

ESSEX REGIONAL RETIREMENT SYSTEM

MANAGEMENT LETTER

DECEMBER 31, 2018



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To the Honorable Essex Regional Retirement Board
Essex Regional Retirement System
Danvers, Massachusetts

In planning and performing our audit of the financial statements of the Essex Regional Retirement System (System), as of and for the year ended December 31, 2018, in accordance with auditing standards generally accepted in the United States of America, we considered the Essex Regional Retirement System's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we do not express an opinion on the effectiveness of the System's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies, and, therefore, material weaknesses or significant deficiencies may exist that were not identified.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency or a combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

However, during our audit we became aware of several matters that represent opportunities for strengthening internal controls and operating efficiency. The memorandum that accompanies this letter summarizes our comments and suggestions concerning those matters.

The System's written responses to the comments identified in our audit have not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

We will review the status of these comments during our next audit engagement. We have already discussed these comments and suggestions with various System personnel, and will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations.

This communication is intended solely for the information and use of management of the Essex Regional Retirement System, and is not intended to be and should not be used by anyone other than these specified parties.

Powers & Sullivan LLC

June 10, 2019

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Comments and Recommendations

Accounting for Corrections of Errors in Payroll Withholdings

Comment

During the course of operations, the System sometimes discovered that a member unit has made errors in the amounts withheld from employees for pension deductions. If it is determined that a member underpaid the System, there is typically a make-up period where additional deductions will be withheld from that member over a set timeframe until the error is fully corrected. The total amount of the error may be calculated by the System. However, the amount that will be withheld from each payroll is typically negotiated between the member unit and the employee.

Unless further adjustments are made, the additional make-up withholdings would be treated as regular payroll withholdings. This misclassification impacts both the employee and the member units. The employee would have the make-up withholdings classified in the wrong period in the pension system. Since the system uses payroll withholdings to calculate the payroll for each member unit, this has the result of inflating the payroll of that member unit during the make-up payments. In a similar manner, the payroll for that member unit would have been understated while the error was taking place.

Although these errors are not typically material to the System as a whole, or to the individual member units, they should be accounted for in a manner that will not impact the deductions reported for the member or the payroll reported for that member unit, and consequently the appropriation allocation for all member units.

Recommendation

We recommend the System develop a standard method to recoup funds and account for withholding errors that may be identified by any member unit.

To accomplish this, we recommended two different options for the System to consider.

The simplest method would be for the member unit to make the system whole by paying the amount that should have been initially withheld by the member unit from the employee. The System would record the contributions to apply them to the year in which they were earned by the employee, similar to payments received for contract settlements. This would be a one-time entry on the System's part to correct the error.

An alternative method would be for the System to record a receivable from the member unit. The System would record the contributions to apply them to the year in which they were earned by the employee, similar to payments received for contract settlements. This method would require monthly accounting adjustments by the System for each make-up agreement in place by each potential member unit with such an agreement to reduce the withholdings reported and to reduce the receivable balance. Either method would have the same ending result. The second method would shift the burden of accounting for each of these errors and make-up agreements to the System.

Management's Response

Upon concurrence of the Board, retirement system staff will collect payments for withholding errors by adopting the lump sum payment method, as this is the simplest and most efficient option for the retirement system, the members and the units.

Annual Appropriation for Essex Retirement Board

Comment

The Essex Retirement Board (Board) has historically been assessed for a portion of the annual appropriation based on the Essex Regional Retirement System's portion of the prior year's payroll that is reported to PERAC. There is no cash payment for the assessment to the Board, the amount is recorded in the System's ledgers as an administrative expense. This administrative expense is also used by the Actuary in determining the required annual appropriation in the funding schedule. Because the administrative expense assumption includes the Board's assessment, and because the administrative expense assumption is allocated to the member units, the member units are effectively paying the retirement board's appropriation.

For several years, PERAC has suggested an alternative approach to accounting for the Board's share of the annual appropriation. The alternative approach would exclude the Board from the annual appropriation, and that portion of the appropriation would be allocated to the other member units. When preparing the next funding schedule, the Actuary would reduce the estimated annual administrative expense when determining the total required annual appropriation.

Several timing options for implementing the suggested changes have been presented to the Advisory Council and the Board has voted to revise the administrative expense assumption with the next valuation by eliminating the Retirement Board's appropriation beginning with fiscal year 2022.

Recommendation

We concur that this method will more directly allocate the cost of funding the retirement benefits of the retirement system staff to the member units and recommend that the System go forward, as voted, with the revised method for allocating retirement benefits for the retirement system staff.

Management's Response

This recommendation is a policy decision and requires approval of the Board.

Vacancies in Administrative Roles

Comment

The System has experienced some turnover and the role of Administrative Assistant has been vacant since November 2018. During this time, other employees of the System have been performing the duties of the Administrative Assistant in addition to their normal duties. These additional duties have caused delays in processing normal transactions timely.

Notably, the process of enrolling new members into the System is delayed, in some cases by up to four months. As of April 2019, there are members of the system that were hired as far back as November 2018 that have not been formally enrolled and their enrollment into the System had not yet been approved by the Board.

When an employee who performs a variety of duties falls behind, there is an increased risk that key functions of the System are not being performed timely.

Recommendation

We recommend that the System work to address the staffing shortage as quickly as practical and to implement procedures to ensure that all key functions of the system are being performed timely.

Management's Response

ERRS did redesign job duties as of January 1, 2019 in order to ensure that all required functions were covered. The retirement system also made multiple efforts to create new position descriptions that would cover all functions using existing resources. These efforts met with limited success and ERRS has been short of staff for eleven of the past fifteen months, beginning with the first departure of an employee in March of 2018. ERRS staff will continue to work with the Board to address staffing issues and will also consider recommendations for streamlining its current hiring practices.

Inability to Collect Salary Surveys

Comment

The System receives an annual pension fund appropriation, which is allocated proportionally to all of the member units based on salaries. On September 30th, the System uses the deductions posted to their system, to generate salary totals as of January 1st to September 30th of the current year for the entire system. This report breaks out the salary amounts by member unit. Based on actual salary totals through September 30, the System estimates salaries for the final quarter. This combination of actual and estimated totals are used to arrive at a total salary amount per member unit. This information is then reported on a salary survey, which is sent to the respective member unit in the middle of October. The member unit is instructed to review the salary report, make any necessary changes, and send back a signed copy of the report to the System by October 31. As member units return their documents, the System reviews what is sent back to ensure that the unit concurs with the amount per the salary survey. Any discrepancies are discussed between the member unit and the System and changes are made if necessary.

Once salary reports are received, the System uses the information to proportionally allocate the current year pension fund appropriation among the member units. The schedule is internally reviewed and submitted to PERAC for approval. Any errors in the salary survey's have a direct impact on the appropriation to all member units.

The System has been unable to obtain signed salary surveys back from several of the housing authority member units, and it is typically the same units that do not return their salary surveys every year. Units that do not sign off and return the salary surveys are not attesting that the information is correct, and therefore there is an increased risk that the salary information is incomplete or inaccurate, which effects the proportionate share of the appropriation and net pension liability for all member units. Although the housing authority members are a very small portion of the system in total, inaccuracies in their salary data could have a material impact to the net pension liability allocated to those smaller member units.

Recommendation

We recommend that the System continues to attempt to collect the approved salary surveys from the few member units that have not are not in compliance. In the event that they are unsuccessful, alternative procedures could be developed to verify the accuracy of the salary information.

Management's Response

As noted in the audit, the unverified salary surveys are almost always from small housing authorities and there is presently no mechanism to compel these units to comply. Further, ERRS does not wish to delay the submission of the salary survey to PERAC, as any such delay will result in a postponement in the issuance of the annual appropriation letter, which will negatively affect the budgetary process of ERRS units.

However, ERRS staff may be able to use the new Employer Reporting Module to verify annual salaries of units which fail to respond timely with signed salary surveys. ERRS staff will explore this option in preparation for the 2019 salary survey and appropriation process.