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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’ 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 user organizations applied the controls contemplated in the design of PMRS controls; and (3) such controls had been placed in operation as of December 31, 2010. PMRS uses the Pennsylvania Department of the Treasury and other financial institutions for printing services and investing retirement funds. 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’s controls or the other financial institutions’ controls. The control objectives were specified by the 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 applications presents fairly, in all material respects, the relevant aspects of PMRS’ controls that had been placed in operation as of December 31, 2010. In addition, 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’ controls.

In addition to the procedures we considered necessary to render our opinion as expressed in the previous paragraph, we applied tests to specific controls, listed in Section III of this report, to obtain evidence about their effectiveness in meeting the control objectives, during the period from January 1, 2010 to December 31, 2010. 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 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: (1) retirement participant record changes were not consistently supported by proper authorization and (2) retirement participant record changes were not effectively being monitored. This resulted in the non-achievement of Control Objective 5, “Controls provide reasonable assurance that changes to retirement participant records are processed accurately, completely, timely, and are properly authorized.”

In our opinion, except for the matters referred to in the preceding paragraph, 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, 2010 to December 31, 2010.

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 individual user organizations.

The description of controls at PMRS is as of December 31, 2010, and information about tests of the operating effectiveness of specific controls covers the period from January 1, 2010 to December 31, 2010. 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 the service organization 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 (1) changes made to the system or controls, (2) changes in processing requirements, or (3) changes required because of the passage of time may alter the validity of such conclusions.

The information included in Section IV of this report is presented by the PMRS to provide additional information to user organizations and is not a part of their description of controls that may be relevant to a user organization’s internal control. Such information has not been subjected to the procedures applied in the examination of the description of the controls applicable to the processing of transactions for user organizations and, accordingly, we express no opinion on it.

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.

Clifton Henderson LLP

Baltimore, Maryland
July 25, 2011
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 (the 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 (the Plan).

PMRS offers various plan designs including defined benefit, cash balance, 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 only after the personal involvement of key PMRS staff managers. This being said, PMRS does have a significant reliance on technology. PMRS has put in place a major software package to handle the benefit calculations, record keeping, and numerous accounting transactions. 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 and a majority of fiscal transactions.

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.
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An Effective Organizational Structure

PMRS utilizes a functional organizational structure in which functions are segregated into one (1) of four (4) 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, the four (4) division Chiefs, and the Chief Technology Officer (CTO). These positions constitute the management team that retains overall responsibility for the daily operations. Management reports to the Board.

Oversight Responsibility

The Board meets every two (2) 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 (there is no mandatory enrollment for any of its municipal pension plans). The PMRS staff has a clear understanding that the agency’s governing Board and Secretary will hold them accountable for these two (2) 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 retaining of an independent investment consultant hired through a competitive Request for Proposal process. The current contract with Dahab Associates expires in March of 2015. The independent investment consultant 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 (3) years. The Board’s most recently adopted investment guidelines are as of January 2010.

The actuarial risks are managed through the employment of an independent actuary hired through a competitive bid process. The actuary, Cheiron, performs annual valuations that monitor actuarial experiences and compares them to expected funding levels. PMRS also conducts a 5-year experience study to ensure the reasonableness of assumptions. The most recent 5-year experience study was presented to the Board in the summer of 2010.
SECTION II

DESCRIPTION OF CONTROLS

Control Activities

The Secretary monitors the operational risks by closely supervising PMRS’ staff. The Board monitors the operational risks by conducting performance reviews of the Secretary and Assistant Secretary. 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 tends to be a balance between formal and informal because of the small size of the agency. In 2010, the Board reviewed and either adopted or revised seven (7) policy statements. These included Policy Statements 10-1 (Investment Guidelines), 10-2 (Plan Withdrawal Procedure), 10-3 (Calculation of Withdrawing Plan’s Portion of Retired Member’s Reserve), 10-4 (Contract Purchasing); 10-5 (Deferred Retirement Option Plan), and 10-6 (Return to Service Policy); 10-7 (Utilization of Actuarial Tables). Additionally the Board addressed several issues related to the System’s efforts to obtain favorable IRS tax qualification determination, including the election to participate in the I.R.S.’ Employee Plans Compliance Resolution System and the adoption of a template contract designed to address all I.R.S. qualification rules not found in the law, regulations, or Board adopted policies. (See IRS Tax Qualification Determination below). PMRS also has regulations that expand definitions for terms not expressly defined in the PMRS law.

Monitoring Controls

On a day-to-day basis, the monitoring of PMRS’ controls is the responsibility of the management team. While no formal checklist exists detailing the operational controls, employee performance evaluations are a key tool used to ensure managerial control of quality and consistent service 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.
SECTION II

DESCRIPTION OF CONTROLS

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 statement 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 address the soundness and adequacy of accounting, operating, automated systems, and administrative controls.

The integrity of the benefit-processing component of the agency is also examined. Finally, the agency processes payments and expenditures through a network of checks and balances associated with the Commonwealth’s Comptroller System and the State Treasurer as Custodian of PMRS’ assets. 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

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 PMRS. All subsequent requests to modify a plan’s benefit structure also must be submitted through a resolution or ordinance.

The recording of a new plan is initiated by a municipal entity contacting PMRS with the specifics of the benefit plan they would like to establish. The staff of the Municipal Services Division prepares the sample plan documents and the Office of General Counsel reviews and initials every page of the plan agreements before the documents are sent to the municipality. The Municipal Services representative also logs the request in a Microsoft Access database created for tracking purposes. The municipality then submits the adopted ordinance (or resolution if the entity does not possess the legal authority to adopt ordinances) and agreement for final processing to the staff of the Municipal Services Division.

Upon receipt of an ordinance or resolution and signed agreement, the Municipal Services Division representative reviews the documents for accuracy and completeness insuring that the provided agreement has not been altered. If acceptable, the documents are submitted to the Office of General Counsel for a second review of completeness and authenticity. Once the Office of General Counsel grants approval to proceed, the enrollment is scheduled for Board consideration and approval. 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 those of the PMRS Board Chairman, PMRS Secretary, and the appropriate municipal officials.
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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's 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 are supported by an adopted ordinance or resolution and signed agreement. An 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. The same 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 cash balance 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 regular interest and excess interest (referred to hereafter simply as interest) to participant accounts.

The Board must set the regular interest rate for PMRS prior to the beginning of a new calendar year. The Board set regular interest at 6.0% effective January 1, 2005 and it has retained that rate for every year since, including 2010. Excess interest is an award made by the Board and is annually calculated based upon PMRS investment performance and the reserve balances maintained during the previous year. No excess interest was awarded in 2010.
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The computation and crediting of regular interest is performed within the CPAS application on the computer system. There is a different computational process when 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 occurs with the processing of a credited interest calculation as of December 31 of each year or a prorated amount upon completion of a retirement or termination calculation prior to the end of the year. Excess interest involves the calculation (outside of the CPAS software) of the retirees’ present value and the account balances of the municipality and each of the active members as of the end of a given year.

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 change. 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 last four digits of the social security number are generated by the Accounting Division and sent to each employer for review and completion. This document is the Pennsylvania Municipal Retirement Board (PMRB) Form 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 cash balance plan or if an employer is contributing an additional amount to fund a separate annuity in a defined benefit plan), 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 period, which already has had a contribution posted. If the member is not enrolled in the Plan, a contribution error will be generated.
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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 Fiscal Technician 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.

The PMRS Board has adopted the provisions of Act 205 of 1984 (the Act) as the required funding standard for all PMRS plans, except counties for which a separate provision has been created. The Act creates what is called the plan’s Minimum Municipal Obligation or “MMO.” The System’s consulting actuary, Cheiron, provides the data needed for the calculation, which is garnered from each plan’s biennial valuation required under Act 205. The data is imported into the CPAS database (Employer Actuary Factors for Billing.) Using this data, batches are created in August, which initiates a process whereby each plan’s MMO for the next year is created. Batches are created separately for defined benefit (DB) and cash basis (CB) plans.

The batch process is used to generate a MMO Worksheet for each plan. Each municipality must complete and return the MMO worksheet after it is approved by the municipality’s governing body. The MMO calculation is verified by the Accounting staff and then required data received from the municipality is input into the batch. In the processing of the batch, there is also a second verification of the associated MMO math. On January 1, Annual Bills (MMO) are generated from the batch and mailed to the municipalities. As part of the batch process, the appropriate accounting entries are recorded in the General Ledger and verified by the Accounting staff. Payments are part of the receipts process and will be recorded as payments against these invoices. PMRS can always see the current balance of each account receivable by going into the Employer on CPAS and clicking on any of the Accounts.

Compliance Reports

At year-end, the Accounting Division staff produces financial reports and disclosure information that comply with Government Accounting Standards Board Statement Number 25 and is used by the plan in completing their financial statements. Information needed to prepare these year-end reports is generated from within the CPAS record-keeping system. Accounting Division staff coordinates with the Membership Services Division staff prior to the completion of these year-end reports. Supervisors and/or Division Chiefs are responsible for reviewing the information prior to finalization of the plan’s year-end reports.

In addition, financial information, as well as the individual member statements, is sent to the municipal retirement plan contact person for analysis, documentation, and use in preparing the municipality’s financial statements. The contact person is asked to verify data, and/or supply any missing data. Tracking of necessary activity (ranking of the order of preparation of statements based on receipt of accurate and complete information from the municipality, date of preparation and distribution of financial information, and date of preparation and distribution of member statements) is stored in an Access database. The information is also posted on the PMRS’ website.
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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 year-end reports. 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 Accounting 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 the CPAS database via multiple steps involving PMRS employees from the Operations staff and the Accounting staff (See Receipt of Checks). Employer receipts are either accompanied by a PMRB-20, “Revenue Transmittal Form” or one is generated by a PMRS staff member who contacts the municipality to document the nature of the receipt. Employee contributions are also deposited via a PMRB-20 and the documentation of the contributions per member are reconciled quarterly via the employers’ submission of a PMRB-21, “Quarterly Report of Contributions” (See Participant and Plan Reporting).

Investment related transactions are entered into the CPAS database by a PMRS Accounting staff member from information contained on receipted “Transmittals of Revenue” or “Voucher Transmittals.”

Receipt of Checks

All checks from a plan sponsor are to be accompanied by a PMRB-20 form that is used to identify the source of the contribution and the intended purpose of the deposit (fund or individuals who are to receive credit for the contribution). The checks and PMRB-20s are reviewed for completeness by the Accounting Division staff, and if necessary, the plan sponsor is contacted to obtain the necessary information to complete the processing of the check. The checks, along with the PMRB-20s, that are ready for deposit are returned to the Operations staff, which, in turn, creates a Receipts Batch in the CPAS software and then enters into the CPAS system the municipality/plan that is to receive credit for the deposit along with the amount of the deposit. Once entered into the CPAS system, the PMRB-20s are returned to the Accounting Division staff with the notation of the Batch Number.
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The Accounting Division then enters the details into the CPAS batch. A report is generated which indicates whether the total of the checks and the total of the details match. If the details match, the batch is posted causing the receipts to be credited to the appropriate plans. The batch is also updated to the ledger and a report is generated which is to accompany the batch of checks that are transferred to the State Treasurer for processing. Once deposited and cleared, PMRS receives a report indicating the availability of assets for investing.

Disbursements

Disbursements from a retirement plan result 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, PMRS’ 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 requirements for a distribution.

The Membership Services Division staff verifies that the benefit being requested is authorized under the plan provisions. The staff member then generates through the CPAS software an initial calculation for the benefit (i.e., the withdrawal or retirement). The staff verifies 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, a Voucher Transmittal (VT) is generated along with a report detailing the transactions causing a disbursement. The VT, reports and the individuals’ folders for whom the disbursement is generated are transferred to the State Treasurer’s auditors for review and processing. Once accepted by Treasury, the checks are drafted and the folders returned to PMRS. Accounting Division staff receives the folders and copies of the receipted VTs and verifies the transactions have been properly posted electronically by the CPAS software. Accounting staff reconcile the distributions and the checks processed on a monthly basis. When the printed checks are returned from Treasury, they are given to Membership Services Division staff for reconciliation with the preliminary check registers and then mailed.

Fund Valuation

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

DESCRIPTION OF CONTROLS

General Computer Controls

Logical Access Path — Network & CPAS

PMRS is a subset of the Commonwealth of Pennsylvania’s (CWOPA) network. A unique user name and password is required to authenticate to the CWOPA network.

CPAS, PMRS’ pension benefit administration application, requires a separate user name and password to gain access to the application. According to the CTO, CPAS password configurations are controlled at the Oracle database level. CPAS is a graphical user interface (GUI) front-end to the Oracle database.

Password & Account Lockout Configurations — Network & CPAS

Password and account lockout settings have been configured and implemented to restrict access to the CWOPA network and CPAS application.

PMRS’ employees inherit the CWOPA Windows Active Directory (AD) password and account lockout group policy settings; and CPAS password and account lockout settings are controlled at the Oracle database level.

Administrative Access — Network & CPAS

The CWOPA network is administered by the Commonwealth’s Office of Administration (OA), which manages the agencies that operate under the Governor’s jurisdiction and those independent agencies that elect to utilize the CWOPA network. PMRS has the ability to designate an individual(s) to administer CWOPA network user access for their particular Agency. PMRS can only administer CWOPA access for the employees within PMRS. PMRS has designated the CTO as the administrator of the CWOPA application.

User Access Administration — New Hires, Terminations, & Transfers

New access, modifications of access, or the removal of access is initiated via the completion of a universal access request form. The request form requires approval from PMRS Human Resources (HR), IT, and Executive Management (i.e., Secretary or Assistant Secretary) to be considered valid. IT personnel are responsible for granting, modifying, or revoking the access requested and notated on the request form. CPAS has role-based permissions. CWOPA and CPAS application access is removed upon PMRS employee termination.

Change Management

PMRS does not perform application development activities and, therefore, does not modify the source code of the CPAS application. PMRS implements CPAS patches and upgrades that are initiated by the vendor. The vendor also performs bugs/fixes based upon requests from the PMRS Assistant Secretary.
SECTION II

DESCRIPTION OF CONTROLS

The vendor supplies the CTO with the applicable file and downloads instructions through secure e-mail or posts the information on a Secure File Transfer Protocol (SFTP) site. The Assistant Secretary provides verbal authorization to move the file into the test environment. The CTO maintains a log of CPAS changes.

CPAS changes are tested and approved prior to being implemented into the production environment. User acceptance testing is performed by the business owners and applicable end users in order to validate the functionality of the change. The CTO and IT staff receive test and promotion approvals via e-mail. The ability to implement CPAS application changes is restricted to appropriate individuals.

Backup and Recovery

PMRS utilizes Symantec VERITAS Backup Exec software to schedule, manage, and monitor backup activity. Critical CPAS program and data files are backed up to tapes daily and rotated to an off-site storage facility twice weekly (i.e., Wednesdays and Fridays). Backups initiated on Mondays, Wednesdays, and Fridays generally are not rotated off-site unless the backup falls on a holiday or special occasion. PMRS Operations Division personnel deliver to and pick up tapes from a safety deposit box located at the M&T Bank next door to the East Gate Center facility. The tapes are kept off-site until the next rotation occurs. Each backup from Monday through Thursday is kept for a two-week cycle and each Friday’s tape data is kept for a one-month cycle. Backups are monitored by IT personnel daily via the backup software; the system logs are only retained for one month due to retention and storage limits.

Physical Access

PMRS is located within the East Gate Center facility that is managed by a property manager, Property Management, Inc (PMI). Upon entering the East Gate Center facility, there are two (2) entrances to enter PMRS office space (i.e., front door and back exit door). The PMRS server room is located within the centralized office space. The PMRS office space and server room have access control mechanisms that restrict unauthorized physical access. The front door also has a security alarm, which is managed by ADT Security Services. The server room houses servers, PCs, switches, routers, uninterruptible power supply (UPS), etc. The server room keypad code is different from the keypad code required to gain access from the back exit door.
SECTION II

DESCRIPTION OF CONTROLS

User Control Considerations

PMRS controls were designed with the assumption that certain controls would be implemented by municipalities at the plan level. In certain situations, the application of specific controls at the municipal level is necessary to achieve the certain control objectives identified within this report. In such instances, the required municipality level controls are identified under the control objective in Section III of this report.

This section describes additional controls that should be in operation at the municipal level to complement the controls at PMRS. User auditors should consider whether the following controls have been placed in operation at the municipal level:

- Municipalities are responsible for reviewing the plan agreement drafted by PMRS and communicating any revisions prior to adopting a resolution or ordinance.

- The proper municipal officials are responsible for reviewing and signing off on the PMRS Board approved documentation before the plan is formally established within CPAS.

- Municipalities are responsible for providing PMRS with the MMO information by certain required deadlines.

- Municipalities are responsible to meet the financial obligations set forth by PMRS.

- The municipality is responsible for reviewing and completing the quarterly salary/compensation data and contribution amounts on an individual and group basis.

- Municipal plan contacts are responsible for reviewing and approving on the PMRB required forms before a withdrawal or retirement disbursement is processed by PMRS Member Services.

- Members are responsible for reviewing PMRS notification and retirement letters and communicating any discrepancies or concerns to PMRS Member Services.

- Municipalities are responsible for reviewing financial information and individual member statements used in the completion of their financial statements for reasonableness and notifying PMRS of any errors.

- Municipalities are responsible for designating an authorized plan contact and notifying PMRS of plan contact changes.

The list of municipal level control considerations presented above and those presented with certain specified control objectives do not represent a comprehensive set of all the controls that should be employed by municipalities. Other controls may be required at the municipal level.
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 tests of relevant elements of PMRS’ control environment, as described in Section II.

Such tests included inquiry of appropriate management, supervisory, and staff personnel; inspection of PMRS’ documents and records; and observation of PMRS' activities and operations. The results of these tests regarding the control environment were considered in planning the nature, 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

This section presents the following information provided by PMRS:

- The control objectives specified by management of PMRS.
- The controls established and specified by PMRS to achieve the specified control objectives.

Also included in this section is the following information provided by Clifton Gunderson LLP:

- A description of the testing performed by Clifton Gunderson LLP to determine whether PMRS’s controls were operating with sufficient effectiveness to achieve specified control objectives. Clifton Gunderson LLP determined the nature, timing, and extent of testing performed.
- The results of Clifton Gunderson LLP’s tests of operating effectiveness.
**Plan Set Up 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 Specified by PMRS</th>
<th>Testing Performed by Clifton Gunderson LLP</th>
<th>Results of Tests</th>
</tr>
</thead>
</table>
| New municipality retirement plans require the following before they can be formally established:  
  - An entry within PMRS’ tracking database.  
  - A plan agreement/contract approved by the PMRS Board;  
  - A resolution or ordinance approved by the PMRS Board;  
  - Signatures from PMRS officials, Municipality officials, as well as General Counsel and Attorney General Representatives. | Inspected a haphazard sample of new municipality plan documentation created and performed the following:  
  - Inspected the contract to determine whether the contract was properly approved by PMRS  
  - Inspected to determine whether the contract was supported by municipality signature and supporting ordinance or resolution  
  - Inspected to determine whether the contract was reviewed and approved by Legal Counsel  
  - Inspected to determine whether the plan was accurately established in CPAS  
  - Inspected to determine whether the contract was logged for tracking. | No relevant exceptions noted. |
| Board approved plan agreements, resolutions, ordinances, and other supporting documentation between PMRS and the municipality are filed and retained by PMRS for the duration of the plan. | Inspected a haphazard sample of new municipality plans created to determine that the contract and supporting documentation were available for review. | No relevant exceptions noted. |
| Municipal Services Division personnel utilize a checklist to verify that the plans have been accurately established in CPAS based upon the documentation obtained during plan setup. | Inspected a haphazard sample of new municipality plans created and noted the Municipal Service Division completed a checklist to determine that the plans had been accurately established in CPAS. | No relevant exceptions noted. |
| The ability to modify (i.e., add, edit, or delete) municipal data within CPAS is restricted to appropriate individuals based upon job function. | Inspected a listing within the system of individuals with the ability to create or edit plans and reviewed each individual with the business process owner to determine the reasonableness of the access. | No relevant exceptions noted. |
### Plan Set Up and Administration – Contributions

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

<table>
<thead>
<tr>
<th>Control Specified by PMRS</th>
<th>Testing Performed by Clifton Gunderson LLP</th>
<th>Results of Tests</th>
</tr>
</thead>
<tbody>
<tr>
<td>PMRS determines the minimum municipality obligation (MMO) due on defined benefit plans upon receipt of a completed MMO worksheet containing municipality signature.</td>
<td>Observed the process for determining and distributing the minimum municipality obligation for defined benefit plans. Inspected a haphazard sample of defined benefit municipalities and inspected to determine whether a minimum municipality obligation was determined and distributed to the municipality.</td>
<td>No relevant exceptions noted. No relevant exceptions noted.</td>
</tr>
<tr>
<td>PMRS enters municipality contributions based on the Revenue Transmittal Form (PMRB-20) into CPAS.</td>
<td>Inspected a haphazard sample of municipality contributions to determine that contributions were accurately and completely entered into CPAS from the PMRB-20 From.</td>
<td>No relevant exceptions noted.</td>
</tr>
<tr>
<td>PMRS agrees the amount billed through the Municipal Minimum Obligation (MMO) to cash received.</td>
<td>Inspected a haphazard sample of defined benefit municipalities to determine that obligation contributions were accurately and completely processed by comparing the MMO to funds received and entered into CPAS.</td>
<td>No relevant exceptions noted.</td>
</tr>
<tr>
<td>PMRS reconciles municipality contributions to municipality quarterly reports (PMRB-21).</td>
<td>Inspected a haphazard sample of municipality quarterly reports to determine that contributions were accurately and completely entered in CPAS.</td>
<td>No relevant exceptions noted.</td>
</tr>
<tr>
<td>PMRS performs monthly reconciliation of cash accounts.</td>
<td>Inspected a haphazard sample of monthly cash reconciliations for completeness and accuracy.</td>
<td>No relevant exceptions noted.</td>
</tr>
</tbody>
</table>
Control Objective 3:
Controls provide reasonable assurance that retirement plan disbursements are processed accurately, completely, timely, and are properly authorized.

<table>
<thead>
<tr>
<th>Controls Specified by PMRS</th>
<th>Testing Performed by Clifton Gunderson LLP</th>
<th>Results of Tests</th>
</tr>
</thead>
<tbody>
<tr>
<td>PMRS processes withdrawals (e.g., death/terminations/lump sum) disbursements upon receipt of completed PMRB-4 and/or PMRB-4A forms. The forms require member and municipal authorization. PMRS sends a notification letter to the member upon completion.</td>
<td>Inspected a haphazard sample of withdrawals (death, termination, and lump sum) documentation to determine that the PMRB-4 and/or PMRB-4A forms were complete and properly authorized. Inspected the haphazard sample of withdrawals (death, termination, and lump sum) documentation to determine whether PMRS sent a notification letter to member upon completion.</td>
<td>No relevant exceptions noted.</td>
</tr>
<tr>
<td>Withdrawal (death, termination, and lump sum) disbursement amounts are calculated by CPAS based on plan rules and vested amount.</td>
<td>Inspected a haphazard sample of withdrawals (death, termination, and lump sum) disbursements documentation and recalculated disbursement amount based on member election and compared to the calculated balance per CPAS.</td>
<td>No relevant exceptions noted.</td>
</tr>
<tr>
<td>PMRS processes retirement/monthly benefit disbursements upon receipt of a completed PMRB-8 or PMRB-50 form. The forms require notarized signatures from the member and municipality. PMRS sends a retirement letter to the member upon completion.</td>
<td>Inspected a haphazard sample of retirement disbursement documentation to determine that the PMRB-8 and/or PMRB-50 form was complete, contained member and municipal authorization, was notarized, request was accurately entered into CPAS and properly authorized. Inspected a haphazard sample of retirement disbursement documentation to determine that PMRS issued a retirement notification letter to the members upon completion.</td>
<td>No relevant exceptions noted.</td>
</tr>
<tr>
<td>Retirement disbursement amounts are calculated by CPAS based upon the member/participant’s years of service, salary history, and other plan rules.</td>
<td>Inspected a haphazard sample of retirement disbursements and recalculated the disbursement amount based on member election.</td>
<td>No relevant exceptions noted.</td>
</tr>
<tr>
<td>Controls Specified by PMRS</td>
<td>Testing Performed by Clifton Gunderson LLP</td>
<td>Results of Tests</td>
</tr>
<tr>
<td>---------------------------</td>
<td>-------------------------------------------</td>
<td>-----------------</td>
</tr>
<tr>
<td>Copies of withdrawal and retirement requests and the completed PRMB forms are filed and retained by PMRS for the duration of the plan and/or member’s enrollment.</td>
<td>Inspected a haphazard sample of retirement disbursements documentation to determine that PMRS maintained copies of withdrawal and retirement requests and the completed PRMB forms were filed and retained by PMRS for the duration of the plan and/or member’s enrollment.</td>
<td>No relevant exceptions noted.</td>
</tr>
<tr>
<td>PMRS reconciles the prior month’s disbursements (payroll) to the current month’s disbursements (payroll) to verify changes in disbursements are complete and accurate.</td>
<td>Inspected a haphazard sample of monthly payroll reconciliations between the current month’s disbursement and the prior month’s disbursements for completeness and accuracy.</td>
<td>No relevant exceptions noted.</td>
</tr>
<tr>
<td>Disbursements are approved by PMRS management prior to transmittal to Treasury for check processing.</td>
<td>Inspected a haphazard sample of voucher transmittals and reviewed for management approval.</td>
<td>No relevant exceptions noted.</td>
</tr>
</tbody>
</table>
**Control Objective 4:**
*Controls provide reasonable assurance that retirement plan income allocations are processed accurately, completely, and timely.*

<table>
<thead>
<tr>
<th>Controls Specified by PMRS</th>
<th>Testing Performed by Clifton Gunderson LLP</th>
<th>Results of Tests</th>
</tr>
</thead>
<tbody>
<tr>
<td>PMRS Board of Directors approves the regular interest rate, which is recorded and maintained within CPAS.</td>
<td>Inspected Board approval and compared the approved interest rate to the interest rate in CPAS’ master record.</td>
<td>No relevant exceptions noted.</td>
</tr>
<tr>
<td>CPAS calculates the interest income for municipalities and participants based on the interest rate recorded and the account balances contained within CPAS.</td>
<td>Re-performed the annual interest income for a haphazard sample of municipalities and participants.</td>
<td>No relevant exceptions noted.</td>
</tr>
</tbody>
</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.*

<table>
<thead>
<tr>
<th>Controls Specified by PMRS</th>
<th>Testing Performed by Clifton Gunderson LLP</th>
<th>Results of Tests</th>
</tr>
</thead>
<tbody>
<tr>
<td>PMRS enters new plan participants into CPAS upon receipt of completed PMRB-1 and PMRB-2 forms. PMRB-1 forms require member and plan contact authorization while PMRB-2 forms require authorization from the member and two witnesses. PMRS sends an enrollment letter to the member and municipality upon completion.</td>
<td>Inspected a haphazard sample of new participant documentation to determine that new participants created were processed completely and accurately.</td>
<td>No relevant exceptions noted.</td>
</tr>
<tr>
<td>PMRS modifies participant records in CPAS upon receipt of a completed PMRB-5A and/or PMRB-2 forms (participant record changes). PMRB-5A forms require member and plan contact authorization while PMRB-2 forms require authorization from the member and witnessed by two (2) individuals. PMRS sends a record modification letter to the member and municipality upon completion.</td>
<td>Inspected sample of participant record changes to determine that changes to member data were processed completely and accurately.</td>
<td>Six (6) of the 25 participant record changes were not supported by proper authorization.</td>
</tr>
<tr>
<td>Copies of new or modified records and the completed PMRB forms are filed and retained by PMRS for the duration of the plan and/or member’s enrollment.</td>
<td>Inspected sample of new or modified records and determined that PMRB forms were retained.</td>
<td>No relevant exceptions noted.</td>
</tr>
<tr>
<td>The ability to modify (i.e., add, edit, or delete) participant data within CPAS is restricted to appropriate individuals based upon job function.</td>
<td>Inspected a listing of access modification rights for participant data and determined appropriateness.</td>
<td>No relevant exceptions noted.</td>
</tr>
</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.

<table>
<thead>
<tr>
<th>Controls Specified by PMRS</th>
<th>Testing Performed by Clifton Gunderson LLP</th>
<th>Results of Tests</th>
</tr>
</thead>
<tbody>
<tr>
<td>PMRS performs a monthly reconciliation of cash accounts between records in CPAS and information provided by Treasury.</td>
<td>Inspected a haphazard sample of monthly cash reconciliations for completeness and accuracy.</td>
<td>No relevant exceptions noted.</td>
</tr>
<tr>
<td>PMRS performs a monthly reconciliation of the short-term investment fund between records in CPAS and information provided by Treasury.</td>
<td>Inspected a haphazard sample of monthly short-term investment fund reconciliations for completeness and accuracy.</td>
<td>No relevant exceptions noted.</td>
</tr>
</tbody>
</table>
Control Objective 7:
*Controls provide reasonable assurance that plan reporting (participant statements) is accurate, complete, and timely.*

<table>
<thead>
<tr>
<th>Controls Specified by PMRS</th>
<th>Testing Performed by Clifton Gunderson LLP</th>
<th>Results of Tests</th>
</tr>
</thead>
<tbody>
<tr>
<td>PMRS generates and mails annual pension statements to plan members on an individual basis.</td>
<td>Inspected a haphazard sample of participant documentation to determine that annual plan statements were provided.</td>
<td>No relevant exceptions noted.</td>
</tr>
<tr>
<td>PMRS maintains an Access database used to track the status of annual pension statements generated and mailed to plan members.</td>
<td>Inquired and observed the process for updating the tracking database and records to determine its accuracy, effectiveness, and utilization.</td>
<td>No relevant exceptions noted.</td>
</tr>
</tbody>
</table>
**General Computer Controls**

**Control Objective 8:**
*Controls provide reasonable assurance that general computer controls around CPAS are adequate.*

<table>
<thead>
<tr>
<th>Controls Specified by PMRS</th>
<th>Testing Performed by Clifton Gunderson LLP</th>
<th>Results of Tests</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Logical Access</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
| Password and account lockout settings have been configured and implemented to restrict access to the CWOPA network and CPAS application. | Inspected system documentation including network password configurations.  
Inspected password configurations controlling access to the database and CPAS. | No relevant exceptions noted.  
Password configuration has not been implemented for privileged accounts within the database. |
| Administrative access to the CWOPA network and CPAS application is appropriately restricted | Inspected administrative rights to PMRS’ section of the CWOPA network for appropriateness.  
Inspected administrative rights to CPAS for appropriateness. | No relevant exceptions noted.  
No relevant exceptions noted. |
<p>| New access, modifications of access, or the removal of access is initiated via the completion of a universal access request form. The request form requires approval from PMRS Human Resources (HR), IT, and Executive Management. | Inspected documentation for the user accounts created during the audit period to determine that access was approved. | No relevant exceptions noted. |
| CWOPA network and CPAS application access is removed upon PMRS employee termination. | Inspected system documentation for the population of separations during the audit period to determine that access was removed. | No relevant exceptions noted. |
| The production database (Oracle) supporting CPAS is securely configured. | Inspected password configurations controlling access to the database and CPAS. | Password configuration has not been implemented for privileged accounts within the database. |</p>
<table>
<thead>
<tr>
<th>Controls Specified by PMRS</th>
<th>Testing Performed by Clifton Gunderson LLP</th>
<th>Results of Tests</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inspected permissions granted to the database accounts.</td>
<td>Inspected documentation for a haphazard sample of CPAS application patches to determine that the patch was tested and approved.</td>
<td>No relevant exceptions noted.</td>
</tr>
<tr>
<td><strong>Change Management</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CPAS changes are tested and approved prior to being implemented into the production environment.</td>
<td>Inspected documentation for a haphazard sample of CPAS application patches to determine that the patch was tested and approved.</td>
<td>No relevant exceptions noted.</td>
</tr>
<tr>
<td>The ability to implement CPAS application changes is restricted to appropriate individuals.</td>
<td>Inspected a system report of accounts with update access to the production server.</td>
<td>No relevant exceptions noted.</td>
</tr>
<tr>
<td><strong>Computer Operations</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Critical CPAS program and data files are backed up to tapes daily and rotated to an off-site storage facility twice weekly.</td>
<td>Inspected documentation for a haphazard sample of days to determine that back-ups were performed.</td>
<td>The scheduled backup did not complete for one (1) of 25 days selected.</td>
</tr>
<tr>
<td><strong>Physical Access</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The PMRS office space and server room have access control mechanisms that restrict unauthorized physical access.</td>
<td>Observed the exterior security system to determine that it required knowledge of the security PIN or action from PMRS employee to gain access. Observed the computer room’s secured door to determine that it required knowledge of the security PIN to gain access.</td>
<td>No relevant exceptions noted.</td>
</tr>
</tbody>
</table>
SECTION IV
OTHER INFORMATION PROVIDED BY THE PENNSYLVANIA MUNICIPAL RETIREMENT SYSTEM

The information in this section is presented by PMRS to provide additional information and is not a part of PMRS’ description of controls that may be relevant to clients’ internal control as it relates to an audit of financial statements. Such information has not been subjected to the procedures applied in the examination of the description of municipal retirement processing and accordingly, the independent service auditor expressed no opinion on it.

Continuity of Operations Plan (COOP)

The Pennsylvania Municipal Retirement System (PMRS) has operations that must be performed, or rapidly and efficiently resumed, in an emergency. While the impact of an emergency cannot be predicted, planning for operations under such conditions can mitigate the impact of the emergency on our staff or clients (the members and municipalities we serve), our facilities and our mission. To that end, the PMRS has prepared a COOP. This COOP establishes policy and guidance to ensure the execution of the critical functions for the PMRS in the event that an emergency threatens our service area or incapacitates operations, and/or requires the relocation of personnel and functions. This COOP outlines the critical functions and systems needed to continue operations, contact information of key personnel, notification requirements, alternative work sites through cooperative and mutual aid agreements, etc. While the PMRS does have in place a contract with a third-party provider to provide disaster recovery services, PMRS did not perform a thorough test of this plan to validate its effectiveness in 2010.

IRS Tax Qualification Determination

In April of 2008, the IRS announced its intentions to increase its scrutiny of governmental pension plans. The PMRS Board retained independent counsel to evaluate PMRS’ federal tax qualification status, with the expectation of filing for an IRS determination by January 31, 2011. After extensive review of plan documents, it was determined that a number of significant issues and technical deficiencies needed to be addressed.

The IRS maintains several programs that encourage self-regulation. In December of 2009, PMRS took advantage of filing under the Employee Plans Compliance Resolution System (EPCRS) that allows plan administrators to self-identify deficiencies and offer corrective action. The System’s application was accepted by the IRS in March of 2010. The System’s suggested corrective actions were introduced as proposed legislation. The legislation was passed by the General Assembly and signed into law by the Governor of Pennsylvania in the summer of 2010 (See Act 56 of 2010)."

In January 2011, the System filed an application with the I.R.S. to obtain a tax qualification determination. An I.R.S. determination is not expected before the fall of 2011.