

Audit Report

**Board of Trustees of the Maryland Teachers and State
Employees Supplemental Retirement Plans**

November 2009



OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

-
- This report and any related follow-up correspondence are available to the public through the Office of Legislative Audits at 301 West Preston Street, Room 1202, Baltimore, Maryland 21201. The Office may be contacted by telephone at 410-946-5900, 301-970-5900, or 1-877-486-9964.
 - Electronic copies of our audit reports can be viewed or downloaded from our website at <http://www.ola.state.md.us>.
 - Alternate formats may be requested through the Maryland Relay Service at 1-800-735-2258.
 - The Department of Legislative Services – Office of the Executive Director, 90 State Circle, Annapolis, Maryland 21401 can also assist you in obtaining copies of our reports and related correspondence. The Department may be contacted by telephone at 410-946-5400 or 301-970-5400.
-



DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Karl S. Aro
Executive Director

Bruce A. Myers, CPA
Legislative Auditor

November 23, 2009

Delegate Steven J. DeBoy, Sr., Co-Chair, Joint Audit Committee
Senator Verna L. Jones, Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

Ladies and Gentlemen:

We have audited the Board of Trustees of the Maryland Teachers and State Employees Supplemental Retirement Plans (MSRP) for the period beginning October 19, 2006 and ending January 7, 2009. MSRP is responsible for supervising and administering the State's voluntary tax sheltered income deferral plans for State employees and certain employees of local boards of education and municipalities.

Our audit disclosed that MSRP had not published the award of two contracts valued at approximately \$19.8 million on *eMaryland Marketplace*, as required. Additionally, we noted certain monitoring deficiencies relating to MSRP's Investment Contract Pool, that were also reported upon in our special review report dated October 9, 2009.

MSRP's response to this audit is included as an appendix to this report. We wish to acknowledge the cooperation extended to us during the course of this audit by MSRP.

Respectfully submitted,

Bruce A. Myers, CPA
Legislative Auditor

Background Information

Agency Responsibilities

Title 35 of the State Personnel and Pensions Article of the Annotated Code of Maryland provides that the Board of Trustees of the Maryland Teachers and State Employees Supplemental Retirement Plans (MSRP) is responsible for the supervision and administration of the State's three voluntary tax sheltered income deferral plans for State employees and certain employees of local boards of education and municipalities. These plans consist of the Maryland State Employees' Deferred Compensation Plan, the State of Maryland Tax Sheltered Annuity Plan (primarily for employees of State and local educational institutions), and the State of Maryland Savings and Investment Plan, as permitted under Sections 457, 403(b), and 401(k) of the Internal Revenue Code, respectively.

Title 32 of the State Personnel and Pensions Article of the Annotated Code of Maryland authorizes employer matching contributions of up to \$600 per participant each fiscal year, if appropriated, for State Employees' Pension System members who elect to contribute to the supplemental retirement plans. These employer matching contributions are maintained in the State of Maryland Match Plan and Trust, a defined contribution matching plan as permitted under Section 401(a) of the Internal Revenue Code.

The assets of all of MSRP's plans are held in trust for the plan participants. Under current tax laws, income taxes are not due from participants in these supplemental retirement plans on amounts deferred, on amounts contributed by the State, and on income earned on these amounts; rather, distributions are subject to federal, state, and local income taxes when received. Title 35 also provides that expenses incurred by MSRP for the implementation, maintenance, and administration of these plans shall be paid from the contributions to or from the income or assets of the plans.

MSRP has designated a plan administrator for the supplemental retirement plans. The plan administrator conducts the enrollment of all individuals who elect to participate in the plans and acts as the agent of record in coordinating deferrals between the State and the various investment carriers. A contractual agreement has been executed between MSRP and the plan administrator which specifies the rates to be assessed against participant account asset balances to cover related administrative expenses incurred by or on behalf of the plan administrator. This contract covers the period from January 31, 2008 to December 31, 2012.

Financial Statements Audit

MSRP engaged an independent certified public accounting firm to perform audits of the plans' financial statements for calendar years 2006 and 2007. In the related audit reports, the firm stated that these financial statements presented fairly, in all material respects, the net assets available for the plan benefits and the changes in net assets available for plan benefits in conformity with accounting principles generally accepted in the United States of America.

The audited financial statements of the plans indicate that during calendar year 2007, amounts deferred by employees participating in the Maryland State Employees' Deferred Compensation Plan, the State of Maryland Tax Sheltered Annuity Plan, and the State of Maryland Savings and Investment Plan totaled approximately \$66.7 million, \$2.8 million, and \$94.7 million, respectively. The audited financial statements of the State of Maryland Match Plan and Trust indicate that during calendar year 2007, the State contributed \$20.7 million as an employer match to the amounts contributed by the participants of the other plans. These financial statements further indicate that as of December 31, 2007, the assets available for plan benefits for the Maryland State Employees' Deferred Compensation Plan, the State of Maryland Tax Sheltered Annuity Plan, the State of Maryland Savings and Investment Plan, and the State of Maryland Match Plan and Trust totaled approximately \$1.3 billion, \$74.4 million, \$1 billion and \$143 million, respectively.

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of the finding contained in our preceding audit report dated March 16, 2007. We determined that MSRP satisfactorily addressed that finding.

Findings and Recommendations

Purchases and Disbursements

Finding 1

MSRP had not published the award of two contracts valued at approximately \$19.8 million on *eMaryland Marketplace*, as required.

Analysis

MSRP had not published awards for two service contracts on *eMaryland Marketplace*, as required by State law. Specifically, during fiscal years 2007 and 2008, MSRP awarded two contracts for retirement plan administration and audit services valued at approximately \$19.5 million and \$260,000, respectively. However, the award of these contracts was not published on *eMaryland Marketplace*.

The State Finance and Procurement Article of the Annotated Code of Maryland requires that contract awards greater than \$25,000 be published on *eMaryland Marketplace* not more than 30 days after the execution and approval of the contract.

Recommendation 1

We recommend that, in the future, MSRP ensure that contract awards are published on *eMaryland Marketplace* not more than 30 days after the execution and approval of the contract, as required by State law.

Oversight of Investment Contract Pool

Finding 2

MSRP did not adequately document efforts to monitor certain aspects of the Investment Contract Pool (ICP).

Analysis

MSRP was not adequately documenting its efforts to monitor the ICP, including the performance of contractors. Additionally, MSRP did not obtain certain critical documents that would have enhanced its monitoring efforts. These conditions were identified during a special review of the ICP conducted by the Office of Legislative Audits and were presented in a separate report dated October 9, 2009. For example, we noted the following conditions:

- Documentation of efforts taken by MSRP to monitor the performance of its ICP investment manager and sub-managers was lacking.
- MSRP did not always obtain critical documents related to the ICP. For example, sub-managers did not always provide required monthly reports on detailed investment holdings and unrealized gains and losses on investments. Also, MSRP did not obtain copies of certain agreements related to the ICP that were executed between the investment manager and financial institutions.

The ICP, also referred to as the Stable Value Fund, is available as an investment option in the 401(a), 401(k), and 457 Plans. According to the *ICP Fact Sheet* published by MSRP, the ICP invests in a diversified portfolio of stable value contracts issued by banks and other financial institutions, and a variety of fixed income instruments including U.S. Government and agency securities, mortgage-backed securities, asset-backed securities, and corporate bonds. MSRP entered into a contractual agreement with an entity to provide investment management services (investment manager) for ICP funds invested by plan participants. These services include, in part, preparing a written investment policy (with Board approval), selecting investment sub-managers to make investments on behalf of participants, subsequently monitoring the investment performance of the sub-managers, and providing the Board with a quarterly performance review report of the ICP. The reported book value of the ICP was approximately \$729 million as of December 31, 2008.

Recommendation 2

We recommend that MSRP adequately document its ICP monitoring efforts.

Audit Scope, Objectives, and Methodology

We have audited the Board of Trustees of the Maryland Teachers and State Employees Supplemental Retirement Plans (MSRP) for the period beginning October 19, 2006 and ending January 7, 2009. The audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

As prescribed by the State Government Article, Section 2-1221 of the Annotated Code of Maryland, the objectives of this audit were to examine MSRP's financial transactions, records and internal control, and to evaluate its compliance with applicable State laws, rules, and regulations. The areas addressed by this audit included certain aspects of MSRP's oversight of the retirement plans, and procurements and disbursements. We also conducted a separate special review of an allegation received through our fraud, waste, and abuse hotline related to MSRP, the results of which are presented in a separately issued report dated October 9, 2009. We also determined the status of the finding contained in our preceding audit report.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of materiality and risk. Our audit procedures included inquiries of appropriate personnel, inspections of documents and records, and observations of MSRP's operations. We also tested transactions and performed other auditing procedures that we considered necessary to achieve our objectives. Data provided in this report for background or informational purposes were deemed reasonable, but were not independently verified.

MSRP's management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that objectives pertaining to the reliability of financial records, effectiveness and efficiency of operations including the safeguarding of assets, and compliance with applicable laws, rules, and regulations are achieved.

Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

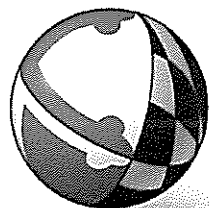
MSRP engaged an independent certified public accounting firm to perform audits of the plans' financial statements for calendar years 2006 and 2007. In the related audit reports, the firm stated that these financial statements presented fairly, in all material respects, the net assets available for the plan benefits and the changes in net assets available for plan benefits in conformity with accounting principles generally accepted in the United States of America. We have relied on the work of the independent accounting firm to provide audit coverage of certain aspects of MSRP's operations (asset fee collections, disbursements from participant accounts). Our audit procedures in these areas were generally limited, therefore, to obtaining a sufficient basis for that reliance.

Our reports are designed to assist the Maryland General Assembly in exercising its legislative oversight function and to provide constructive recommendations for improving State operations. As a result, our reports generally do not address activities we reviewed that are functioning properly.

This report includes a finding relating to a condition that we consider to be a significant deficiency in the design or operation of internal control that could adversely affect MSRP's ability to maintain reliable financial records, operate effectively and efficiently, and comply with applicable laws, rules, and regulations. Our report also includes a finding regarding a significant instance of noncompliance with applicable laws, rules, or regulations. Other less significant findings were communicated to MSRP that did not warrant inclusion in this report.

MSRP's response to our findings and recommendations is included as an appendix to this report. As prescribed in the State Government Article, Section 2-1224 of the Annotated Code of Maryland, we will advise MSRP regarding the results of our review of its response.

APPENDIX



MSRP

Maryland

Teachers & State Employees

Supplemental Retirement Plans

457* 401(k)* 403(b)* Match

BOARD OF TRUSTEES

T. Eloise Foster
Chairperson

Sabrina I. Bass
Robert W. Black, Jr. CPA
Nancy K. Kopp
Linda L. Tanton, Esq.
William W. Whitescarver
Marcia Zercoe

STAFF

Michael T. Halpin *CRC® CRA®*
Secretary to the Board
Executive Director

Debra L. Roberts *CRC® CPA*
Director of Finance

Richard A. Arthur
Technology & Operations Director

Louis A. Holcomb, Jr. *CRC®*
Director of Participant Services

William Donald Schaefer Tower
Suite 200
6 Saint Paul Street
Baltimore, Maryland
21202-1608

Telephone: 410-767-8740
Toll-Free: 1-800-543-5605

TTY: Use 711 in Md.
Or 1-800-735-2258

Fax: 410-659-0349

Visit the MSRP Board website at
www.MSRP.state.md.us

Call About the Plans,
or to Enroll
1-800-545-4730
or Enroll on-line at
www.MarylandDC.com

November 19, 2009

Mr. Bruce A. Myers, CPA
Legislative Auditor
State of Maryland
Office of Legislative Audits
State Office Building, Room 1202
301 West Preston Street
Baltimore, Maryland 21201

Dear Mr. Myers:

The Board of Trustees for the Maryland Teachers and State Employees Supplemental Retirement Plans (MSRP) has reviewed the draft audit report on the Board of Trustees of the Maryland Teachers and State Employees Supplemental Retirement Plans. Attached are the Board's responses to the findings in the report.

The MSRP Board and staff welcome constructive and cooperative efforts to work toward improvements in administering the plans.

The audit report states that MSRP and its Board need to improve documentation of efforts to monitor the ICP. The results of a review of a special consultant concluded that current Board and staff oversight is more than adequate. However, MSRP has agreed to implement the audit recommendations to improve its documentation of monitoring efforts.

The Board believes that we have been responsive to the auditor's concerns and that adequate and appropriate documentation and monitoring are in place that fulfill our fiduciary responsibility to protect Plan participants.

If you have any questions or need additional information, you may contact me at 410-767-8733 or mhalpin@msrp.state.md.us.

Sincerely,

Michael T. Halpin
Executive Director

cc: Chairperson and Members, MSRP Board of Trustees
John K. Barry, Assistant Attorney General

Responses to Legislative Audit Findings and Recommendations
Audit Report: Board of Trustees of the Maryland Teachers and
State Employees Supplemental Retirement Plans
November 2009

Finding 1

MSRP had not published the award of two contracts valued at approximately \$19.8 million on eMaryland Marketplace, as required.

Recommendation 1

We recommend that, in the future, MSRP ensure that contract awards are published on eMaryland Marketplace not more than 30 days after the execution and approval of the contract, as required by State law.

RESPONSE 1

The Board agrees to implement the audit recommendations

Although MSRP did properly post the requests for proposals for both of the noted service contracts on eMaryland Marketplace and properly notified—and debriefed when requested—all unsuccessful vendors for both procurements, we acknowledge that we did not complete the effort to post the contract awards. Future eMaryland Marketplace responsibilities have been assigned to a staff position who will stay up to date with training, log-in access, and other protocols. We expect full compliance will be maintained in the future.

Finding 2

MSRP did not adequately document efforts to monitor certain aspects of the Investment Contract Pool (ICP).

Recommendation 2

We recommend that MSRP adequately document its ICP monitoring efforts.

RESPONSE 2

The Board agrees to implement the audit recommendation to ensure best practices.

MSRP recently contracted with a special consultant to perform a review that included reviewing MSRP staff and Board oversight practices. The special consultant concluded that the current Board and staff oversight is more than adequate and above average as compared to oversight practices of other public defined contribution plans. The special consultant did, however, make recommendations to ensure best practices. The Board is implementing these recommendations. In addition, to better document monitoring efforts, MSRP staff has developed a Compliance and Monitoring Matrix that ensures various reports to monitor performance are properly provided to the Board.

a) Documenting Monitoring of the Performance of the Sub-Managers

The MSRP Board receives both monthly and quarterly reports from the investment manager. In addition, the contracted investment consultant provides commentary and evaluation of the quarterly status of the ICP at the upcoming quarterly Board meeting. MSRP Board staff and the investment manager hold discussions regarding performance of the sub-managers, both informally intra-quarter

Responses to Legislative Audit Findings and Recommendations
Audit Report: Board of Trustees of the Maryland Teachers and
State Employees Supplemental Retirement Plans
November 2009

and formally during the quarterly MSRP Board meetings. As a result of this monitoring effort, actions have been taken when a sub-manager maintains consistent unsatisfactory performance without justification.

In the future, the MSRP Board will ensure that it documents its monitoring of the performance of the sub-managers and their compliance with MSRP's ICP Investment Policy and Guidelines and benchmarks. We recognize that discussions held in the past, including discussions held at the Board meetings, may not have been adequately documented to show evidence of this monitoring activity. The Board will assure adequate documentation of its monitoring of investment sub-managers' performance and compliance, including the Board's discussions on such matters.

b) Procedures to Adequately Document Monitoring Investment Manager's Performance

MSRP has contracted for several years with an investment consultant to assist the Board in monitoring and documenting the performance of all investment options in the Plans. Currently, the investment consultant provides quarterly reports that include performance of the ICP. In the future, MSRP staff will verify that discussions of these documents, specifically the investment manager's performance, are properly documented in greater detail in the Board Meeting minutes.

c) Obtained critical documents related to the ICP

MSRP currently has a complete copy on file of all of the investment manager's signed wrap provider contracts, and will continue to maintain a copy of these agreements and update the files as necessary. Also, MSRP procured additional monthly independent reporting services from its custodial bank which now reports: 1.) valuation of active-strategy sub-manager holdings; 2.) compliance monitoring of active-strategy sub-manager investments; and 3.) investment performance of active-strategy sub-manager portfolios. These reports are archived at MSRP and used to perform quarterly staff reports to the MSRP Board.

Sub-managers submit required monthly reports directly to the investment manager. Per the investment manager, all required sub-manager monthly and quarterly reports and information have been provided as agreed upon between the investment manager and the sub-managers. However, to address this finding, MSRP staff will work with the Legislative Auditors to explore what additional information should be provided monthly. Those suggestions will be reviewed with the Board and the investment manager to determine if any revisions should be made to monthly reports required by the Investment Management Agreements.

d) Review of the ICP Investment Policy and Guidelines

The MSRP Board regularly and at least annually reviews the MSRP's ICP Investment Policy and Guidelines. These reviews will be more fully documented in the appropriate Board meeting minutes.

AUDIT TEAM

Mark A. Ermer, CPA
Audit Manager

Ronnette L. Bailey, CFE
Senior Auditor

Jean M. Cubello
Staff Auditor