

TO: All Retirement Boards

FROM: Joseph E. Connarton, Executive Director

RE: Retroactive Changes to Cash Book Entries

DATE: July 8, 2015

PERAC has recently published its 2014 Annual Report detailing investment, funding, and other activities of the retirement boards for that year. We thank board members and staff for their cooperation in the preparation of that document. Unfortunately, due to the failure of one board to submit its financial data in an accurate and timely manner, that Report was incomplete. Although we have worked with that board to address the issue it should be noted that the Commission will be compelled to take remedial action in the event that this circumstance repeats itself.

Thus we are providing boards with this reminder. PERAC Regulations state the following:

4.03: Copies to be Sent to PERAC

(1) Within four weeks of the close of each month, after all entries for the month have been posted and a trial balance performed, the board shall send to the Commission a photocopy of the following for the month:

- (a) cash book entries;
- (b) trial balance; and
- (c) journal entries

(2) The board shall send or have sent to the Commission a copy of all custodian statements received by the board within four weeks of the close of the month. Such statements shall be separated into the following five categories: cash, short term investments\*, fixed income investments, equities, and pooled funds. Such statements shall include, but not be limited to:

- (a) monthly custodian bank statements which detail transaction activity including investment income, investments purchased, accrued interest paid, investments sold, book value of investments sold, profit/loss on investments sold, accrued interest sold, cusip numbers, name of brokers and commissions paid, trade receivables and payables, trade dates, settlement dates and actual settlement dates.
- (b) monthly account appraisal which provides an alphabetical listing of assets held for each category; information for each asset should include a complete description of the asset, cusip numbers, par value or number of shares, book value and market value.



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\*Short term investments are defined as U.S. Treasury Bills, Commercial Paper, Certificates of Deposit, Repurchase Agreements, Cooperative Shares, Savings and Loan Shares, Money Market and Term Deposits.

(3) The board shall send or have sent to the Commission a copy of all statements received by the board within four weeks of the close of the month. Such statements shall detail the activity of the retirement system including purchases and sales of fund shares, income, dividend re-investments, fund expenses, and ownership interest of the retirement system in any commingled funds, including, but not limited to, separate accounts, bank pooled funds, mutual funds, group trusts and limited partnerships.

Last year we issued two related Memos pertaining to revisions and investment related fees.

REVISIONS

Some confusion has developed over the appropriate process to be used to correct Cash Book filings, PERAC Annual Statements, and other accounting filings submitted to PERAC.

Changes occur in many instances relating to the completion of accounting functions. Cash Books consist of Receipts, Disbursements, Adjusting Journal Entries, a completed trail balance and a general ledger detail for each monthly accounting period. These are required to be filed/received at PERAC within 30 days of each month end. These required filings are reviewed by the PERAC Investment Unit. The results are then inserted into a spreadsheet that tracks the investment results for that period. The investment results of each period are used to calculate the Return on Investment that is published for each retirement system within the PERAC regulatory authority. The integrity of these results should not be compromised since they inform the public as well as the institutional debt rating organizations of the progress the systems are making toward eliminating the unfunded liabilities relating to pension obligations.

Errors can and do occur on a regular basis as we all are aware. These could be mathematical errors, or the misapplication of the understanding of how or where financial transactions are to be recorded in the PERAC Chart of Accounts, or a misunderstanding of the fact pattern relating to the recording of a transaction. They may be related to an estimate, or an accounting principle or an accounting method. These errors could affect the current monthly period Cash Books, a prior monthly period within the same calendar year, or may affect some prior year for which the PERAC Annual Statement has been completed and filed.

The generally accepted accounting practice (GAAP) is to recognize the error in the period in which the error is discovered. The "clean surplus" theory implies that the accumulated Fund Balances reported at the conclusion of the calendar year (except for State and Teachers) are free of material misstatement and available for claims from the retirees and members seeking the benefits entitled to them under the collective rules applied under Chapter 32, MGL, et al. It would undermine the credibility of this information if changes were posted directly to the Funds that were not included in the results reported for the current accounting period. That is why all

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inter fund transfers must be reported specifically in the period they occur and reflect how they affect to related Fund Balances.

It is generally not a good practice to change accounting information previously reported. It is never a good practice to make changes to original source documents. The result is to undermine the reliability of the accounting records. It could lead to the contention the system is deliberately misstating its financial results to mislead or otherwise obscure the operations of the system.

Prior period adjustments must be limited to specific circumstances that would otherwise undermine the integrity of comparable information already reported to the public. You should seek the guidance and permission of PERAC when determining the appropriate cause to restate financial information previously filed with the public.

In summary, the reporting of accurate, complete, and correct information in the current period results in the most accurate reflection of your investment results for that period. Anything else tends to skew this result. Repetitive errors and changes are symptomatic of poor internal financial controls. These may result in increased audit risk assessment.

The rule is to report all errors and changes in the current accounting period. Do not initiate a retroactive change to a previous accounting period. This simple rule should make it easier to complete the filing requirements for regular cash books and related submissions.

FEES

All investment service providers with whom the board is involved must be reflected on the books. Fees paid to all investment service providers must be tracked, recorded, and incorporated into the Annual Statement. In addition, all entries on the schedules must be completed. If the board is no longer paying fees but assets remain with the service provider then the records should indicate that fact with an entry of \$0. A failure to do so and a blank entry will be considered incomplete.

In filing the Annual Statement there are two investment service provider Schedules that must be completed, Schedule 5 and Schedule 7. Schedule 5 reflects the activity for pooled funds and includes a summary of all their activity by category for the calendar reporting period. Schedule 5 is an effort to reconcile the pooled fund values reported on the Assets page, while Schedule 7 is an effort to reconcile the Management Fees included in the Expense Fund. Schedule 5 should agree with the values reported on the Assets page for each pooled fund category. Schedule 7 should reflect all investment service providers and their fees including those that are listed on Schedule 5.

We trust the foregoing is of assistance. If you have any questions, do not hesitate to contact the PERAC Investment Unit or the PERAC Audit Unit.