



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

*Making government work better*

Official Audit Report – Issued May 4, 2016

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## Massachusetts State Retirement Board

For the period July 1, 2012 through June 30, 2014





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

*Making government work better*

May 4, 2015

Nicola Favorito, Esq., Deputy Treasurer / Executive Director  
Massachusetts State Retirement Board  
One Winter Street, Eighth Floor  
Boston, MA 02108

Dear Mr. Favorito:

I am pleased to provide this performance audit of the Massachusetts State Retirement Board. This report details the audit objectives, scope, methodology, findings, and recommendations for the audit period, July 1, 2012 through June 30, 2014. 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 Massachusetts State Retirement Board 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

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## LIST OF ABBREVIATIONS

BVF	Benefit Verification Form
CMR	Code of Massachusetts Regulations
COSO	Committee of Sponsoring Organizations of the Treadway Commission
DMF	Death Master File
ERM	enterprise risk management
HRD	Human Resources Division
ICP	internal control plan
IRS	Internal Revenue Service
IT	information technology
LexisNexis	LexisNexis Risk & Information Analytics Group, Inc.
MMARS	Massachusetts Management Accounting and Reporting System
MSRB	Massachusetts State Retirement Board
MSERS	Massachusetts State Employees' Retirement System
MTAERS	Massachusetts Turnpike Authority Employees' Retirement System
OSA	Office of the State Auditor
OSC	Office of the State Comptroller
OSD	Operational Services Division
OST	Office of the State Treasurer and Receiver General
PERAC	Public Employee Retirement Administration Commission
PRIT	Pension Reserves Investment Trust
SSA	Social Security Administration
SSTA	Self-Service Time and Attendance

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## EXECUTIVE SUMMARY

The Massachusetts State Employees' Retirement System (MSERS), one of the Commonwealth of Massachusetts's 104<sup>1</sup> contributory retirement systems, provides retirement, disability, survivor, and death benefits to state employees and employees of certain other public entities and to their beneficiaries. MSERS is administered by the Massachusetts State Retirement Board (MSRB) and operates under the purview of the Office of the State Treasurer and Receiver General (OST). In fiscal year 2014, MSRB issued more than \$1.8 billion in benefit payments to more than 57,000 retirees and survivors.

In accordance with Section 12 of Chapter 11 of the Massachusetts General Laws, the Office of the State Auditor (OSA) has conducted a performance audit of certain activities of MSRB for the period July 1, 2012 through June 30, 2014. This audit was undertaken to determine whether MSRB provided pension benefits, incurred administrative expenses, and conducted its activities in compliance with applicable laws, regulations, policies, and procedures.

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

<b>Finding 1a</b> <b>Page <a href="#">12</a></b>	MSRB made benefit payments of more than \$687,000 to deceased pensioners.
<b>Finding 1b</b> <b>Page <a href="#">13</a></b>	MSRB underpaid a total of more than \$271,000 to pensioners whose designated beneficiaries had died.
<b>Finding 1c</b> <b>Page <a href="#">13</a></b>	MSRB did not perform a 5% random sampling of Benefit Verification Forms (BVs), as required by Section 15.01(3) of Title 840 of the Code of Massachusetts Regulations, to ensure that information regarding pensioners' continued eligibility for benefits is accurate. One undetected inaccuracy may have involved fraudulent activity of more than \$7,000, which is now being investigated.
<b>Recommendations</b> <b>Page <a href="#">14</a></b>	<ol style="list-style-type: none"><li>1. MSRB should develop and implement controls that facilitate communication with external parties regarding matters affecting its operations and ensure that it stays informed of new or changed regulations concerning access to the federal Social Security Administration's (SSA's) death data. These controls could include more frequent death-match analyses (e.g., monthly rather than quarterly) if MSRB considers them beneficial.</li><li>2. MSRB should perform and document random reviews and verifications of biennial BVs to determine the accuracy of information reported and stored on its MSERS database.</li></ol>

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1. The number was 105 until the Athol Retirement Board was dissolved at the end of 2014.

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<b>Finding 2</b> <b>Page <u>19</u></b>	MSRB did not have a complete and updated internal control plan (ICP).
<b>Recommendation</b> <b>Page <u>21</u></b>	<ol style="list-style-type: none"><li>1. MSRB should collaborate with OST to update its ICP to include the following:<ol style="list-style-type: none"><li>a. an updated departmental risk assessment</li><li>b. all eight components of enterprise risk management</li><li>c. the method that personnel should use to report internal control issues and/or policy violations</li><li>d. the process to be used to report unaccounted-for variances, losses, shortages, or thefts of funds or property to OSA</li></ol></li></ol>

### **Post-Audit Action**

After our audit ended, MSRB took measures to ensure that it has access to the most current information from SSA's Death Master File, which contains the Social Security numbers of deceased individuals. As of March 22, 2016, it had recovered approximately \$608,785 (net) of the erroneous payments identified in this audit and had fully paid \$271,302 of reimbursements to pensioners who had been underpaid. It also incorporated risk assessments into its ICP.

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## OVERVIEW OF AUDITED ENTITY

### Background

The Massachusetts State Retirement Board (MSRB), established by Chapter 532 of the Acts of 1911, is responsible for administering the Massachusetts State Employees' Retirement System (MSERS), one of 104 public contributory retirement systems within the Commonwealth of Massachusetts. MSRB administers MSERS for state employees and also administers the former Massachusetts Turnpike Authority Employees' Retirement System (MTAERS) and benefits for employees of the state's judiciary branch. All the systems, though they operate independently, are bound together under one retirement law: Chapter 32 of the Massachusetts General Laws, which establishes the benefits, contribution requirements, and accounting structure for the systems.

MSERS is a contributory defined-benefit retirement system, governed by Chapter 32 of the General Laws, that provides retirement, disability, survivor, and death benefits to members and their beneficiaries. All state employees who are regularly employed on a part-time or full-time permanent basis are required to enroll with MSRB and make mandatory pretax contributions through payroll deductions. Members contribute a percentage of their earnings based on the date they joined MSERS:

Date Joined	Contribution Rate
Before January 1, 1975	5%
January 1, 1975 through December 31, 1978	7%
January 1, 1979 through December 31, 1983	7% + 2% on earnings over \$30,000
January 1, 1984 through June 30, 1996	8% + 2% on earnings over \$30,000
July 1, 1996 through present	9% + 2% on earnings over \$30,000

Retirement allowance benefits can be up to 80% of the average of the member's salary for his/her three highest-paid consecutive years of service.

In addition to Chapter 32, Chapter 7 of the General Laws governs how public employee retirement systems are overseen and regulated by the Public Employee Retirement Administration Commission (PERAC). Section 1 of Title 840 of the Code of Massachusetts Regulations governs the administrative procedures, financial operations, recordkeeping, and reports required of public employee retirement systems.

As part of its oversight, PERAC performs periodic reviews of records of all retirement systems at least once every three years. PERAC also provides training as well as legal and technical assistance.

MSRB files an annual report with PERAC for each fiscal year on or before December 31 of the following fiscal year. The annual report contains the financial conditions of MSERS and MTAERS, as well as statistical information regarding membership, findings of audits, the most recent actuarial valuation,<sup>2</sup> the system's investment portfolio, and any other pertinent information that PERAC deems appropriate.

The Pension Reserves Investment Management Board manages and invests MSRB member contributions; these funds are held in a trust fund known as the Pension Reserves Investment Trust (PRIT). MSRB's annual reports for fiscal years 2014 and 2015 listed the following net asset values as of June 30, 2015:

	As of June 30, 2014	As of June 30, 2015
<b>MSERS investment in the PRIT Capital Fund</b>	\$23,669,094,186	\$23,773,734,016
<b>MSERS investment in the Cash Fund</b>	\$18,791,719	\$22,408,386
<b>MTAERS investment in the PRIT Capital Fund</b>	\$194,225,413	\$183,840,545
<b>MTAERS investment in the Cash Fund</b>	\$56,352	\$203,948

## Retirement Board Composition

MSRB is a five-member board established by Section 18 of Chapter 10 of the General Laws. It includes the State Treasurer and Receiver General, who is its chair; one member appointed by the State Treasurer and Receiver General; two members elected by current and active members of MSERS; and one member chosen by the other members of MSRB. As of December 2015, the board consisted of the following members:

- Chair ex officio: Deborah B. Goldberg, State Treasurer and Receiver General
- Appointed member: Patricia Deal
- Elected member: Ralph White
- Elected member: Theresa McGoldrick
- Chosen member: Christopher Condon

2. An actuarial valuation is a statement of future values of pension assets and liabilities based on certain assumptions, including pensioner demographics.

The board is required to meet at least once a month. According to its Benefit Guide dated April 2015, it “processes and approves retirement applications, ordinary and accidental disability retirements, refunds, service purchases, and survivor benefits” and “is a resource for state employees seeking information on retirement.”

MSRB maintains offices in Boston and Springfield to administer and implement its policies. According to its website, as of January 1, 2015, there were 63 permanent full-time, 5 permanent part-time, and 4 contract employees serving more than 88,000 active MSERS and MTAERS members and more than 57,000 retirees and survivors (see Appendix A for further information). MSERS’s and MTAERS’s disbursements for annuities, pensions, and expenses for January 2013 through June 2015 were as follows:

	January 2013–June 2013*	July 2013–June 2014	July 2014–June 2015
<b>MSERS disbursements</b>	\$946,414,946	\$1,959,815,252	\$2,077,145,958
<b>MTAERS disbursements</b>	\$9,447,549	\$18,359,129	\$18,259,907

\* MSRB was required to convert from a calendar year to a fiscal year under Chapter 447 of the Acts of 2012.

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## 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 Massachusetts State Retirement Board (MSRB) for the period July 1, 2012 through June 30, 2014. During our review of MSRB pension-benefit distributions, we found instances where MSRB continued to distribute pension benefits to pensioners or designated beneficiaries whom we identified through our death-match analysis as deceased. Accordingly, we expanded the period covered by our audit testing in this area into fiscal year 2016 (to August 31, 2015).

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. Is MSRB properly administering its operations in compliance with applicable laws, regulations, policies, and procedures in the following areas?	
a. pension-benefit-related activities, including pension-benefit calculations, eligibility verifications, timely retirement-benefit terminations, and refunds of contributions to members terminating employment	<b>No; see Findings <u>1a</u>, <u>1b</u>, and <u>1c</u></b>
b. payment of administrative expenses	<b>Yes</b>
c. board governance, including compliance with open-meeting laws and board-member requirements	<b>Yes</b>

In addition, as part of our review of internal control procedures performed within the context of our audit objectives, we noted that MSRB did not have an updated internal control plan (ICP) as required by the Office of the State Comptroller (OSC) (Finding 2).

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We gained an understanding of the internal controls that we deemed significant to our audit objectives and evaluated the design and effectiveness of those controls.

In order to achieve our objectives, we performed the following audit procedures:

- We reviewed various MSRB internal documents, including its ICP, organization chart, financial statements, personnel policy and procedure manual, board minutes, and various documents supporting retirement applications.
- We assessed MSRB's controls regarding the oversight of pension-benefit-related activities. Specifically, we performed the following procedures:
  - We reviewed MSRB's policies and procedures for pension-benefit calculations, as well as applicable criteria, including Section 9 of Title 840 of the Code of Massachusetts Regulations (CMR) and Section 5 of Chapter 32 of the General Laws.
  - We interviewed managers of MSRB's Retirement Counselor Department to obtain an understanding of the board's process for calculating pension benefits.
  - We tested 240 superannuation<sup>3</sup> benefit calculations (comprising a nonstatistical random sample of 80 pensioners who chose Option A, 60 who chose Option B, and 100 who chose Option C; see Appendix B for details on these options) from a population of 5,581 pensioners with effective retirement dates during our audit review period in MSRB's benefit-administration system, UNISYS. Although pension payments for the Massachusetts Turnpike Authority Employees' Retirement System (MTAERS) were included in our pension-payment population, our random selection of pensioner payments did not result in any MTAERS pensioners being selected because MTAERS accounted for such a small proportion (632 of 57,739, or 1.1%) of pension payments.
  - We reviewed supporting documentation such as retirement applications, birth certificates, and marriage certificates to determine whether benefit payments were accurately calculated.
  - We reviewed MSRB verification policies and procedures used during its biennial confirmation of continuing pension eligibility.
  - We reviewed MSRB policies and procedures for termination of retirement benefits, including related criteria such as 840 CMR 15. We also reviewed procedures related to the collection of amounts that were owed MSRB as a result of overpayments due to late termination notices.
  - We interviewed managers of MSRB's Survivor Benefits and Finance Departments to obtain an understanding of MSRB's process for detecting and resolving instances where benefits should be terminated (in particular, benefit recipients' deaths).

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3. The Massachusetts Public Employee Retirement Guide defines "superannuation" as "the term that is used to describe the process of being retired upon reaching a certain age and meeting other requirements, including length of creditable service." Our test of benefit calculations did not include disability retirement calculations because these payments are subject to oversight by the Public Employee Retirement Administration Commission and therefore were considered low risk.

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- To determine whether benefits were being paid to deceased recipients, we obtained a list of all current retirees and Option C beneficiaries as of October 2014 and ran a match against the Social Security Administration's Death Master File, which contains the Social Security numbers of deceased individuals. Upon discovering discrepancies in the death-match data provided by MSRB's third-party vendor, we ran subsequent death-match analyses as of May 31 and August 31, 2015.
  - We reviewed MSRB's policies and procedures for refunding contributions to members who terminated their employment, as well as the related criterion: Internal Revenue Service (IRS) Publication 15-A, Section 8.<sup>4</sup>
  - We interviewed managers of MSRB's Refunds and Rollover Departments to obtain an understanding of MSRB's process for recording refund applications and issuing refund checks.
  - We tested a judgmental sample of 40 individual refund payments from a population of 327 refunds processed during four one-week periods within our audit period. We reviewed refund applications to determine whether federal income taxes were withheld in accordance with IRS regulations.
  - We conducted an analysis of administrative expenses paid in fiscal years 2013 and 2014 to determine expense categories for audit review and selected the five expense categories (salaries, contract employees, postage, information-technology [IT] professionals, and leases) whose expenses made up the highest percentages of MSRB's discretionary expenses paid; these five categories represented 87% of total discretionary expenses. We assessed MSRB's controls over payment of these administrative expenses. Specifically, we performed the following procedures:
    - We reviewed MSRB's policies and procedures for recording and approving employee attendance and approving the payroll expenditure, as well as applicable criteria such as the state Human Resources Division's (HRD's) Executive Department Time and Attendance Policy and OSC's Payroll Expenditure Approval Policy.
    - We interviewed managers of MSRB's Finance Department to obtain an understanding of MSRB's process for recording and approving employee attendance. (MSRB started using HRD's Self-Service Time and Attendance [SSTA] system in July 2012.)
    - We randomly selected 6 of 52 biweekly payrolls processed during our audit period (3 per fiscal year) and tested a nonstatistical random sample of 60 employees out of a population of 321 employees (10 per biweekly payroll period) to determine whether the attendance recorded in the SSTA reports agreed with the attendance recorded on supporting attendance logs and had been properly approved.
    - We reviewed MSRB policies and procedures for the procurement of IT professionals' contracts, as well as applicable criteria such as 801 CMR 21, the Operational Services Division's (OSD's) How to Do a Competitive Procurement Policy, and requirements stipulated

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4. Refunds of member contributions are subject to 20% federal withholding tax unless directly rolled over into another qualified retirement plan.

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in OSD's Request for Response for vendors applying for a statewide contract to supply IT professional services.

- We interviewed managers of MSRB's Information Technology and Finance Departments to obtain an understanding of the agency's process for conducting competitive procurements, executing statewide contract agreements, and approving and recording invoices for payment.
- We reviewed contract-procurement files to determine whether procurements were conducted in accordance with state regulations. We tested a judgmental sample of 24 payments (12 per fiscal year) from a population of 128 payments recorded in the Massachusetts Management Accounting and Reporting System (MMARS) during our audit period. We reviewed paid invoices to determine whether payments were approved and accurately paid.
- For contract-employee expenses, we selected all contract employees paid during our audit period, judgmentally chose 12 payroll periods (6 from each fiscal year), and reviewed payment files to determine whether salary payments were accurately recorded, valid, properly approved, and in agreement with executed contracts.
- We interviewed managers of MSRB's Finance Department to obtain an understanding of MSRB's process for executing leases for office space and paying monthly rent. MSRB leases office space at two locations: Boston and Springfield. We tested a random sample of 12 rent payments (8 for Boston and 4 for Springfield) from a population of 58 rent payments recorded in MMARS during our audit period. We reviewed executed lease agreements to determine whether they were properly executed and whether rent payments agreed with the payments stipulated in the lease agreements.
- We interviewed the Finance Department staff to obtain an understanding of MSRB's process for obtaining postage, including rental of post-office boxes. We selected 24 payments from 197 total transactions during the audit period and tested them to determine whether payments were properly processed and recorded.
- We assessed MSRB's controls regarding board governance. Specifically, we performed the following procedures:
  - We reviewed applicable criteria, including Sections 18–25 of Chapter 30A of the General Laws (the Open Meeting Law), Chapter 268A of the General Laws (the Conflict of Interest Law for State Employees), 940 CMR 29 (the Attorney General's regulations that interpret and enforce the Open Meeting Law), and 941 CMR 2 (MSRB's administrative regulations).
  - We interviewed MSRB's executive staff to obtain an understanding of its processes for conducting monthly board meetings and obtaining required documents from board members.
  - We reviewed a random sample of board-meeting agendas and minutes (for both open and executive sessions) for four months of our audit period to determine whether notices of meetings were publicly posted before they occurred and whether minutes were properly completed and approved for all the months of our audit period.

- We reviewed board members' files to determine whether all required documents were received from board members.
- We assessed MSRB's controls regarding the reliability of its computer systems. Specifically, we performed the following procedures:
  - To assess the reliability of MMARS, which is maintained by OSC, we reviewed selected process and system controls and interviewed knowledgeable agency officials about the data. Process controls are an organization's policies and procedures that could affect the accuracy and completeness of data. System controls are the underlying structures and programming of computer systems that could affect the accuracy and completeness of data. Based on the analysis conducted, we determined that the data were sufficiently reliable for the purposes of this audit.
  - To assess the reliability of MSRB's benefit-administration system, UNISYS, we reviewed existing information, tested selected system controls, and interviewed knowledgeable IT staff members about the data. Based on the analysis conducted, we determined that the data were sufficiently reliable for the purposes of this audit.

Whenever sampling was used, we applied a nonstatistical approach; therefore, the results of our tests cannot be projected over the entire population and only apply to the items selected.

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## DETAILED AUDIT FINDINGS WITH AUDITEE'S RESPONSE

### 1. The Massachusetts State Retirement Board did not ensure that it had the necessary information to make correct pension-benefit payments.

The Massachusetts State Retirement Board (MSRB) did not ensure that it had the most current information regarding MSRB pensioners and designated beneficiaries who had died. As a result, MSRB paid a total of approximately \$687,000 to 105 deceased pensioners and underpaid a total of approximately \$271,000 to 44 pensioners whose benefits should have increased when their beneficiaries died. In addition, MSRB could not provide documentation that it was conducting an audit of at least 5% of the Benefit Verification Forms (BVs) it receives from its members every two years.

#### MSRB Verification of Dates of Death

Each quarter, MSRB provides its contractor LexisNexis Risk & Information Analytics Group, Inc. (LexisNexis) with a copy of its entire retiree payee file. LexisNexis cross-matches the information in this file with the federal Social Security Administration's (SSA's) Death Master File (DMF)<sup>5</sup> to determine whether any MSRB benefit recipients have died. LexisNexis returns the retiree payee file and the results of its match to MSRB for examination and, if necessary, appropriate action. MSRB also examines monthly death reports provided by the state's Group Insurance Commission, as well as notifications from family members of deceased pensioners.

In addition, to ensure that pensioner information on file is accurate, MSRB contracts with a third-party vendor, Standard Modern Company, to mail out BVs once every two years.<sup>6</sup> The BVF must be signed by the benefit recipient and notarized. The third-party vendor processes and reviews returned BVs to determine completeness (for instance, whether the BVF has been signed and notarized). The vendor compares other information, such as the recipient's name, address, Social Security number, and marital status, to the Massachusetts State Employees' Retirement System (MSERS) file and reports any

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5. The DMF is a database generated by the Social Security Administration (created from SSA payment records) containing information about persons who have Social Security numbers and whose deaths were reported to SSA. This file is updated weekly.

6. Section 15.01 of Title 840 of the Code of Massachusetts Regulations requires that each retirement board perform, at least once every two years, a verification of all retirees and beneficiaries who receive a monthly benefit. To this end, MSRB requires benefit recipients to file notarized affidavits including statements certifying that they are currently alive. The last benefit-verification process was initiated in April 2014 for an estimated 58,000 individuals.

discrepancies to MSRB for follow-up. If the pensioner does not return the BVF by the designated due date, his/her pension benefits are suspended until the form is received.

**a. MSRB made approximately \$687,000 in pension-benefit payments to deceased individuals.**

During our audit, we obtained a list of all current retirees and Option C beneficiaries (see Appendix B) as of October 2014, June 2015, and August 2015 and compared it to the DMF. This death-match analysis identified 105 deceased pensioners who received retirement benefits totaling \$687,491<sup>7</sup> after their dates of death. According to SSA data, the 105 pensioners had been deceased for periods ranging from 5 to 403 days, with a median<sup>8</sup> of 103 days and an average overpayment of \$6,547.

**Authoritative Guidance**

Under Section 13(1)(b) of Chapter 32 of the Massachusetts General Laws, for the month in which a pensioner passes away, the pensioner or beneficiary is entitled to a prorated payment (depending on the date of death). Any payment covering the period after the date of death is an asset of MSERS; the retired member or beneficiary is not entitled to that payment.

**Reasons for Payments to Deceased Pensioners**

Effective March 26, 2014, SSA began limiting the availability of the DMF in accordance with Section 203 of the federal Bipartisan Budget Act of 2013. Specifically, records of individuals with death dates of March 26, 2014 and later would now only be provided to customers who had a "fraud prevention interest" or "a legitimate business purpose" for the information and for three years after the date of the pensioner/beneficiary's death.

To provide death data to MSRB, LexisNexis was required to ensure that MSRB had a permissible purpose for accessing the DMF. To this end, LexisNexis should have notified MSRB that it needed to provide additional certification data to enable SSA to allow MSRB full access to the DMF. However, because of a breakdown in communication, MSRB was not advised of the certification requirement by LexisNexis; as a result, MSRB unknowingly received SSA death data that excluded deaths that occurred between March 26, 2014 and August 31, 2015. This resulted in continued payments to some

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7. This represents the gross amount due pensioners before the withholding of taxes and, if applicable, insurance premiums.  
8. The median is the midpoint of a group of numbers. In a group that contains outliers, or observations that are significantly higher or lower than the majority (and may represent measurement errors), it can be used to provide a more accurate representation of the majority of the group.

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pensioners who had died, as well as unadjusted payments to pensioners whose payments should have increased after their beneficiaries' deaths.

**b. MSRB underpaid surviving pensioners by approximately \$271,000.**

Our death-match analysis also identified 44 cases, totaling \$271,302, in which surviving pensioners were underpaid because their monthly benefits were not raised after the deaths of their designated beneficiaries. Each pensioner's benefits should have been raised, as of the date the beneficiary died, to the amount the pensioner would have received on the date of retirement if s/he had never selected a beneficiary. Of the 44 beneficiaries, 43 had been deceased for periods ranging from 10 to 497 days, with a median of 321 days and an average underpayment of \$5,350. One beneficiary had been deceased for 3,269 days, with a total underpayment of \$41,264.

**Authoritative Guidance**

According to Section 12(2) of Chapter 32 of the General Laws, retirement allowances shall be paid during the member's lifetime and cease upon his/her death, except for any amount s/he chooses to assign to a beneficiary. One such choice, Option C, allows the member (including the 44 members mentioned above) to set aside part of his/her retirement allowance to be paid to a beneficiary after the member's death. If the beneficiary dies first, the member thereafter receives the full allowance amount.

**Reasons for Underpayments**

MSRB received out-of-date information on death dates because of the previously mentioned communication breakdown, which caused 43 of the 44 underpayments. MSRB management was unable to provide a reason for not identifying the beneficiary who had been deceased for 3,269 days.

**c. MSRB did not verify the accuracy of randomly sampled BVFs.**

MSRB officials indicated that they conducted random verifications to determine the accuracy of information reported on returned BVFs, but the agency could not give us substantiating documentation. Without random verifications, there is inadequate assurance that all the information reported by members, which MSRB uses to determine their continued eligibility for pension benefits, is complete and accurate.

Of particular concern was that in one instance, a pensioner received benefit overpayments of \$7,316 over a 13-month period (May 2014–June 2015). Our death-match analysis revealed that the pensioner had passed away on May 29, 2014. However, her most recent BVF was signed, dated, and notarized on August 21, 2014 (with no reporting to MSRB of her passing) three months after her death. We brought this matter to the attention of MSRB officials, and from its subsequent inquiries, MSRB established that the person notarizing the form lived at the same address as the deceased and, according to the Secretary of State's Office, was not a valid notary public.

After we brought this matter to MSRB's attention, the board immediately stopped pension-benefit payments and attempted to recoup the funds from the recipient's bank account. However, the bank notified MSRB that the account had no funds remaining. According to MSRB officials, the case was referred to the Middlesex District Attorney's Office and is currently being investigated.

### **Authoritative Guidance**

According to Section 15.01(3) of Title 840 of the Code of Massachusetts Regulations (CMR), "The retirement board may review and verify the accuracy of any affidavit [BVF] submitted and shall audit a random sample of at least five per cent of the affidavits received."

### **Reasons for Lack of Verifications**

MSRB told us it was not able to comply with the 5% requirement because of the volume of documents involved. With more than 57,000 beneficiaries, MSRB would need to review almost 3,000 documents. According to MSRB, this extensive review would require more personnel than are available.

### **Recommendations**

1. MSRB should develop and implement controls that facilitate communication with external parties regarding matters affecting its operations and ensure that it stays informed of new or changed regulations concerning access to SSA death data. These controls could include more frequent death-match analyses (e.g., monthly rather than quarterly) if MSRB considers them beneficial.
2. MSRB should perform and document random reviews and verifications of biennial BVFs to determine the accuracy of information reported and stored on its MSERS database.

### **Post-Audit Action**

After our audit ended, MSRB took measures to ensure that it has access to the most current information from SSA. It also reviewed all the payments to deceased pensioners that we had identified, and it

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recovered approximately \$608,785 (net) of these payments through March 22, 2016. Finally, MSRB fully paid \$271,302 of reimbursements to pensioners who had survived their beneficiaries and been underpaid.

## Auditee's Response

### Finding 1a

*The Office of the State Auditor ("OSA") reported that during the relevant audit period it identified 105 deceased MSERS retirees/survivors for whom benefit payments had been issued after their date of death which totaled \$687,491.00. The median period of death was 103 days and an average overpayment of \$6,547.00. For the reasons set forth below, the MSRB believes these figures are incorrect and mischaracterize the scope of overpayments. . . .*

*As a consequence of statutory requirements affecting its business operations, the MSRB will regularly be in an overpayment situation when adjusting benefits due to the death of a retiree or survivor. Under current statutory limits, the MSRB may only issue benefit payments on the last business day of each month. Benefit payments are authorized through the processing of the pension warrant, the vehicle by which the monthly benefit payment total is communicated from the MSRB to the Office of the Comptroller to confirm the availability of funds. The pension warrant closes approximately ten (10) days before the end of a month to allow for proper processing, transfer of funds and issuance of actual benefit checks or electronic deposits on the last business day of the month. For a monthly benefit payment to be stopped or adjusted, it must be effectuated prior to the close of the pension warrant. If a death occurs during the month and is not reported for several weeks, a typical occurrence, that current month's benefit payment will be paid in the then established amount.*

*As noted by the OSA, the MSRB implemented measures to help ensure the eligibility of its retirees/survivors for benefits. For several years, the MSRB contracted with Lexis/Nexis who assembles and maintains data from outside data bases, such as the Social Security Master Death Index and other sources, to compare the Lexis/Nexis data against that of the MSRB. However, given the above operational timelines, even with monthly data matches against MSRB system records, a new death is not likely to be included in a third party data base within the same month as the date of death and be available to the MSRB. . . .*

*As noted by the OSA, beginning March 26, 2014, unknown to the MSRB, Lexis/Nexis limited the universe of data available for the MSRB's data matches and consequently, the MSRB's ability to identify retirees, beneficiaries, or survivors who had died was impacted. This situation was corrected by the MSRB with Lexis/Nexis on June 10, 2015.*

*A review of the June 2015 death match data from the OSA showed there were forty-eight (48) retirees/survivors who were deceased within the previous ninety (90) days of the match, which if processes were working as expected, would have been discovered. The amount of overpayment for these retirees/survivors was \$154,667.84.*

*In August 2015, an additional death match was performed by both the OSA and MSRB to determine if the identified problem with Lexis/Nexis had been corrected. It is the MSRB's point of view that all of these death match results would have been discovered in the normal course of business and should be excluded from the total value of overpayments the OSA has reported. This match showed eighteen (18) retirees/survivors as having been overpaid for a total of \$103,104.09.*

*Additionally, these overpayments are shown by the OSA as the gross amount and not net of any insurance premiums or taxes withheld. The MSRB recovers these amounts from the respective companies or government, and pursues the recovery of the net payment to the retiree/survivor with the retiree's/survivor's estate.*

*In response to the OSA's identification of \$687,491.00 in overpayments, as of March 22, 2016 the MSRB has recovered \$608,785.44 of net overpayments from the estates of 104 retirees/survivors. As of March 22, 2016, seventeen (17) retiree overpayments have not been paid in full. Of these seventeen (17), one (1) represents the retiree identified in finding Section (c) below (net amount \$6,865.10); three (3) are on payment plans, with \$7,966.47 (net) remaining to be paid, from a starting balance of \$30,783.87 (net); and thirteen (13), who originally owed \$33,448.92 (net), continue to owe \$20,408.91 (net), and have been presented with demand letters.*

## **Finding 1b**

*This audit finding indicates that the MSRB did not increase benefits in a timely way to retirees who had selected the survivor benefit option [Option C] where the designated beneficiary had then predeceased the retiree.*

*One (1) of the reported forty-four (44) cases highlighted accounted for 15% of the amount in question due to the length of time at issue. Of the remaining forty-three (43) cases the average underpayment was approximately \$5,300.00. . . .*

*Before a benefit may be converted from the Option C to Option A level, which causes an increase in the retiree's monthly benefit, the designated beneficiary's death must be verified to the MSRB by the submission of the death certificate. Thereafter, adjustments are made in the MSRB's computer system and the retiree's benefit is prospectively enhanced to the Option A level.*

*In addition to data matches, the MSRB also relies on its members to report deaths of beneficiaries. Therefore, due in part to the time necessary to confirm a person's death, converting benefits from the Option C to Option A levels cannot occur in the same month of death and a minimum of approximately sixty (60) days could elapse before increased benefit payments are made to a retiree.*

*As previously explained the MSRB relies on a third-party source for information, which relies on additional parties for information and the time of reporting said information. The OSA compared MSRB data to the Social Security Administration death data available in October 2014, June 2015 and August 2015. It was with the June 2015 comparison that*

*the OSA results led to the discovery of the fact that the Social Security Administration information was not part of the MSRB's death data protocol. This was corrected by the MSRB with Lexis/Nexis on June 10, 2015.*

*All forty-four (44) surviving retirees/survivors were made whole after they provided the proper documentation to the MSRB. This resulted in a 100% payment of the identified \$271,302.16 of underpayments.*

*In addition to the foregoing efforts, the MSRB also partners with the Group Insurance Commission ("GIC") to ensure that it identifies and confirms beneficiary changes. Specifically, on a monthly basis, the MSRB exchanges data with the GIC after the month's benefit payments (the pension warrant) have been processed. A retiree who has health and life insurance benefits provided through the Commonwealth would have designated beneficiaries with the GIC for those purposes. The monthly data exchange allows for the MSRB and the GIC to identify deaths that may have been reported to one agency, but not the other.*

### **Finding 1c**

*The OSA report reflects that while the MSRB indicated that it conducted random verifications to determine the accuracy of information returned on Benefit Verification Forms ("BVF"), substantiating documentation was not available. Moreover, in one particular instance a death was not detected through the Benefit Verification process review, where a BVF was submitted signed, dated and "notarized."*

*As prescribed by regulations, the MSRB issues a Benefit Verification Form ("BVF") at least every two (2) years to all its benefit recipients to assist in the substantiation of their continued eligibility. Benefits are suspended if eligibility cannot be verified. . . .*

*As of its January 1, 2014 Actuarial Valuation, the MSERS had more than 57,000 benefit recipients. Because of the number of retirees and beneficiaries, the MSRB has for the past several years contracted with an outside vendor . . . to administer the initial mailings of the BVF's. In 2014, the selected vendor also conducted the initial review of the returned BVF's. . . .*

*The vendor [is required] to confirm each BVF is complete, properly executed, notarized and that no changes to the demographic information have been submitted. . . . MSRB staff are responsible for following up with the individual members. . . .*

*It should be noted that 840 CMR 15.01(3) does not define what steps are required to "audit" the verification statements that are received. . . .*

*In the course of the 2014 BVF effort, the vendor issued mailings in April, June and July. During the period of April 2014 through August 2014, more than 2,100 initially submitted BVF's that were deemed not acceptable, incomplete or required additional follow-up directly with retirees and beneficiaries of the retirement system, were returned to the MSRB*

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*for inquiry and follow up. By November 2014, more than seventy (70) individuals had benefits suspended for lack of compliance.*

*Further, during the same April through August 2014 period, the vendor returned to the MSRB over 9,900 submitted BVF's for changes to demographic information, beneficiary information, etc. These BVF's also required direct inquiry and follow up by MSRB staff with the affected retirees and beneficiaries.*

*The above 12,000 BVF's, which were returned and whose deficiencies were addressed individually by MSRB staff, represent more than 20% of the benefit recipients. . . . By a reasonable definition of "audit" the actions taken by the MSRB [satisfy] the requirement of the regulations. Moreover, during this time it should be noted that the MSRB continued to conduct its regular external data matches of its entire benefit recipient data base, which would have the same effect as doing random reviews of the BVF's.*

## **Auditor's Reply**

### **Finding 1a**

We do not agree with MSRB's assertion that the figures in our report are incorrect and mischaracterize the scope of overpayments. In its own response, MSRB acknowledges that these payments were improper and states that as of March 22, 2016, it has recovered nearly all (\$608,785.44 net amount of the \$687,491.00 gross amount) the overpayments cited in our report, indicating that our figures were accurate and not mischaracterized.

We acknowledge that there may be a lag between the date when a pensioner becomes deceased and the date when MSRB can make the proper adjustment to the pensioner's benefits. However, as noted in our report, for the 105 individuals in question, the median period of time that these individuals received benefits after their date of death was 103 days, with a high of 403 days, which indicates that this was a systemic problem, not merely a matter of lag time.

Although we acknowledge MSRB's successful recovery efforts, we disagree with its assertion that additional overpayments based on the June and August matches would have been discovered "in the normal course of business." We believe that, had we not found that MSRB was receiving incomplete death-match information from LexisNexis, the disparity and overpayments would have continued indefinitely. Also, we disagree with MSRB's statement that "this situation was corrected on June 10, 2015." Though it is true that the agency signed an amendment with LexisNexis on this date to allow full access to the SSA DMF, MSRB did not run a new match with the corrected data until September

2015 (with data as of August 31, 2015), even though LexisNexis notified it on July 6, 2015 that the DMF was now available.

Lastly, because MSRB only runs quarterly death matches, we encourage MSRB to conduct more frequent (e.g., monthly) death matches to accelerate the recovery of any overpayments.

### **Finding 1b**

Based on its response, MSRB is taking appropriate measures to address our concerns, including reimbursing all the pensioners in question.

### **Finding 1c**

The verification work MSRB states that it performs appears to be extensive, but as stated in our report, there was no specific documentation that MSRB had complied with 840 CMR 15.01(3), which states that "the retirement board *may* review and verify the accuracy of any affidavit submitted and *shall* audit a *random sample of at least five per cent* of the affidavits received" (emphasis added).

MSRB's contention that the reviews it performed "would have the same effect as doing random reviews" is not accurate. A "random" sample would be one in which each BVF had an equal opportunity of being selected for verification, whereas the outside vendor's review of BVFs only selected those with exceptions.

Finally, because we agree that the word "audit" is not clearly defined in the regulations promulgated by the Public Employee Retirement Administration Commission (PERAC), we suggest that MSRB seek clarity from PERAC on this matter.

## **2. MSRB did not have a complete and updated internal control plan.**

MSRB's internal control plan (ICP) and risk assessment were not current, and the ICP did not contain all of the components required by the Office of the State Comptroller (OSC). Our review of MSRB's ICP disclosed the following issues:

- The ICP and risk assessment had not been updated since fiscal year 2011 and did not consider or adequately identify all eight components of enterprise risk management (ERM) described in the OSC Internal Control Guide. Specifically, the ICP did not consider or adequately identify the following six ERM components: Internal Environment, Objective Setting, Event Identification, Risk Response, Information and Communication, and Monitoring.

- The ICP did not describe the method that agency personnel should use to report internal control issues and/or policy violations.
- The ICP did not describe the process for reporting unaccounted-for variances, losses, shortages, or thefts of funds or property to OSA.
- The ICP did not specify who should receive copies of the plan.

An updated ICP helps ensure that MSRB can achieve its objectives efficiently, effectively, and in compliance with applicable state laws and regulations and that its assets are properly safeguarded against loss, theft, and misuse. A risk assessment is an integral part of an entity's internal control process because it identifies and analyzes risks and helps management prioritize the activities where controls are most needed to mitigate risk. MSRB's lack of a risk assessment, with cross-references of risks to controls established to mitigate them, could hinder it from achieving its goals and objectives and ensuring the integrity and effectiveness of its internal control system. If processes are not clearly defined and in place, unreported internal control weaknesses and noncompliance could eliminate the opportunity for management to address the noncompliance and take timely corrective action.

### **Authoritative Guidance**

The OSC Internal Control Guide states,

*All operating departments in Massachusetts state government are required to develop and document departmental internal controls, which must be prioritized and summarized into a departmental internal control plan based on a risk assessment. Responsibility for the department internal control plan resides with the department's Internal Control Officer (ICO). . . .*

*Each department's internal control plan will be unique; however, it should be based on the same framework—the organization's mission statement, goals and objectives, and components of internal control recommended by [the Committee of Sponsoring Organizations of the Treadway Commission, or COSO]. The plan should be reviewed and updated as conditions warrant, but at least annually.*

In its document Enterprise Risk Management—Integrated Framework, or COSO II, COSO defines ERM as “a process, effected by the entity's board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage the risks to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.” To comply with OSC internal control guidelines, an ICP must contain information on the eight components of ERM: Internal Environment, Objective Setting, Event Identification, Risk Assessment, Risk Response, Control Activities, Information and Communication, and

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Monitoring. COSO guidance states that all components of an internal control system must be present and functioning properly and operating together in an integrated manner in order to be effective. In addition, OSC's Internal Control Guide requires ICPs to be updated as often as changes in management, level of risk, program scope, and other conditions warrant, but at least annually.

The OSC Internal Control Guide further requires that the ICP address the method agency personnel should use to report internal control issues and the process to be used to report any unaccounted-for variances, losses, shortages, or thefts to OSA and that it specify the personnel to whom the ICPs should be distributed.

### **Reasons for Issues**

According to MSRB officials, the Office of the State Treasurer and Receiver General (OST) began updating ICPs, risk assessments, policies, and procedures for all its departments (e.g., MSRB, Unclaimed Property, Cash Management) in 2012. These officials stated that ICPs were only updated in departments that were considered high risk and that OST considered MSRB a low-risk department.

### **Recommendation**

1. MSRB should collaborate with OST to update its ICP to include the following:
  - a. an updated departmental risk assessment
  - b. all eight components of ERM
  - c. the method that personnel should use to report internal control issues and/or policy violations
  - d. the process to be used to report unaccounted-for variances, losses, shortages, or thefts of funds or property to OSA

### **Post-Audit Action**

MSRB revised its ICP in February 2015 to include risk assessments.

### **Auditee's Response**

*The Office of the Treasurer and Receiver General consists of twelve discrete departments, boards and commissions, including the MSRB, each with its own Internal Control Plan ("ICP") and risk assessment. Since 2011, the MSRB has been in the process of updating its software system with on-going changes to its ICP.*

*Currently, the Internal Control Officer ("ICO") is in the process of updating and standardizing all of the Treasury's ICP's to meet the requirements of the Internal Control Guide. These updates include*

*a risk assessment, the eight ERM components, the method that personnel should use to report internal control issues and/or policy violations and a process to be used for the reporting of unaccounted for variances, losses, shortages, or theft of funds or property to the OSA.*

*Since a new presentation methodology is being devised and developed, the ICO has been consulting the Office of the Comptroller for guidance and approval.*

### **Auditor's Reply**

Based on its response, MSRB is taking appropriate measures to address our concerns.

## APPENDIX A

### Massachusetts State Retirement Board Information

#### Membership Information<sup>9</sup>

<b>Active Members of Massachusetts State Employees' Retirement System (MSERS) and former Massachusetts Turnpike Authority Employees' Retirement System (MTAERS)</b>	<b>January 1, 2014</b>	<b>January 1, 2015</b>
Up to 10 years	41,714	42,232
10 to 20 years	22,458	22,801
20 to 30 years	16,675	15,921
30+ years	7,309	7,554
<b>Total Active</b>	<b><u>88,156</u></b>	<b><u>88,508</u></b>
<b>Retired Members</b>		
Superannuation	46,035	47,381
Disability	3,810	3,880
Other/Survivor	6,482	6,513
<b>Total Retired</b>	<b><u>56,327</u></b>	<b><u>57,774</u></b>
<b>Total Members</b>	<b><u>144,483</u></b>	<b><u>146,282</u></b>

#### Financial Information<sup>10</sup>

	<b>Six Months Ended June 30, 2013</b>	<b>Fiscal Year 2014</b>	<b>Fiscal Year 2015</b>
<b>Annuities</b>			
MSERS	\$163,188,688.05	\$ 355,759,182.53	\$ 379,401,525.07
MTAERS	1,641,741.70	2,976,147.17	3,237,592.55
<b>Total Annuities</b>	<b><u>\$164,830,429.75</u></b>	<b><u>\$ 358,735,329.70</u></b>	<b><u>\$ 382,639,117.62</u></b>
<b>Pensions</b>			
MSERS	\$713,477,208.32	\$1,456,466,523.05	\$1,539,557,743.11
MTAERS	7,306,929.61	14,352,373.34	14,033,984.67
<b>Total Pensions</b>	<b><u>\$720,784,137.93</u></b>	<b><u>\$1,470,818,896.39</u></b>	<b><u>\$1,553,591,727.78</u></b>
<b>Expenses</b>			

9. Source: Massachusetts State Board of Retirement website (most recent data posted).

10. Source: Annual Reports of Financial Condition for the Massachusetts State Employees' Retirement System. The Massachusetts State Retirement Board converted from calendar-year to fiscal-year reporting in 2012 and issued a six-month "short period" report for fiscal 2013.

	<b>Six Months Ended June 30, 2013</b>	<b>Fiscal Year 2014</b>	<b>Fiscal Year 2015</b>
MSERS	\$ 69,749,049.41	\$ 147,589,546.23	158,186,689.43
MTAERS	498,877.53	1,030,608.10	988,329.45
<b>Total Expenses</b>	<u>\$ 70,247,926.94</u>	<u>\$ 148,620,154.33</u>	<u>\$ 159,175,018.88</u>
<b>Total Disbursements</b>			
MSERS	<u>\$946,414,945.78</u>	<u>\$1,959,815,251.81</u>	<u>\$2,077,145,957.61</u>
MTAERS	<u>9,447,548.84</u>	<u>18,359,128.61</u>	<u>18,259,906.67</u>
<b>Total Massachusetts State Retirement Board Disbursements</b>	<u>\$955,862,494.62</u>	<u>\$1,978,174,380.42</u>	<u>\$2,095,405,864.28</u>

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## APPENDIX B

### Retirement Allowance Options<sup>11</sup>

At retirement, state employees choose one of three options that determine how retirement benefits are paid. If no option is selected, Chapter 32 of the Massachusetts General Laws states that the member defaults to Option B.

Retirement allowances are paid monthly. The payment amount depends on the option selected. The option also determines what benefits, if any, will be paid to survivors. The options are as follows:

- Option A: Members receive their full retirement benefit in monthly payments during their lifetime. All benefit payments cease upon their death, and no benefits are provided for their survivors.
- Option B: Members receive a lifetime benefit that is approximately 1% to 5% less per month than Option A. The annuity portion (member contributions) of their benefits is reduced to allow for a potential benefit for their beneficiaries. Upon a member's death, surviving beneficiaries are paid the unexpended balance of the accumulated total contributions.
- Option C: Members receive a lifetime benefit that is approximately 7% to 15% less per month than Option A. Upon a member's death, the designated beneficiary is paid a monthly benefit for the remainder of his or her lifetime.

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11. Source: Massachusetts Public Employee Retirement Guide.