

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

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, 1999 and 1998, and have issued our report thereon dated August 17, 2001. 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 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 1 and 2.

Internal Control Over Financial Reporting

In planning and performing our audits, 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 3 to 21.

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 items 3 through 7 to be material weaknesses.

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.

Tamuning, Guam
August 17, 2001

GOVERNMENT OF GUAM
RETIREMENT FUND
(A Public Corporation)

Schedule of Findings

September 30, 1999 and 1998

Finding No. 1 –Dual Participation

Criteria

Title 4, Chapter VIII, Article 1, §8206, Subsection (c) of the Guam Code Annotated states that, beginning October 1, 1995, the Government of Guam Defined Contribution Retirement System shall be the single retirement program for all new employees whose employment commences on or after that date. No additional new employees may be admitted to the existing defined benefit retirement system.

Condition

In one of the sixty files tested, we noted one person who retired under the defined benefit system, was elected to an official position, and became a participant in the defined contribution system.

Cause

We cannot determine the cause of this condition.

Effect

This practice will result in additional costs to the Government of Guam.

Recommendation

We recommend that Fund personnel obtain a legal opinion as to the propriety of this action.

Prior Year Status

As the reports on compliance and internal control for 1998 and 1999 are being issued concurrently, all 1998 findings are being repeated in 1999.

Auditee Response/Corrective Action Plan

Not received as of the date of release of the report.

Finding No. 2 – Quarterly Withholding Returns

Criteria

Employers are required to file quarterly withholding tax returns by the end of the month following the end of each calendar quarter.

Condition

Quarterly withholding tax returns were not being filed for several years. The quarterly withholding tax returns for fiscal year 1998 were filed in December 2000.

Cause

The responsibility for filing these returns was not clearly assigned to any one individual at the GGRF.

Effect

Failure to file required returns can lead to penalties and interest.

Recommendation

We recommend that one person act as a compliance monitor for all required filings relating to payroll and annuities. There should be a person designated as a backup in case the primary compliance monitor is unable to fulfill the requirements for whatever reason.

Prior Year Status

As the reports on compliance and internal control for 1998 and 1999 are being issued concurrently, all 1998 findings are being repeated in 1999.

Auditee response and corrective action plan

Not received as of the date of release of the report.

Finding No. 3 – Purchased Service Credits

Criteria

Title 4, Chapter VI, Article 1, §8140, Subsection (c) of the Guam Code Annotated states that service credits can be purchased over a period not to exceed five years, upon receipt of a proper application. The payment plan will be supported by a promissory note and will bear interest until final payment is made. Payments can be made through payroll deduction. The member also has the option of making full payment.

Condition

We reviewed the list of active participants with promissory notes, and we could not determine that proper payroll deductions are being made. A subsidiary ledger of promissory note balances is maintained, but was not recorded in the general ledger.

Cause

The cause appears to be a lack of resources in the accounting department.

Effect

An adjusting entry was proposed to place the promissory note balance on the statement of net assets.

Recommendation

The subsidiary ledger of promissory notes receivable should be reconciled with the general ledger balance on a monthly basis.

Prior Year Status

As the reports on compliance and internal control for 1998 and 1999 are being issued concurrently, all 1998 findings are being repeated in 1999.

Auditee Response and Corrective Action Plan

The adjusting entry will be posted and subsidiary ledgers will be reconciled monthly to the general ledger.

Finding No. 4 – Service Credit Overpayments

Criteria

Title 4, Chapter VI, Article 1, §6.1, Subsection (c) of the Guam Code Annotated states that if a member makes an overpayment for service credits, the member shall be reimbursed for the overpayment within 30 days or recalculation. A statement indicating full payment shall be provided to such member.

Condition

The list of active participants with promissory notes for service credits contains several credit balances, indicating overpayments. We cannot determine if these overpayments were liquidated within the mandated time frame.

Cause

This condition results from not reconciling the subsidiary ledger with the general ledger. The non-reconciliation results from a lack of staffing in the accounting department.

Effect

An adjustment entry was proposed to correct the promissory note balance.

Recommendation

We recommend that accounting department duties be shifted so that one person is assigned responsibility for reconciling the promissory notes with the general ledger.

Prior Year Status

As the reports on compliance and internal control for 1998 and 1999 are being issued concurrently, all 1998 findings are being repeated in 1999.

Auditee Response and Corrective Action Plan

Not received as of the date of release of the report.

Finding No. 5 – DC Plan Contribution Rate

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

We noted an agency that used a rate in excess of 5%. This departure from the statute was not detected by the agency or the fund.

Cause

Lack of a procedure to check the contribution rates.

Effect

Excess deferrals and contributions have been made on behalf of the employees of this agency.

Recommendation

Implement control totals for wages, deferrals and agency unfunded liability contributions prior to processing the agency reports. Use simple mathematical tests to determine if the amounts appearing in the reports comply with the statute.

Prior Year Status

As the reports on compliance and internal control for 1998 and 1999 are being issued concurrently, all 1998 findings are being repeated in 1999.

Auditee Response and Corrective Action Plan

Not received as of the date of release of the report.

Finding No. 6 – 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 becomes unreliable.

Recommendation

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

Prior Year Status

As the reports on compliance and internal control for 1998 and 1999 are being issued concurrently, all 1998 findings are being repeated in 1999.

Auditee Response and Corrective Action Plan

Not received as of the date of release of the report.

Finding No. 7 – DC Plan Cash Accounts

Criteria

All cash in GGRF DC accounts, with the exception of interest income net of bank charges, are held in trust.

Condition

Records are not maintained in a manner that makes it easy to determine for whom cash balances are maintained at any given time.

Cause

Unknown

Effect

Funds may be disbursed in a manner inconsistent with the intended purpose or may not be disbursed at all.

Recommendation

There should be an internal audit of cash balances to determine if any funds have been incorrectly remitted or not remitted at all.

Prior Year Status

As the reports on compliance and internal control for 1998 and 1999 are being issued concurrently, all 1998 findings are being repeated in 1999.

Auditee Response and Corrective Action Plan

Not received as of the date of release of the report.

Finding No. 8 – Annuity Worksheet

Criteria

Title 4, Chapter 8, Article 1, §8140, subsection (c) of the Guam Code Annotated states that the Chairman of the Board of Trustees shall be in charge of the administration of the detailed affairs of the Fund. The Chairman shall keep all books, records, files and accounts of the Fund and receive all applications for annuities, benefits and refunds. This includes signing final annuity worksheets. The annuity worksheet includes a space for the Chairman to record his signature.

Condition

In 37 of 60 files of retirees tested, the Chairman did not sign the annuity worksheets.

Cause

The Fund makes a provisional calculation of the annuity in order to commence the annuity in a timely manner. The provisional calculation is usually reviewed and approved some time later. The lack of a signature on the files tested was an oversight.

Effect

Without the Chairman's review and signing of the form, there is a possibility that annuities could be unauthorized or improperly calculated.

Recommendation

The Chairman should sign all annuity worksheets or the Board should consider assigning final review of the worksheets to another individual.

Prior Year Status

As the reports on compliance and internal control for 1998 and 1999 are being issued concurrently, all 1998 findings are being repeated in 1999.

Auditee Response and Corrective Action Plan

Not received as of the date of release of the report.

Finding No. 9 – Service Credit

Criteria

Title 4, Chapter 3, Article 1, §.8114 Subsection (c) of the Guam Code Annotated states that in computing credited service, twelve or more days of service in any month shall constitute a month of service, service between six and twelve days during any month shall constitute one-half month of service. Service of less than six days during any month shall be disregarded. Not more than one month of service shall be creditable on account of service rendered during any month and not more than one year service shall be creditable on account of service rendered during any year.

Condition

In three of the sixty files tested, the service factor used was not properly calculated based on the formula.

Cause

This condition appears to be the result of not having a standard formula in the system that is capable of applying the basic formula to the service history. The calculations are presently done manually.

Effect

The final computation of annuities may not be correct.

Recommendation

The system should be programmed so that mathematical errors in annuity computations are eliminated. There should be a documented review of the annuity calculation by a supervisory level person.

Prior Year Status

As the reports on compliance and internal control for 1998 and 1999 are being issued concurrently, all 1998 findings are being repeated in 1999.

Auditee Response and Corrective Action Plan

Not received as of the date of release of the report.

Finding No. 10 – File Checklist and Documentation

Criteria

The Fund adopted policies and procedures that require a checklist to be completed for each new retiree and maintained in the retiree's file.

Condition

In our testing of sixty retiree files, we noted 4 instances where beneficiary designations were not properly notarized. We also noted 24 instances where individual contribution ledgers are not on file.

Cause

This condition seems to be caused by a reduction in staffing in the records section. There is only one person involved in filing and accessing more than five thousand retiree files.

Effect

There can be several effects from this condition, including disputes as to proper beneficiaries, calculation of annuities, and date of retirement.

Recommendation

The records section staffing should be increased. There may be opportunities to shift responsibilities of staff in other sections so they can take partial responsibility for the records section.

Prior Year Status

As the reports on compliance and internal control for 1998 and 1999 are being issued concurrently, all 1998 findings are being repeated in 1999.

Auditee Response and Corrective Action Plan

Not received as of the date of release of the report.

Finding No. 11 – Annuity and Gross Pay Computations

Criteria

Source documents should contain sufficient information to allow for proper summarization, recording in the books of original entry, and presentation in the financial statements.

Condition

In one of the sixty retiree files tested, the annuity worksheet shows a calculated amount that differs from the amount actually being paid to the retiree.

Cause

The subsidiary ledgers maintained by the benefits section are not reconciled to the general ledger maintained by the accounting department.

Effect

We are unable to determine that the total amount reflected as annuities is accurate.

Recommendation

The annuity disbursements should be summarized and reconciled to the general ledger on a monthly basis.

Prior Year Status

As the reports on compliance and internal control for 1998 and 1999 are being issued concurrently, all 1998 findings are being repeated in 1999.

Auditee Response and Corrective Action Plan

Not received as of the date of release of the report.

Finding No. 12 – Remittance of Contributions

Criteria

Established accounting policies and procedures should be in place to provide reasonable assurance that transactions are properly summarized and recorded.

Condition

GGRF transmitted contributions for a single payroll period twice.

Cause

Lack of adequate internal controls.

Effect

Participants have been credited with contributions for which they were not entitled.

Recommendation

Have the plan administrator install program controls that will “flag” multiple contributions for the same pay period for a participant and generate a report identifying this condition. These unusual postings can then be investigated and verified.

Include amounts and dates on the contribution transmittal log and reconcile these amounts to the contributions reflected in the reports issued by the plan administrator.

Article 4 Section 4.7 provides the fund with the authority to make the required adjustments.

Prior Year Status

As the reports on compliance and internal control for 1998 and 1999 are being issued concurrently, all 1998 findings are being repeated in 1999.

Auditee Response and Corrective Action Plan

Not received as of the date of release of the report.

Finding No. 13 – Remittance of Contributions

Criteria

Article 4 Section 4.5 indicates that contributions shall be paid in cash to the Fund within five working days of the payroll issuance date for the salary related to such contributions. Failure to make timely payments by any employer shall cause the Board to invoke the penalties and conditions of GCA Section 8209.

Condition

Contributions were remitted in excess of three months after the payroll period end date.

Cause

The remittance from the agency was delayed in certain instances.

Effect

There is the potential for lost earnings on participant contributions.

Recommendation

In the event that GGRF is responsible for a delay in remitting contributions, the plan document could include a provision to impose a penalty. These amounts could then be allocated to the respective participants to offset potential lost income.

Prior Year Status

As the reports on compliance and internal control for 1998 and 1999 are being issued concurrently, all 1998 findings are being repeated in 1999.

Auditee Response and Corrective Action Plan

Not received as of the date of release of the report.

Finding No. 14 – Investment Transfers

Criteria

Transfers between investment options should have no effect on total investments reflected in the plan summary.

Condition

Amounts reflected as transfers in and out (between investment options) in the investment grand totals report prepared by the plan administrator were not equal amounts.

Cause

Unknown

Effect

Investment balances may be misstated.

Recommendation

Obtain clarification from the plan administrator on this issue.

Prior Year Status

As the reports on compliance and internal control for 1998 and 1999 are being issued concurrently, all 1998 findings are being repeated in 1999.

Auditee Response and Corrective Action Plan

Not received as of the date of release of the report.

Finding No. 15 – Forfeiture Reconciliation

Criteria

The investment grand total report and the forfeiture account summary, both prepared by the plan administrator, are designed so that forfeiture amounts on these two documents will be equal in amount.

Condition

Forfeitures per the investment grand totals report and the forfeiture account summary, as prepared by the plan administrator, did not reflect the same amounts.

Cause

Unknown

Effect

Investment balances may be misstated.

Recommendation

Obtain clarification from the plan administrator on this issue.

Prior Year Status

As the reports on compliance and internal control for 1998 and 1999 are being issued concurrently, all 1998 findings are being repeated in 1999.

Auditee Response and Corrective Action Plan

Not received as of the date of release of the report.

Finding No. 16 – 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 a penalty for non-response of withholding the 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

As the reports on compliance and internal control for 1998 and 1999 are being issued concurrently, all 1998 findings are being repeated in 1999.

Auditee response and corrective action plan

Not received as of the date of release of the report.

Finding No. 17 – Segregation of Duties

Criteria

An organization should ensure that there is a proper segregation of duties regarding cash receipts. Cash receipts should be accurately recorded.

Condition

All incoming mail goes to the director's office. A list of cash received is prepared and then forwarded to the accounting department for preparation of a cash receipt, deposit slip and for delivery to the bank. The list prepared in the director's office is not compared with the cash receipts or deposit slip after the deposit has been made.

Cause

Unknown.

Effect

There is a possibility that not all cash (checks) received in the mail actually make it to the bank.

Recommendation

The current procedures should not be changed. There should be one procedure added; however, and that would be for the person preparing the initial list to later compare the list to the cash receipts and to the deposit slip.

Prior Year Status

As the reports on compliance and internal control for 1998 and 1999 are being issued concurrently, all 1998 findings are being repeated in 1999.

Auditee response and corrective action plan

Not received as of the date of release of the report.

Finding No. 18 – Reconciliation of Plan Balances

Criteria

Transactions should be summarized, recorded and processed properly and accurately.

Condition

When GGRF decided to split out the general ledger for the defined contribution plan, an unreconciled difference arose. This unreconciled difference was \$435,727 at September 30, 1998.

Cause

When the defined contribution plan began, transactions in the general ledger were not properly identified as defined contribution transactions.

Effect

This unreconciled difference causes the audit opinion to be qualified.

Recommendation

We believe that there is sufficient information on file to determine the cause of the unreconciled difference and to record the proper adjustments needed. It is only a matter of committing the resources at the GGRF to the project.

Prior Year Status

As the reports on compliance and internal control for 1998 and 1999 are being issued concurrently, all 1998 findings are being repeated in 1999.

Auditee response and corrective action plan

Not received as of the date of release of the report.

Finding No. 19 – Collectibility of Receivables

Criteria

Financial statement balances for accounts receivable should reflect the amount considered collectible. Accounts receivable should be properly and accurately recorded.

Condition

There are several general ledger receivable accounts for which detailed subsidiary ledgers are not available. Further, GGRF has not evaluated the collectibility of its receivables or established an allowance for doubtful receivables.

Cause

Unknown.

Effect

Financial statement balances for receivables were overstated. An adjustment was proposed to establish an allowance of more than \$8 million.

Recommendation

Receivables should be evaluated periodically for collectibility. Receivables not considered collectible should either be written off or covered by an allowance for doubtful accounts. Subsidiary ledgers should support general ledger receivable accounts.

Prior Year Status

As the reports on compliance and internal control for 1998 and 1999 are being issued concurrently, all 1998 findings are being repeated in 1999.

Auditee response and corrective action plan

Not received as of the date of release of the report.

Finding No. 20 – Depreciation expense

Criteria

Depreciation of items of property and equipment should be recorded in a systematic and rational manner over the useful lives of the items.

Condition

GGRF utilizes the straight-line method to record depreciation. In practice, GGRF depreciates acquisitions using the straight-line method in the year of acquisition. The remaining book value is then depreciated straight-line over the remaining number of full years. This results in items being depreciated over less than the full useful life.

As an example, a five year property purchased on June 1 will be depreciated for four months in that fiscal year, using a sixty month life. In the next fiscal year, the book value is divided by four. In the second fiscal year, the book value is divided by three, and so on. This asset would then be fully depreciated four years and four months after acquisition.

Cause

Unknown

Effect

Depreciation expense and accumulated depreciation are overstated prior to the end of an item's useful life.

Recommendation

We recommend that depreciation expense be recorded using a simple straight-line method based on the number of months of useful life.

Prior Year Status

As the reports on compliance and internal control for 1998 and 1999 are being issued concurrently, all 1998 findings are being repeated in 1999.

Auditee response and corrective action plan

Not received as of the date of release of the report.

Finding No. 21 – 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 staff 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 his or her job functions.

Prior Year Status

As the reports on compliance and internal control for 1998 and 1999 are being issued concurrently, all 1998 findings are being repeated in 1999.

Auditee response and corrective action plan

Not received as of the date of release of the report.