

Audit Report

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**Maryland Teachers and State Employees  
Supplemental Retirement Plans**

July 2018

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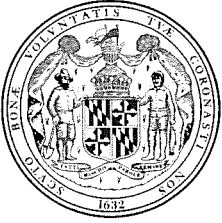
**OFFICE OF LEGISLATIVE AUDITS**  
DEPARTMENT OF LEGISLATIVE SERVICES  
MARYLAND GENERAL ASSEMBLY

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DEPARTMENT OF LEGISLATIVE SERVICES  
OFFICE OF LEGISLATIVE AUDITS  
MARYLAND GENERAL ASSEMBLY

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Thomas J. Barnickel III, CPA  
Legislative Auditor

July 13, 2018

Senator Craig J. Zucker, Co-Chair, Joint Audit Committee  
Delegate C. William Frick, Co-Chair, Joint Audit Committee  
Members of Joint Audit Committee  
Annapolis, Maryland


Ladies and Gentlemen:

We have conducted a fiscal compliance audit of the Maryland Teachers and State Employees Supplemental Retirement Plans (MSRP) for the period beginning August 20, 2014 and ending February 11, 2018. 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 lacked assurance that the plan administrator had sufficient protections against operational and security risks including the security of sensitive participant data, such as the social security numbers of approximately 60,000 plan participants. In addition, MSRP did not reconcile employee payroll records generated by the State's Central Payroll Bureau, which reflected actual payments made, with the corresponding State Personnel System reports of the amounts that should have been paid based on employee time and salary data entered into the system.

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,

  
Thomas J. Barnickel III, 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. The Board consists of nine members appointed by the Governor. The deferral plans consist of the Deferred Compensation Plan, the Tax Sheltered Annuity Plan (for employees of State and local educational institutions), and the 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' Alternate Contributory Pension Plan members who elect to contribute to the supplemental retirement plans. These employer matching contributions are maintained in a fourth plan administered by MSRP, the Match Plan and Trust, which is a defined contribution matching plan as permitted under Section 401(a) of the Internal Revenue Code.

The assets of MSRP's four 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. Effective April 2011, the Board began accepting Roth contributions to both the 457 and 401(k) plans. Unlike the other plans, Roth contributions are made on an after-tax basis, and eligible distributions of Roth contributions and any earnings will not be further taxed. 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 the plans 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 that 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. The current contract period extends from January 1, 2013 through December 31, 2018. In February 2017, MSRP modified the contract, with the approval of the Board of Public Works, to include an option for plan participants to obtain investment advisory services from the plan administrator for an additional fee.

## **Financial Statement Audits**

MSRP engaged an independent certified public accounting firm to perform audits of the plans' financial statements for calendar years 2014, 2015, and 2016. In the related audit reports, the firm stated that these financial statements presented fairly, in all material respects, the respective net position of MSRP and the respective changes in its net position held in trust for deferred compensation benefits in accordance with accounting principles generally accepted in the United States of America.

The audited financial statements of the plans indicate that, during calendar year 2016, amounts deferred by employees participating in the Deferred Compensation Plan, the Tax Sheltered Annuity Plan, and the Savings and Investment Plan totaled approximately \$66.8 million, \$3.0 million, and \$85.9 million, respectively. These financial statements further indicate that, as of December 31, 2016, the assets available for plan benefits for the Deferred Compensation Plan, the Tax Sheltered Annuity Plan, the Savings and Investment Plan, and the Match Plan and Trust totaled approximately \$1.6 billion, \$88.3 million, \$1.7 billion, and \$176.9 million, respectively.

# Findings and Recommendations

## System Security

### **Finding 1**

**The Maryland Teachers and State Employees Supplemental Retirement Plans (MSRP) lacked assurance that the plan administrator had sufficient protections against operational and security risks including the security of sensitive participant data maintained by the administrator.**

### **Analysis**

MSRP lacked assurance that the plan administrator, a private retirement management company, had sufficient protections against operational and security risks including the security of sensitive participant data, such as social security numbers, maintained by the administrator. Specifically, MSRP's contract with the company did not require the company to obtain an independent review of its system security. As a result, significant operational and security risks could exist and remain undetected, resulting in increased vulnerability of systems and data to compromise or loss. There were approximately 60,000 plan participants as of June 30, 2017.

The company administered the plans by processing plan enrollment applications, investing related contribution payments, and disbursing funds, and had obtained a System and Organization Control (SOC) 1 Type 2 review from an independent accounting firm. The resulting report addressed the company's recordkeeping system and the suitability of the design, and the operating effectiveness of its controls for the year ending December 31, 2016.

Although obtaining this type of review is appropriate because the company's services and related internal controls affect the financial statements for the plans, the review did not provide assurance regarding the company's system security, availability, processing integrity, data confidentiality, and privacy. Because of the nature and sensitivity of plan information (such as, personally identifiable information), we believe MSRP should also require the company to obtain a SOC 2 Type 2 review to address certain key security controls. Appropriate controls would ensure, for example, that

- data backups and data at rest are encrypted;
- intrusion detection, malware prevention, data loss prevention, and antivirus protection have been implemented;

- user account and password controls for applications and databases are in accordance with an agreed-upon standard;
- restrictions of connections between trusted and untrusted networks are reviewed at planned intervals; and
- production data are not used in development environments.

The American Institute of Certified Public Accountants has issued guidance concerning examinations of service organizations. Based on this guidance, service providers may contract for an independent review of controls, resulting in an independent auditor's report referred to as a SOC report. There are several types of SOC reports with varying scope and levels of review and auditor testing. The SOC 2 Type 2 report includes the results of the auditor's review of controls placed in operation and tests of operating effectiveness for the period under review. In addition, this report could include an evaluation of the company's information technology security, availability (such as, business continuity management), processing integrity (completeness, accuracy, and timeliness), confidentiality (data protection), and privacy (data access and monitoring).

#### **Recommendation 1**

**We recommend that MSRP**

- a. ensure that future contracts with companies processing MSRP data include provisions requiring the company to regularly obtain SOC 2 Type 2 reviews pertaining to its system operations,**
- b. obtain and review these SOC 2 Type 2 reports, and**
- c. ensure that the related independent reviews adequately address critical security concerns and that the company implements all critical report recommendations.**

## **Payroll**

### **Finding 2**

**Controls had not been established to ensure the propriety of MSRP's payroll.**

#### **Analysis**

MSRP had not established adequate controls over the processing of payroll under the Statewide Personnel System (SPS), which was implemented in May 2016. Specifically, MSRP did not obtain payroll registers from the State's Central Payroll Bureau (CPB) and, consequently, did not reconcile the total biweekly payroll payments from CPB with total payroll as reflected in the payroll reports generated from SPS. According to State records, MSRP's payroll expenditures totaled approximately \$1.2 million during fiscal year 2017.

Generally, employees recorded their work time directly into SPS for online approval by their assigned supervisors. Payroll payments were processed by CPB based on the approved work time for the pay period and the salary information reflected in SPS. However, MSRP did not obtain the CPB payroll registers so that it could compare the total payroll paid with the SPS payroll summary reports reflecting the amounts that should have been paid based on each employee's approved work time and salary information.

This reconciliation is particularly important with respect to SPS because certain unique system design features often result in differences between the CPB and SPS reports. For example, SPS payroll summary reports for a particular pay period will reflect all activity relevant to the pay period, irrespective of when the transactions were processed. Conversely, CPB payroll registers only reflect activity processed during the particular pay period. Because the reconciliations were not performed, MSRP lacked assurance that payroll payments were proper and were supported by the related time records and salary information maintained within SPS.

We obtained MSRP's payroll registers from CPB for three pay periods and were able to verify that the amounts to be paid according to the SPS payroll summary reports agreed with the amounts paid by CPB.

#### **Recommendation 2**

**We recommend that MSRP obtain and compare CPB payroll registers for each pay period with SPS summary reports, reconcile any differences, and ensure that this reconciliation is documented.**

## **Audit Scope, Objectives, and Methodology**

We have conducted a fiscal compliance audit of the Maryland Teachers and State Employees Supplemental Retirement Plans (MSRP) for the period beginning August 20, 2014 and ending February 11, 2018. 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.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of significance and risk. The areas addressed by the audit included plan administration, procurements and disbursements, and payroll.

MSRP engaged an independent certified public accounting firm to perform audits of the plans' financial statements for calendar years 2014, 2015, and 2016. In the related audit reports, the firm stated that these financial statements presented fairly, in all material respects, the respective net position of MSRP and the changes in its net position held in trust for deferred compensation benefits in accordance with accounting principles generally accepted in the United States of America. This independent certified public accounting firm also performed certain agreed upon procedures to assist in evaluating the administration of the plans for calendar years 2014 through 2016. In the related agreed upon procedures reports, no findings were identified by the firm for the procedures performed. We have relied on the work of the independent accounting firm to provide audit coverage of certain aspects of MSRP's operations (contributions from participating employees, asset fee collections, benefits paid). Our audit procedures in these areas were generally limited, therefore, to obtaining a sufficient basis for that reliance.

To accomplish our audit objectives, our audit procedures included inquiries of appropriate personnel, inspections of documents and records, observations of MSRP's operations, and tests of transactions. Generally, transactions were selected for testing based on auditor judgment, which primarily considers risk.

Unless otherwise specifically indicated, neither statistical nor non-statistical audit sampling was used to select the transactions tested. Therefore, the results of the tests cannot be used to project those results to the entire population from which the test items were selected.

We performed various data extracts of pertinent information from the State's Financial Management Information System (such as revenue and expenditure data) and the State's Central Payroll Bureau (payroll data). These extracts are performed as part of ongoing internal processes established by the Office of Legislative Audits and were subject to various tests to determine data reliability. We determined that the data extracted from these sources were sufficiently reliable for the purposes the data were used during this audit.

We also extracted data from the Statewide Personnel System (SPS) for the purpose of testing related payroll transactions. We performed various tests of the relevant data and determined that the data were sufficiently reliable for the purposes the data were used during the audit. Finally, we performed other auditing procedures that we considered necessary to achieve our audit objectives. The reliability of data used in this report for background or informational purposes was not assessed.

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 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.

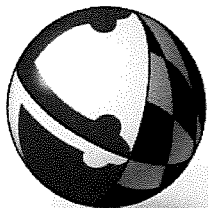
Our reports are designed to assist the Maryland General Assembly in exercising its legislative oversight function and to provide constructive recommendations for improving State operations. As a result, our reports generally do not address activities we reviewed that are functioning properly.

This report includes findings relating to conditions that we consider to be significant deficiencies 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/or comply with applicable laws, rules, and regulations. Our audit did not disclose any significant instances of

noncompliance with applicable laws, rules, or regulations. A less significant finding was 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

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July 10, 2018

Mr. Thomas J. Barnickel III, CPA  
Legislative Auditor  
Office of Legislative Audits  
301 West Preston Street, Room 1202  
Baltimore, Maryland 21201

Dear Mr. Barnickel:

Following is our response to your report of the audit of the Board of Trustees of the Maryland Teachers and State Employees Supplemental Retirement Plans for the period beginning August 20, 2014 and ending February 11, 2018. We would preface our response with complements to your staff for conducting this examination in a most courteous, professional and constructive manner.

We accept both of the findings in the report and have already implemented the recommended corrective actions, as follows.

First, future contracts for Plans administrator will include requirements for the contractor to obtain annual SOC 2 Type 2 reviews and provide each report to the Board for review and to assess compliance with all critical report recommendations. This is also consistent with current guidance from the Department of Information Technology and the Procurement Unit of the Department of Budget and Management.

Second, we regularly obtain Central Payroll Bureau payroll registers for each pay period and compare each with the Statewide Personnel System payroll summary reports. These reviews are documented and any differences will be reconciled promptly.

Sincerely,

Michael T. Halpin

Copies: T. Eloise Foster, Chairperson, Board of Trustees  
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