

Audit Report

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

January 2023



OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

Joint Audit and Evaluation Committee

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DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Victoria L. Gruber
Executive Director

Gregory A. Hook, CPA
Legislative Auditor

January 5, 2023

Senator Clarence K. Lam, M.D., Senate Chair, Joint Audit and Evaluation Committee
Delegate Mark S. Chang, House Chair, Joint Audit and Evaluation Committee
Members of Joint Audit and Evaluation 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 February 12, 2018 and ending May 15, 2022. 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 did not have sufficient controls over disbursements made from its custodial bank account, which had a balance totaling \$831.5 million as of December 31, 2021. Two employees had the ability to direct the bank to make disbursements from the account without independent review and approval, and MSRP did not verify the propriety of disbursements made from this account on behalf of investment managers. In addition, MSRP did not reconcile its 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.

Finally, our audit also included a review to determine the status of the two findings contained in our preceding audit report. We determined that MSRP satisfactorily addressed one of the findings. The remaining finding is repeated in this report.

MSRP's response to this audit is included as an appendix to this report. We

reviewed the response to our findings and related recommendations, and have concluded that the corrective actions identified are sufficient to address all audit issues.

We wish to acknowledge the cooperation extended to us during the audit by MSRP. We also wish to acknowledge MSRP's willingness to address the audit issues and implement appropriate corrective actions.

Respectfully submitted,

A handwritten signature in black ink that reads "Gregory A. Hook". The signature is written in a cursive style with a clear, legible font.

Gregory A. Hook, 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. Except for Roth contributions, 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. Since Roth contributions to both the 457 and 401(k) plans are made on an after-tax basis, eligible distributions of Roth contributions and any earnings are not 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 August 15, 2019 through August 14, 2024, which could be renewed through August 14, 2025. This agreement also includes 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 2017, 2018, 2019, 2020 and 2021. 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 2021, amounts deferred by employees participating in the Deferred Compensation Plan, the Tax Sheltered Annuity Plan, and the Savings and Investment Plan totaled approximately \$91.9 million, \$2.6 million, and \$95.8 million, respectively. These financial statements further indicate that, as of December 31, 2021, 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 \$2.4 billion, \$131.3 million, \$2.8 billion, and \$257.8 million, respectively.

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of the two findings contained in our preceding audit report dated July 13, 2018. As disclosed in Figure 1 on the following page, we determined that MSRP satisfactorily addressed one of these findings. The remaining finding is repeated in this report.

**Figure 1
Status of Preceding Findings**

Preceding Finding	Finding Description	Implementation Status
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.	Not repeated
Finding 2	Controls had not been established to ensure the propriety of MSRP's payroll.	Repeated (Current Finding 2)

Findings and Recommendations

Custodial Bank Account

Finding 1

The Maryland Supplemental Retirement Plans (MSRP) did not establish sufficient controls over disbursements made from the bank account used to hold certain investments and process related transactions.

Analysis

MSRP did not establish sufficient controls over disbursements made from the bank account used to hold investments and process transactions for the investment contract pool.¹ The account can be accessed by authorized MSRP personnel and third party investment managers who instruct the bank to make specified disbursements, such as for paying bank fees and purchasing investments.

- Two MSRP employees had the ability to direct the bank to make disbursements without independent review and approval. These employees also had the ability to modify bank access, such as granting authority to make disbursement requests.

¹ MSRP provides the Investment Contract Pool as an option for participants with an investment that emphasizes safety through preservation of principal and accrued income.

- MSRP did not verify the propriety of disbursements directed by investment managers who routinely used the account to purchase and redeem investments. MSRP management advised us that it did not perform a review of these disbursements since it relied on the investment managers to perform their fiduciary duty.

As a result of these conditions, improper disbursements could be made from the bank account without timely detection. According to bank records, the market value of the account (investments and cash) totaled \$831.5 million as of December 31, 2021. During calendar year 2021, there were 226 disbursements totaling \$80.0 million from the account.

Recommendation 1

We recommend that MSRP

- a. use available bank records to ensure that all disbursements processed by MSRP and investment managers are subject to independent review and approval, at least on a test basis; and**
- b. remove the ability to modify bank access from employees who routinely process transactions.**

Payroll

Finding 2

MSRP did not ensure payroll payments processed by the State's Central Payroll Bureau (CPB) were consistent with the related MSRP time records and salary information maintained within the Statewide Personnel System (SPS).

Analysis

MSRP did not ensure payroll payments processed by CPB were consistent with the related time records and salary information maintained within SPS. Specifically, MSRP did not obtain payroll register reports from CPB and, consequently, did not reconcile the total biweekly payroll payments from CPB for its employees with total payroll as reflected in the payroll reports generated from SPS. According to the State's records, MSRP's payroll expenditures totaled approximately \$1.3 million during fiscal year 2021.

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. Our review disclosed that MSRP did not obtain the CPB payroll

registers to 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.

The reconciliations are important because certain unique SPS design features often resulted in differences between the CPB and SPS reports. In this regard, we obtained the CPB payroll register for the pay period ending December 28, 2021 and compared it to the SPS payroll summary report and noted that the total payroll reflected in the CPB payroll register (\$36,786) exceeded the SPS payroll summary report total (\$31,583) by \$5,203. MSRP was not aware of the difference, which we were subsequently able to resolve.

A similar condition was commented upon in our preceding audit report. In response to that report, MSRP advised us that they obtained biweekly payroll registers from CPB and reconciled them to the related SPS records, but MSRP further advised that these reconciliations were discontinued in April 2020.

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 (repeat).

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 February 12, 2018 and ending May 15, 2022. 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, purchasing and disbursements, and payroll. We also determined the status of the findings contained in our preceding audit report.

MSRP engaged an independent certified public accounting firm to perform audits of the plans' financial statements for calendar years 2017, 2018, 2019, 2020 and 2021. 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 2018 through 2020. 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.

Our assessment of internal controls was based on agency procedures and controls in place at the time of our fieldwork. Our tests of transactions and other auditing procedures were generally focused on the transactions occurring during our audit period of February 12, 2018 to May 15, 2022, but may include transactions before or after this period as we considered necessary to achieve our audit objectives.

To accomplish our audit objectives, our audit procedures included inquiries of appropriate personnel, inspections of documents and records, tests of transactions, and to the extent practicable, observations of MSRP's operations. Generally, transactions were selected for testing based on auditor judgment, which primarily considers risk, the timing or dollar amount of the transaction, or the significance of the transaction to the area of operation reviewed. As a matter of course, we do not normally use sampling in our tests, so unless otherwise specifically indicated, neither statistical nor non-statistical audit sampling was used to select the transactions tested. Therefore, unless sampling is specifically indicated in a finding, the results from any tests conducted or disclosed by us cannot be used to project those results to the entire population from which the test items were selected.

We also 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). The 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 evaluating certain payroll data. 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. As provided in *Government Auditing Standards*, there are five components of internal control: control environment, risk assessment, control activities, information and communication, and monitoring. Each of the five components, when significant to the audit objectives, and as applicable to MSRP, were considered by us during the course of this audit.

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. 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

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* * *

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December 28, 2022

Mr. Gregory A. Hook, CPA
Legislative Auditor
Department of Legislative Services
Office of Legislative Audits
The Warehouse at Camden Yards
351 West Camden Street, Suite 400
Baltimore, MD 21201

Re: Fiscal Compliance Audit for Period 2/12/2018 through 5/15/2022

Dear Mr. Hook:

In regard to the audit report prepared by the Office of Legislative Audits (“OLA”) for the above-referenced audit of the Maryland Teachers & State Employees Supplemental Retirement Plans (“MSRP”), I submit MSRP’s response.

We appreciate the professional manner in which OLA’s auditors conducted this audit. The agency accepts both findings and has implemented (or will soon implement) the appropriate corrective actions, which are detailed herein.

Finding 1

The MSRP Board of Trustees (the “Board”) has recently approved updated internal audit procedures to ensure that segregation of functions, quarterly internal testing, and compliance reporting are incorporated to ensure that banking transactions are monitored. MSRP audit staff will perform functions consistent with separation of the approval and payment processes and will also ensure that contract compliance is thoroughly documented and reported to the Board on at least an annual basis. MSRP is in the process of reprocurring custodial banking services and intends to fully implement a process consistent with OLA’s recommendation. The contract monitoring responsibilities will be separate from the payment and approval process.

Finding 2

At the conclusion of the audit conducted in 2018, MSRP’s Executive Director submitted the agency’s audit response letter dated July 10, 2018, in which he addressed this initial finding. The letter indicated that the agency had established a regular practice of obtaining Central Payroll Bureau (“CPB”) payroll registers for each pay period and comparing and reconciling them with the payroll summary reports obtained from the Statewide Personnel System (“SPS”). In April of 2020, MSRP’s Executive Director passed away and an Interim Executive Director was appointed and served in this role from April of 2020 until early January of 2021, at which time I was appointed. The documented history indicates that MSRP’s former Executive Director was personally conducting the payroll reconciliations, and the process evidently failed to continue once he passed away. *MSRP notes that this reconciliation process is necessitated by the inability of CPB’s mainframe system to integrate and interface with the SPS Workday system.*

At the beginning of the current audit, this repeat finding was brought to my attention, and I immediately contacted CPB and set up training for two MSRP staff members. System training was completed on 5/17/2022. *Due to delays within the CPB system, MSRP staff was without the ability to begin conducting the regular reconciliations until mid-July of 2022.* Since then, the reconciliations have been completed on a biweekly basis, and this is now a standard MSRP practice that will continue until MSRP is notified that it is no longer necessary.

Very truly yours,

A handwritten signature in blue ink that reads "Ronda B. Bell". The signature is fluid and cursive, with the first letters of each name being capitalized and prominent.

Ronda Butler Bell

Executive Director & Board Secretary

cc: Hon. T. Eloise Foster, MSRP Board Chair
Thomas M. Brandt, Jr., MSRP Audit Committee Chair
Debra L. Roberts, MSRP Deputy Executive Director & CFO

Maryland Teachers and State Employees Supplemental Retirement Plans

Agency Response Form (Audit Period 02/12/2018 – 05/15/2022)

Custodial Bank Account

Finding 1
The Maryland Supplemental Retirement Plans (MSRP) did not establish sufficient controls over disbursements made from the bank account used to hold certain investments and process related transactions.

We recommend that MSRP

- a. use available bank records to ensure that all disbursements processed by MSRP and investment managers are subject to independent review and approval, at least on a test basis; and
- b. remove the ability to modify bank access from employees who routinely process transactions.

Agency Response			
Analysis			
Please provide additional comments as deemed necessary.			
Recommendation 1a	Agree	Estimated Completion Date:	10/31/2022
Please provide details of corrective action or explain disagreement.	The Board has recently approved updated internal audit procedures to ensure that segregation of functions, quarterly internal testing, and compliance reporting are incorporated to ensure that banking transactions are monitored. MSRP audit staff will perform functions consistent with separation of approval and payment processes; and ensure that contract compliance is thoroughly documented and reported to the Board, at least annually.		
Recommendation 1b	Agree	Estimated Completion Date:	1/31/2023
Please provide details of corrective action or explain disagreement.	MSRP is in the process of reprocurring custodial banking services and intends to fully implement a process consistent with the OLA recommendation. The contract monitoring responsibilities will be separate from payment and approval process.		

Maryland Teachers and State Employees Supplemental Retirement Plans

Agency Response Form (Audit Period 02/12/2018 – 05/15/2022)

Payroll

Finding 2
MSRP did not ensure payroll payments processed by the State’s Central Payroll Bureau (CPB) were consistent with the related MSRP time records and salary information maintained within the Statewide Personnel System (SPS).

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 (repeat).

Agency Response			
Analysis			
Please provide additional comments as deemed necessary.	At the conclusion of the audit conducted in 2018, MSRP’s Executive Director submitted the agency’s audit response letter dated July 10, 2018, in which he addressed this initial finding. The letter indicated that the agency had established a regular practice of obtaining Central Payroll Bureau (“CPB”) payroll registers for each pay period and comparing and reconciling them with the payroll summary reports obtained from the Statewide Personnel System (“SPS”). In April of 2020, MSRP’s Executive Director passed away and an Interim Executive Director was appointed and served in this role from April of 2020 until early January of 2021, at which time MSRP’s current Executive Director was appointed. The documented history indicates that MSRP’s former Executive Director was personally conducting the payroll reconciliations, and the process evidently failed to continue once he passed away. <i>MSRP notes that this reconciliation process is necessitated by the inability of CPB’s mainframe system to integrate and interface with the SPS Workday system.</i>		
Recommendation 2	Agree	Estimated Completion Date:	5/17/2022
Please provide details of corrective action or explain disagreement.	At the beginning of the current audit, this repeat finding was brought to the attention of MSRP’s Executive Director, who immediately contacted CPB and set up training for two MSRP staff members. System training was completed on 5/17/2022. <i>Due to delays within the CPB system, MSRP staff was without the ability to begin conducting the regular reconciliations until mid-July of 2022.</i> Since then, the reconciliations have been completed on a biweekly basis, and this is now a standard MSRP practice that will continue until MSRP is notified that it is no longer necessary.		

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