

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

Years ended September 30, 2005 and 2004

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The Board of Trustees
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, 2005 and 2004, and have issued our report thereon dated April 20, 2006. 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 2004-1, 2002-5 and 2002-10.

We also noted certain additional matters that we reported to the Board of Trustees of GGRF in a separate letter dated April 20, 2006.

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 number 2001-17.

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 the audit committee, management and the Board of Trustees of the GGRF. However, this report is a matter of public record and its distribution is not limited.

Bryant & Conner, P.C.

Tamuning, Guam
April 20, 2006

CURRENT YEAR FINDINGS

Finding 2005-1 Bank Reconciliations

Criteria

Bank reconciliations should be performed in a timely manner.

Condition

GGRF staff did not prepare regular monthly reconciliations for the DB plan retiree payroll bank account.

Cause

This condition occurred as a result of the resignation of the individual tasked with the responsibility of ensuring that the reconciliations are completed in a timely manner.

Effect

Possible misstatement of cash balance, susceptibility to fraud.

Recommendation

Management of GGRF should ensure that bank reconciliations are performed in a timely manner, and are reviewed by a person other than the preparer.

Auditee Response/Corrective Action Plan - 2005

Management concurs with this finding.

Due to the resignation of various employees within the Accounting Department, GGRF did not have sufficient staff to ensure timely completion of the bank reconciliations.

The Acting Director has tasked the Controller with the responsibility of ensuring that the reconciliations are performed in a timely manner.

PRIOR YEAR FINDINGS BEING REPEATED

Finding No. 2004-1 Disability Medical Exams

Criteria

4GCA, Chapter 8, §8127(a) states “At least once each year during the first five (5) years following the allowance of a disability annuity to any member, and at least once in every three (3) year period thereafter, the Board of Trustees shall require any disability annuitant to undergo a medical examination to be made by a place mutually agreed upon, by a physician or physicians engaged by the Board...”

Condition

In two of five disability retiree files tested, there is no indication that the retirees obtained the required medical examinations.

Cause

Lack of enforcement.

Effect

We can not determine whether these disability annuitants remain qualified to receive their annuities. We can not determine whether these annuitants are able to return to gainful employment.

Recommendation

Management of GGRF should enforce compliance with Guam statutes and should perform regular reviews of disability annuitant files to ensure that the required medical examinations are being conducted.

Audit Response/Corrective Action Plan - 2004

We agree with this finding.

The finding is a result of a backlog of documents to be filed into respective individual records. The Records Division is staffed with one (1) clerk supervisor. GGRF is in the process of recruitment of additional clerical staff to address these shortcomings. These positions are expected to be filled prior to the end of fiscal year 2005.

Finding No. 2004-1 Disability Medical Exams, continued

Auditee Response/Corrective Action Plan – Update for 2005

Management has taken an active role to address this finding, which was identified during the 2004 audit.

Currently, the required medical examination forms for 2004 to present have been filed in the respective member folders. In addition, as of May 2006, Management has offered an applicant the position of Clerk II under the priority placement program and is currently awaiting a response from the applicant. Management is also in the process of recruiting a Clerk I and Clerk III. These positions are expected to be filled by June 30, 2006.

The Acting Director has tasked the Benefits Services Division Administrator with the responsibility of ensuring that medical examination forms for prior years are located and filed in the respective member folders. The recruitment/filling of the clerk positions will facilitate the completion of this task.

Finding No. 2004-3 ERIP Credit Life Insurance

Criteria

4GCA, Chapter 8, § authorizes GGRF to obtain quotes for credit life insurance to protect against the risk that annuitants will pass away before repaying their obligations under the early retirement incentive program (ERIP). The cost of this insurance to GGRF would be the same amount that is provided to all Government of Guam employees under its group term life insurance program. ERIP participants were allowed to purchase up to five years of service, and to pay for these purchases over a period not to exceed fifteen years.

Condition

GGRF has not purchased credit life insurance to cover the ERIP notes. Some of the annuitants have passed away without repaying their notes. GGRF is unable to collect the balance owed by these annuitants, and has obtained a legal opinion that they cannot seek repayment from the annuitants' survivors.

Cause

At the time the ERIP came into existence, management evaluated the cost of obtaining credit life insurance and determined that the cost was prohibitive.

Effect

For the year ended September 30, 2004 GGRF wrote-off more than \$319,000 in uncollectible notes receivable. The financial impact is far greater than \$319,000, as the annuities were calculated using the additional years of service being purchased under the ERIP. Even if the ERIP notes are not fully collected by GGRF, the amount of the annuity is not changed. The survivor will collect the higher annuity until the survivor passes away. Further, since GGRF will not collect the entire amount due under the note, GGRF is not able to put those funds to use to produce investment returns.

Recommendation

We believe that current management should evaluate the cost of purchasing credit life insurance, and compare this cost to the potential exposure created by paying higher annuities through the life expectancy of the survivors.

Management should determine whether they can legally require the survivors to continue paying for the ERIP notes. As an alternative, management should determine whether they can legally reduce the calculated annuity due to the non-payment for the years of service purchased.

Finding No. 2004-3 ERIP Credit Life Insurance, continued

Auditee Response/Corrective Action Plan - 2004

We agree with this finding.

The Fund was authorized via statute to obtain credit life insurance for participants in this program; however, this was not performed. The Controller has been tasked with developing a viable solution for this finding. He will work with Fund legal counsel to develop legal remedies. This is expected to be completed during fiscal year 2005.

Auditee Response/Corrective Action Plan – Update for 2005

The GGRF Board has opted to establish a reserve for self-insurance. By opting for self-insurance an amount equal to what the Fund would have had to pay toward premiums will be placed in a reserve account. As such, the 2006 budget includes \$139,200 for self-insurance, which will be reflected in the September 30, 2006 financial statements.

Management opted for self-insurance because it did not obtain the required insurance when the ERIP notes were entered into, it cannot legally require survivors to continue paying for the ERIP notes, and it cannot legally reduce the calculated annuity due to the non-payment for the years of service purchased.

For the fiscal year ended September 30, 2005, the Fund wrote-off approximately \$94,000 in uncollectible notes receivable due to the death of annuitants. If the reserve was initially set up in 2000 the Fund would not have had to write off any of the notes, but instead charge them against the reserve. In addition, even if funds were set aside now, absent any interest that would have been generated on the reserve account, the reserve account would still be in the black.

The Acting Director has tasked the Controller with the responsibility of ensuring that the self-insurance account is established and appropriately reflected in the September 30, 2006 financial statements.

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 for the DB plan during the fiscal year 2002 audit, 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:

- Incomplete documentation provided by the member.
- Delayed follow-up on pending items by the GGRF staff.
- List of pending items not maintained in file.
- 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 on the pending items consistently.

Auditee Response/Corrective Action Plan - 2004

We agree with this finding.

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 before the end of fiscal year 2005. As previously noted, the implementation of an estimated annuity was the result of delays of any and all income transactions or posting of employee and employer contributions towards individual member accounts, and retrieval of source documents from employing agencies that would complete service and annuity finalizations. We continued to work with all Agencies for the timely receipt of contribution information and contribution receipts, however, the Fund is subject to delays from the members employing agency in the retirement process.

Finding 2002-2 Finalization of Annuity Computations, continued

Auditee Response/Corrective Action Plan – Update for 2005

Management has taken an active role to address this finding, which was identified during the 2002 audit.

The Benefits Services Division has aggressively reduced the number of files pending annuity finalization from 580 in 2004 to 110 as of May 2006, while simultaneously processing new retiree annuities. The delays in finalizing individual annuities are attributed to discrepancies/inconsistencies identified in the validation of employee/employer contributions reported by the respective Agencies. The discrepancies and inconsistencies include:

- Missing retirement contribution deductions for various payperiods.
- Inclusion of Non-Base Income requiring the need to obtain a payroll summary in order to itemize excessive gross payment and determine the actual annual gross salary.
- Failure of the Agencies to remit to the Fund the appropriate percentage rate of employee/employer contributions.
- Untimely response to the Fund's request for information and or payment from the employing agency.

The Acting Director has tasked the Benefits Services Division Administrator with the task of ensuring that continued due diligence is taken to ensure that annuities pending finalization are followed-up and finalized in a timely manner.

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 – 2004

We agree with this finding.

The Controller and the Investment Specialist have completed their research and will be presenting the findings to the Investment Committee at their regularly scheduled meeting in August 2005 with recommendations that a policy be established by the Board of Trustees formalizing the treatment of these recoveries.

Finding No. 2002-5 Recovery of Fees, continued

Auditee Response/Corrective Action Plan – Update for 2005

It was the position of the prior Board of Trustees, that recovery of fees would be used to offset administrative expenses incurred. Under 4GCA Article 2 Section 8217 Administrative Fees, the Board was allowed to charge both employee and employer accounts a percentage of contributions. In addition, in order to reduce the impact to the initial membership accounts, the Board negotiated with the Plan Administrator for an increase in the percentage of the rebated amount charged by participating mutual funds.

Finding No. 2002-9 Allocation of Forfeitures

Criteria

Title 4, Chapter 8, 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 ninth 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 – 2004

We agree with this finding.

The Controller and the Investment Specialist have completed their research and will be submitting their findings to the Investment Committee at their regularly scheduled meeting in August 2005 with recommendations for policy implementation in accordance with Title 4, Guam Code Annotated, Chapter 8 § 8210 to the Board of Trustees.

Finding No. 2002-9 Allocation of Forfeitures, continued

Auditee Response/Corrective Action Plan – Update for 2005

As discussed in Finding 2002-10, the Legislature is currently hearing Bill 293 which will clarify the expenditure of forfeitures for startup cost and administrative cost. The mechanism to allocate the remaining balance of forfeitures is addressed in 4GCA Article 2 Section 8210.

The Acting Director has tasked the Controller with the responsibility of ensuring that forfeited amounts are properly allocated to the respective employer's future contributions in accordance with Title 4, Chapter 8, Article 2, Section 8210.

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

Criteria

Section 8210(e) of Article 2, Chapter 8 of Title 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 - 2004

We agree with this finding.

The Controller and the Investment Specialist have completed their research and will be submitting their findings to the Investment Committee at their regularly scheduled meeting in August 2005 with recommendations for policy implementation in accordance with Title 4, Guam Code Annotated, Chapter 8 § 8210 to the Board of Trustees.

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

Auditee Response/Corrective Action Plan – Update for 2005

It was reported out, by Controller, in the Investment Committee Meeting of January 7, 2005, the need for authorization to use the forfeiture money to repay start-up costs and administrative cost; and after that the allocation of the forfeitures. As such, the Board of Trustees at its Regular Meeting of January 14, 2005 voted to authorize the reimbursement of Defined Benefit start-up costs and administrative fees to the Defined Benefit Plan from the Defined Contribution Plan forfeitures.

In addition, on May 3, 2006, a legislative hearing was held to receive both oral and written testimony on Bill 293, which was drafted in order to clarify the Boards authority to offset administrative expenses against forfeitures. This Bill is pending approval by the Guam Legislature.

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 and in fiscal years 2001-2004 as Finding 2001-17.

Auditee Response/Corrective Action Plan - 2004

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.

Auditee Response/Corrective Action Plan – Update for 2005

Management of GGRF concurs with this finding, which resulted from the lack of formal accounting policies and procedures.

The Acting Director has tasked the Controller with the responsibility of ensuring that formal accounting policies and procedures are established to ensure that reconciliations are performed timely, on a monthly basis and are reviewed by an individual other than the preparer.