

GOVERNMENT OF GUAM RETIREMENT FUND

Report on Compliance and Internal Control over Financial Reporting
Based on an Audit of Financial Statements Performed in Accordance With
Government Auditing Standards

September 30, 2003 and 2002

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The Board of Directors
Government of Guam Retirement Fund

We have audited the accompanying financial statements of the Government of Guam Retirement Fund (GGRF), as of and for the fiscal years ended September 30, 2003 and 2002, and have issued our report thereon dated August 15, 2004. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the GGRF's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards* which are described in the accompanying schedule of findings as Findings 2002-5 and 2002-10.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the GGRF's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the GGRF's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings as item numbers 2002-7, 2001-15, 2001-17, 2001-20 and 2001-24.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider item 2001-17 to be a material weakness.

This report is intended for the information and use of management and Board of Trustees of the GGRF. However, this report is a matter of public record and its distribution is not limited.

Bryant & Connor, P.C.

Tamuning, Guam

August 15, 2004

CURRENT YEAR FINDINGS

Finding No. 2003-1

Criteria

4GCA, Chapter 8, §8130 states “Refund on Separation. (a) Upon complete separation from service before a member shall have completed at least twenty (20) years of total contributions, including regular interest, but no payment of interest shall be made in any case which total service is less than one (1) year. Total contributions shall include all contributions made by a member to obtain various types of credit authorized by this Chapter...”

4GCA, Chapter 8, §8137 (b) states “...The amount of contributions by the Government shall be determined by applying the applicable percentage rate of contributions as hereinabove prescribed to the total salaries paid to the members during each payroll period, and all such amounts shall be paid into the Fund following the close of each payroll period, concurrently with the contributions made to the Fund by the members. For the purposes of this Section, the term total salaries of members shall be interpreted to include Base Pay, as defined in 4 GCA § 8301 (1), of members participating in the Government Defined Contribution System.”

4GCA, Chapter 8, §8137 (c) states “An amount resulting from the application of a rate equal to the average rate of return on the investment of retirement funds in the preceding fiscal year of total delinquent payments during the period when such payments are delinquent. In addition an amount equal to one percent (1%) per year of delinquent payments shall be paid over to the Fund as penalty for late payment. As used in this Section, delinquent payments means payments due the Fund pursuant to 4 GCA § 8136 and Subsections (a) and (b) of this Section which are not paid over to the Fund within ten (10) working days after the issuance of payroll checks...”

Condition

In our testing of 20 refunds, we found that refunds to members were for the amount of contributions actually remitted to GGRF, plus interest thereon. In 4 of the 20 refunds tested, we noted that amounts had been withheld from the member but not remitted to GGRF. If those contributions had been remitted to the GGRF, the members would have received interest on those amounts. As it stands, some members receiving refunds have not received the full amount to which they otherwise would have been entitled.

Cause

GGRF staff computed interest only on contributions actually received.

Effect

Members may be entitled to larger refunds, and may have a cause of action to pursue.

Recommendation

We recommend that GGRF consult with legal counsel on this issue.

Auditee response/Corrective Action Plan

We do not agree with this finding. The Fund has a policy of not calculating this interest component unless all contributions are received from the agency that employs the member.

PRIOR YEAR FINDINGS BEING REPEATED

Finding 2002-1 Computation of Average Annual Salary

Criteria

In determining a member's annuity, the three highest average annual salaries (AAS) are used. The source documents for determining the average annual salary are not specified or limited to one particular type.

Condition

In most of the 75 files tested, there was a manual computation made by the reviewer. The GGRF's software produces reports showing salaries on a fiscal year basis. GGRF staff preparing the computation must then make a manual computation to determine a member's salary on a calendar-year basis.

Cause

The ability to produce the figures on a calendar-year basis has not been programmed into the system.

Effect

The manual calculations are not as efficient as automated ones would be, and are more prone to errors.

Recommendation

The software should either be modified to allow for an automated computation or other source documents (such as W-2s) could be used to determine average annual salary.

Auditee Response/Corrective Action Plan

We agree with this finding.

The process in determining the average annual salary is dictated by the effective date of retirement. A computation of the gross earnings retrospective from such date should result in a three year highest average income. The individual member contribution statements are the source document used to calculate the average annual salary. W-2 forms are also requested for submission by the member, should it be warranted in order to reconcile any earnings discrepancies. Employees who have opted for Inclusion under the Non-Base Option program have presented challenges in efforts to achieve the actual gross averages. These computations can be a combination of calendar years and/or fiscal year gross income earnings, which represents a 36 month or 3 year highest average annual salary.

The Fund is pursuing the implementation of software programs in which to calculate gross average annual salary income earnings, to reduce or remove errors prone to manual calculations. This process is under the direction of the Member and Benefits Administrator and is expected to be completed in fiscal year 2004.

Finding Update:

The Fund, with the assistance of its software consultant, has completed a working module for the computerized calculation of the “Average Annual Salary” computation. This is expected to be implemented December 1, 2004.

Finding 2002-2 Finalization of Annuity Computations

Criteria

Members who apply for retirement are entitled to an annuity based on average annual salary and years of service. The final annuity must be approved by the Chairman of the Board of Trustees.

Condition

In 17 of the 75 files tested, the final annuity was not determined in some cases for more than one year.

Cause

There appear to be at least four reasons for such delays:

1. Incomplete documentation provided by the member.
2. Delayed follow-up on pending items by the GGRF staff.
3. List of pending items not maintained in file.
4. Lack of personnel at records section

Effect

Retirees are paid an estimated annuity during the time from being initially approved until the final annuity is determined, and retroactive adjustment is made. Ultimately, the proper annuity is paid to the retiree.

Recommendations

- a. A list of incomplete or pending applications should be maintained.
- b. GGRF staff should follow up on pending items regularly and aggressively.
- c. Documentation should be maintained in the respective files to show that GGRF is acting the pending items consistently.

Auditee Response/Corrective Action Plan

We agree with this finding.

The implementation of an estimated annuity was the result of the delays of any and all income transactions or postings of employee and employer contributions towards individual member accounts, and retrieval of source documents from employing agencies that would complete service and annuity finalizations.

The Members and Benefits Administrator is working with the Fund's Quality Assurance Section to review and amend standards and procedures to address the tracking, maintenance, and follow up on pending files for annuity finalizations.

Finding Update:

The Fund in its fiscal year 2005 budget has budgeted for the addition of staff to assist with the annuity finalizations. These positions are expected to be filled by November 30, 2004.

Finding 2002-3 Member Files

Criteria

Files must be maintained for all members and retirees to allow for the proper treatment of contributions and determination of annuities. These files must contain certain documents as required by statute.

Condition

In most of the 75 files tested, we found the files to be disorganized and incomplete.

Cause

The number of files in the storage area is in the thousands. An indexing system was not put in place when the GGRF was created. Accordingly, there is not one standard system for organizing the documents in the files.

Effect

Determination of contributions, years of service, eligibility, beneficiaries, and other important issues is difficult and inefficient.

Recommendation

Member files should be orderly and should include a checklist of the required documents on the front inside cover of the file. The files should be divided into standardized sections, with the same type of documents placed in the same location in every single file.

Auditee Response/Corrective Action Plan

We agree with this finding.

The Members and Benefits Administrator is working with the Fund's Quality Assurance Section to review and amend standards, procedures, and guidelines to address the discrepancies with the current filing systems. A member file index guide is being created to provide organization of the required source documents. Additionally, The Fund has considered the recruitment of employee positions to augment records division.

Finding Update:

The Fund in its fiscal year 2005 budget has budgeted for the addition of staff to assist with the filing and records management of member and annuitant files. These positions are expected to be filled by November 30, 2004.

Finding No. 2002-4 Verification of DC Plan Contributions

Criteria

Article 4 Sections 4.1 (Employee Contributions) and 4.2 (Employer Contributions); indicate that mandatory contributions are to be made at the rates indicated at GCA Section 8208 and 8209, respectively. The rate indicated is 5% in both instances.

Condition

Certain contributions are not being remitted to the plan administrator.

Cause

Participants are not completing enrollment forms in a timely manner.

Effect

At September 30, 2002, more than \$95,000 in unremitted contributions were being held by GGRF. This figure has grown to approximately \$200,000 at September 30, 2003.

Recommendation

Request of all agencies that they require employees to obtain a certification of plan eligibility as well as provide proof of enrollment in the appropriate plan prior to processing the participant's payroll.

Auditee response/Corrective Action Plan

We agree with this finding. However, the Fund has no control over individual employee plan enrollment. We have discussed this with Great-West and they do send correspondence to new employees who fail to enroll. It is up to the individual employee to comply with the mandates of the law. We continue to send out reminder notices to each personnel/human resource department at each respective agency/department to emphasize the importance of the enrollment process.

Finding Update:

The Fund in fiscal year 2004 provided all agency heads with a listing of their employees that have not submitted the proper documentation for enrollment in the Defined Contribution Plan. The Fund maintains these member contributions in a separate interest bearing account and will remit these funds to Great-West upon proper enrollment of the member.

Finding No. 2002-5 Recovery of Fees

Criteria

The recovery or refund of fees previously paid related to the purchase of certain investments should be allocated to the participants.

Condition

Recovered fees are being used to pay the general and administrative charges incurred by the plan administrator.

Cause

Lack of formal guidance in statute or regulation.

Effect

Participants are not being credited with amounts to which they may be entitled.

Recommendation

Adopt regulations addressing the proper treatment of these recoveries. However, until such time GGRF may wish to consider holding any recoveries in a reserve account until appropriate treatment is identified.

Auditee response/Corrective Action Plan

We agree with this finding. The Fund, in fiscal year 2004, is in the process of formulating regulations, potential legislation, and required plan amendments addressing this issue. The Controller, with the assistance of the Investment Specialist, will submit their research to the Investment Committee and their recommendations will be submitted to the Board of Trustees for their review and approval. The Fund will also submit any required draft legislation to the Fund's senate oversight chair for appropriate action.

Finding Update:

The Controller and the Investment Specialist will be presenting the findings of their research to the Investment Committee at their regularly scheduled meeting in November with recommendations that a policy be established by the Board of Trustees formalizing the treatment of these recoveries.

Finding No. 2002-6 Verification of Contributions

Criteria

Payroll/remittance reports should facilitate calculations by GGRF to determine if amounts reported comply with the 5% contribution requirement by both the employee and the agency and the employer's share for the unfunded liability.

Condition

Certain agencies do not provide a breakdown of payroll to indicate what amount represents base pay in comparison to total gross payroll. Certain agencies only report amounts withheld.

Cause

Unknown

Effect

GGRF staff are unable to verify compliance with required withholding amounts.

Recommendation

Request all agencies to provide more detailed payroll/remittance reports.

Auditee response/Corrective Action Plan

We agree with this finding. In fiscal year 2004, the Director will request that agencies provide a detailed breakdown of employee payroll gross totals to verify compliance with statute.

Finding Update:

The Fund in fiscal year 2005 has requested that all agency heads provide the Fund with a detail staff payroll listing in order for the Fund to address this finding.

Finding No. 2002-7 Access to participant Accounts

Criteria

Internal controls should be in place to limit GGRF staff's ability to make changes to participant accounts. Certain changes should only be made by the plan administrator.

Condition

Certain GGRF staff have complete access to participant accounts including the ability to change investment allocations.

Cause

Unknown.

Effect

GGRF could inadvertently make changes to participant investment allocations.

Recommendation

Request plan administrator to implement new access controls which limit GGRF staff access to inquiry only.

Auditee response/Corrective Action Plan

We agree with this finding. In fiscal year 2004 all functions related to the detail processing of the Defined Contribution Plan will be turned over to Great-West Inc.

Finding Update:

In March of 2004, the Fund assigned all functions related to the detail processing of the Defined Contribution Plan members to Great-West Inc.

Finding No. 2002-9 Allocation of Forfeitures

Criteria

Title 4, Chapter VIII, Article 2, Section 8210 provides that non-vested employer contributions be credited to a suspense account in the event of a participant's termination. The suspense account is to be maintained for a period of five years following the termination of the member contemplating a return to employment and reinstatement of the forfeited amount. In the event that the forfeited amount is not reinstated, the amount attributable to such member will be released and used to offset future employer contributions in an amount proportionate to the respective employer's contributions in the preceding five years.

Condition

The plan is in its fifth year of existence. It is uncertain if the mechanism is in place to allocate forfeited amounts to the respective employer's future contributions.

Cause

This issue has yet to be encountered and therefore may not have been addressed.

Effect

Proper allocation of the forfeited amounts may prove difficult.

Recommendation

Ensure mechanism to allocate forfeitures is in place and will operate properly.

Auditee response/Corrective Action Plan

We agree with this finding. The Fund, in fiscal year 2004, is in the process of formulating regulations, potential legislation, and required plan amendments addressing this issue. The Controller, with the assistance of the Investment Specialist, will submit their research to the Investment Committee and their recommendations will be submitted to the Board of Trustees for their review and approval. The Fund will also submit any required draft legislation to the Fund's senate oversight chair for appropriate action.

Finding Update:

The Controller and the Investment Specialist will be presenting the findings of their research to the Investment Committee at their regularly scheduled meeting in November with recommendations for policy implementation in accordance with Title 4, Guam Code Annotated, Chapter 8 § 8210.

Finding No. 2002-10 Use of Forfeitures to Pay Administrative Expenses

Criteria

Section 8210(e) of Article 2, Chapter 4 as amended indicates that forfeitures released from the suspense account shall be first applied to the payment of the plan's administrative expenses as allowed by Section 8217. Section 8217(a) allows the Board of Trustees to assess the plan participants up to two percent (2%) of member and employer contributions as a reimbursement of administrative expenses. Furthermore, Section 8217(c) was added to Article 2, Chapter 8 of Title 4 to indicate that for fiscal years beginning after October 2001 and thereafter, the Board of Trustees may use the forfeitures to offset administrative charges and fees allowed under this section.

Condition

Subsequent to year-end, forfeitures were used to offset administrative expenses. The only fees and charges allowed under Section 8217 are those that are charged to the participants. Since there was no charge to the participants in fiscal year 2002, it may not be appropriate to use these amounts to offset administrative expenses.

Cause

We believe the intent of the enacted legislation was to allow the GGRF to recover administrative expenses. We believe that the wording of the legislation does not clearly convey the intent.

Effect

General and administrative expenses may be understated.

Recommendation

If the intent of the legislation was to allow the fund to offset general and administrative expenses without first having to charge the participants, then it may be necessary to amend the legislation. Until this is clarified, GGRF may wish to consider holding any released forfeitures in a reserve account until appropriate treatment is identified.

Auditee response/Corrective Action Plan

We agree with this finding. The Fund, in fiscal year 2004, is in the process of formulating regulations, potential legislation, and required plan amendments addressing this issue. The Controller, with the assistance of the Investment Specialist, will submit their research to the Investment Committee and their recommendations will be submitted to the Board of Trustees for their review and approval. The Fund will also submit any required draft legislation to the Fund's senate oversight chair for appropriate action.

Finding Update:

The Controller and the Investment Specialist will be presenting the findings of their research to the Investment Committee at their regularly scheduled meeting in November with recommendations that a policy be established by the Board of Trustees formalizing the treatment of forfeitures.

Finding No. 2001-15 - Property and Equipment

Criteria

Items of property and equipment must be properly identified, accounted for and protected to minimize the possibility of physical loss.

Condition

Although there are identification tags on items of property and equipment and there is a fixed subsidiary ledger, there is no periodic physical inventory conducted for items of property and equipment.

Cause

Lack of oversight of the internal control function.

Effect

Items of property and equipment could be removed from the GGRF's office without timely detection.

Recommendation

GGRF should conduct a periodic physical inventory of items of property and equipment. The physical inventory should be reconciled to the subsidiary ledger.

Prior Year Status

This finding was reported in fiscal year 2000 as Finding 2000-14.

Auditee response/Corrective Action Plan

We agree with this audit finding.

We will be conducting a physical inventory on all Fund property and equipment to be reconciled with subsidiary ledger. This will be completed by the end of fiscal year 2003.

Finding Update:

The physical inventory was completed in June 2003 and adjustments made accordingly to the subsidiary ledger.

Finding No. 2001-17 – DC Plan General Ledger Details

Criteria

General ledger accounts should be routinely reconciled.

Condition

With the exception of cash, earnings, change in value and administrative fees, virtually all general ledger accounts are not routinely reconciled to underlying records and source documents.

Cause

Lack of formal accounting policies and procedures.

Effect

Financial reporting can become unreliable.

Recommendation

Establish formal accounting policies that include the reconciliation of significant general ledger accounts.

Prior Year Status

This finding was reported in fiscal year 2000 and 1999 as Finding 1999-6.

Auditee response/Corrective Action Plan

We agree with this finding.

Monthly/Quarterly reconciliations are being performed to tie transactions per G/L to FASCORP statements.

Finding Update:

Procedures are still being developed to address this finding. In fiscal year 2005 the Fund has budgeted for additional staff in the Accounting & Investment Division to assist in the operations of the division.

Finding No. 2001-20 Verification of Annuitants

Criteria

Benefit payments should be made only to those entitled to receive benefits.

Condition

GGRF does not have procedures in place to identify persons no longer entitled to receive benefits.

Cause

There is no policies and procedures manual.

Effect

GGRF has overpaid retirees and their beneficiaries. In one case, the overpayment exceeded \$100,000.

Recommendation

We have two recommendations. First, GGRF should send confirmation letters to all off-island retirees or beneficiaries once a year to determine if they are alive. The confirmation letters should give the recipients adequate time to respond, with the penalty for non-response being the withholding of annuity checks.

Second, GGRF personnel should randomly select canceled checks throughout the year to compare the signature on the back of the check with signatures in the GGRF's files.

Prior Year Status

This finding was reported in fiscal year 2000 and 1999 as Finding 1999-16.

Auditee response/Corrective Action Plan

We agree with this finding.

We agree with both procedures and recommendations.

In addition to the recommendations provided by the auditor, we are awaiting for the authorization to use the Social Security Index. This service will provide information on individuals who may have expired on the date of inquiry. Upon use of authorization of the SS Index, we will create policy and procedures to address this finding.

Finding Update:

In August 2003, the Fund sent out personal information update forms to all annuitants to properly update their files and to identify those individuals that are entitled to receive retirement annuities. This will also be performed in November 2004.

Finding No. 2001-24 Required Vacations

Criteria

Mandatory vacations should be required for individuals in key control positions.

Condition

The Government of Guam Retirement Fund does not require employees to take vacations or to have other employees assume the vacationing employee's duties while on vacation.

Cause

GGRF were not aware of this internal control feature.

Effect

This situation creates the possibility that a dishonest employee could perpetrate a fraud and may be able to conceal the fraud.

Recommendation

Mandatory vacations should be implemented for individuals in key control positions. While a person is on vacation, a different employee who has been cross-trained to perform those functions should perform the vacationing person's job functions.

Prior Year Status

This finding was reported in fiscal year 2000 and 1999 as Finding 1999-21.

Auditee response/Corrective Action Plan

We agree with this finding.

There is no policy in place that requires staff to take leave if they do not wish to. Management will henceforth require the scheduling of leave, dependent on the availability of hours and individual employee might have for leave taking.

Finding Update:

Effective October 1, 2004, a formal leave plan schedule was implemented by the GGRF Director.