

# PERAC AUDIT REPORT



Essex Regional  
Contributory Retirement System



JAN. 1, 2006 - DEC. 31, 2008



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# PERAC

COMMONWEALTH OF MASSACHUSETTS | PUBLIC EMPLOYEE RETIREMENT ADMINISTRATION COMMISSION

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March 17, 2010

The Public Employee Retirement Administration Commission ("PERAC") has completed an examination of the Essex Regional Retirement System pursuant to G.L. c. 32, § 21. The examination covered the period from January 1, 2006 to December 31, 2008. This audit was conducted in accordance with the accounting and management standards established by PERAC in regulation 840 CMR 25.00. Additionally, all supplementary regulations approved by PERAC and are on file at PERAC are listed in this report.

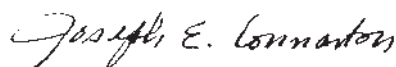
In our opinion, the financial records are not being maintained and the management functions are not being performed in conformity with the standards established by PERAC. Please refer to the exceptions noted in the findings presented in this report.

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

At a special meeting on February 16, 2010, PERAC assigned a team consisting of an attorney, an auditor and an accountant ("Monitoring Team") to monitor the operations of the Essex Regional Retirement Board. It is expected that the Monitoring Team will report on progress made by the ERRB in addressing the concerns noted herein.

In closing, I acknowledge the work of examiners Carol Niemira, James Ryan, James Sweeney and James Tivnan who conducted this examination.

Sincerely,



Joseph E. Connarton  
Executive Director



# EXPLANATION OF FINDINGS AND RECOMMENDATIONS

## I. Bank Reconciliations

The Essex Regional Retirement Board's ("ERRB") two primary bank accounts (i.e. Salem Five Checking and Money Market) have not been properly reconciled for the period ending 12/31/08. Furthermore, the reconciliation only confirms the transaction activity on the bank statement. The bank balance per the bank statement is not reconciled with the ending general ledger cash account balance. The auditors noted unexplained variances between the adjusted bank balance and the general ledger of \$3,822.96 for the Money Market account and \$2,330.09 for the Checking account. As of the end of September 2009, no bank reconciliations have been prepared for any month in 2009.

In addition, individuals who have access to cash transactions, check processing, and general ledger maintenance and processing also prepare the reconciliations.

**Recommendation:** In order to strengthen internal controls the bank reconciliations must be prepared and approved by individuals whose functions do not encompass cash transactions, check processing and general ledger maintenance. Bank reconciliations must be performed in a timely manner on a monthly basis. Incorrectly and untimely prepared bank reconciliations are a serious internal control weakness. ERRB must review the bank reconciliations on a monthly basis.

### **ERRB Response:**

ERRB agrees with the recommendation, but notes that in a small organization it is difficult to achieve adequate segregation of duties. The ERRB staff member who reconciles bank statements has check signing responsibilities but does not prepare checks or maintain the general ledger. Since two of five full-time staff members changed positions or were new in 2009, the previous division of accounting responsibilities among staff is currently being reviewed and new accounting policies and procedures are being instituted. ERRB will make every effort to ensure adequate segregation of duties and to ensure that monthly bank reconciliations are completed within four weeks of the end of the month in future.

## 2. Pooled Fund Investment Manager Statements

During the audit period, the ERRB invested in approximately 25 pooled funds. The Essex Regional Retirement System ("System") does not make use of the detailed statements issued by the investment managers as its primary data source. General ledger investment account activity is only reconciled to the State Street Bank custodial statements. The Investment Manager Statements are filed away and not referred to or reconciled against as an additional proof. This issue has been mentioned in past audits. Reconciling balances to the Investment Manager Statements is a necessary test to confirm the accuracy of the financial results reported by the custodian. In addition, pooled fund statements contain additional information not available from custodial reports, which must be used when accounting for this type of investment.

**Recommendation:** At least quarterly, data from pooled fund managers' statements should be used to post to the general ledger and reconciled to the custodian for accuracy, taking any timing differences into consideration. The Public Employee Retirement Administration Commission ("PERAC") Guide "How to Complete a Pooled Fund Worksheet" is a good source of reference.

## EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

### **ERRB Response:**

ERRB agrees with the recommendation and will reconcile investment manager statements to the general ledger on a regular basis. Since ERRB has recently transferred 80% of its funds to PRIT, it will need to review the reporting provided by PRIT and will request assistance from PERAC in determining the most appropriate reconciliation process under this new business arrangement.

### **3. Expense Warrant Approvals by ERRB**

Warrants for approving administrative, refund/transfer, and payrolls are ratified by an ERRB vote on a monthly basis. However, the warrants are not reviewed by line item during the meeting before ERRB votes on approval. The monthly ERRB vote of the expense warrants is taken after the actual distribution of the funds to pay the monthly expenses. This is in violation of G.L. c. 32, § 23(2)(a) which states that : “Payments from such funds shall be made by him only upon vouchers signed by two persons designated by the Board of any such System by a vote a duly attested copy of which, bearing upon its face specimen signatures of such persons, shall be filed with the treasurer-custodian as his authority for making payments upon vouchers so signed. No voucher shall be drawn unless it shall have been previously authorized by vote of the Board.”

ERRB members routinely make and vote on motions approving payments to themselves. For example, the pertinent section of the minutes of the October 29, 2008 meeting state: "Upon motion by William P. Martineau, seconded by Roberta A. Josephson, it VOTED: that the following charges against ERRB be hereby approved and ordered paid (among the list of payments are): Timothy A. Bassett \$93.49, Roberta A. Josephson \$44.44, William P. Martineau \$28.28, and Timothy A. Bassett \$319.39.

**Recommendation:** ERRB must vote to authorize any combination of two or more ERRB members to sign expenditure warrants before payment is made. These warrants should also include payments by wire transfers. The two ERRB members must be exclusive of the Chairman/Executive Director. In the case that either of the two signing ERRB members is unavailable to sign the warrants, an alternate ERRB member should also be voted on and appointed.

When ERRB votes to approve payment to an ERRB member, such member must recuse him or herself from voting on such payment.

### **ERRB Response:**

ERRB has always provided detailed warrants to Board members for their review and approval at monthly meetings. At the monthly meeting, the warrant is reviewed and any expense that does not normally appear on a monthly basis is explained in detail. ERRB has been using this practice for over 10 years and understands and agrees with its importance in reviewing the warrant.

ERRB has already instituted the practice of having separate votes on warrant items involving payments to individual Board members and understands its importance. All ERRB Board members now understand the importance of recusing themselves on any vote regarding payment to the member.

## EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

ERRB has also recently instituted the practice of having all members present at a Board meeting sign the warrant and believes this is responsive to the recommendation.

ERRB has also recently adopted accounting procedures to ensure that no payments are made until the payment is approved by the Board.

### **4. Vendor Selection Process**

The auditors observed that a Request for Proposal (“RFP”) process is only being used for the selection of Investment Managers and Consultants. “Best Business Practices” require that a similar process be implemented for vendors performing ERRB services or projects, including legal services. Examples of auditor observations related to several vendors that were hired to perform services or projects without any outside bidding process taking place. It appears that some individuals or firms were hired, at least in part, based upon a reported apparent relationship that an ERRB member had with the individual or firm.

**Recommendation:** PERAC recommends an RFP be done approximately every five years (for all vendors), to confirm that the current entity is indeed the best candidate to serve this System on terms that compare to other suitable vendors. “Best Business Practices” would further emphasize that an RFP/competitive process be done at all times upon the initial hiring of a vendor or individual. Implementing these vendor selection controls will serve to get the best possible quality of service with a reasonable price, along with preventing a perception of a conflict of interest.

### **ERRB Response:**

Retirement boards are explicitly exempted from M.G. L. Chapter 30, Uniform Procurement Act. Despite the lack of clear guidance on procurement standards for retirement boards in statute or regulation, ERRB has tried to follow best practices in its purchasing and vendor selection processes. In many instances where a formal RFP process was not used ERRB did obtain three or more quotes for services or goods, but may have neglected to adequately document the request for quote process and keep records on the quotes received.

ERRB agrees that making its procurement processes more competitive and documenting them better is important. Recently ERRB has negotiated significant reductions on copying, telephone service, and security.

ERRB intends to use an RFP process in future for all service providers, other than legal services, whenever a new vendor is sought, but ERRB does not believe a regularly scheduled RFP process would be cost effective if required for all vendors every five years.

ERRB understands that few, if any, retirement boards competitively procure legal services and does not believe that best practice requires this.

## EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

### **PERAC Response:**

ERRB notes that retirement boards are exempted from G.L. c. 30B, the Uniform Procurement Act. However, that exemption does not apply to the fiduciary duty owed by Board members to the system members and beneficiaries. G.L. c. 32, § 23 (3) requires a Board member to “...discharge his duties for the exclusive purpose of providing benefits to members and their beneficiaries with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims and by diversifying the investments of the system so as to minimize the risk of large losses unless under the circumstances it is clearly prudent not to do so.” PERAC Regulations reiterate this requirement and also provide a Code of Ethics for Fiduciaries. See 840 CMR 17.00.

This standard requires the ERRB in discharging its duties (in this case selecting vendors) do so “with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims...” This is often referred to as the Prudent Expert Rule. The G.L. c. 30B exemption does not override this responsibility and it is clear that a Prudent Expert would employ a competitive process in the selection of all vendors in order to meet his/her fiduciary duty. The ERRB must meet that requirement. That is particularly the case in the area of legal services for which the ERRB expends substantial sums.

The ERRB does not dispute the PERAC comment that “It appears that some individuals or firms were hired, at least in part, based upon a reported apparent relationship that an ERRB member had with the individual or firm.” All vendors should be selected by way of a thorough vetting process without any bias or appearance of bias toward a particular vendor.

### **5. Expense Budgeting Process**

The ERRB Advisory Council has not been certifying the ERRB’s Annual Budget. ERRB does present their annual budget to the ERRB Advisory Council. An Annual Expense Budget is developed in the fall of each year. The budget does not include an annual expense line item for Management and Custodial Fees. Furthermore, no variance analysis is performed for actual expenditures charged on the general ledger versus the budgeted line items. The auditors observed that large unfavorable fluctuations from the budgeted line items were not reviewed, explained, or investigated.

**Recommendation:** The ERRB Advisory Council must act to “certify” the annual budget in compliance with G.L. c. 34B, § 19. In order to strengthen internal controls over the expenditure process, the annual budget should be compared against actual general ledger expenditures on at least a quarterly basis. Budgeted line items should be developed for Management and Custodial Fees. Any large fluctuations from the ERRB approved budget should be investigated and explained. ERRB should review the quarterly analysis versus budget each quarter.

## EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

### **ERRB Response:**

ERRB believes the process it uses of presenting the annual budget to the Advisory Council and answering questions on the proposed budget in fact, is what certification requires. A July 17, 2009 letter from PERAC to Ellen S. Guerin, Treasurer/Collector of Taxes for the Town of Boxford, is the basis for this belief. The letter indicates PERAC's view that the Council does not have the authority to change or amend the amounts in the budget submission, and that to certify is to "...review it for accuracy as well as for consistency with the existing funding schedule."

We intend to add detail to the budget as the recommendation suggests, but since the majority of ERRB's funds are now being managed by PRIT we will have to see what information is available from PRIT on management and custodial fees before we know what detail we can add in these particular categories.

We agree that a budget variance report, often known as "Budget vs Actual" would provide important information to the Board in its role as the budgeting authority, and also to the Advisory Council and to members of the retirement system or the general public. ERRB will develop a quarterly Budget vs Actual report and make it available to whoever may request it. The Advisory Council meets biannually and we will provide this information at each meeting. We agree that large variations evident on the Budget vs Actual report should be explained to those receiving the report and will try to incorporate this information in the report itself.

### **6. System Administration and ERRB Member Attendance**

A member of ERRB was absent for 30%, 33% and 41% of meetings in 2006, 2007 and 2008 respectively. Through August 2009, this member has missed 55% of ERRB meetings. This member frequently participated by speakerphone on many of the observed absences. During a crucial ERRB meeting on November 5, 2009 to discuss and take a final vote on transfer of the ERRB investments to the Pension Reserves Investment Trust Fund, an ERRB member was not in attendance, participated by speaker phone, and was ineligible to vote on this important matter. The result is an attendance rate for this ERRB member well below the seventy-five percent minimum considered reasonable for each of the years evaluated. Such a level of absenteeism is considered excessive.

**Recommendation:** Attendance at ERRB meetings is an obligation that must be fulfilled by all ERRB members. The ERRB should consider adjusting the schedule of ERRB meetings in order to better accommodate its members. In instances where a significant level of absenteeism occurs, it is the ERRB's responsibility to take appropriate action with members who fail to maintain minimum attendance requirements. Participation by conference call may be permitted however, it does not qualify toward a quorum, nor is voting by conference call allowed. Relying on participation via conference call could compromise the ERRB's obligation to fulfill their fiduciary duties as trustees for the Retirement System.



## EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

### **ERRB Response:**

There is no statute allowing a legal remedy on this recommendation. The Board attendance policy allows a member to participate via speakerphone and this member, known to be the corporate memory and most experienced in pension administration, has maintained perfect attendance using this option. The Board has followed the procedures outlined by its legal counsel that speakerphone participation cannot be counted for quorum purposes, making motions, or voting. The Board operates by accepting opinions offered in a civilized manner by all members.

### **7. Supporting Expense Documentation**

In several instances, the auditors noted inadequate documentation to support the authorization for warrant disbursements.

During the fall of 2008, seven candidates were interviewed for the Membership Auditor position. Each candidate was compensated at a rate of \$27.23 per hour for the three to four hours of required testing and interview time. Although other documentation existed elsewhere, only a brief description of hours, times and rate per hour was written on a check stub located in files related to the warrant. The payments were included in the general ledger account for Salaries. Upon subsequent inquiry, the auditors were informed that these candidates were compensated for the time that they spent taking specific aptitude tests for the Membership Auditor position.

From 2005 until the end of 2008, \$5,000 per month has been paid to a government lobbyist law firm. The monthly invoice is consistently a flat \$5,000 with no description of the services performed. No current existing contract was made available pertaining to these services. In January 2009, the fee increased to \$6,000 per month.

In 2008, approximately \$8,000 was paid to a consultant for services to complete the ERRB newsletter. All that was available to justify the selection of this vendor was a resume with no contract. The payments to the consultant by ERRB represented the budgeted balance that was due to the previous editor of the newsletter. The auditors also noted in 2007 that \$3,000 was paid to another individual for project work. No contract or vendor selection process was used before the person was hired.

A review of legal bills documents a pattern of significant legal expenditures. Over the three-year period ending December 31, 2008, \$454,285 has been expended by ERRB for legal services.

As of July 2009, six law firms are apparently providing various legal counsel and services to ERRB compared with two at the end of 2005. The auditor was informed that no search process or request for proposals was performed prior to engaging these firms. The auditor was informed that no contracts, engagement letters, or formal agreements have been executed with these firms.

**Recommendation:** Every cash disbursement must have sufficient supporting documentation on file and readily accessible. The documentation should support the ERRB's business rationale for selecting and utilizing the services of the vendor.

## EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

Best practices require that in all instances noted a competitive process should have been used in obtaining these services. The expenditure must not be processed for payment unless the warrant or voucher has full, complete, and adequate detailed supporting documentation and has been reviewed and approved by ERRB.

### **ERRB Response:**

ERRB acknowledges the importance of maintaining adequate documentation for all expenses and have recently begun a process of reorganizing our invoice and procurement files. In line with other changes in accounting policies and procedures, we have instituted a new vendor file system and will add to these files the receipts and other documentation that is often available but may not have been physically attached to invoices. We will also add information on the procurement process used in selecting the vendor, where appropriate.

In the first of the specific instances mentioned in the finding, ERRB believes it conducted a careful and thorough hiring process for the membership position and that having candidates each work on real tasks for half a day was an important part of ensuring the organization was hiring someone with the skills needed. We also believe that paying candidates to perform actual operational tasks is justified and fair.

In the matter of the law firm selected as legislative counsel, this firm is paid on a retainer basis, which ERRB believes is the most cost-effective way to obtain such services. On a monthly basis, the Executive Director reports the legislative update. We agree that a letter agreement outlining a general scope of services to be provided by the firm would be useful.

We agree also that all legal services billings should include more detail for those reviewing the billings and evaluating the performance of the firms. However, we note here that the services themselves and the matters to which they pertain are discussed in detail at Board meetings and with Board members who request additional information.

In addition, we note that while significant legal expenses were incurred through affirmative decisions of the Board, many arise from litigation or other actions with legal ramifications for ERRB, initiated by member units, potential retirees, retirees, members or external parties.

### **8. Open Meeting Law Violations**

This finding was made outside the current audit period. ERRB has been conducting monthly and special ERRB meetings in violation of G.L. c. 39, § 23A. The District Attorney for the Essex District (“DA”) found that the June 4, 2009 meeting as well as the July 27, 2009 meeting violated the plain requirements of the open meeting law. The first violation was for conducting a meeting behind locked doors. The second violation involved not posting the official notices required by the open meeting law and not allowing the meeting to be recorded by an employee of a local access cable television provider. On February 2, 2010, the DA filed a complaint in Essex Superior Court for ERRB’s failure to post an open meeting for January 25, 2010 in violation of G.L. c. 39, § 23B when ERRB entered executive session and failed to announce that it would return into open session later that day to vote on ERRB’s position of Chairman.

## EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

**Recommendation:** ERRB is required to properly post an official notice in advance of all regular and special meetings at each governmental unit. The meeting place must be fully accessible to the public. ERRB must allow interested parties in the future to make audio and video recordings of any ERRB meetings provided that the audio and video recordings do not interfere with the proper conduct of the business activities and deliberations of ERRB.

**ERRB Response:**

The Board and management of ERRB understand the importance of compliance with the Open Meeting Law and were using meeting notice procedures previously used by Essex County, of posting notices in its office and on its website. We now understand that ERRB as a regional entity is subject to different requirements.

ERRB will provide Board members and senior staff with copies of the law and the Attorney General's Open Meeting Law Guidelines.

In addition, we intend to provide training on this law, as well as on the Public Records law and Conflicts of Interest law (as recently updated in 2009) to Board and staff.

We would very much appreciate the pro-active involvement of PERAC in developing and offering such training for all retirement boards, as we expect this sort of training to be more authoritative and effective than training we might arrange ourselves.

### **9. Inadequate Controls For Travel and Business Related Expenses**

ERRB has a specific travel regulation, which document numerous procedures for reporting expenses and providing reimbursement. It was noted that many of the travel practices were not in compliance. Based upon our review of travel and business related expenses in the period, January 1, 2006 – September 30, 2009, it is evident that internal controls are inadequate for authorizing, reporting, and reimbursing staff and ERRB members for travel and business related expenses.

An official travel expense form requiring the traveler to sign “under the pains and penalties of perjury” is not utilized. Many travel costs qualified for reimbursement are identified only on the reimbursement check stub. No designated space for an authorized signature exists on the travel form. All travel expenses require the approval of the Chairman/Executive Director. His electronic signature then appears on the reimbursement check.

A lack of advance planning and coordination of business related travel is evident. In February 2009, five ERRB members and one staff person incurred room deposit charges for a scheduled conference. Only one ERRB member attended and the other five cancelled without advance notification to the hotel. ERRB incurred and approved payment for a total of \$767.90 in cancellation fees charged by the hotel.

## EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

The explanations provided as support for many business meetings conducted by ERRB are brief and generally inadequate. They frequently only disclose the name of the persons attending the meeting and fail to disclose their business affiliation or the necessary business purpose of the meeting. The Internal Revenue Service ("IRS") requires more formal and complete documentation in order to qualify as a deductible business meeting/travel costs as stated in IRS publication 463.

ERRB has adopted the IRS per diem meal and incidental expense allowance. This is used for both local daily travel and trips requiring overnight travel. The auditors observed that ERRB is not in compliance with the IRS policy in this matter. The IRS rules require 75% of the standard per diem rate be reimbursed on the first and last day of a business trip. This 75% allowance was only applied once through December 31, 2008. The auditors also observed several occasions when actual meal expenses were incurred in addition to the per diem rate reimbursed. However, it should be noted that those actual meal expenses were reimbursed back to ERRB. The auditors also observed several occasions when meals were provided as part of an event registration fee, however, per diem meal allowances were also paid.

Numerous transactions related to business travel were charged to ERRB's credit card and lacked adequate documentation.

ERRB provides an ERRB Advisory Council business breakfast or luncheon on a periodic basis. Three payments for breakfasts averaging \$550 each and held in February 2008, January 2009, and June 2009 were without any supporting documentation. On one occasion, a staff member informed the auditors that they had forgotten to retrieve the bill from the restaurant. On another occasion, a breakfast held in December 2006 had \$948.93 in meal costs documented with no other information listing the 33 attendees and their business affiliations was disclosed.

**Recommendation:** All ordinary and necessary travel and business entertainment costs including educational seminars must be fully and completely reported on an official travel expense report. Direct billings must have sufficient supporting documentation to clarify ERRB expenditure. The travel expense request for reimbursement should be signed by the person seeking reimbursement "under the pains and penalties of perjury". As required by the IRS, a complete description of the trip or meeting, including the names of the attendees at the meeting and their relevant business affiliations should be documented on the expense report.

The meal and incidental per diem costs should comply with the IRS rules and per diem costs should be reduced by 25% on the first and last day of a trip. The per diem allowance should be restricted to events involving overnight travel and must not be reimbursed when daily local travel is involved.

Meals should not be charged to the System credit card or otherwise separately accounted for if the per diem rate is applied. Furthermore, ERRB should not allow any per diem meal allowance if meals are already included in an event registration fee.

## EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

An administrative staff member should be responsible for coordinating all business travel planning and reservations in order to prevent unnecessary cancellation fees. This individual should also be responsible for reviewing expense documentation for accuracy.

ERRB should make a concerted effort to comply with the detailed travel regulation it has established.

### **ERRB Response:**

ERRB acknowledges that some internal controls need improvement to prevent the problems noted in this finding. We note also the following:

- ERRB stopped allowing meal and travel costs to be charged on the organization's credit card as soon as this practice was identified as a problem by PERAC auditors in the last year. We also are checking that all authorized expenditures or reimbursements are in line with the IRS guidelines upon which our travel policy is based.
- ERRB is developing a new *Travel & Business Expense Form* and will require that all travel expenses, items purchased on the organization's credit card, and requests for reimbursement be submitted on this form. This form will require the signature of the person requesting reimbursement or who used the charge card, and also the signature of someone authorized by the Board to approve these expenditures. The signature of the person submitting will be over the "pains and penalties of perjury" language suggested in the recommendation in this finding.
- We believe the consistent use of this form will provide a number of internal controls: ensuring that payments/reimbursements are in conformance with ERRB's travel policy; ensuring that all amounts on the organization's charge card are fully documented and justified; and ensuring all payments/reimbursements are appropriately authorized.

ERRB agrees with the recommendation that an administrative staff person be designated to coordinate and review all travel and individual business expense purchases and will do so as part of the reorganization of accounting tasks referred to in Finding #1.

Finally, ERRB recognizes the need to develop and have the Board approve a clear, comprehensive policy on signatory authority and its delegation.

### **10. Open Meeting Law Violations**

The Massachusetts Open Meeting Law (G.L. c.39, § 23B) strictly limits the subject matter that may be discussed in Executive Session rather than Open Session at a meeting of a governmental body. ERRB, on a number of occasions during the audit period, violated the Executive Session provisions of the Open Meeting law. Although there are a number of instances when a body may meet in Executive Session to discuss certain subjects, none of those exceptions appear to be applicable in the instances reviewed by PERAC auditors.

## EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

A regular meeting of ERRB was held on September 30, 2005. ERRB voted to enter into executive session to discuss “pending legal cases and personnel matters.” A brief update on a court case was followed by a lengthy discussion of the 2006 budget. The discussion of litigation is a matter that under the statute may be the subject of an Executive Session. “Personnel matters” unless those matters deal with “the reputation, character, physical condition or mental health, rather than professional competence of an individual” may not be the subject of an Executive Session. Similarly, although there is an exemption to the law “to conduct strategy sessions in preparation for negotiations with non-union personnel...” such a session did not take place in this instance.

In this instance matters related to the ERRB budget and employee compensation, including the Chairman/Executive Director’s salary, were discussed. Specifically, the proposal advanced fixed the Chairman/Executive Director’s compensation to the average salary of the Town Managers of the two largest towns in the System. A 1% bonus for staff that opted not to participate in ERRB’s health insurance plan was also proposed. Upon voting to conclude the executive session, the budget, including the items noted, was approved in the open meeting on a 3 to 2 vote, with the Chairman/Executive Director voting in favor. The Chairman/Executive Director was eligible for and ultimately received the 1% bonus.

**Recommendation:** The Open Meeting Law of the Commonwealth of Massachusetts, G. L. c. 39, § 23B limits executive session meetings to very specific purposes. Budget discussions as well as personnel matters with certain exceptions are required to be held in open meetings.

The Chairman/Executive Director must recuse himself from voting on matters that directly affect his salary and benefit plans.

### **ERRB Response:**

Please see ERRB’s response to Finding #8.

In addition, ERRB understands that conflicts of interest law requires that the Executive Director/Chairman must recuse himself from voting on matters that directly affect his salary and benefit plans.

ERRB has already begun to document compliance with recusals and votes in greater detail in its Board minutes and has appointed a new minute-taker.

### **I I. Open Meeting Law Violation, Approval of Warrant Item in Executive Session**

A special meeting of ERRB was held on September 6, 2006. ERRB voted to enter into executive session to discuss “personnel matters.” ERRB’s Attorney and Actuary reviewed the Chairman/Executive Director’s Contract and Supplemental Agreement, which focused on an annuity being purchased for the benefit of the Chairman/Executive Director. Within this executive session, ERRB voted to approve this contract and agreement. The Chairman/Executive Director is recorded as abstaining from this vote.

## EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

ERRB, while remaining in Executive Session, then voted unanimously, with the Chairman/Executive Director participating, to approve payment for the legal expense incurred in amending the Chairman/Executive Director's contract.

The discussion and approval of an employment contract and a warrant item in executive session may be in violation of the Open Meeting Law, G L. c. 39, § 23B.

**Recommendation:** The Open Meeting Law of the Commonwealth of Massachusetts, G L. c. 39 § 23B limits executive session meetings to very specific purposes. Budget and contract discussions are required to be held in open meetings.

The Chairman/Executive Director must recuse himself from voting on matters that directly affect his salary and benefit plans.

### **ERRB Response:**

Please see ERRB's response to Finding #8.

### **12. Invalid Meeting Lacking A Quorum, and Open Meeting Law Violation**

A purported meeting of ERRB was held on October 25, 2006 without a quorum being present. Two ERRB members were physically present in the conference room at the System's offices. A third member participated by conference call via speaker phone. A member who is not physically present at a meeting may not vote via speakerphone. During this meeting, the two ERRB members present, one of whom was the Chairman/Executive Director, voted to go into executive session to discuss two issues. The first issue involved the payback of deductions taken on the personal use of an automobile. The second issue related to a discussion of legal invoices pertaining to services provided for "amending the Executive Director's contract." In Executive Session the two members present, including the Chairman/Executive Director, voted to approve these legal bills. These items were not voted and approved in an open session.

**Recommendation:** An ERRB meeting cannot be convened without a valid quorum present. All actions voted, confirmed, or ratified at this session may be invalid. ERRB business can only be conducted at a legal meeting of ERRB.

The subject matter involved (deductions payback and legal invoices) does not fall within the exceptions to the Open Meeting Law that permit these items to be discussed in Executive Session.

The Chairman/Executive Director must recuse himself from voting on matters that directly affect his salary and benefit plans.

### **ERRB Response:**

Please see ERRB's response to Finding #8.

In addition, ERRB understands that ERRB business can only be conducted at a legal meeting of ERRB. No future meeting will proceed without a quorum.

Please also see ERRB's response to Finding #6.

## EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

### **13. Violation of the Campaign Finance Law**

In the Fall of 2008, ERRB mailed a newsletter to all members and retirees, which included an article on the statewide ballot question #1, a referendum on abolishing the Massachusetts state income tax. The tenor of the article was that voting “yes” on this ballot question “was a bad deal for retirees.” ERRB expended almost \$46,000 for newsletters during 2008. It is estimated that half of this amount was for the fall newsletter that addressed the issue contested in State Ballot Question #1.

**Recommendation:** These activities may violate Massachusetts G.L. c. 55, Disclosure And Regulation Of Campaign Expenditures And Contributions. In *Anderson v. City of Boston*, 439 U.S. 1389 (1978), the state's Supreme Judicial Court prohibited a municipality from spending public money to try to convince voters to support a statewide ballot question. The Office of Campaign and Political Finance has applied this principle to prohibit the use of public resources for any political campaign purpose whatsoever.

#### **PERAC Update:**

On February 16, 2010 the Office of Campaign & Political Finance ruled that the activity noted above “...did not comply with the campaign finance law...” and that “...the ERRB should not have used public resources to influence a ballot question.” As a result, PERAC understands that the Chairman/Executive Director provided restitution in the amount of \$5,000.

#### **ERRB Response:**

ERRB acknowledges that it has received the *Office of Campaign and Political Finance* ruling on this matter. This matter has been settled.

ERRB will refer to and abide by the *Office of Campaign and Political Finance* ruling in its future decision-making regarding the use of ERRB resources.

### **14. Unauthorized Wire Transfers of Interest/Annuity Wire Transfers Without Warrant or ERRB vote**

The auditors observed that two \$83,400 transactions for an annuity contract purchased on behalf of the Chairman/Executive Director were initiated and wired into a trust account via the Chairman/Executive Director's authorization. There is no record of ERRB formally voting to approve these expenditures in their official minutes. These payments were not disclosed on the warrants for the months in which these payments were completed. The internal control procedures related to the wire transfer process are insufficient. The Chairman/Executive Director both initiates and authorizes wire transfers.

**Recommendation:** G.L. c. 32, § 23(2)(a) requires that all “...Payments from such funds shall be made by him only upon vouchers signed by two persons designated by the board of any such System by a vote a duly attested copy of which, bearing upon its face specimen signatures of such persons, shall be filed with the treasurer-custodian as his authority for making payments upon vouchers so signed. No voucher shall be drawn unless it shall have been previously authorized by vote of the



## EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

board.” These transactions were completed in violation of this statute. ERRB must comply with this statute for all disbursements. It is recommended that all wire transfers be confirmed by an administrative staff person and disclosed on the monthly expenditure warrant for line item approval by at least two ERRB members.

The Chairman/Executive Director should have recused himself from authorizing these transfers.

### **ERRB Response:**

The ERRB usually makes wire transfers only when required by the terms of investments contracts. These transfers must be made within fairly short time frames. They are authorized by letter or form faxed to State Street Bank, custodian for the funds. We agree with the recommendation that an administrative staff person confirm the transfer and will institute this procedure.

We also will institute the procedure of confirming these transfers with the Board by including them on a warrant for line item approval.

The Executive Director is the only person authorized to sign wire transfers, but ERRB will add a second authorized signatory for wire transfers to avoid possible future conflicts of interest.

### **PERAC Response:**

The ERRB does not dispute the PERAC comment “The auditors observed that two \$83,400 transactions for an annuity contract purchased on behalf of the Chairman/Executive Director were initiated and wired into a trust account via the Chairman/Executive Director’s authorization. There is no record of ERRB formally voting to approve these expenditures in their official minutes. These payments were not disclosed on the warrants for the months in which these payments were completed.”

### **15. Failure to Maintain Public Records**

At the beginning of the audit field examination, auditors were informed that several documents requested were not in the possession of ERRB. Original or copies were reported to no longer be located in ERRB’s office or available for retrieval from off-site storage. Ultimately, some records related to the Chairman/Executive Director annuity contract were provided to the auditors. These records had been retrieved from a safe deposit box located in Marblehead, MA by the Chairman/Executive Director.

**Recommendation:** Failure to maintain proper custody of all relevant records of ERRB’s activities is an apparent violation of the governing statute and PERAC regulations. Public documents and personal data must be protected by ERRB and made available for inspection, pursuant to G.L. c. 32, § 21(1)(c), and 840 CMR §§ 6.11, 27.00.

### **ERRB Response:**

The Board and management of ERRB understand the importance of maintaining public records in compliance with public records law and PERAC regulations and will make every effort to prevent future violations.

## EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

ERRB will provide Board members and senior staff with copies of the public records law and the PERAC regulations 840 CMR sections 6.11 and 27.00.

In addition, we intend to provide training on this law, as well as on the Open Meeting law and Conflicts of Interest law (as recently updated in 2009) to Board and staff.

We would very much appreciate the pro-active involvement of PERAC in developing and offering such training for all retirement boards, as we expect this sort of training to be more authoritative and effective than training we might arrange ourselves.

### **PERAC Response:**

The ERRB does not dispute the PERAC comment “At the beginning of the audit field examination, auditors were informed that several documents requested were not in the possession of ERRB. Original or copies were reported to no longer be located in ERRB’s office or available for retrieval from off-site storage. Ultimately, some records related to the Chairman/Executive Director annuity contract were provided to the auditors. These records had been retrieved from a safe deposit box located in Marblehead, MA by the Chairman/Executive Director.”

Since the beginning of the audit, PERAC has experienced significant difficulty in obtaining documents from the ERRB. As recently as March 2010, a PERAC attorney asked for documents and was referred by the Chairman/Executive Director to Lundregan & Casey, PC as the main conduit to at least seven law firms. That firm referred the request to Dwyer & Collora, LLP. PERAC has yet to receive the requested documents. It is our understanding that the ERRB will consider asserting attorney client privilege with respect to the documents at its meeting of March 29, 2010.

### **16. Inappropriate Use of Retirement Funds**

ERRB voted at the March 2008 meeting to “set aside \$5,000 from the reserve fund” to hire Boston Benefit Partners to work with the retirees and active members of the Town of Groveland. Boston Benefit Partners assists clients in the development, financing, implementation, administration and communication of medical, dental, life, disability and other employee benefit programs. ERRB voted unanimously at its July 2008 meeting “to accept the proposal (from Boston Benefit Partners) with certain edits and to appropriate \$30,000 to provide six, five thousand dollar grants.” These Technical Assistance Grants are to assist towns interested in changing from their present insurance to the State Group Insurance Commission (“GIC”). The Chairman/Executive Director stated that no contract or agreement was executed with Boston Benefit Partners. A decision of a town to transfer insurance coverage for its employees to the GIC is not retirement related.

These disbursements would appear to be an inappropriate use of retirement funds.

**Recommendation:** Every cash disbursement must have sufficient supporting documentation on file and be readily accessible. The documentation should support the ERRB’s business rationale for selecting and utilizing the services of the vendor. Best practices require that in all instances noted a competitive process should have been used in obtaining these services. The expenditure must not

## EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

be processed for payment unless the warrant or voucher has full, complete and adequate detailed supporting documentation and has been reviewed and approved by ERRB.

The expenses of ERRB must be limited to providing a benefit for the members and beneficiaries of the System. ERRB must take prudent and appropriate action in determining what expenditures will benefit the System.

### **ERRB Response:**

ERRB believes that its activities related to assisting towns transferring insurance coverage for their employees to GIC was appropriate because it fits within PERAC regulations 840 CMR 1.01 Board Members' Duty. "A board member shall discharge all of his/her duties solely in the interest of members and their beneficiaries, and 1) For the exclusive purpose of: a) providing benefits to members and their beneficiaries; and b) defraying reasonable expenses of administering the system."

The 2007 action of the legislature to allow towns to transfer both active and retired employees into the GIC provides that retirees participate in the Public Employee Committee which negotiates the transfer and that retirees have 10% of the vote on whether or not to join the GIC, along with active employees.

In addition, joining the GIC can both lower the cost of health insurance for individual retirees and for towns. ERRB believed that this important opportunity to improve the health insurance benefits available to retirees - many of whom have very small pensions and face difficult choices in finding affordable health insurance - justified its providing assistance to towns who requested it.

ERRB did not issue an RFP to engage the services of Boston Benefit Partners, LLC (BPP), but BPP is an authorized vendor under a state blanket agreement for management consultants, program coordinators, and planners. BBP services are used extensively by the Group Insurance Commission in structuring their insurance programs.

BBP made presentations to the ERRB Board before each municipal assignment began and made a summary report to the Board at the completion of the project. The ERRB had a written letter of engagement based on an hourly rate with BPP. In future, ERRB will outline a more detailed written contract. The Board voted to transfer funds from the reserve to cover the cost of the letter of engagement.

### **PERAC Response:**

G.L. c. 32, § 23 (3) requires a retirement board member to "...discharge his duties for the exclusive purpose of providing benefits to members and their beneficiaries with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims and by diversifying the investments of the system so as to minimize the risk of large losses unless under the circumstances it is clearly prudent not to do so." The duties of a retirement board are primarily set forth in G.L. c. 32, § 20. Other sections of G.L. c. 32 and provisions of G.L. c. 34B also include "duties" to be discharged by a retirement board. These statutes relate solely to the

## EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

retirement rights and benefits of the members and beneficiaries and do not set forth duties of a retirement board with respect to retiree health insurance with the exception of purely ministerial functions related to payment of premiums. G.L. c. 32A and G.L. c. 32B set forth the provisions regarding health insurance for public employees and retirees. Those provisions do not set forth any duties that a retirement board must discharge. There are many rights and benefits available to retirees that are beyond the scope of G.L. c. 32 and the expenditure of retirement system assets on those matters raises the possibility of a violation of fiduciary duty.

In addition these funds were expended for “Technical Assistance Grants” to assist towns interested in changing from their present insurance to the State Group Insurance Commission (GIC). Such an action does not necessarily result in an economic or a service benefit for retirees.

### **17. Non-Business Related Expense Reimbursements**

ERRB regularly reimburses ERRB members, management, and staff for meals (i.e.; coffee, snacks, lunches, dinners) on non-overnight local business trips. These meals are not considered to be a reimbursable travel and entertainment expense because no ordinary and necessary business was documented as being transacted during the meal involved. No formal travel expense report supported these meal reimbursements. Staff lunches were allowed on the return trip to the Danvers office location after meetings conducted at local town offices. On one occasion, an additional tip was given at a dinner even though the bill had a 20% gratuity included. As a result, the final tip ended up being 57%.

ERRB approved reimbursement to an employee in the course of pursuing an advanced educational degree. These costs included such items as coffee, snacks, mileage, parking, train, taxi, tolls and car service costs. On one occasion, this employee was reimbursed \$250 for car service transportation one way from the educational institution to the employee’s residence.

The Chairman/Executive Director approves all expenses, including his own (procedures were changed during the course of the PERAC audit). In addition, in his capacity as Chairman, he participates in the monthly vote to approve payments related to these expenses.

**Recommendation:** ERRB must immediately discontinue the practice of reimbursing ERRB members, management, and staff for meals and travel costs for local travel or those considered to be personal in nature, and all reimbursements must be deemed reasonable by ERRB.

The approval of the reimbursement of the Chairman/Executive Director’s expenses must be made by another staff member designated by ERRB, not the Chairman/Executive Director.

### **ERRB Response:**

ERRB stopped reimbursing the types of expenses cited in this finding as soon as the auditors discussed it with management. It is now ERRB’s policy that local meals and snacks, educational expenses, and other non-business related expenses are not reimbursable and may not be paid by the organization. Meal expense is only reimbursed if (sic) relates to approved business-related overnight travel and has not already been reimbursed through a per diem or conference/event fee.

## EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

Please also see the response to Finding #9 for ERRB's plans and commitments to address controls on travel, meal, and other reimbursed or charged expenses.

### **18. Credit Card Usage Undocumented or Not Adequately Supported**

The FIA Platinum Plus credit card is used extensively by the System. The card is issued in the name of the Chairman/Executive Director of ERRB.

The monthly activity charged on the card range from office supplies and computer equipment to hotel and meal costs. Receipts were observed to be missing that substantiate the charge on the billing statement. The auditors observed numerous restaurant charges and occasional hotel charges that were not adequately explained or disclosed on a separate travel expense reimbursement form. The card was regularly used to purchase supplies for the staff and office facilities. This contradicts the approved travel regulation that states in part, "Credit cards shall not be used to purchase supplies or other items that ERRB, ERRB members, or ERRB's staff use on a regular basis and which can be anticipated and purchased by way of a competitive process." Such purchases bypass the usual competitive process involved in a sound and responsible public entity purchasing policy. The auditors also noted that the card incurred late payment fees and interest charges. In February 2009, the credit card was frozen due to payment not being received on a timely basis.

The auditors observed the System credit card was used for personal travel expenses that were subsequently reimbursed by personal check. Although reimbursed to ERRB by the traveler, the card is routinely used for ancillary hotel costs such as liquor and movies, which the established travel regulation specifically excludes from reimbursement. ERRB regularly allows spouses to accompany members on travel to educational seminars. These spouse related travel costs are also included in the charges to the credit card pending reimbursement to the System. In November 2008, the card was used for hotel and meal costs during a personal weekend side trip at a guest house in Williamstown, MA. The \$741.58 in charges was reimbursed back to the ERRB by a member of ERRB. Subsequent inquiry resulted in an explanation of a personal side trip with a spouse in which the auditors were informed that the couple's personal credit cards were compromised. As a result, the only means of payment available was ERRB's credit card.

**Recommendation:** In order to comply with the existing approved travel regulation, personal use and the purchase of supplies or other items that are used on a regular basis should be prohibited. In order to improve financial control and eliminate personal charges on the System credit card, staff and ERRB members should be encouraged to use their personal credit cards for business travel. Meals should not be charged to the card unless directly related to a business meeting that is fully documented on an official expense report. Payments should be processed in a timely manner in order to prevent late payment and finance charges. The credit card must be issued in ERRB's name, not in the name of the Chairman/Executive Director.

## EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

### **ERRB Response:**

ERRB agrees with the recommendation and has tried to address it through its response to Finding #9 and Finding #17.

There remain a small number of instances where purchasing supplies (including software or small equipment items) online is by far the least expensive option and ERRB credit card will be used in such instances and for authorized business travel that is fully documented on an official expense report.

We note here that the card is in the name of the Essex Regional Retirement Board with the notation Timothy Bassett, not as the cardholder but as the authorized agent. The bank insists that the card include the name of an individual as well as the organization.

**PERAC Response:** During the course of the audit, auditors determined that the FIA Platinum Plus credit card was issued in the name of the Chairman/Executive Director of ERRB. PERAC understands that the FIA Platinum Plus credit card is now issued in the name of ERRB with the Chairman/Executive Director as the authorized agent.

### **19. Off Warrant Voucher Approval**

This finding was made outside the current audit period. The Chief Operating Officer (“COO”) indicated during the course of this audit that the Chairman/Executive Director had requested she sign several checks in payment for legal services over \$10,000. Two signatures are required for checks over \$10,000. The COO reportedly refused to sign the checks because the vouchers had not been included on any approved warrant and ratified by ERRB. The Chairman/Executive Director reportedly stated that the bills were approved during an executive session. The COO questioned the validity of these legal services as no detail was provided. The Chairman/Executive Director reportedly requested the ERRB Advisory Committee Appointee co-sign the checks. Reportedly, this person also refused to sign. On February 9, 2010, an auditor requested documentation regarding the checks from the COO. The COO denied the request at the direction of the Chairman/Executive Director who claimed to refer such request to ERRB’s attorneys. To date, the Chairman/Executive Director and ERRB’s attorneys have not complied with the request. On February, 11, 2010, PERAC reported ERRB’s violations of G.L. c. 32, § 21(1)(c) to the Attorney General’s Office.

On February 9, 2010, The COO, without providing the requested documentation, told the auditor that bank statements in her possession stated that the off warrant checks in question, totaling \$132,113.88 in legal fees, were issued under only the signature of the Chairman/Executive Director to the following law firms for the following amounts:

- Casey & Lundregan, PC \$37,960.00 (check cleared, date unknown)
- Casey & Lundregan, PC \$22,800.00 (check cleared, date known)
- Dwyer & Collora, LLP \$50,812.38 (check cleared on October 10, 2009)
- Laredo & Smith, LLP \$20,541.50 (check cleared on October 21, 2009)

## EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

**Recommendation:** All valid ERRB expense items must be approved by a vote in open meetings. Vouchers should provide sufficient detail to clearly state the nature of the services rendered.

Failure to maintain proper custody of all relevant records of ERRB's activities and to make those records available to PERAC is an apparent violation of the governing statute and PERAC regulations.

**ERRB Response:**

ERRB understands the importance of maintaining internal controls on expenditures in all situations.

ERRB recognizes the need for the Board to develop and approve a clear, comprehensive policy on signatory authority and its delegation, and to ensure that such a policy addresses whether two signatures are required by the Board for amounts over a certain threshold and to whom signatory authority is delegated when the primary signatory is unavailable.

In addition, ERRB intends to re-file signatory documents with its banks that communicate clearly to the banks that any restrictions on signatories are to be considered binding and will reinforce with all staff and Board members the critical importance of not paying for expenditures prior to the approval of such payments on a warrant that provide sufficient detail for the approval to be meaningful.

**PERAC Response:**

Although the ERRB "understands the importance of maintaining internal controls..." "recognizes the need to develop and approve a clear comprehensive policy ..." and "intends to re-file signatory documents..." it does not dispute the Finding that a total of over \$132,000 in payments were made to vendors in violation of the procedures required and without proper ERRB approval.

This action appears to have been taken unilaterally by the Chairman/Executive Director. In addition, PERAC, as of this date has not received the information from the ERRB that was requested regarding this issue. The members and beneficiaries are entitled to have the entire ERRB review and approve these expenditures prior to payment being issued.

### **20. ERRB Action Without Local Approval/Reclassification of Dispatchers**

ERRB approved a motion on September 27, 2006 to transfer dispatchers from Group 1 to Group 2 if member units amend local job descriptions. The Chairman/Executive Director is recorded as abstaining from this vote. In the subsequent Actuarial Valuation Data submission, the ERRB included eighty dispatchers in Group 2 without action having taken place at the local level to change job descriptions. As a result, the annual appropriation of member units was adjusted based upon the dispatchers having been moved to Group 2.

**Recommendation:** The Actuarial Valuation process must be based on the actual number of employees in each Group classification. Factors that anticipate a proposed classification should be separately identified.

## EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

### **ERRB Response:**

ERRB acknowledges that the cost of reclassifying the dispatchers was included in the FY2009 and FY2010 appropriations and divided among all ERRB units even though only some units approved moving their dispatchers to Group 2. The FY2011 appropriation was adjusted to remove the dispatcher cost and further reduced by approximately \$82,000 for the dispatcher cost included in the FY2009 and FY2010 appropriations.

ERRB is considering further efforts to ensure that assessments under the next actuarial valuation are calculated fairly. Specifically, ERRB is considering determining each unit's appropriation based on the liabilities of that unit and a proportional allocation of the assets, similar to the methodology used by the Middlesex Retirement System. The current allocation method based on total annual payroll can create inequity with some units subsidizing other units.

### **21. Failure to Elect Chairman/First Member and the Fifth Member**

On December 31, 2008, the term of the incumbent Chairman/First Member expired. ERRB failed to choose a Chairman/First Member within the time frame set forth in G.L. c. 34B, § 19. As a result, the responsibility for making that appointment became that of PERAC.

On June 30, 2009, the term of the incumbent Fifth Member expired. ERRB failed to choose a Fifth Member within the time frame set forth in G.L. c. 34B, § 19. As a result, the responsibility for making that appointment became that of PERAC.

**Recommendation:** ERRB must establish a mechanism for tracking the terms of its members to insure that positions are filled in accordance with G.L. c. 34B, § 19 upon the expiration of terms or vacancies.

### **ERRB Response:**

ERRB acknowledges an administrative oversight and agrees with the recommendation to establish a tracking mechanism. The Chairman of the Board will be responsible for tracking Board member terms and vacancies.

### **PERAC Response:**

PERAC does not agree that such actions were administrative oversights.

PERAC has been informed that prior to the meeting in December 2008, an ERRB staff member reminded the Chairman/First Member that his term was about to expire. PERAC understands that, in 2009, following the term's expiration, the Chairman/First Member was reminded by staff to place the issue of reviewing the Chairman/First Member's term on the meeting agenda prior to several regularly scheduled ERRB meetings. The Chairman/First Member failed to heed the advice of staff on these occasions.

Regarding the fifth member, it has been established that Casey & Lundregan, PC, then Lundregan Law Office, PC, drafted a legal memorandum ("Memo") for ERRB dated March 10, 2004 regarding the term of the fifth member. The subject matter of the Memo is "Kathy O'Leary – Appointment of



## EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

Fifth Member”. When the Memo was issued on March 10, 2004, Ms. O’Leary’s term was scheduled to end on June 30, 2004.

In spite of repeated requests to ERRB, we have not received a copy of the Memo or any other related memoranda from the ERRB. PERAC has received a copy of the Memo from another retirement board which had received a copy of the Memo from ERRB.

The Memo will be discussed at PERAC’s next regularly scheduled meeting on Tuesday, March 23, 2010 at 1:00 pm at its Somerville, MA offices.

### **22. Investment Funded Prior To Formal Approval**

ERRB funded an investment on August 1, 2008, with Levine Leichtmann Capital Partners IV prior to receiving notice from PERAC’s Investment Director that all required regulatory documents had been submitted. This violation was noted in a letter to ERRB dated February 20, 2009, after ERRB finally resolved the violation.

**Recommendation:** ERRB must comply with PERAC’s Investment Regulations, 840 CMR 16.08 which states in part: “The selection and hiring of investment managers, consultants, custodian banks and other investment related service providers by all retirement boards shall be subject to a competitive process which satisfies the boards’ fiduciary duty and meets the requirements of M.G.L. c. 32 and 840 CMR. Prior to retention of the vendor, Boards shall notify the Commission that such a process, as well as the provisions of G.L. c. 32 and 840 CMR, was adhered to.” Written acknowledgement from PERAC is required before an investment can be funded. PERAC memorandum #12/2005 dated March 7, 2005 entitled “Overview of Investment Regulation Issues” provides explicit guidance on this issue.

#### **ERRB Response:**

The Essex Regional Retirement Board decided to invest in Levin (sic) IV after a successful investment in Levin (sic) III where over 50% of the capital invested had been returned. The Levin (sic) IV investment was the same strategy and the same management as Fund III therefore a search was not required to make the follow-on investment in Fund IV given that over 50% of the capital had been returned. A letter should have been written to PERAC explaining the decision and asking for approval as had been done with past follow-on investments.

### **23. Indirect Payments for Lobbying Registration**

In 2007 and 2008, ERRB, through its credit card, made payments to the Office of the Secretary of State for lobbyist/client registration fees. According to a communication received by PERAC from the Chairman/Executive Director, the firm of Kearney, Donovan and McGee (“KDM”), a law firm retained by the ERRB to provide lobbying services, paid “client fees” on behalf of the ERRB for calendar years 2006 and 2008. The ERRB then reimbursed KDM for these payments.

In addition, the Chairman/Executive Director has submitted to PERAC a communication from the Massachusetts Coalition of Police (“MCP”), an organization to which the Chairman/Executive

## EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

Director provided lobbying services through his association with Peter McCarthy & Associates. That letter indicates that MCP paid the lobbyist registration fee of the Chairman/Executive Director during the period in which he provided those services to the MCP.

**Recommendation:** The manner in which the payments were made to the Secretary of State for lobbyist/client registration was indirect, inconsistent and opaque. Furthermore, inquiries should be made of the Secretary of State as to whether these fees are due from a public entity such as the ERRB. In the event that such fees are due, best practices would dictate that the ERRB make payments directly. The payment of private business related fees owed by the Chairman/Executive Director by an organization, some of whose members may be members of the System, may raise concerns in certain circumstances about the ability of the Chairman/Executive Director to perform his duties objectively.

Every cash disbursement must have sufficient supporting documentation on file and readily accessible. The documentation should support the ERRB's business rationale for selecting and utilizing the services of a lobbyist. Best practices require that in all instances noted, a competitive process should have been used in obtaining these services. The expenditure must not be processed for payment unless the warrant or voucher has full, complete, and adequate detailed supporting documentation and has been reviewed and approved by ERRB.

### **ERRB Response:**

ERRB paid "client" lobbying fees, not agent or lobbyist fees, as required by M.G.L. Chapter 3, Section 41. ERRB is required, as the client of registered legislative agents, to register and pay the annual fee to the Secretary of State's office.

ERRB agrees that such registration fee payments should be done directly by ERRB and appear on the warrant for approval and will do so in future.

### **PERAC Response:**

The ERRB does not dispute the Finding but states that ERRB "...is required, as the client of registered legislative agents, to register and pay the annual fee to the Secretary of State's office." PERAC recommended that ERRB seek an opinion from the Secretary of State "as to whether these fees are due from a public entity..." Furthermore the ERRB makes no comment regarding PERAC's statement that "The payment of private business related fees owed by the Chairman/Executive Director by an organization, some of whose members may be members of the System, may raise concerns in circumstances about the ability of the Chairman/Executive Director to perform his duties objectively."

### **FINAL DETERMINATION:**

***PERAC audit staff will follow up in six (6) months to ensure appropriate actions have been taken regarding all findings.***

# STATEMENT OF LEDGER ASSETS AND LIABILITIES

| AS OF DECEMBER 31,                        |                      |                      |                      |
|---|----------------------|----------------------|----------------------|
|   | 2008                 | 2007                 | 2006                 |
| <b>Net Assets Available For Benefits:</b> |                      |                      |                      |
| Cash                                      | \$14,169,829         | \$7,317,791          | \$6,051,650          |
| Fixed Income Securities                   | 11,701,555           | 19,142,004           | 15,133,406           |
| Equities                                  | 34,737,079           | 29,524,478           | 30,503,624           |
| Pooled Domestic Equity Funds              | 41,661,922           | 95,411,364           | 96,021,675           |
| Pooled International Equity Funds         | 22,874,759           | 49,688,635           | 48,416,671           |
| Pooled Domestic Fixed Income Funds        | 0                    | 0                    | 34,259,085           |
| Pooled Alternative Investment Funds       | 56,596,857           | 69,248,223           | 18,151,410           |
| Pooled Real Estate Funds                  | 25,661,156           | 30,721,999           | 29,979,607           |
| PRIT Cash Fund                            | 0                    | 0                    | 0                    |
| PRIT Core Fund                            | 0                    | 0                    | 0                    |
| Interest Due and Accrued                  | 90,064               | 130,616              | 151,969              |
| Accounts Receivable                       | 3,988,251            | 1,243,317            | 774,130              |
| Accounts Payable                          | (5,315,861)          | (2,827,417)          | (360,960)            |
| <b>Total</b>                              | <u>\$206,165,610</u> | <u>\$299,601,011</u> | <u>\$279,082,268</u> |
| <b>Fund Balances:</b>                     |                      |                      |                      |
| Annuity Savings Fund                      | \$88,892,104         | \$81,945,695         | \$76,677,898         |
| Annuity Reserve Fund                      | 27,882,428           | 27,503,442           | 26,044,079           |
| Pension Fund                              | 26,714,115           | (2,659,042)          | 2,679,197            |
| Military Service Fund                     | 24,661               | 24,514               | 24,368               |
| Expense Fund                              | 0                    | 0                    | 0                    |
| Pension Reserve Fund                      | 62,652,302           | 192,786,402          | 173,656,725          |
| <b>Total</b>                              | <u>\$206,165,610</u> | <u>\$299,601,011</u> | <u>\$279,082,268</u> |

## STATEMENT OF CHANGES IN FUND BALANCES

|                          | Annuity<br>Savings<br>Fund | Annuity<br>Reserve<br>Fund | Pension<br>Fund     | Military<br>Service<br>Fund | Expense<br>Fund | Pension<br>Reserve<br>Fund | Total<br>All<br>Funds |
|--------------------------|----------------------------|----------------------------|---------------------|-----------------------------|-----------------|----------------------------|-----------------------|
| Beginning Balance (2006) | \$72,214,471               | \$24,268,564               | \$8,691,887         | \$17,164                    | \$0             | \$139,053,984              | \$244,246,069         |
| Receipts                 | 10,512,864                 | 726,008                    | 17,776,043          | 31,563                      | 2,495,287       | 34,601,548                 | 66,143,314            |
| Interfund Transfers      | (4,228,592)                | 4,251,757                  | 0                   | (24,359)                    | 0               | 1,193                      | 0                     |
| Disbursements            | (1,820,845)                | (3,202,250)                | (23,788,733)        | 0                           | (2,495,287)     | 0                          | (31,307,115)          |
| Ending Balance (2006)    | 76,677,898                 | 26,044,079                 | 2,679,197           | 24,368                      | 0               | 173,656,725                | 279,082,268           |
| Receipts                 | 11,553,173                 | 773,991                    | 16,981,414          | 146                         | 2,507,030       | 21,523,666                 | 53,339,420            |
| Interfund Transfers      | (4,462,635)                | 4,462,659                  | 2,393,966           | 0                           | 0               | (2,393,990)                | 0                     |
| Disbursements            | (1,822,742)                | (3,777,287)                | (24,713,619)        | 0                           | (2,507,030)     | 0                          | (32,820,677)          |
| Ending Balance (2007)    | 81,945,695                 | 27,503,442                 | (2,659,042)         | 24,514                      | 0               | 192,786,402                | 299,601,011           |
| Receipts                 | 12,283,805                 | 817,645                    | 22,503,405          | 147                         | 2,620,790       | (100,545,404)              | (62,319,612)          |
| Interfund Transfers      | (3,388,703)                | 3,391,707                  | 29,585,692          | 0                           | 0               | (29,588,697)               | 0                     |
| Disbursements            | (1,948,693)                | (3,830,366)                | (22,715,940)        | 0                           | (2,620,790)     | 0                          | (31,115,789)          |
| Ending Balance (2008)    | <u>\$88,892,104</u>        | <u>\$27,882,428</u>        | <u>\$26,714,115</u> | <u>\$24,661</u>             | <u>\$0</u>      | <u>\$62,652,301</u>        | <u>\$206,165,610</u>  |

# STATEMENT OF RECEIPTS

|   | FOR THE PERIOD ENDING DECEMBER 31, |                     |                     |
|---|------------------------------------|---------------------|---------------------|
|   | 2008                               | 2007                | 2006                |
| <b>Annuity Savings Fund:</b>  |                                    |                     |                     |
| Members Deductions  | \$10,173,915                       | \$9,456,773         | \$8,854,355         |
| Transfers from Other Systems  | 1,127,401                          | 1,234,958           | 903,887             |
| Member Make Up Payments and Re-deposits   | 188,933                            | 112,823             | 191,204             |
| Member Payments from Rollovers  | 317,201                            | 303,768             | 145,372             |
| Investment Income Credited to Member Accounts   | 476,354                            | 444,851             | 418,045             |
| Sub Total   | <u>12,283,805</u>                  | <u>11,553,173</u>   | <u>10,512,864</u>   |
| <b>Annuity Reserve Fund:</b>  |                                    |                     |                     |
| Investment Income Credited to the Annuity Reserve Fund  | 817,645                            | 773,991             | 726,008             |
| <b>Pension Fund:</b>  |                                    |                     |                     |
| 3 (8) (c) Reimbursements from Other Systems Received from Commonwealth for COLA and Survivor Benefits | 531,058                            | 514,184             | 483,694             |
| Pension Fund Appropriation  | 684,666                            | 738,028             | 791,243             |
|   | <u>21,287,681</u>                  | <u>15,729,201</u>   | <u>16,501,107</u>   |
| Sub Total   | <u>22,503,405</u>                  | <u>16,981,414</u>   | <u>17,776,043</u>   |
| <b>Military Service Fund:</b>   |                                    |                     |                     |
| Contribution Received from Municipality on Account of Military Service                                | 0                                  | 0                   | 31,460              |
| Investment Income Credited to the Military Service Fund   | 147                                | 146                 | 103                 |
| Sub Total   | <u>147</u>                         | <u>146</u>          | <u>31,563</u>       |
| <b>Expense Fund:</b>  |                                    |                     |                     |
| Expense Fund Appropriation  | 0                                  | 0                   | 0                   |
| Investment Income Credited to the Expense Fund  | 2,620,790                          | 2,507,030           | 2,495,287           |
| Sub Total   | <u>2,620,790</u>                   | <u>2,507,030</u>    | <u>2,495,287</u>    |
| <b>Pension Reserve Fund:</b>  |                                    |                     |                     |
| Federal Grant Reimbursement   | 67,521                             | 59,663              | 89,707              |
| Pension Reserve Appropriation   | 0                                  | 0                   | 0                   |
| Interest Not Refunded   | 24,310                             | 19,151              | 16,787              |
| Miscellaneous Income  | 0                                  | 0                   | 9,608               |
| Excess Investment Income (Loss)   | (100,637,235)                      | 21,444,852          | 34,485,445          |
| Sub Total   | <u>(100,545,404)</u>               | <u>21,523,666</u>   | <u>34,601,548</u>   |
| <b>Total Receipts, Net</b>  | <u>(\$62,319,612)</u>              | <u>\$53,339,420</u> | <u>\$66,143,314</u> |

# STATEMENT OF DISBURSEMENTS

| FOR THE PERIOD ENDING DECEMBER 31,                          |                     |                     |                     |
|---|---------------------|---------------------|---------------------|
|   | 2008                | 2007                | 2006                |
| <b>Annuity Savings Fund:</b>                                |                     |                     |                     |
| Refunds to Members  | \$1,041,410         | \$1,218,392         | \$945,204           |
| Transfers to Other Systems                                  | <u>907,283</u>      | <u>604,349</u>      | <u>875,640</u>      |
| Sub Total   | <u>1,948,693</u>    | <u>1,822,742</u>    | <u>1,820,845</u>    |
| <b>Annuity Reserve Fund:</b>                                |                     |                     |                     |
| Annuities Paid  | 3,782,721           | 3,717,184           | 3,178,690           |
| Option B Refunds  | <u>47,645</u>       | <u>60,103</u>       | <u>23,560</u>       |
| Sub Total   | <u>3,830,366</u>    | <u>3,777,287</u>    | <u>3,202,250</u>    |
| <b>Pension Fund:</b>  |                     |                     |                     |
| Pensions Paid:  |                     |                     |                     |
| Regular Pension Payments                                    | 17,941,774          | 16,339,609          | 15,242,933          |
| Survivorship Payments                                       | 1,129,351           | 1,235,070           | 1,203,013           |
| Ordinary Disability Payments                                | 215,051             | 225,419             | 307,634             |
| Accidental Disability Payments                              | 2,719,656           | 2,558,249           | 2,386,624           |
| Accidental Death Payments                                   | 61,378              | 691,007             | 634,371             |
| Section 101 Benefits  | 105,239             | 85,928              | 81,732              |
| 3 (8) (c) Reimbursements to Other Systems                   | 543,491             | 3,578,337           | 3,932,425           |
| State Reimbursable COLA's Paid                              | 0                   | 0                   | 0                   |
| Chapter 389 Beneficiary Increase Paid                       | 0                   | 0                   | 0                   |
| Sub Total   | <u>22,715,940</u>   | <u>24,713,619</u>   | <u>23,788,733</u>   |
| <b>Military Service Fund:</b>                               |                     |                     |                     |
| Return to Municipality for Members Who Withdrew Their Funds | <u>0</u>            | <u>0</u>            | <u>0</u>            |
| <b>Expense Fund:</b>  |                     |                     |                     |
| Board Member Stipend  | 15,000              | 15,250              | 13,500              |
| Salaries  | 487,004             | 452,539             | 451,194             |
| Legal Expenses  | 144,117             | 144,218             | 183,213             |
| Medical Expenses  | 65                  | 240                 | 82                  |
| Travel Expenses   | 20,764              | 20,351              | 28,911              |
| Administrative Expenses                                     | 232,245             | 207,845             | 138,881             |
| Furniture and Equipment                                     | 6,321               | 31,670              | 13,405              |
| Management Fees   | 1,241,812           | 1,405,966           | 1,424,235           |
| Custodial Fees  | 263,425             | 67,181              | 73,829              |
| Consultant Fees   | 142,165             | 74,998              | 107,468             |
| Condominium Management Fees                                 | 15,466              | 27,152              | 14,941              |
| Service Contracts   | 32,002              | 39,845              | 27,603              |
| Fiduciary Insurance   | <u>20,404</u>       | <u>19,775</u>       | <u>18,026</u>       |
| Sub Total   | <u>2,620,790</u>    | <u>2,507,030</u>    | <u>2,495,287</u>    |
| <b>Total Disbursements</b>                                  | <u>\$31,115,789</u> | <u>\$32,820,677</u> | <u>\$31,307,115</u> |

# INVESTMENT INCOME

|   | FOR THE PERIOD ENDING DECEMBER 31, |                     |                     |
|---|------------------------------------|---------------------|---------------------|
|   | 2008                               | 2007                | 2006                |
| <b>Investment Income Received From:</b>                 |                                    |                     |                     |
| Cash  | \$306,668                          | \$345,789           | \$245,036           |
| Short Term Investments                                  | 0                                  | 0                   | 2,092               |
| Fixed Income  | 2,161,293                          | 945,762             | 432,941             |
| Equities  | 674,843                            | 368,049             | 372,549             |
| Pooled or Mutual Funds                                  | 1,285,466                          | 1,335,691           | 1,812,763           |
| Commission Recapture                                    | <u>5,994</u>                       | <u>5,334</u>        | <u>3,853</u>        |
| <b>Total Investment Income</b>                          | <u>4,434,265</u>                   | <u>3,000,626</u>    | <u>2,869,235</u>    |
| <b>Plus:</b>  |                                    |                     |                     |
| Realized Gains  | 10,471,813                         | 2,243,156           | 2,277,061           |
| Unrealized Gains  | 9,896,128                          | 35,581,286          | 40,450,609          |
| Interest Due and Accrued - Current Year                 | <u>90,064</u>                      | <u>130,616</u>      | <u>151,969</u>      |
| Sub Total   | <u>20,458,005</u>                  | <u>37,955,058</u>   | <u>42,879,639</u>   |
| <b>Less:</b>  |                                    |                     |                     |
| Paid Accrued Interest on Fixed Income Securities        | (57,337)                           | (176,829)           | (163,496)           |
| Realized Loss   | (20,812,450)                       | (1,108,538)         | (810,529)           |
| Unrealized Loss   | (100,614,165)                      | (14,347,476)        | (6,637,089)         |
| Interest Due and Accrued - Prior Year                   | <u>(130,616)</u>                   | <u>(151,969)</u>    | <u>(12,871)</u>     |
| Sub Total   | <u>(121,614,569)</u>               | <u>(15,784,812)</u> | <u>(7,623,985)</u>  |
| <b>Net Investment Income (Loss)</b>                     | <u>(96,722,299)</u>                | <u>25,170,871</u>   | <u>38,124,889</u>   |
| <b>Income Required:</b>                                 |                                    |                     |                     |
| Annuity Savings Fund                                    | 476,354                            | 444,851             | 418,045             |
| Annuity Reserve Fund                                    | 817,645                            | 773,991             | 726,008             |
| Military Service Fund                                   | 147                                | 146                 | 103                 |
| Expense Fund  | <u>2,620,790</u>                   | <u>2,507,030</u>    | <u>2,495,287</u>    |
| <b>Total Income Required</b>                            | <u>3,914,936</u>                   | <u>3,726,019</u>    | <u>3,639,444</u>    |
| Net Investment Income (Loss)                            | <u>(96,722,299)</u>                | <u>25,170,871</u>   | <u>38,124,889</u>   |
| Less: Total Income Required                             | <u>3,914,936</u>                   | <u>3,726,019</u>    | <u>3,639,444</u>    |
| <b>Excess Income (Loss) To The Pension Reserve Fund</b> | <u>(\$100,637,235)</u>             | <u>\$21,444,852</u> | <u>\$34,485,445</u> |

## SCHEDULE OF ALLOCATION OF INVESTMENTS OWNED

(percentages by category)

| AS OF DECEMBER 31, 2008             |                             |                                  |
|-------------------------------------|-----------------------------|----------------------------------|
|                                     | MARKET VALUE                | PERCENTAGE<br>OF TOTAL<br>ASSETS |
| Cash                                | \$14,169,829                | 6.8%                             |
| Fixed Income                        | 11,701,555                  | 5.6%                             |
| Equities                            | 34,737,079                  | 16.7%                            |
| Pooled Domestic Equity Funds        | 41,661,922                  | 20.1%                            |
| Pooled International Equity Funds   | 22,874,759                  | 11.0%                            |
| Pooled Alternative Investment Funds | 56,596,857                  | 27.3%                            |
| Pooled Real Estate Funds            | 25,661,156                  | 12.4%                            |
| PRIT Cash Fund                      | 0                           | 0.0%                             |
| PRIT Core Fund                      | 0                           | 0.0%                             |
| <b>Grand Total</b>                  | <b><u>\$207,403,156</u></b> | <b><u>100.0%</u></b>             |

For the year ending December 31, 2008, the rate of return for the investments of the Essex Regional Retirement System was (33.05)%. For the five-year period ending December 31, 2008, the rate of return for the investments of the Essex Regional Retirement System averaged 2.19%. For the 24-year period ending December 31, 2008, since PERAC began evaluating the returns of the retirement systems, the rate of return on the investments of the Essex Regional Retirement System was 8.09%.



## SUPPLEMENTARY INVESTMENT REGULATIONS

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

March 24, 2008

16.08

In accordance with Investment Guideline 99-3, the Essex Regional Retirement Board is authorized to invest in Ascent Venture Partners V. The Board has been a satisfied investor in Ascent Venture Partners IV. The management team and strategy are unchanged and Ascent Venture Partners has submitted an updated Exemption Application.

December 11, 2007

21.01(2)

The Essex Regional Retirement Board has voted to invest in the Analytic Investors Core Equity Plus Fund. This is a 130/30 fund, in which overall exposure to the market is 1.0 time but where the manager may “short” up to 30% of the portfolio and go “long” with those proceeds. The Board is hereby authorized to take “short” positions up to 30% of the total portfolio value.

May 20, 2004

16.08

In accordance with Investment Guideline 99-3, the Essex Regional Retirement Board may invest in the Massachusetts Technology Development Corporation Heritage Fund, L.P. As confirmed in a letter from MTDC's President, this fund is the successor fund to the MTDC Commonwealth Fund in which the Board has been a limited partner. The new fund will have the identical investment strategy as the previous one. The Board has submitted the required documents in support of this investment.

March 26, 2004

16.08

In accordance with Investment Guideline 99-3, the Essex Regional Retirement Board is authorized to invest in Ascent Venture Partners IV. The board has been a satisfied investor in Ascent Venture Partners III and the new fund will have the same portfolio management team and investment strategy as the fund in which the board is currently invested.

October 23, 2003

16.08

In accordance with PERAC Investment Guideline 99-2, the Essex Regional Retirement Board is authorized to make a minor modification to its large cap equity mandate with Freedom Capital Management Company. As part of its rebalancing program, the Board will supplement its current large cap equity separate account and its commingled Equity Style Fund with an allocation to Freedom's “Style-Weighted Concentrated Fund”. This fund will incorporate the best ideas in both growth and value stocks, has the same S&P 500 benchmark, and is managed by the same team as Freedom's other large cap products

## SUPPLEMENTARY INVESTMENT REGULATIONS (Continued)

February 12, 2002

16.08

In accordance with Investment Guideline 99-2, the Essex Regional Retirement Board is modifying its fixed income mandate with State Street Research & Management and Financial Management Advisors. In order to save on management and custody fees, the mandates are changing from separate account management to commingled funds. The new funds are the "State Street Research Core Fixed Income Fund" and the "FMA High Yield Appreciation Limited Partnership". Both changes involve identical portfolio management teams and investment objectives.

July 26, 2000

We have received your Board's response to PERAC Memo #44/1999 regarding Supplemental Investment Regulations. In accordance with your decision, self-imposed restrictions on your Board's percentage of holdings in specific asset classes have been rescinded. Your Board must, however, make asset allocation decisions subject to your fiduciary duty.

Please note that the restrictions pertaining to real estate and alternative investments contained in 840 CMR 19.01 remain in effect.

January 7, 2000

16.08

In accordance with PERAC Investment Guideline 99-3, the Essex County Retirement Board may invest in Boston Millennia Partners II, L.P. The board is an investor in Boston Millennia Partners I and has submitted the required documentation in support of this request.

June 30, 1998

20.09

(1) Venture capital investments shall not exceed 3% of the total market value of the portfolio at the time of the investment provided that in any system with assets in excess of nineteen million dollars, venture capital investments may be made up to an amount equal to 5% of the total market value of the portfolio at the time of investment, shall be considered a separate asset class, and provided further that:

(a) the board does not participate in the selection of the personnel responsible for making venture capital investments or otherwise exercise discretion in business affairs and should this be required, prior to any participation by the board, the board shall consult with PERAC to determine the appropriate course of action;

(b) such personnel retain authority in the decision making process, and

(c) should an investment in venture capital result in the direct ownership of securities, such shall be permitted only until such time as divestiture is Prudent.

(2) Venture capital investments shall only be made in venture capital funds operated by venture capital firms having their principal places of business in the United States.

(3) All venture capital investments shall be made in companies which have their principal places of business in the United States.

## SUPPLEMENTARY INVESTMENT REGULATIONS (Continued)

September 3, 1997

20.08 (e)

Enrollment in the Securities Lending Program offered by Northern Trust Company for the Sector Plus Group Trust provided that the lending of securities is limited to brokers, dealers, and financial institutions and that the loan is collateralized by cash or United States Government securities according to applicable regulatory requirements.

January 25, 1996

21.01(3)

Futures Contracts other than as follows:

(a) Forward Currency Contracts may be written against securities in the international portfolio by an investment advisor registered under the Investment Advisors Act of 1940 and who has been granted a waiver from PERAC for international investments.

(b) Forward Currency Contracts may be written against securities in the international portfolio to a maximum of twenty-five percent (25%) of the international portfolio's non-dollar holdings at market value. Speculative currency positions unrelated to underlying portfolio holdings are strictly prohibited.

February 10, 1994

16.02 (4)

The board may employ a custodian bank and may charge such expenses against earned income from investments provided that such expenses shall not exceed in any one-year .08% of the value of the fund.

20.04 (1)

United States based corporations and equities of foreign corporations.

20.07 (5)

Equity investments shall be made only in securities listed on a United States stock exchange, traded over the counter in the United States, or listed and traded on a foreign exchange.

March 30, 1989

20.06 (8)

Sales of fixed income investments with maturities exceeding one year shall not exceed 150% of the market value of all fixed income obligations in any twelve-month period, excluding cash and short term obligations.

20.07 (6)

Sales of equity investments shall not exceed 100% of the average market value of all equity holdings in any twelve-month period.

# NOTES TO FINANCIAL STATEMENTS

## NOTE I – SUMMARY OF PLAN PROVISIONS

The plan is a contributory defined benefit plan covering all Essex Regional Retirement System member unit employees deemed eligible by the retirement board, with the exception of school department employees who serve in a teaching capacity. The Teachers' Retirement Board administers the pensions of such school employees.

### ADMINISTRATION

There are 106 contributory Retirement Systems for public employees in Massachusetts. Each system is governed by a retirement board, and all boards, although operating independently, are governed by Chapter 32 of the Massachusetts General Laws. This law in general provides uniform benefits, uniform contribution requirements, and a uniform accounting and funds structure for all systems.

### PARTICIPATION

Participation is mandatory for all full-time employees. Eligibility with respect to part-time, provisional, temporary, seasonal, or intermittent employment is governed by regulations promulgated by the retirement board, and approved by PERAC. Membership is optional for certain elected officials.

There are 3 classes of membership in the Retirement System:

#### **Group 1:**

General employees, including clerical, administrative, technical, and all other employees not otherwise classified.

#### **Group 2:**

Certain specified hazardous duty positions.

#### **Group 4:**

Police officers, firefighters, and other specified hazardous positions.

## NOTES TO FINANCIAL STATEMENTS (Continued)

### MEMBER CONTRIBUTIONS

Member contributions vary depending on the most recent date of membership:

|                    |   |
|--------------------|---|
| Prior to 1975:     | 5% of regular compensation                                      |
| 1975 - 1983:       | 7% of regular compensation                                      |
| 1984 to 6/30/96:   | 8% of regular compensation                                      |
| 7/1/96 to present: | 9% of regular compensation                                      |
| 1979 to present:   | an additional 2% of regular compensation in excess of \$30,000. |

### RATE OF INTEREST

Interest on regular deductions made after January 1, 1984 is a rate established by PERAC in consultation with the Commissioner of Banks. The rate is obtained from the average rates paid on individual savings accounts by a representative sample of at least 10 financial institutions.

### RETIREMENT AGE

The mandatory retirement age for some Group 2 and Group 4 employees is age 65. Most Group 2 and Group 4 members may remain in service after reaching age 65. Group 4 members who are employed in certain public safety positions are required to retire no later than the end of month they attain age 65. There is no mandatory retirement age for employees in Group 1.

### SUPERANNUATION RETIREMENT

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

- completion of 20 years of service, or
- attainment of age 55 if hired prior to 1978, or if classified in Group 4, or
- attainment of age 55 with 10 years of service, if hired after 1978, and if classified in Group 1 or 2

## NOTES TO FINANCIAL STATEMENTS (Continued)

### AMOUNT OF BENEFIT

A member's annual allowance is determined by multiplying average salary by a benefit rate related to the member's age and job classification at retirement, and the resulting product by his creditable service. The amount determined by the benefit formula cannot exceed 80% of the member's highest three year average salary. For veterans as defined in G.L. c. 32, § 1, there is an additional benefit of \$15 per year for each year of creditable service, up to a maximum of \$300.

- Salary is defined as gross regular compensation.
- Average Salary is the average annual rate of regular compensation received during the 3 consecutive years that produce the highest average, or, if greater, during the last three years (whether or not consecutive) preceding retirement.
- The Benefit Rate varies with the member's retirement age, but the highest rate of 2.5% applies to Group 1 employees who retire at or after age 65, Group 2 employees who retire at or after age 60, and to Group 4 employees who retire at or after age 55. A .1% reduction is applied for each year of age under the maximum age for the member's group. For Group 2 employees who terminate from service under age 55, the benefit rate for a Group 1 employee shall be used.

### DEFERRED VESTED BENEFIT

A participant who has completed 10 or more years of creditable service is eligible for a deferred vested retirement benefit. Elected officials and others who were hired prior to 1978 may be vested after 6 years in accordance with G.L. c. 32, § 10.

The participant's accrued benefit is payable commencing at age 55, or the completion of 20 years, or may be deferred until later at the participant's option.

### WITHDRAWAL OF CONTRIBUTIONS

Member contributions may be withdrawn upon termination of employment. Employees who first become members on or after January 1, 1984, may receive only limited interest on their contributions if they voluntarily terminate their service. Those who leave service with less than 5 years receive no interest; those who leave service with greater than 5 but less than 10 years receive 50% of the interest credited.

## NOTES TO FINANCIAL STATEMENTS (Continued)

### DISABILITY RETIREMENT

The Massachusetts Retirement Plan provides 2 types of disability retirement benefits:

#### ORDINARY DISABILITY

**Eligibility:** Non-veterans who become totally and permanently disabled by reason of a non-job related condition with at least 10 years of creditable service (or 15 years creditable service in systems in which the local option contained in G.L. c. 32, § 6(I) has not been adopted).

Veterans with ten years of creditable service who become totally and permanently disabled by reason of a non-job related condition prior to reaching “maximum age”.

**Retirement Allowance:** Equal to the accrued superannuation retirement benefit as if the member was age 55. If the member is a veteran, the benefit is 50% of the member’s final rate of salary during the preceding 12 months, plus an annuity based upon accumulated member contributions plus credited interest. If the member is over age 55, he or she will receive not less than the superannuation allowance to which he or she is entitled.

#### ACCIDENTAL DISABILITY

**Eligibility:** Applies to members who become permanently and totally unable to perform the essential duties of the position as a result of a personal injury sustained or hazard undergone while in the performance of duties. There are no minimum age or service requirements.

**Retirement Allowance:** 72% of salary plus an annuity based on accumulated member contributions, with interest. This amount is not to exceed 100% of pay. For those who became members in service after January 1, 1988 or who have not been members in service continually since that date, the amount is limited to 75% of pay. There is an additional pension of \$708.60 per year (or \$312.00 per year in systems in which the local option contained in G.L. c. 32, § 7(2)(a)(iii) has not been adopted), per child who is under 18 at the time of the member’s retirement, with no age limitation if the child is mentally or physically incapacitated from earning. The additional pension may continue up to age 22 for any child who is a full time student at an accredited educational institution.

## NOTES TO FINANCIAL STATEMENTS (Continued)

### ACCIDENTAL DEATH

**Eligibility:** Applies to members who die as a result of a work-related injury or if the member was retired for accidental disability and the death was the natural and proximate result of the injury or hazard undergone on account of which such member was retired.

**Allowance:** An immediate payment to a named beneficiary equal to the accumulated deductions at the time of death, plus a pension equal to 72% of current salary and payable to the surviving spouse, dependent children or the dependent parent, plus a supplement of \$312 per year, per child, payable to the spouse or legal guardian until all dependent children reach age 18 or 22 if a full time student, unless mentally or physically incapacitated.

The surviving spouse of a member of a police or fire department or any corrections officer who, under specific and limited circumstances detailed in the statute, suffers an accident and is killed or sustains injuries resulting in his death, may receive a pension equal to the maximum salary for the position held by the member upon his death.

In addition, an eligible family member may receive a one time payment of \$100,000 from the State Retirement Board.

### DEATH AFTER ACCIDENTAL DISABILITY RETIREMENT

Effective November 7, 1996, Accidental Disability retirees were allowed to select Option C at retirement and provide a benefit for an eligible survivor. For Accidental Disability retirees prior to November 7, 1996, who could not select Option C, if the member's death is from a cause unrelated to the condition for which the member received accidental disability benefits, a surviving spouse will receive an annual allowance of \$6,000.

### DEATH IN ACTIVE SERVICE

**Allowance:** An immediate allowance equal to that which would have been payable had the member retired and elected Option C on the day before his or her death. For death occurring prior to the member's superannuation retirement age, the age 55 benefit rate is used. The minimum annual allowance payable to the surviving spouse of a member in service who dies with at least two years of creditable service is \$3,000, provided that the member and the spouse were married for at least one year and living together on the member's date of death.

The surviving spouse of such a member in service receives an additional allowance equal to the sum of \$1,440 per year for the first child, and \$1,080 per year for each additional child until all dependent children reach age 18 or 22 if a full time student, unless mentally or physically incapacitated.



## NOTES TO FINANCIAL STATEMENTS (Continued)

### COST OF LIVING

If a system has accepted Chapter 17 of the Acts of 1997, and the Retirement Board votes to pay a cost of living increase for that year, the percentage is determined based on the increase in the Consumer Price Index used for indexing Social Security benefits, but cannot exceed 3.0%. Section 51 of Chapter 127 of the Acts of 1999, if accepted, allows boards to grant COLA increases greater than that determined by CPI but not to exceed 3.0%. The first \$12,000 of a retiree's total allowance is subject to a cost-of-living adjustment. The total Cost-of-Living adjustment for periods from 1981 through 1996 is paid for by the Commonwealth of Massachusetts.

### METHODS OF PAYMENT

A member may elect to receive his or her retirement allowance in one of 3 forms of payment.

**Option A:** Total annual allowance, payable in monthly installments, commencing at retirement and terminating at the member's death.

**Option B:** A reduced annual allowance, payable in monthly installments, commencing at retirement and terminating at the death of the member, provided, however, that if the total amount of the annuity portion received by the member is less than the amount of his or her accumulated deductions, including interest, the difference or balance of his accumulated deductions will be paid in a lump sum to the retiree's beneficiary or beneficiaries of choice.

**Option C:** A reduced annual allowance, payable in monthly installments, commencing at retirement. At the death of the retired employee, 2/3 of the allowance is payable to the member's designated beneficiary (who may be the spouse, or former spouse who remains unmarried for a member whose retirement becomes effective on or after February 2, 1992, child, parent, sister, or brother of the employee) for the life of the beneficiary. For members who retired on or after January 12, 1988, if the beneficiary pre-deceases the retiree, the benefit payable increases (or "pops up") based on the factor used to determine the Option C benefit at retirement. For members who retired prior to January 12, 1988, if the System has accepted Section 288 of Chapter 194 of the Acts of 1998 and the beneficiary pre-deceases the retiree, the benefit payable "pops up" in the same fashion. The Option C became available to accidental disability retirees on November 7, 1996.

## NOTES TO FINANCIAL STATEMENTS (Continued)

### ALLOCATION OF PENSION COSTS

If a member's total creditable service was partly earned by employment in more than one retirement system, the cost of the "pension portion" is allocated between the different systems pro rata based on the member's service within each retirement system.

## NOTES TO FINANCIAL STATEMENTS (Continued)

### NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES

The accounting records of the System are maintained on a calendar year basis in accordance with the standards and procedures established by the Public Employee Retirement Administration Commission.

The Annuity Savings Fund is the fund in which members' contributions are deposited. Voluntary contributions, re-deposits, and transfers to and from other systems, are also accounted for in this fund. Members' contributions to the fund earn interest at a rate determined by PERAC. Interest for some members who withdraw with less than ten years of service is transferred to the Pension Reserve Fund. Upon retirement, members' contributions and interest are transferred to the Annuity Reserve Fund. Dormant account balances must be transferred to the Pension Reserve Fund after a period of ten years of inactivity.

The Annuity Reserve Fund is the fund to which a member's account is transferred upon retirement from the Annuity Savings Fund and Special Military Service Credit Fund. The annuity portion of the retirement allowance is paid from this fund. Interest is credited monthly to this fund at the rate of 3% annually on the previous month's balance.

The Special Military Service Credit Fund contains contributions and interest for members while on a military leave for service in the Armed Forces who will receive creditable service for the period of that leave.

The Expense Fund contains amounts transferred from investment income for the purposes of administering the retirement system.

The Pension Fund contains the amounts appropriated by the governmental units as established by PERAC to pay the pension portion of each retirement allowance.

The Pension Reserve Fund contains amounts appropriated by the governmental units for the purposes of funding future retirement benefits. Any profit or loss realized on the sale or maturity of any investment or on the unrealized gain of a market valued investment as of the valuation date is credited to the Pension Reserve Fund. Additionally, any investment income in excess of the amount required to credit interest to the Annuity Savings Fund, Annuity Reserve Fund, and Special Military Service Credit Fund is credited to this Reserve account.

The Investment Income Account is credited with all income derived from interest and dividends of invested funds. At year-end the interest credited to the Annuity Savings Fund, Annuity Reserve Fund, Expense Fund, and Special Military Service Credit Fund is distributed from this account and the remaining balance is transferred to the Pension Reserve Fund.

## NOTES TO FINANCIAL STATEMENTS (Continued)

### NOTE 3 - SUPPLEMENTARY MEMBERSHIP REGULATIONS

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

September 24, 1996

Membership:

That an employee must work a minimum of twenty hours per week to meet the requirements of membership in the retirement system. A permanent part-time employee who does not work a fixed number of hours per week shall become a member of the system after a period of ninety (90) days if his average work week calculated at the end of the ninety (90) day period averages twenty hours or more.

Creditable Service:

That a full-time employee will receive one (1) full year of creditable service for each year employed. A part-time employee whose position has always been part-time is granted full creditable service. A part-time employee who becomes fulltime has the part-time service prorated.

Membership:

Elected Officials: That if an elected official is not a member of the retirement system before their election by popular vote, they do not have to join the system; but they may join by applying for membership, in writing, within ninety (90) days of assuming their elective office.

August 2, 2004 and September 9, 2003

Travel Regulations:

The Board has adopted Supplementary Travel Regulations under the provisions of G.L. c. 7, § 50 and G.L. c. 32, § 21(4). (Regulations available upon written request.)

## NOTES TO FINANCIAL STATEMENTS (Continued)

### NOTE 4 - ADMINISTRATION OF THE SYSTEM

The System is administered by a five-person Board of Retirement consisting of the Chairman who shall be elected by the other four board members and appointed by them as chief executive officer, a second member elected by the Advisory Council, a third and fourth member who shall be elected by the members in or retired from the service of such system, and a fifth member appointed by the other four Board members.<sup>1</sup>

Chairman: Timothy Bassett

#### Advisory Council

Member: Kevin Merz Term Expires: 12/31/12

Elected Member: Glenn Morse Term Expires:

Elected Member: William Martineau Term Expires:

Appointed Member: Katherine O'Leary

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

The investment of the system's funds is the responsibility of the Board. All retirement allowances must be approved by the Retirement Board and are then submitted to the PERAC Actuary for verification prior to payment. All expenses incurred by the System must be approved by a majority vote of the Board. Payments shall be made only upon vouchers signed by two persons designated by the Board.

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

|                          |   |  |
|--------------------------|---|--|
| Chairman:                | ) |  |
| Advisory Council Member: | ) | \$50,000,000 Fiduciary Insurance and             |
| Elected Members:         | ) | \$1,000,000 Fidelity Bond                        |
| Appointed Members:       | ) | MACRS policy                                     |
| Staff Employee:          | ) | St. Paul Travelers, National Union Fire and Arch |

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<sup>1</sup> There are technical legal issues regarding the dates of the expiration of the terms of the third and fourth members. There are substantial legal issues regarding whether the first and fifth members are properly serving their terms. These issues are currently under review of the Monitoring Team and PERAC Senior Staff. It should be noted that the term of the first member is currently under the review of the Middlesex County Superior Court.

## NOTES TO FINANCIAL STATEMENTS (Continued)

### NOTE 5 - ACTUARIAL VALUATION AND ASSUMPTIONS

The most recent actuarial valuation of the Essex Regional System was prepared by The Segal Company as of January 1, 2008.

|   |                      |
|---|----------------------|
| The actuarial liability for active members was                | \$212,653,240        |
| The actuarial liability for retired and inactive members was  | <u>232,518,314</u>   |
| The total actuarial liability was                             | 445,171,554          |
| System assets as of that date were                            | <u>301,420,965</u>   |
| The unfunded actuarial liability was                          | <u>\$143,750,589</u> |
| The ratio of system's assets to total actuarial liability was | 67.7%                |
| As of that date the total covered employee payroll was        | \$111,726,856        |

The normal cost for employees on that date was 9.03% of payroll

The normal cost for the employer including administrative expenses was 5.96% of payroll

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

Investment Return: 8.50% per annum  
 Rate of Salary Increase: 5.00% per annum

### GASB STATEMENT NO. 25, DISCLOSURE INFORMATION AS OF JANUARY 1, 2008

| Actuarial<br>Valuation<br>Date | Actuarial<br>Value of<br>Assets<br>( a ) | Actuarial<br>Accrued<br>Liability<br>( b ) | Unfunded<br>AAL<br>(UAAL)<br>( b-a ) | Funded<br>Ratio<br>( a/b ) | Covered<br>Payroll<br>( c ) | UAAL as a<br>% of<br>Cov. Payroll<br>( (b-a)/c ) |
|--------------------------------|--|--|--------------------------------------|----------------------------|-----------------------------|--|
| 1/1/2008                       | \$301,420,965                            | \$445,171,554                              | \$143,750,589                        | 67.7%                      | \$111,726,856               | 128.7%   |
| 1/1/2006                       | \$261,327,047                            | \$376,034,621                              | \$114,707,574                        | 69.5%                      | \$98,641,094                | 116.3%   |
| 1/1/2004                       | \$229,852,971                            | \$333,396,222                              | \$103,543,251                        | 68.9%                      | \$93,404,002                | 110.9%   |
| 1/1/2002                       | \$218,346,198                            | \$287,390,715                              | \$69,044,517                         | 76.0%                      | \$85,005,338                | 81.2%  |

## NOTES TO FINANCIAL STATEMENTS (Continued)

### NOTE 6 - MEMBERSHIP EXHIBIT

|  | 1999                | 2000                | 2001                | 2002                | 2003                | 2004                | 2005                | 2006                | 2007                | 2008                |
|--|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| <b>Retirement in Past Years</b>                |                     |                     |                     |                     |                     |                     |                     |                     |                     |                     |
| Superannuation                                 | 2                   | 48                  | 7                   | 32                  | 64                  | 8                   | 73                  | 75                  | 14                  | 12                  |
| Ordinary Disability                            | 1                   | 2                   | 0                   | 0                   | 1                   | 0                   | 1                   | 1                   | 0                   | 0                   |
| Accidental Disability                          | 0                   | 1                   | 0                   | 0                   | 4                   | 1                   | 6                   | 7                   | 0                   | 0                   |
| <b>Total Retirements</b>                       | 3                   | 51                  | 7                   | 32                  | 69                  | 9                   | 80                  | 83                  | 14                  | 12                  |
| Total Retirees, Beneficiaries<br>and Survivors | 1,454               | 1,509               | 1,444               | 1,480               | 1,501               | 1,498               | 1,580               | 1,615               | 1,584               | 1,585               |
| Total Active Members                           | 3,027               | 3,135               | 3,271               | 3,300               | 3,146               | 3,015               | 2,987               | 3,144               | 3,188               | 3,329               |
| <b>Pension Payments</b>                        |                     |                     |                     |                     |                     |                     |                     |                     |                     |                     |
| Superannuation                                 | \$8,683,752         | \$9,574,446         | \$9,898,380         | \$10,527,968        | \$11,878,170        | \$13,004,480        | \$13,806,107        | \$15,242,933        | \$16,339,609        | \$17,941,774        |
| Survivor/Beneficiary Payments                  | 799,789             | 899,405             | 937,488             | 977,893             | 1,037,535           | 1,127,176           | 1,195,411           | 1,203,013           | 1,235,070           | 1,129,351           |
| Ordinary Disability                            | 304,553             | 312,949             | 309,718             | 288,299             | 290,690             | 336,560             | 281,611             | 307,634             | 225,419             | 215,051             |
| Accidental Disability                          | 1,565,189           | 1,627,756           | 1,677,851           | 1,741,172           | 1,832,263           | 2,012,159           | 2,114,484           | 2,386,624           | 2,558,249           | 2,719,656           |
| Other  | 1,479,808           | 769,809             | 1,590,101           | 936,365             | 978,071             | 1,017,337           | 1,164,938           | 4,648,530           | 4,355,272           | 710,109             |
| <b>Total Payments for Year</b>                 | <u>\$12,833,091</u> | <u>\$13,184,365</u> | <u>\$14,413,538</u> | <u>\$14,471,697</u> | <u>\$16,016,729</u> | <u>\$17,497,712</u> | <u>\$18,562,551</u> | <u>\$23,788,734</u> | <u>\$24,713,619</u> | <u>\$22,715,940</u> |

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