units to ensure that the Actuarial Unit stays informed of newly approved retirement cases for which a benefit calculation will need to be approved.

Post-Audit Action

After our audit ended, PERAC's general counsel and deputy director informed us that PERAC had begun the process of contacting retirement boards as necessary to request that the calculations identified in the audit be submitted for review and approval.

OVERVIEW OF AUDITED ENTITY

Background

The Public Employee Retirement Administration Commission (PERAC), established by Chapter 306 of the Acts of 1996, is responsible for the oversight and regulation of the 104 public retirement systems in Massachusetts. PERAC provides a variety of daily oversight functions to retirement boards. Its various units (see Appendix A) approve benefit calculations; review disability applications; review investment procurement, contracts, and vendor disclosures; and conduct retirement system actuarial valuations.¹ In addition, PERAC performs field examinations and desk reviews of the records of all public retirement systems at least once every three years. PERAC also provides training as well as legal and technical assistance to retirement boards.

PERAC has promulgated regulations (Section 10 of Title 840 of the Code of Massachusetts Regulations) governing disability retirement procedures that retirement boards must follow. As part of its oversight under these requirements, PERAC schedules medical examinations and is responsible for final approval of every disability case.

According to its enabling statute, PERAC falls under, but is not subject to, the Executive Office for Administration and Finance; it is thus an independent agency. As of September 2017, PERAC had 54 employees. Its headquarters are at 5 Middlesex Avenue in Somerville.

Commission Composition and Duties

In accordance with Section 49 of Chapter 7 of the Massachusetts General Laws, PERAC is directed by seven unpaid commissioners. The Governor² appoints three members and the State Auditor appoints three members;³ these six members choose a seventh member as chair, as well as an executive director,

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1. The PERAC website defines “actuarial valuation” as follows: “The valuation is a ‘snapshot’ picture of how well the plan is funded at that time. The valuation compares the plan’s liabilities (current and future payments to be made upon retirement, death, disability, or termination of employment) with the plan’s assets (both employer and employee contributions credited with investment earnings).”
 2. Of the three members appointed by the Governor, one is the Governor or his/her designee, one is a representative of a public safety union, and one is an expert in the investment of funds.
 3. Of the three members appointed by the State Auditor, one is the State Auditor or his/her designee, one is the president of the Massachusetts American Federation of Labor and Congress of Industrial Organizations or his/her designee, and one is a representative of the Massachusetts Municipal Association. Generally accepted government auditing standards require that organizations be free from organizational impairments to independence with respect to the entities they audit. This disclosure is made for informational purposes only, and this circumstance did not interfere with our ability to perform our audit work and report the results thereof impartially.

who plans and oversees the administrative functions of the agency. As of September 2017, the commission was directed by the following members:

- Philip Y. Brown, Esq., chair
- Kathleen M. Fallon, designee, appointed by the Governor
- Timothy Dooling, designee, appointed by the State Auditor
- James M. Machado, public safety representative, appointed by the Governor
- Jennifer F. Sullivan, investment professional, appointed by the Governor
- Kate Fitzpatrick, Massachusetts Municipal Association representative, appointed by the State Auditor
- Robert B. McCarthy, American Federation of Labor and Congress of Industrial Organizations designee, appointed by the State Auditor

The commissioners, who meet once per month, vote on internal and external policies and procedures, promulgate regulations, adopt an annual operating budget, and recommend legislation. They have also established several subcommittees (see Appendix B) that meet regularly to review and concentrate on specific areas of policies/procedures.

Medical Panel Examinations

Pursuant to Chapter 32 of the General Laws, any member of a public retirement system in Massachusetts who applies for disability retirement benefits must be examined by three independent doctors who specialize in the applicant's area of disability. The doctors are referred to as a medical panel. For an applicant to receive disability retirement benefits, at least two of the three panel physicians must agree that s/he cannot perform the essential duties of his/her particular job and that the disability is likely to be permanent. In the case of an application for accidental disability retirement, at least two of the three panel physicians must also certify that the injury is job-related. PERAC is statutorily responsible for scheduling and paying for these medical appointments.

In addition to completing a thorough physical examination, the medical panel reviews the medical information provided by the applicant's retirement board, completes appropriate certificates, and submits a written narrative report to PERAC in support of its conclusions. PERAC reviews each narrative report and certificate to ensure that every question has been answered and that the physicians have

complied with PERAC’s procedures and requirements. After its review, PERAC forwards the completed narrative report and certificates to the applicant’s retirement board.

PERAC Final Approval of Disability Applications

On receipt of the medical panel report and other evidence, the applicant’s retirement board makes its decision about whether to grant disability retirement benefits. If the retirement board approves the application, it sends the application to PERAC for final action. If the board denies the application, it advises the applicant of his/her right to appeal the decision.

According to statute, PERAC must approve every disability application before it becomes effective. Upon receipt, PERAC has 30 days to review an application; if the application is not reviewed, it is automatically approved. Each application is reviewed by two PERAC attorneys in the PERAC Legal Unit. The Legal Unit either approves the application, or remands it to the retirement board if it finds that the board’s decision was “(1) made upon unlawful procedure, (2) unsupported by substantial evidence, (3) arbitrary and capricious, or (4) a result of fraud or misrepresentation,” as set forth in Section 21(1)(d) of Chapter 32 of the General Laws.

According to its executive director, PERAC processes between 500 and 600 disability applications annually. The total number of approved disability cases averaged approximately 526 per year during the last five years.

PERAC Disability Retirement Approvals in Calendar Years 2013–2017*

Retirement Type	2013	2014	2015	2016	2017
Accidental [†]	486	483	462	412	418
Ordinary [‡]	83	81	72	83	53
Total Approved	<u>569</u>	<u>564</u>	<u>534</u>	<u>495</u>	<u>471</u>

* Statistical information was provided by PERAC management.

† Accidental disability retirement benefits are for applicants who are permanently and totally disabled from performing the essential duties of their positions because of job-related injuries or exposure to job-related hazards.

‡ Ordinary disability retirement benefits are for applicants who are permanently and totally disabled from performing the essential duties of their positions for any reason independent of their work.

Disability Benefit Calculations

Under Section 21(3) of Chapter 32 of the General Laws, PERAC is required to approve the amounts of retirement allowances granted by retirement boards.⁴ After PERAC approves a retirement board's decision to grant disability retirement benefits, the board performs the initial benefit calculation and sends it to PERAC for approval along with required information used to determine the amount (such as the applicant's annuity savings account information and payroll records) before the board makes the first payment to the applicant. PERAC reviews the information and performs its own calculation. PERAC discusses any calculated benefit amounts that do not match the initial calculations with the retirement board that provided them to determine the reason for the discrepancy. All discrepancies are resolved before PERAC generates an approval letter. Once the benefit amount is approved, PERAC generates an approval letter and sends it to the retirement board, notifying the board that PERAC has approved the benefit and its amount.

4. The state's two largest retirement systems, the Massachusetts State Employees' Retirement System and the Massachusetts Teachers' Retirement System, are allowed to calculate their own benefits using automated systems approved by PERAC.

AUDIT OBJECTIVES, SCOPE, AND METHODOLOGY

In accordance with Section 12 of Chapter 11 of the Massachusetts General Laws, the Office of the State Auditor has conducted a performance audit of certain activities of the Public Employee Retirement Administration Commission (PERAC) for the period July 1, 2015 through June 30, 2017.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Below is a list of our audit objectives, indicating each question we intended our audit to answer; the conclusion we reached regarding each objective; and, if applicable, where each objective is discussed in the audit findings.

Objective	Conclusion
1. Did PERAC effectively administer various aspects of the disability retirement application process? Specifically,	
a. Did PERAC process medical evaluations for disability retirement applicants in accordance with Section 6 of Chapter 32 of the General Laws?	Yes
b. Did PERAC review and approve decisions to grant disability retirement benefits made by local retirement boards as required by Section 21(1)(d) of Chapter 32 of the General Laws?	Yes
c. Did PERAC ensure that disability retirement benefit payments were accurately calculated by local retirement boards as required by Section 21(3)(a) of Chapter 32 of the General Laws?	No; see Finding <u>1</u>

To achieve our audit objectives, we gained an understanding of the internal control environment related to our audit objectives and tested the operating effectiveness of controls over oversight of medical evaluations of applicants seeking disability retirement benefits and approval of retirement boards' decisions to grant disability retirement. We also conducted further audit testing as follows:

- To gain an understanding of PERAC's process for scheduling and monitoring medical panel examinations, we reviewed the agency's internal control plan (ICP) and related policies and procedures. We also interviewed the manager of Medical Services, the general counsel and

deputy director, and other staff members who were responsible for monitoring and evaluating the medical panel process.

- We obtained a data extract consisting of all 1,147 disability retirement cases finalized during our audit period from PERAC's disability database. Using data analysis tools, we identified all disability retirement cases ultimately approved by PERAC during the audit period. We selected a nonstatistical random sample of 35 of the 945 approved cases and reviewed supporting documentation (such as retirement applications, medical records, and physician information from the Massachusetts Board of Registration in Medicine website) to determine whether the physicians chosen by PERAC to evaluate applicants were of the appropriate specialties and appeared not to have previously treated or examined the applicants.
- We reviewed applicant case files to determine whether medical panel certificates and narrative reports were properly completed, signed by physicians, and sent by PERAC to the retirement boards within five days as required by state regulations.
- To gain an understanding of PERAC's process for reviewing and approving retirement boards' decisions to grant disability retirement benefits, we reviewed its ICP and related policies and procedures. We also interviewed the general counsel and deputy director, the deputy executive director, and other staff members who were involved in approving disability retirement benefit applications.
- We selected a nonstatistical random sample of 35 of the 945 cases approved during our audit period and reviewed applicant case files to verify that that all required documentation (such as completed disability retirement applications, statements of facts found by retirement boards, certificates and narrative reports of regional medical panels, injury reports, statements from the applicants' employers, and descriptions of applicants' essential job duties) was received from retirement boards and that boards' decisions were approved by PERAC's executive director within 30 days.
- To gain an understanding of PERAC's process for approving retirement boards' disability retirement benefit calculations, we reviewed PERAC's ICP and related policies and procedures and interviewed the senior actuarial associate and the benefit calculation specialist.
- Because of the absence of adequate internal controls to verify that all calculations from retirement boards were received and performed correctly, we tested a nonstatistical random sample of 60 out of 671 cases approved during our audit period and reviewed supporting documentation to determine whether all required documentation was received from the retirement boards; approval letters signed by PERAC's executive director were on file to certify PERAC's final approval; and benefit amounts were calculated correctly.
- Based on the results of the above testing, we selected an additional nonstatistical random sample of 60 cases approved during our audit period for testing. We then summarized the results of the two samples and performed additional testing on one retirement board.

Data Reliability

During our audit period, the disability retirement process solely involved hardcopy documentation. All of the information PERAC receives comes from local retirement boards by mail. This information is then entered in PERAC's disability database, the system of record for monitoring the disability retirement application process, by PERAC's staff. We relied on hardcopy source documents, interviews, and other non-computer-processed data for supporting documentation. We determined the reliability of data obtained from PERAC's disability database by performing validity and integrity tests, including (1) testing for missing data and (2) scanning for duplicate records. We also traced electronic data to original source documents to ensure that the data were accurate and could be relied on. We determined that the data were sufficiently reliable for the purposes of audit testing.

Whenever sampling was used, we applied a nonstatistical approach, and as a result, we were not able to project our results to the entire populations.

DETAILED AUDIT FINDINGS WITH AUDITEE'S RESPONSE

1. The Public Employee Retirement Administration Commission did not always approve disability retirement benefits calculated by retirement boards.

The Public Employee Retirement Administration Commission (PERAC) did not review and approve all disability retirement benefits calculated by local retirement boards. Specifically, during our audit period, PERAC did not approve the benefit calculations for 30 (16%) of the 191 approved disability retirement benefit cases we examined. As a result, there is a higher-than-acceptable risk that inaccurate benefit payments could be paid to recipients of disability retirement benefits.

These calculations either have not been received or are in the process of being reviewed by PERAC; therefore, we were unable to verify their accuracy. For the calculations we were able to review, we did not identify any errors.

After PERAC approves a retirement board's decision to grant a disability retirement benefit, the retirement board calculates the benefit and forwards it to PERAC for its approval before making the first payment to the applicant. In 8 of the 120 approved disability retirement benefit cases we reviewed, we could not locate evidence of PERAC's approval of the benefit calculation. Of these 8 instances, 5 came from the Boston Retirement System. We then reviewed the remaining 71 approved disability retirement benefit cases from the Boston Retirement System and identified an additional 22 instances in which benefit calculations had not been approved.

Authoritative Guidance

Under Section 21(3) of Chapter 32 of the Massachusetts General Laws, PERAC is required to approve the amounts of disability retirement benefits granted by retirement boards.

Reasons for Issue

PERAC has not implemented monitoring controls to ensure that it receives all disability retirement benefit calculations and related documentation from retirement boards. PERAC acknowledged that internal controls were not in place to ensure that disability applications approved by the Legal Unit were always reviewed by the Actuarial Unit as required by statute.

PERAC officials indicated that for 14 of the 30 cases in which benefit amounts had not been approved by PERAC, the agency had received the calculations from the retirement boards but needed further clarification; however, the retirement boards had not responded to requests for clarification. For 13 of the 30 cases, PERAC officials indicated that the retirement boards never sent the calculations and necessary information for approval. For the remaining 3 cases, PERAC Actuarial Unit staff members said that they had received the calculations but had not yet reviewed them. PERAC officials were unable to provide a reason for not having reviewed these calculations yet.

Recommendations

1. PERAC should perform reviews to identify all disability retirement benefits for which benefit calculations have not been approved.
2. PERAC should develop and implement monitoring controls to ensure that retirement boards follow its existing regulations. These controls should ensure that all required disability retirement benefit calculations and necessary documentation are submitted to PERAC for approval before the board makes the first payment to the applicant. The controls could include communication between PERAC's Legal and Actuarial Units to ensure that the Actuarial Unit stays informed of newly approved retirement cases for which a benefit calculation will need to be approved.

Auditee's Response

Overall, we are pleased that the State Auditor's comprehensive review of our disability process found full compliance with the medical and legal requirements of the disability process. Nonetheless, we take seriously the finding that the disability calculation process lacked sufficient controls to ensure that all disability calculations were reviewed by PERAC's Actuarial Unit. Since receipt of the draft [report] . . . we have taken steps to address any outstanding calculations and established controls to prevent a reoccurrence of the identified issue.

The Draft Audit identified [17] applications that were in the office but had not been timely reviewed and approved by the Actuarial Unit; [14] had been initially reviewed but held due to concerns with the Board's calculation, and 3 had not yet been reviewed at all. Be advised that in each case the review has been completed and letters of approval have been sent to the Board. . . .

PERAC has also established an additional protocol between the Legal and Actuarial Units to ensure that all disabilities approved by the Legal Unit are submitted by boards and reviewed by the Actuarial Unit. Each quarter, information on all disabilities approved by the Legal Unit will be provided to the Actuarial Unit through a shared spreadsheet, which will then be updated by Actuarial staff as applications are received and approved. This will ensure that all applications are submitted, and establish a timeline to follow up on applications that have not been submitted.

APPENDIX A

Public Employee Retirement Administration Commission Units⁵

The Public Employee Retirement Administration Commission (PERAC) is divided into nine distinct units with varying responsibilities. The units are as follows:

Actuarial Unit

The unit determines the annual appropriation for each of the 104 retirement systems.

As part of the appropriation process, the unit performs an actuarial valuation (or reviews a valuation performed by an outside actuary) of each of the 104 retirement systems every few years. . . .

Each retirement board establishes a funding schedule (or expected series of payments). . . . PERAC is responsible for reviewing and approving funding schedules. . . .

In addition, the Unit calculates and verifies the amount of each retirement allowance granted by the local systems.

Administration Unit

The unit is responsible for the day-to-day operations as it relates to fiscal policies, procurement policies, payroll administration and overseeing the agency budget expenditures.

Audit Unit

PERAC's Audit Unit is responsible for performing a triennial audit of each retirement system to ensure that all financial and managerial functions are being performed in accordance with statute and regulation. . . .

PERAC field auditors not only perform audits but also provide technical assistance as needed. It is the goal of the Auditing Unit to provide education and training to all retirement system staff in the financial operations of the retirement systems.

Communications Unit

The Communications Unit organizes symposiums about Massachusetts public pension statutes, regulations and policies for Retirement Board Members, their staff and other interested parties . . . maintains the Commission's website; and publishes a wide variety of reports, newsletters, bulletins, and educational pieces. The majority of publications produced by PERAC are developed in-house by the Communications Unit.

5. These descriptions are based on information from the PERAC website. All quotations are from that site.

Compliance and Investments Unit

The Compliance Unit is responsible for the regulatory oversight of the investment portfolios of the Massachusetts Public Retirement Systems. . . .

The Unit also oversees board member education.

Disability Unit

The . . . Disability Unit oversees the processes associated with four different aspects of disability retirement: disability retirement applications, comprehensive medical evaluations, rehabilitation, and restoration-to-service.

Fraud Prevention Unit

The Unit has the powers and duties necessary for the prevention and investigation of fraudulent disability pension claims and payments. The Unit is responsible for data collection relating to all disability retirees, including earnings statements, registry information, criminal offender record information, retirement board records and other relevant information.

Information Systems Unit

The Information Systems Unit provides support for information technology . . . to meet the information technology needs of all PERAC Units.

Legal Unit

The Public Employee Retirement Administration Commission's Legal Unit assists the Commission with various responsibilities including, but not limited to:

- *Representing the Commission in hearings before administrative agencies. . . .*
- *Reviewing applications for disability retirement and accidental death benefits*
- *Reviewing and approving the supplementary rules of retirement boards.*

APPENDIX B

Public Employee Retirement Administration Commission Standing Committees⁶

Administrative Sub-Committee

This sub-committee will be assigned responsibility over the general administrative issues of the operation of the Commission. It will work with the Executive Director for budget preparation, considering personnel grievances, regulation preparation as they relate to administrative directive, corrective legislation deemed necessary to carry out the administrative mandate of the Commission, and other administrative oversight as deemed necessary by the sub-committee chair.

Legislative Sub-Committee

This sub-committee will be assigned responsibility over the Commission's analysis and response to Commonwealth and Federal legislation as it deems appropriate in the best interests of the public retirement system community and other interests of the Commonwealth. The sub-committee will coordinate with staff to develop procedures dealing with proactive treatment of legislative initiatives, develop legislative positions for review and action by the Commission, review opinions established by staff for concurrence by the Commission, and recommend for introduction any other legislative initiatives that it deems necessary for the Commission's fulfillment of its responsibilities.

Disability Intervention Sub-Committee

This sub-committee will be primarily responsible for assisting staff in the development of preliminary regulations for implementation of the Early Intervention Program and in general oversight after the section is operational. Review all disability related processes, including rehabilitation and reinstatement guidelines. The sub-committee will be responsible for review of staff recommendations on current legislative analysis and in developing recommendations for the Commission's adoption on any corrective legislation that may be necessary to fully implement the program.

Audit/Fraud Sub-Committee

This sub-committee will be primarily responsible for assisting staff in the development of preliminary regulations for implementation of the Pension Fraud Program and in general oversight after the section is operational. The subcommittee will also be responsible for reviewing the annual audit report to be presented to the Commission as well as being the Commission's representative for any sensitive audit findings or fraud investigations that must be brought to the Commission's attention.

6. These descriptions are quoted from mass.gov.

Investment Sub-Committee

This sub-committee will be primarily responsible for the review and recommendation of regulations on investment policies and practices allowed by the Commission. The sub-committee will also be responsible for the review with staff of any new type or derivation of any traditional asset class. The subcommittee will be responsible for review of the annual investment report before presentation to the Commission.