PENNSYLVANIA MUNICIPAL RETIREMENT SYSTEM

REPORT ON CONTROLS PLACED IN OPERATION AND TESTS OF OPERATING EFFECTIVENESS

For the Period
January 1, 2004 to December 31, 2004
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SECTION I.

INDEPENDENT SERVICE AUDITOR’S REPORT

Board of Directors
Pennsylvania Municipal Retirement System
Harrisburg, Pennsylvania

We have examined the accompanying description of controls related to the retirement benefit processing activities performed by the Pennsylvania Municipal Retirement System (PMRS). Our examination included procedures to obtain reasonable assurance about whether (1) the accompanying description presents fairly, in all material respects, the aspects of PMRS’s controls that may be relevant to a user organization’s internal control as it relates to an audit of financial statements, (2) the controls included in the description were suitably designed to achieve the control objectives specified in the description, if those controls were complied with satisfactorily and the user organization applied those aspects of internal control contemplated in the design of PMRS controls as described in Section III, and (3) such controls had been placed in operation as of December 31, 2004. PMRS uses the Pennsylvania Department of the Treasury and other financial institutions for printing services and investing retirement funds respectively. The accompanying description includes only those control objectives and related controls of PMRS, and does not include control objectives and related controls of the Pennsylvania Department of the Treasury or other financial institutions. Our examination did not extend to the Pennsylvania Department of the Treasury controls or the other financial institutions’ controls. The control objectives were specified by management of PMRS. Our examination was performed in accordance with standards established by the American Institute of Certified Public Accountants and included those procedures we considered necessary in the circumstances to obtain a reasonable basis for rendering our opinion.

In our opinion, the accompanying description of the aforementioned application presents fairly, in all material respects, the relevant aspects of PMRS’s controls that had been placed in operation as of December 31, 2004. Also in our opinion, the controls, as described, are suitably designed to provide reasonable assurance that the specified control objectives would be achieved if the described controls were complied with satisfactorily and user organizations applied the controls contemplated in the design of PMRS’s controls.

In addition to the procedures we considered necessary to render our opinion as expressed in the previous paragraph, we applied tests to specified controls, listed in Section III, to obtain evidence about their effectiveness in meeting the control objectives, described in Section III of this report, during the period from January 1, 2004 to December 31, 2004. The specific controls and the nature, timing, extent, and results of the tests are listed in Section III. This information has been provided to user organizations of PMRS and to their auditors to be taken into consideration along with information about the internal control at user organizations, when making assessments of control risk for user organizations.
PMRS Management states in its description of Control Objective 1 that controls provide reasonable assurance that new retirement plans are established accurately, completely, timely, and are properly authorized. Based on inquiries of PMRS personnel and tests of specific controls, we determined that the controls as stated were not operating with sufficient effectiveness as follows: We found one plan from a sample of ten new plans that the commencement date entered in the Centralized Pension Administration System (CPAS) did not agree with the date stated on the plan agreement; we found three enrollment plans from a sample of ten new plan enrollments that the corresponding signed agreement did not contain authorizing signatures indicating review by the PMRS Board; we found seven new enrollment plans from the sample of ten new plan enrollments that the corresponding signed agreement did not contain authorizing signatures indicating review by the Legal Counsel; we found one new plan from the sample of ten new plans that the membership effective date entered in CPAS did not agree with the date stated on the PMRB-1 form. This resulted in the nonachievement of the Control Objective 1, “Controls provide reasonable assurance that new retirement plans are established accurately, completely, timely, and are properly authorized.”

PMRS Management states in its description of Control Objective 4 that controls provide reasonable assurance that retirement plan income allocations are processed accurately, completely, and timely. Based on inquiries of PMRS personnel and tests of specific controls, we determined that the controls as stated were not operating with sufficient effectiveness as follows: we could not perform interest re-calculations tests because current interest earnings information was not entered in the CPAS information system; we could not verify the calculation of the 6.5% in computing municipal interest for five municipalities. This resulted in the nonachievement of the Control Objective 4, “Controls provide reasonable assurance that retirement plan income allocations are processed accurately, completely, and timely.”

PMRS Management states in its description of Control Objective 5 that controls provide reasonable assurance that changes to retirement participant records are processed accurately, completely, timely, and are properly authorized. Based on inquiries of PMRS personnel and tests of specific controls, we determined that the controls as stated were not operating with sufficient effectiveness as follows: management could not provide documentation supporting the upgrade requests of seven plan upgrades from a sample of ten; management could not provide new approved plan agreements reflecting the change of four plan upgrades from a sample of ten. This resulted in the nonachievement of the Control Objective 5, “Controls provide reasonable assurance that changes to retirement participant records are processed accurately, completely, timely, and are properly authorized.”

PMRS Management states in its description of Control Objective 7 that controls provide reasonable assurance that plan reporting (participant statements) is accurate, complete, and timely. Based on inquiries of PMRS personnel and tests of specific controls, we determined that the controls as stated were not operating with sufficient effectiveness as follows: management could not provide ten of the 2004 year end statements showing calculated credited service, contribution, interest and ending balance from a sample of ten; we found that three municipality year end plan statements from a sample of ten were not printed or mailed; we found one municipality year end plan from a sample of ten was not computed. This resulted in the
nonachievement of the Control Objective 7, “Controls provide reasonable assurance that plan reporting (participant statements) is accurate, complete, and timely.”

PMRS Management states in its description of Control Objective 8 that controls provide reasonable assurance that general computer controls around CPAS are adequate. Based on inquiries of PMRS personnel and tests of specific controls, we determined that the controls as stated were not operating with sufficient effectiveness as follows; PMRS lacks procedures for periodic reviews of CPAS user access privileges and comprehensive security practices; the latest security patches have not been applied; there was no business continuity plan. This resulted in the nonachievement of the Control Objective 8, “Controls provide reasonable assurance that general computer controls around CPAS are adequate.”

In our opinion, except for the matters referred to in the preceding paragraphs, the controls that were tested, as described in Section III, were operating with sufficient effectiveness to provide reasonable, but not absolute, assurance that the control objectives specified in Section III were achieved during the period from January 1, 2004 to December 31, 2004.

The relative effectiveness and significance of specific controls at PMRS and their effect on assessments of control risk at user organizations are dependent on their interaction with the controls and other factors present at individual user organizations. We have performed no procedures to evaluate the effectiveness of controls at user organizations.

The description of controls at PMRS is as of December 31, 2004, and information about tests of the operating effectiveness of specific controls covers the period from January 1, 2004 to December 31, 2004. Any projection of such information to the future is subject to the risk that, because of change, the description may no longer portray the controls in existence. The potential effectiveness of specific controls at PMRS is subject to inherent limitations and, accordingly, errors or fraud may occur and not be detected. Furthermore, the projection of any conclusions, based on our findings, to future periods is subject to the risk that changes may alter the validity of such conclusions.

This report is intended solely for use by the management of PMRS, its member municipalities, the independent auditors of its member municipalities and the Commonwealth of Pennsylvania.

Baltimore, Maryland
May 15, 2005
SECTION II

PENNSYLVANIA MUNICIPAL RETIREMENT SYSTEM
DESCRIPTION OF CONTROLS PLACED IN OPERATION

Who is the Pennsylvania Municipal Retirement System?

The Pennsylvania Municipal Retirement System (PMRS) is an agent multiple-employer pension system created by the Commonwealth of Pennsylvania by passage of Act 15 of 1974. PMRS seeks to help Pennsylvania’s local governments, regardless of size or resources, secure the future retirement of their employees by providing comprehensive, cost efficient and professional pension administration services through a pension plan tailored to the participants’ and sponsor’s requirements. Responsibility for the organization and administration of PMRS is vested in the eleven-member Pennsylvania Municipal Retirement Board (Board).

The Pennsylvania Municipal Retirement System - A Resource for Local Government Retirement Planning

PMRS administers sound, cost-effective pension plans for local government employees on a contracted basis. Services include accounting, actuarial valuations, employee record keeping and counseling, and asset management. Any Pennsylvania county, city, town, township, borough, municipal authority, or institution supported and maintained by a municipality may enter into a contract to have PMRS administer their employee benefit plan.

PMRS offers various plan designs including defined benefit, defined contribution, and hybrid plans. Because of the flexibility given to the employers to design a pension plan that meets each municipality's individual needs, an employee’s pension benefit is dependent upon the individual municipality's contracted benefit package. Benefits provided to participants in PMRS typically include age and service retirements, provisions for vesting, disability benefits, survivor benefits, and death benefits. A plan’s cost is determined by individual plan characteristics and actual demographic and economic experience. The funding of individual plans depends upon the contract in place and may have only a municipal contribution (employer), or a municipal and an employee contribution.

PMRS meets the service needs of its clients through personal attention of the trained staff. The vast majority of benefits provided and services rendered are done so only after the personal involvement of key PMRS staff managers. This being said, PMRS has a growing reliance on technology. PMRS has put in place a major software package to handle the benefit calculations and record keeping, the CPAS application. While all benefit calculations are reviewed for accuracy and proper reflection of contracted benefits, CPAS is currently utilized for initial calculations of retirement, vested and termination benefits. CPAS is also relied upon for all interest calculations.

System managers periodically review the controls based on these processes. Manual checks of all retirement and termination calculations are also obligatory. Benefits are reviewed against plan documents (contracts, benefit summaries and CPAS maintained logs) to ensure that the appropriate benefit is properly being calculated.
An Effective Organizational Structure

PMRS utilizes a functional organizational structure in which functions are segregated into one of four divisions according to the type of services to be provided. The divisions are Membership Services, Municipal Services, Accounting, and Operations. The organization is managed by the Secretary and Assistant Secretary, and the four division chiefs who retain overall responsibility for the daily operations. Management reports to the Board.

Oversight Responsibility

The Board meets every two months to discuss pertinent administrative matters, set operational policy, take necessary legal action, and review financial performance. The Board assumes general supervision over the staff, agency operations, and investment of PMRS’ assets.

Control Environment Information

The agency, while a state created entity, has developed an independent, entrepreneurial outlook. PMRS operates as a small private enterprise, with customer satisfaction, and professionalism as key concepts because PMRS exists by attraction (it does not have mandatory enrollment for all municipal pension plans). The PMRS staff has a clear understanding that the governing Board and Secretary will hold them accountable for these two principles. The staff reports to the Board on a variety of measures for both agency responsiveness and customer satisfaction and tracks progress in meeting each effort.

Risk Assessment Controls

The Board measures and determines the risks associated with the overall operations of the agency. The Board concentrates primarily on investment and actuarial risks. The Secretary is responsible for determining the operational risks of all transactions.

The investment risks are monitored by the employment of an independent investment consultant hired through a competitive Request for Proposal process. The current contract with Dahab Associates expired in December of 2004. The independent investment manager monitors the investment advisors’ performance quarterly and shares the reports with the Board who meets with the advisors at least annually. The Board also monitors risks by conducting asset allocation studies every three years, the most recent one having been completed in May of 2002.

The actuarial risks are managed through the employment of an independent actuary hired through a competitive bid process. The actuary performs annual valuations that monitor actuarial experiences and compares them to expected funding levels. The Segal Company was awarded the current contract, which runs through 2006. PMRS also conducts a five-year experience study to ensure the reasonableness of PMRS’ assumptions. The next five-year experience study is scheduled to be presented to the Board in the fall of 2005.
Control Activities

The Secretary monitors the operational risks by closely supervising PMRS’ staff. The Board monitors the operational risks by conducting annual performance reviews of the Secretary and Assistant Secretary using Commonwealth of Pennsylvania employee evaluation forms. The Board also hears from each division manager at each Board meeting when they report on their division’s day-to-day operations.

Information and Communication Controls

The flow of information and communications tend to be more informal than formal because of the small size of the agency. The Board has begun a process to formalize a number of procedures by the adoption of policy statements or rules. In 2003, the Board adopted a rule providing guidance on the definition of permanent employment. PMRS also has regulations that were revised effective June 2000. The regulations expanded definitions for terms not expressly defined in the PMRS law and also included specific instructions for municipal plans seeking to withdraw from membership in the PMRS.

Monitoring Controls

On a day-to-day basis the monitoring of the Agency’s controls is the responsibility of the management team. While no formal checklist exists detailing the operational controls, annual employee performance evaluations are a key tool used to ensure managerial control of quality and consistent product delivery. Managers are expected to review and initial all work products (estimates, letters, and benefit payments) before final processing occurs.

Personnel Controls

PMRS, as a state government agency, is required to abide by the personnel requirements of the Commonwealth's Executive Board and the civil service standards applicable to state government hiring. These requirements cover all critical aspects of employment services including hiring, training, development, performance appraisals, and termination. In addition, all new employees are issued a job description that identifies the various procedural items applicable to their employment duties. The Operations Division, utilizing the Civil Service Commission, is primarily responsible for recruiting and evaluating job applicants. Based on the sensitivity of the underlying job, various levels of background checks are performed on applicants prior to their employment.

Audits

The PMRS record-keeping services are subject to periodic internal audits by the Department of the Auditor General (AG) of the Commonwealth of Pennsylvania (Commonwealth). Additionally, an independent financial statements audit, awarded on a competitively bid basis, is conducted annually. The audits are designed to evaluate compliance with PMRS policies and procedures as evidenced in the adopted policy statements, laws and regulations to which PMRS is subject. The audits also address the soundness and adequacy of accounting, operating, automated systems, and administrative controls.
The independent auditors report directly to the Board. An audit plan is developed utilizing a formal risk analysis methodology and provides for balanced coverage of all major business activities.

**Plan Initiation/Modifications**

*New Plan Initiation*

The recording of a new plan is initiated by a municipal entity submitting an ordinance (or resolution if the entity does not possess the legal authority to adopt ordinances) to the staff of the Municipal Services Division. Plan administration begins with and includes the initial request to the Board (either through adoption of a resolution or ordinance) to enroll a plan into the System. All subsequent requests to modify a plan’s benefit structure also must be submitted through a resolution or ordinance.

Upon receipt of an ordinance and signed agreement, the Municipal Services representative logs the receipt in an Access database created for tracking purposes. The representative also reviews the documents for accuracy and completeness. If acceptable, the documents are submitted to PRMS’ legal counsel for a preliminary review (prior to formal Board adoption of the enrollment or plan amendment). If the Board, for timing reasons, considers a plan’s request prior to the legal staff’s review, approval of the document is always subject to confirmation of the legal staff’s approval of the documents.

Once the documents have been formally approved by the Board and have passed the legal staff’s initial review, they are then submitted to the legal staff for final review and signature. As a Commonwealth contract, the signatures of representatives from the Governor’s Office of General Counsel and the Attorney General of the Commonwealth are needed as well as the PMRS Board Chairman, PMRS Secretary, and the appropriate municipal officials.

A plan record is created in CPAS upon Board approval of the enrollment. The Municipal Services Division staff is responsible for the creation of the new plan files and records. All new plan files are established in accordance with the specifications adopted in the plan ordinance and agreement. The Municipal Services Division is responsible for ensuring that all new plan benefits are properly placed in the CPAS rules associated with the new plan and are supported by an adopted ordinance and signed agreement. The Access database is used to track the processing of the newly enrolled plan and follows its progress through the setup stages.

*Municipal Services Records – Creation or Modification*

The Municipal Services staff is responsible for establishing plan records and modifying existing benefit rules. Subsequently, the new or changed rules are reviewed for accuracy and completeness by the staff member’s supervisor. A hard copy of the created record or changed record is maintained in a file for each plan. An Access database is also used to track the processing of the amended plan and follow its progress through the various legal, procedural and documentation stages.

All plan control records are established in accordance with specifications set forth in the adopted agreement. The control records established in the plan record specify all subsequent transactions affecting participant accounts.
Participant Record Keeping

For each participant enrolled in a retirement plan, a record (i.e., an account) is maintained. The information maintained in the participant account includes enrollment data (e.g., participant’s name, social security number, address, hire date, enrollment date, birth date, gender, and contribution rate).

Membership Services Records – Creation or Modification Participant Record Keeping

Individual account information is maintained for each participant. Activity posted to these accounts includes participant contributions, and in defined contribution plans, the employer contributions as well as credited interest and excess interest. The controls over the posting of contributions and withdrawals are covered in the Asset Recording and Disbursements sections. The following discussion will focus on the crediting of interest and excess interest (referred to hereafter simply as interest) to participant accounts.

The Board must set the regular interest rate for the System prior to the beginning of a new calendar year. The Board established regular interest at 6.5% in 1987 and has kept it at that rate ever since. Excess interest is an award made by the Board and is annually calculated based upon the system’s investment performance and the reserve balances maintained during the previous year.

The computation and crediting of interest income is performed within the CPAS application on the computer system. This computation varies based on whether regular interest or excess interest is to be posted to the account. Regular interest is determined by multiplying the daily account balance by the regular interest factor. An actual posting of regular interest only occurs with the actual processing of a year-end calculation or a benefit calculation.

Participant Additions and Modifications

Within each plan, new members may be added and modifications may be made to an existing member’s record based on authorized written instructions from the member or plan contact person. The addition of new members and the modification of data must be documented on standardized enrollment, beneficiary or change forms, or via other acceptable, written, and verifiable communications. Other changes (e.g., name changes and address changes) may be reported on standardized forms or via other acceptable verifiable correspondence. The plan contact is responsible for submitting the necessary forms or correspondence in a timely manner to the Membership Services Division.

Upon receipt, the Membership Services Division staff assigned to the file maintenance for the data area being altered makes the requested changes. The change is documented by printing a copy of the transaction and filing the same, with the written request for the change, in the member’s paper file. A note indicating who made the change; why the change was made, and the date of the change is placed in the member’s electronic remarks section of the record in
CPAS. Confirmations of these changes are also sent to the member and the member’s employer for documentation purposes.

**Participant and Plan Reporting**

On a quarterly basis, member listings by plan and social security number are generated by the Operations Division and sent to each employer for review and completion. This document is the PMRS-21 (Quarterly Report of Contributions) form. Plan contacts are responsible for reviewing this information and communicating members’ compensation, deductions, if any, employer contributions (if a defined contribution plan or if an employer is contributing to fund a separate defined contribution annuity), breaks in service and, if applicable, any new members that have enrolled within the quarter. In addition, the Plan’s contact at the plan level confirms the contribution rate.

The quarterly report process also assists in plan reconciliation of employee deductions and deposits. The CPAS software will not allow the posting of a member’s contribution in excess of $2.00 of the expected contribution identified under the plan’s rules, and will give a warning if the contribution is less than the expected contribution. A member contribution cannot be made for a time period which already has had a contribution posted. If the member is not enrolled in the plan, a contribution error will be generated.

The record-keeping system reports member level contributions, arrears payments and obligations for purchases of previous service or purchase of military service time and withdrawals. Each report is subtotaled for aggregate plan totals. The Accounting Division clerk is responsible for generating these reports and verifying any discrepancies. Separately the Accounting Division staff matches the amount of the contributions credited to a plan’s participants and the amount of dollars received. This reconciliation insures proper crediting of the receipts and contributions.

**Compliance Reports**

At year-end, the Operations Division staff in conjunction with the Membership Services Division and Accounting Division staffs produces compliance reports and a set of financial statements through the CPAS record-keeping system. Division Chiefs are responsible for reviewing these reports before a plan’s financial statements can be prepared. In the case of individual member year-end reports, copies are sent to the retirement plan contact person for analysis, documentation, and use in preparing the plan sponsor’s financial statements. The contact person is asked to verify data, and/or supply any missing data.
**Member Statements**

To ensure that out-of-balance member statements are not produced, an independent procedure conducted by the Accounting Division staff verifies that the sum of all the individual account balances within the plan agrees with the total of plan assets and matches previous year’s reported balances and current year receipts. This control is performed as part of preparing each plan’s financial statements. Member statements are printed, reviewed and sent to the member with a copy sent to the plan’s contact for the municipal files and a copy is filed in the member’s PMRS paper file. This control is tracked in an Access database and is initiated with the receipt of each plan’s PMRB-21 Quarterly Report of Contributions for the 4th quarter of the year.

When a plan’s PMRB-21 data for the entire year is completely processed, the database is updated and the plan’s year-end processing starts with a review of all members’ accounts and all transactions within the plan (deaths, enrollments, terminations and retirements). Once each member in the plan is accounted for, the year-end calculation is performed by the Member Services Division. This calculation is then used to create the member statements. Tracking of the statements mailed and the copies stored are documented in the Access database.

**Asset Recording**

Asset Recording (i.e., the recording of employer and employee contributions) is entered into a PMRS Access database that tracks all contributions received at PMRS. The information is taken from the processed deposits on a monthly basis and manually entered into the CPAS software by PMRS employee input. The plan’s contact submits a hardcopy report (PMRB-21) to PMRS quarterly documenting the employee contributions. For employer contributions, a PMRB-20 is filed with the contribution received on an event occurrence basis. The PMRS employee keys the individual participant contribution information into a pending file on the record-keeping system. (See Participant and Plan Reporting). A PMRS employee also enters the employer receipts in the CPAS database (See Receipt of Checks).

**Receipt of Checks**

All checks are to be accompanied by a form (PMRB-20) which is used to identify the source of the contribution and the intended amount for deposit. The checks and PMRB-20s are reviewed for completeness by the Accounting Division staff. Those checks that are approved for processing are given to the Operations Division staff for manual entry into an Access database record-keeping system. A report is generated and the details of the checks are provided to the Accounting Division, which enters the details into the same record-keeping system. Another report is generated to ensure the detail matches the check totals and that the proper accounts are credited. These reports are processed daily.

The Accounting Division staff investigates checks not accompanied by a PMRB-20. Proper documentation is prepared via telephone communications or the check is returned to the municipality to insure proper crediting of all monies.
Checks are then bundled and transferred to the State Treasurer, the designated depository of PMRS’ assets. Once deposited and cleared, PMRS receives a report indicating the availability of the assets for investing. Upon receipt of the report, the detail is updated from the Access database record-keeping system into the CPAS software by manual input of PMRS staff.

**Disbursements**

Disbursements from a retirement plan results from employee initiated events (i.e., retirement, death, disability, or termination of employment). While the participant or beneficiary submitting an appropriate PMRS-designated form generally initiates these transactions, the plan’s contact person usually assists in the handling of the transaction. Upon receipt, PRMS’ Membership Services staff reviews the form to determine (1) if the information is accurate and complete, (2) if the member is authorized under the plan to request a distribution, and (3) if the member has met the plan’s requirements for a distribution.

The Membership Services Division staff verifies that the benefit being requested is authorized under the plan’s provisions. The staff member then generates through the CPAS software an initial calculation for the benefit (i.e. the withdrawal or retirement). Staff personnel verify the consistency of the computer system-generated calculation by examining the amount to be paid with the member’s account balance and contribution history. Benefits are examined by the employee and the employee’s supervisor for reasonableness against the plan’s benefit summary, contract or known benefits. The transaction is then processed in CPAS thus causing the change to the member’s account and plan status.

Once processed the Accounting staff receives the member’s file and then records the transaction in an Access database record-keeping system. The Accounting Division staff also verifies the accuracy of the data against the posted transaction and the processed vouchers. Vouchers are prepared to generate disbursements due the withdrawing or retiring members. Reports are available to verify the appropriate money movement. The Accounting Division also reconciles the money transfers and disbursements to the accounts and the Treasury Department’s reports. Discrepancies are resolved by reviewing the transaction in question and then making either supplemental payouts or adjustments to the records. The Accounting Division reconciles the distribution and checks processed on a monthly basis.

Printed checks are returned from Treasury to the Membership Services staff where they are reconciled to the preliminary check registers and vouchers before being mailed.

**Fund Valuation**

PMRS provides record keeping on the basis of dollars deposited and interest credited. PMRS provides yearly asset reports to plan contacts and their members. Members can call PMRS on a toll-free number to obtain a current value of their own account.
General Computer Controls

The following descriptions outline the data processing environment of PMRS and the general controls surrounding the system.

Description of Processing Environment

All plan processing is done internally using a Windows NT 4.0 server platform with network connectivity from a Windows 2000 desktop environment. Major software housed on the system is the aforementioned CPAS proprietary software licensed to PMRS that uses an Oracle database. Access control is provided by a combination of operating and application software.

Organization and Administration

The Chief Technology Officer (CTO) reports directly to the Secretary of the Agency and is directly responsible for security of the computer networks used by PMRS and for the design of the agency’s disaster recovery plan associated with the computer network. Within the Operations Division, the Chief is responsible for maintaining and overseeing application programming, computer operations, and technical support personnel.

System Development, Maintenance and Documentation

Currently PMRS is using a computer software purchased from CPAS, Inc. CPAS, Inc. does the development of the CPAS application but a committee of the Secretary, Assistant Secretary, Division Chiefs in Accounting, Member Services, Municipal Services and two key Operational Division staff monitor and document needed application modifications. The CTO of PMRS oversees the development and design of the Access database records. The Operations IT staff handles the routine maintenance and report generation.

Physical Security

The data center of PMRS is located in a separate locked room. Access to the room is restricted to only four of the PMRS staff. The door leading into the data center is closed during non-business hours, but could be left open during the day.

Access Controls

An informal process of administrating data security is centralized within PMRS’ CTO’s office. The Chief Technology Officer performs maintenance to the security systems and monitors access violations. Record-keeping and application security administration is handled in the CTO’s office.
Computer Operations

Informal system event schedule procedures have been developed and are in use. These procedures contain checks, including those by outside departments when necessary, to ensure all events are run accurately, completely, and timely.

Recovery and Backup Awareness

Preventative/protective measures that have been implemented reduce the likelihood of a disaster or system outage. These measures include a fire suppression system and an uninterruptible power supply system (including battery backup.) All critical program and data files are backed up to cartridge/tape daily and rotated to an off-site storage facility (security box at a bank) twice weekly. These files are retained off-site for one month and then reused.
SECTION III

INFORMATION PROVIDED BY CLIFTON GUNDERSON LLP

Test of Control Environment Elements

In addition to the test of operating effectiveness of specified controls described in this section, our procedures included consideration and test of the following relevant elements of PMRS’s control environment:

Such tests included inquiry of appropriate management, supervisory, and staff personnel; inspection of PMRS’s documents and records; and observation of PMRS’s activities and operations. The results of these tests were considered in planning the nature and timing, and extent of our tests of the specified controls placed in operation related to the control objectives described below.

Control Objectives, Related Controls Placed in Operation, and Tests of Operating Effectiveness

PMRS has specified its control objectives and has identified control policies and procedures designed to achieve those objectives. The management of PMRS has determined the objectives. For each control objective, PMRS’s control policies and procedures that are designed to achieve the stated control objective are described.
Plan Setup and Administration

Control Objective 1:

*Controls provide reasonable assurance that new retirement plans are established accurately, completely, timely, and are properly authorized.*

<table>
<thead>
<tr>
<th>Control Objectives and Related Controls Placed in Operation.</th>
<th>Description of Tests of Operating Effectiveness</th>
<th>Results of Test</th>
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<tr>
<td>All new plans are formally submitted to and reviewed/approved by PMRS’ actuary and the Board for appropriateness, completeness, and authorization before being set-up in the system.</td>
<td><strong>Examination:</strong> For a sample of ten retirement plans compared the plan set-up documents to information contained in the CPAS application to determine that the employer’s name, plan year-end, and plan options per the plan contract and plan document were accurately recorded in the system.</td>
<td>In one out of ten sampled new plans, the plan commencement date entered in CPAS did not match with the date stated on the plan agreement. In three out of ten sampled new plan enrollments, the corresponding signed agreement did not contain authorizing signatures indicating review by the PMRS Board. In seven out of ten sampled new plan enrollments, the corresponding signed agreement did not contain authorizing signatures indicating review by the Legal Counsel. <strong>No other exceptions found.</strong></td>
</tr>
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<td>Individual members submit a PMRB-1 form that contains their personal information and beneficiary information. This information is then input into the CPAS application.</td>
<td><strong>Examination:</strong> For a sample of ten newly created individual members, compared the personal information recorded in the CPAS system to the municipality’s source documents.</td>
<td>In one out of ten sampled new plan individuals, the membership effective date entered in CPAS did not match with the date stated on the PMRB-1 form.</td>
</tr>
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<td><strong>Examination:</strong> Tested, a sample of ten newly created individual members to verify that confirmation letters were written to the individual and the municipal plan administrator.</td>
<td>No other exceptions found.</td>
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</table>
**Plan Set Up and Administration – Contributions**

**Control Objective 2:**
*Controls provide reasonable assurance that plan contributions are processed accurately, completely, and timely.*

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<tr>
<td>Pre-printed Quarterly Reports (Form PMRB-21) with member identification information (name and Social Security Number) and account information (rate and balance) are mailed to the plans for completion.</td>
<td><strong>Examination:</strong> Recalculated a sample of 6 member contribution amounts and compared that value to CPAS and the PMRB-21 report. <strong>Examination:</strong> Compared member contribution changes for a sample of 6 individuals to the PMRB-21 report and the CPAS application. <strong>Inspection:</strong> Inspected a copy of the PMRS Quarterly Summary Report used for contribution reconciliation purposes.</td>
<td><strong>No exceptions noted.</strong></td>
</tr>
<tr>
<td>Completed reports are opened, date-stamped, and reviewed by the Fiscal Technician to ensure all required items are completed (credits, salary, contributions, arrears, and signature). If discrepancies are identified, the report is returned or the plan contact person contacted. If there are no discrepancies, the report is delivered to the data input clerk.</td>
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<tr>
<td>Reconciliations are performed quarterly between data entered into the system and all member contribution input reports.</td>
<td></td>
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<tr>
<td>Quarterly, member contribution reports reflecting summary data changes are generated, compared to original member</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Control Objectives and Related Controls Placed in Operation</td>
<td>Description of Tests of Operating Effectiveness</td>
<td>Results of Test</td>
</tr>
<tr>
<td>------------------------------------------------------------</td>
<td>-------------------------------------------------</td>
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</tr>
<tr>
<td>input updates, and provided to the municipalities for their review.</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Receipts (checks)</strong></td>
<td><strong>Examination:</strong></td>
<td>In one of the two individuals selected, the contribution from municipality’s quarterly report did not match with the record of contribution in CPAS.</td>
</tr>
<tr>
<td>Contribution checks are reviewed for appropriateness (signature, errors, etc.) and if complete, as compared to accompanying documentation, deposited daily into the Pennsylvania Department of the Treasury. Treasury deposit documentation is compared to municipality remittances for appropriateness prior to updating accounts on the system.</td>
<td>Traced and compared contribution amounts for one municipality and two individuals to the Minimum Municipal Obligation Worksheets, the PMRB-20 form, Treasury documentation, and internal PMRS reconciliation documentation.</td>
<td>No other exceptions found.</td>
</tr>
</tbody>
</table>
Plan Setup and Administration – Disbursements

Control Objective 3:
Controls provide reasonable assurance that retirement plan disbursements are processed accurately, completely, timely, and are properly authorized.

<table>
<thead>
<tr>
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<th>Description of Tests of Operating Effectiveness</th>
<th>Results of Test</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retirement (Supplemental - initial check)</td>
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</tbody>
</table>
| Completed Application for Retirement (PMRB-8, PMRB-50, and PMRB-4A) forms are reviewed by PMRS to ensure that all required data is provided, retirement date is valid, member is eligible for benefit applied for, and required signatures are present. | **Examination:**

Selected an individual and compared their application for retirement to the amount calculated by CPAS as their benefit and agreed this amount to the appropriate voucher transmittal form and internal PMRS reconciliation information.

**Observation:**

Observed the location of the checks to ensure that they are stored in a safe until needed. | **No exceptions noted.** |
<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td><strong>Retirement Monthly Payroll</strong></td>
<td><strong>Examination:</strong> Reviewed the Payroll New Entries and Payroll Deletions reports used for reconciliation purposes by PMRS and the Commonwealth Treasury Department. Performed procedures to determine whether 5 new entries and 5 deletions are supported by proper documentation.</td>
<td>No exceptions noted.</td>
</tr>
<tr>
<td>A Monthly Membership Services Division Retirement Technician makes deletions or corrections to the retired member files based upon deaths, change in address, and banking instructions. The Membership Services Division Chief reviews all changes to verify the accuracy of the documentation and related written authorization. System-generated reports calculate the differences in the accounts from the prior month. All differences are investigated and resolved.</td>
<td><strong>Examination:</strong> Recalculated benefits for 35 individuals based on the participant’s eligibility and plan provisions.</td>
<td></td>
</tr>
<tr>
<td><strong>Withdrawal of Contributions</strong></td>
<td><strong>Examination</strong> Reviewed the applicable forms for a sample of 9 individuals to ensure that the application for withdrawal of funds was appropriately authorized. <strong>Examination</strong> Reviewed the information currently in the CPAS application for 9 individuals to ensure that they had been removed from plan records.</td>
<td>No exceptions noted.</td>
</tr>
<tr>
<td>The Member and related municipal official complete the appropriate Application for Withdrawal of Contributions (PMRB-4), which is reviewed by PMRS for completeness and authorization.</td>
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</table>


Plan and Trust Administration – Participant Income Allocations

**Control Objective 4:**

*Controls provide reasonable assurance that retirement plan income allocations are processed accurately, completely, and timely.*

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td><strong>Active Member Regular Interest</strong></td>
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<tr>
<td>System generated regular interest (defined by law as the PMRB pre-established rate) for all members active as of 12/31 is calculated and applied during year-end processing and is randomly sampled, reviewed, and unusual transactions are recalculated for accuracy by the Membership Services Division Chief. Differences are investigated and resolved.</td>
<td><strong>Examination:</strong> For a sample of 5 individuals, recalculated total regular interest plan earnings allocated to the individual and compared the amount to the plan history file in CPAS.</td>
<td>We could not perform interest re-calculations tests because interest earnings information was not updated in CPAS. No other exceptions found.</td>
</tr>
<tr>
<td><strong>Municipal regular interest</strong></td>
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<tr>
<td>The Accounting Division Chief and Staff Accountant select between eight and twenty sample plans to recalculate municipal regular interest that is system generated to ensure accuracy.</td>
<td><strong>Examination:</strong> For a sample of ten retirement plans, recalculated total regular interest plan earnings allocated to the plan and compared the amount to the plan history file in CPAS.</td>
<td>We could not verify the use of 6.5% in computing municipal interest for five municipalities. No other exceptions found.</td>
</tr>
<tr>
<td><strong>Active member, municipal, and retired member excess interest</strong></td>
<td><strong>Inspection:</strong> Inspected a letter from the actuary stating that no excess interest was applied for the year ended December 31, 2004 (same as 2003 letter).</td>
<td>No exceptions noted.</td>
</tr>
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<tr>
<td>The Staff Accountant manually enters municipal excess interest into the PMRS system and totals are checked to the plan’s allocation to the municipal account. Differences are investigated and resolved. Retired member excess interest is manually entered into the PMRS system by Accounting Division Accountant 1 and each retired member’s allocation total is matched to the allocation input form. Differences are investigated and resolved.</td>
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</table>
Plan and Trust Administration – Participant Record Changes

Control Objective 5:
Controls provide reasonable assurance that changes to retirement participant records are processed accurately, completely, timely, and are properly authorized.

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<tr>
<td>The Membership Services Section Retirement Technician receives a signed written authorization (PMRB-5A) form from the plan’s contact person or a signed request from an active or retired member and reviews the form for proper completion.</td>
<td>Examination: Selected a sample of ten plan upgrades and verified approval and incorporation of change in CPAS as well as letter sent communicating the change.</td>
<td>In seven out of ten sampled plan upgrades, letters requesting/communicating the upgrade was not on file.</td>
</tr>
<tr>
<td>The Membership Services Section Retirement Technician manually enters changes into the system. A letter is generated for both the plan administrator and the individual requesting the change.</td>
<td></td>
<td>In four out of ten sampled plan upgrades, new approved plan agreements reflecting the changes were not on file.</td>
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<td></td>
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<td>No other exceptions found.</td>
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</tbody>
</table>
Asset Recording

Control Objective 6:

*Controls provide reasonable assurance that retirement plan cash movements are processed accurately, completely, timely, and are properly authorized.*

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| All of PMRS’ cash movements are identified in a report generated by the State Treasurer’s office (the Custodian). The report identifies the previous day’s activities including investment sales and purchases. Either the Secretary or Assistant Secretary of PMRS must authorize all expenditures in writing. The PMRS Investment Accountant verifies the transactions occurred as documented. | **Examination:** Reviewed 6 monthly reconciliation packets for accuracy and completeness  
**Examination:** Tested a sample of 6 individual voucher transmittals to verify existence of supporting documentation authorizing the transfer.  
**Inquiry:** Discussed the process by which the PMRS bank accounts are reconciled with information provided by the Commonwealth Treasury Department. Determined that any unreconciled items are resolved in a timely manner. | No exceptions noted. |
**Participant Reporting**

**Control Objective 7:**
*Controls provide reasonable assurance that plan reporting (participant statements) is accurate, complete, and timely.*

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| Annual Pension Statements are prepared and sent out to individual members. PMRS uses this statement as a way of reminding the plan members of their availability to answer questions or concerns that members may have about PMRS retirement plan benefits. | **Inspection:**
Reviewed a database that contains a record of completion for all FY2004 plan summary statements. | In all ten samples examined, 2004 year end statement showing calculated credited service, contribution, interest and ending balance was not on file. |
| PMRS maintains a database that tracks plan statements sent out. This database maintains a checklist that shows the following: recipients of the statement, date statement was printed, date statement was mailed and the person mailing the statement. | **Examination:**
For 10-sampled individual plan members, verified year-end plan statement showing calculated credited service, contribution, interest and ending balance. For ten sampled individual plan members, verified whether year end plan agreements were run, printed and mailed to the Municipality of the selected individuals by inspecting copies of screen prints of tracking database. | In three out of ten sampled, Municipality year-end plan statements were neither printed nor mailed. |
| | In one out of ten sampled, Municipality year-end plan statement was not run. | **No other exceptions found.** |
## General Computer Controls

**Control Objective 8:**

*Controls provide reasonable assurance that general computer controls around CPAS are adequate.*

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| CPAS processing is done on Windows NT 4.0 server platform with network connectivity from a Windows 2000 desktop environment. CPAS uses an Oracle database. Informal system event schedule procedures have been developed and are in use. These procedures contain checks to ensure that all events are accurately identified. Access control is provided by a combination of access controls in the operating system and the CPAS application software. An informal process of administering data security is centralized within PMRS’ CTO’s office. The Chief Technology Officer performs maintenance to the security systems and monitors access violations. Record-keeping and application security administration is handled in the CTO’s office. | **Inspection:** Inspected access request documentation and confirmed that administrative rights to Windows NT4.0 server and DBA access to Oracle is appropriate.  
**Inspection:** Inspected the Windows NT 4.0 operating system and confirmed that the latest security patches have been applied. Also evaluated network-monitoring tools in place.  
**Inspection:** Inspected access request documentation for all PMRS employees with access to CPAS and verified that the access rights were authorized by appropriate personnel.  
**Inspection:** Inspected list of employees terminated during FY 2004 and verified that their access rights were terminated in CPAS and in Windows NT 4.0 server.  
**Inspection:** Reviewed PMRS’ procedures for revalidating accesses to CPAS NT and the Oracle environment. | PMRS lacks procedures for:  
- Periodic reviews of CPAS user access privileges, and  
- Comprehensive security practices.  
CPAS application security is weak.  
The latest security patches have not been applied. |
The data center of PMRS is located in a separate locked room. Access to the room is restricted to only four of the PMRS staff. The door leading into the data center is closed during non-business hours, but could be left open during the day.

Currently CPAS, Inc. develops the CPAS application but a committee monitors and documents the needed application modifications.

In 2003, PMRS created the position of Chief Technology Officer (CTO). The CTO is responsible for security of the computer networks and for the design of the agency’s disaster recovery plan associated with the computer network.

All critical program and data files are backed up to cartridge/tape daily and rotated to an off-site storage facility (security box at a bank) twice weekly. These files are retained off-site for one month and then reused.

| Inspection: | Inspected access rights to the computer room. |
| Examination | Tested a sample of CPAS application changes to verify that the requests were properly authorized and the subsequent implementation done in accordance with PMRS guidelines. |
| Evaluation | Reviewed PMRS disaster recovery procedure/plan and testing results. |

No Business Continuity plan.

No other exceptions found.