



**U.S. Department of the Interior
Office of Inspector General**

AUDIT REPORT

**GOVERNMENT EMPLOYEES
RETIREMENT SYSTEM,
GOVERNMENT OF THE VIRGIN ISLANDS**

**REPORT NO. 99-I-261
MARCH 1999**



United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

MAR 26 1999

Ms. Corine King
Chairperson, Board of Trustees
Government Employees Retirement System
No. 48C-50C Kronprindsens Gade
Charlotte Amalie, Virgin Islands 00802

Subject: Audit Report on the Government Employees Retirement System, Government of the Virgin Islands (No. 99-I-261)

Dear Ms. King:

This report presents the results of our audit of the Government Employees Retirement System, Government of the Virgin Islands. The objective of the review was to determine whether (1) the Retirement System satisfactorily implemented recommendations contained in our September 1991 report "Followup of Recommendations Concerning the Employees Retirement System, Government of the Virgin Islands" (No. 91-I-143); (2) the Government made timely deposits of employer and employee contributions into the Retirement System's bank account in accordance with the consent judgment issued by the U.S. District Court; and (3) the Retirement System properly accounted for and collected interest receivable from the Government.

We found that improvements were needed in the Retirement System's (1) administration of loans to its members and (2) accounting for employer and employee contributions to the Retirement System. Specifically:

- For the 16 recommendations contained in the 1991 report, we found that 4 recommendations had been partially implemented and 10 recommendations had not been implemented. We also considered 1 recommendation implemented and withdrew 1 recommendation. Because all of the recommendations had not been implemented, the Retirement System did not have adequate control over loans to members, and there were 1,054 delinquent loans, with outstanding balances totaling \$5.3 million.
- - Erroneous amounts were deducted from employees' salaries as contributions to the Retirement System, which resulted in the need to refund an average of about \$104,000 annually, and the Retirement System lost about \$1 million in interest income because of the Government's delays in submitting biweekly retirement contributions to the Retirement System. Additionally, the Retirement System's bank account had not been reconciled since fiscal year 1995. As a result, a difference of \$15 million existed between the bank statement balance and the cash balance shown in the Retirement System's internal records.

Based on the January 28, 1999, response (Appendix 3) to the draft report from your office, we consider 10 of the 11 new recommendations (A.2, A.3, A.4, A.5, A.6, B.1, B.2, B.3, B.4, and B.5) unresolved and request additional information for one recommendation (No. A. 1) (see Appendix 4). Although the response provided detailed information on actions proposed to implement the 16 unresolved recommendations from the 199 1 report, the response did not address the new recommendations made in our current report as a result of our followup audit.

The Inspector General Act, Public Law 94-452, Section 5(a)(3), as amended, requires semiannual reporting to the U.S. Congress on all audit reports issued, the monetary impact of audit findings (Appendix 1), actions taken to implement audit recommendations, and identification of each significant recommendation on which corrective action has not been taken.

In view of the above, please provide a response to this report, as required by Public Law 97-357, by April 30, 1999, to our Caribbean Office, Federal Building - Room 207, Charlotte Amalie, Virgin Islands 00802. The response should provide the information requested in Appendix 4.

We appreciate the assistance of the management and staff of the Government Employees Retirement System in the conduct of our audit.

Sincerely,

A handwritten signature in black ink, appearing to read "Eljay B. Bowron". The signature is fluid and cursive, with a large initial "E" and "B".

Eljay B. Bowron
Inspector General

cc: Governor of the Virgin Islands

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INTRODUCTION

BACKGROUND

The Government Employees Retirement System was established in October 1959 to administer the employee pension plan of the Government of the Virgin Islands. The plan offers retirement benefits in seven categories: regular service, hazardous duty, senator/legislator, duty-connected disability, nonduty-connected disability, duty-connected death, and survivor's annuities. The Retirement System also provides its members with automobile, land, home mortgage, and personal loans.

The Government and its independent instrumentalities are required by law to contribute an amount equal to 14.5 percent of their employees' salaries to the Retirement System. The members of the Retirement System are required to contribute 8 percent of their salaries for regular employees; 9 percent for senators/legislators; and 10 percent for employees in certain high risk jobs, such as police officers, as provided for in Act No. 5226. Contributions are submitted to the Retirement System on a biweekly or monthly basis through lump-sum checks that include employers' and employees' contribution payments.

The Retirement System is governed by a Board of Trustees that comprises seven members (three each from St. Thomas and St. Croix and one from St. John), and the Retirement System's day-to-day operations are managed by an Administrator and four Assistant Administrators. As of September 30, 1997, the Retirement System managed investments and real estate valued at more than \$1 billion. The most recent actuarial study stated that as of September 30, 1997, the Retirement System had an unfunded pension liability of \$296.6 million.

As a result of a lawsuit brought by the Retirement System against the Commissioner of Finance and the Government of the Virgin Islands, the U.S. District Court in December 1983 issued a consent judgment that required the Department of Finance to pay all employer and employee retirement contributions into the Employees Retirement System Fund within 30 days of the end of each biweekly pay period. The consent judgment was modified in April 1994 to require (1) the establishment of an interest-bearing bank account in the name of the Retirement System's Board of Trustees and (2) the deposit into this account, by the Department of Finance, of all employer and employee retirement contributions and other payroll deductions made on behalf of the Retirement System within 21 days of the end of each biweekly pay period. An April 1994 addendum to the consent judgment required the Department of Finance and the Retirement System to determine, based on their respective records, the amount of Retirement System cash being held by the Department of Finance as of September 30, 1993, and to deposit 75 percent of the lower of such amounts into the Retirement System's interest-bearing bank account no later than August 15, 1994.

OBJECTIVE AND SCOPE

The objective of our audit was to determine whether (1) the Retirement System satisfactorily implemented recommendations contained in our prior audit reports on the Retirement System (see Prior Audit Coverage), (2) the Government made timely deposits of employer and employee contributions into the Retirement System's bank account in accordance with the consent judgment issued by the U. S. District Court, and (3) the Retirement System properly accounted for and collected interest receivable from the Government based on the consent judgment.

To accomplish the audit objective, we reviewed documents and records pertaining to the Retirement System's operations during fiscal years 1996, 1997, and 1998 (through June). In addition, we interviewed Retirement System personnel regarding actions taken to implement the prior audit recommendations and to collect and record employee and employer contributions. The audit was conducted at the Retirement System offices on St. Thomas and St. Croix.

Our review was made, as applicable, in accordance with the "Government Auditing Standards," issued by the Comptroller General of the United States. Accordingly, we included such tests of records and other auditing procedures that were considered necessary under the circumstances to accomplish the audit objective.

Based on the limited objective and scope of our audit, we evaluated internal controls only to the extent that they related to corrective actions taken on the prior audit recommendations and the amended consent judgment issued by the District Court of the Virgin Islands. The internal control weaknesses identified in these areas are addressed in the Findings and **Recommendations** section of this report. Our recommendations, if implemented, should improve the internal controls in these areas.

PRIOR AUDIT COVERAGE

During the past 5 years, the Office of Inspector General has not issued any audit reports on the Government Employees Retirement System. However, in September 1985, the Office of Inspector General issued the report "Employees Retirement System, Government of the Virgin Islands" (No. V-TG-VIS-24-84), which stated that improvements were needed in the controls over (1) reserve funding, (2) loan policies and administration, (3) interest income, (4) the performance of professional investment managers, and (5) duty-connected disability annuities. Specifically, the report stated that the Retirement System may not have accumulated sufficient reserves to guarantee the payment of all promised retirement benefits, loan procedures were not **sufficient** to prevent lost revenues and to protect the Retirement System's interests, annual revenues of more than \$164,000 were not realized because of the procedures used by the Retirement System to compute interest on personal loans, actions taken by the Retirement System were not sufficient to timely correct poor performance demonstrated by investment managers, and internal controls were not sufficient to detect and minimize errors in computing duty-connected disability annuities.

Additionally, in September 1991 the Office of Inspector General issued the report "Followup of Recommendations Concerning the Employees Retirement System, Government of the Virgin Islands" (No. 91-I-1431), which stated that 15 of the 24 recommendations contained in the 1985 report had not been implemented. The report further stated that although some improvements had been made in reserve funding, personal loan interest computations, investment management, and disability annuity calculations, additional improvements were needed with regard to loan administration. Specifically, the Retirement System did not have current and accurate records on the status of loans, minimal collection efforts were made on delinquent loans, and Retirement System personnel did not take sufficient action to ensure that automobiles and real property purchased by members through loans from the Retirement System were adequately insured. As a result of the **followup** audit, we made three new recommendations. Additionally, based on the Governor's response to the draft of the **followup** audit report, we considered 2 of the 15 outstanding recommendations from the 1985 report resolved and implemented and the remaining 13 prior recommendations and the 3 new recommendations unresolved. Our current audit disclosed that 4 of these 16 unresolved recommendations had been partially implemented and ~~that~~ 10 recommendations had not been implemented. We also considered 1 recommendation implemented and withdrew 1 recommendation.

FINDINGS AND RECOMMENDATIONS

A. LOANS TO MEMBERS

We found that the Retirement System did not fully implement 15 of the 16 unresolved recommendations contained in our 1991 **followup** report (see Appendix 2) and therefore did not adequately administer loans to members of the Retirement System. Specifically, the Retirement System did not (1) initiate collection actions on delinquent loans, (2) have accurate and reliable loan information on its computer system, (3) implement standardized written policies and procedures for loan processing, and (4) ensure that all automobile and mortgage loans had current insurance policies to protect the Retirement System's interests. The laws related to the operations of the Retirement System are contained in Title 3, Chapter 27, of the Virgin Islands Code. The deficiencies existed because the Retirement System's computer system was outdated (a new system was being installed as of July 1998) and a key position within the Retirement System's loan administration section had been vacant since 1995. As a result, as many as 1,054 loans, with outstanding balances of about \$5.3 million, were delinquent as of February 1998; the computerized loan files contained duplicate accounts, incorrect social security numbers, and incorrect or outdated loan status information; automobile loans were not approved and mortgage loans were not closed timely; and 32 of 35 automobile and home mortgage loans reviewed did not have required insurance policies.

Collection Enforcement

Of the 16 recommendations contained in the 1991 **followup** report (13 recommendations carried forward from the 1985 report and 3 new recommendations), we found that 4 recommendations were partially implemented and 10 recommendations were not implemented. We also considered 1 recommendation implemented and withdrew 1 recommendation. (A summary of the status of each recommendation is in Appendix 2.) Specifically, the Retirement System took actions to (1) establish escrow accounts for mortgage holders; (2) establish a Mortgage Loan Fund, as required by Title 33, Section 3026, of the Virgin Islands Code; (3) ensure that annuity computations were verified for accuracy; and (4) ensure that the Government's independent agencies submitted retirement contribution information in a timely manner and in a format usable by the Retirement System. However, the Retirement System did not have adequate controls over loans to members of the Retirement System.

The Retirement System provides, to eligible members, automobile, land, home mortgage, and personal loans. According to Title 3, Chapter 27, of the **Virgin Islands Code**, members contributing to the Retirement System for at least 2 years can obtain personal loans for \$20,000 or 75 percent of their contributions paid into the Retirement System, whichever is less. Members contributing to the Retirement System for at least 5 years can also obtain automobile loans of up to \$18,000, land purchase loans of up to \$30,000, and home mortgage loans of up to \$105,000. According to Retirement System records, as of February 1998, the

Retirement System had 13,445 outstanding loans, totaling \$6 1.9 million. Of that amount, 1,054 loans, totaling \$5.3 million, were recorded as delinquent, as shown in Table 1:

Table 1. Retirement System Loans Recorded as Delinquent

<u>Type of Loan</u>	<u>No. of Loans</u>	<u>Outstanding Balance</u>
Home Mortgage	184	\$2,964,088
Personal	816	2,127,609
Automobile	47	157,592
Land Purchase	<u>7</u>	<u>67,643</u>
Total	<u>1,054</u>	<u>\$5.3 16.932</u>

We reviewed a sample of 80 loans, totaling \$907,729, that were identified in the Retirement System's records as delinquent. We found that only 44 of the 80 loans were delinquent. The remaining 36 loans consisted of 15 loans to retired members who continued to make loan payments after retirement, 8 loans to active members who either were current in their loan payments or had paid off their loans, 5 loans that were paid off from the members' retirement contributions, 3 loans that were paid off upon the death of the members, 1 loan that was not recorded in the name of the correct member, 1 loan for which Retirement System officials could not determine the borrower, and 3 loans for which the loan files could not be located. Based on our review, we determined that the Retirement System had initiated collection actions on only 10 of the 44 loans which were verified as delinquent and that the period of delinquency of the 44 loans ranged from 128 to 5,146 days (4 months to 14 years). For example:

- A mortgage loan with an outstanding balance of \$32,955 had been delinquent since September 24, 1987, or a total of 3,843 days (10.5 years).
- An automobile loan with an outstanding balance of \$4,240 had been delinquent since April 5, 1990, or a total of 3,039 days (8.3 years).
- A personal loan with an outstanding balance of \$2,035 had been delinquent since March 1, 1984, or a total of 5,146 days (14.1 years).

We also found that the Retirement System had not deducted loan payments **from** the annuities of at least two members who had retired or **from the refund** of retirement contributions of one member who had resigned **from** government service.

We believe that the Retirement System should establish a collection enforcement program that includes procedures which ensure that (1) automatic deductions for required loan payments are made from all active and retired members who have outstanding loans; (2) **delinquent** loan amounts are deducted **from** the retirement contribution refunds due members who leave government service; (3) foreclosure is initiated **on the** automobiles, land, or homes of members who have defaulted on their loans and who have not made reasonable efforts to

pay the delinquent amounts; and (4) all delinquent loans are reported to the major credit bureaus. The Retirement System should also obtain periodic updates from the Motor Vehicle Bureau of the Virgin Islands Police Department on the ownership status of automobiles purchased with loans that are delinquent to improve the chances of repossessing the vehicles of individuals.

Computer Files

As stated in the section "Collection Enforcement," we found that the computerized loan files maintained by the Retirement System were not reliable. In 1987, the Retirement System began using a new computer for its loan operations. During the conversion to the new computer, loan account information was not verified, and incorrect data, such as loan balances and interest rates, were transferred to the new computer. As a result, Retirement System personnel had to manually recalculate interest and loan amounts to provide accurate loan balances in response to inquiries or for collection enforcement action. We also found that the computer system contained (1) duplicate names (accounts); (2) incorrect social security numbers; (3) loan balances that reverted to the old, incorrect balance after having been recalculated and corrected; (4) loans that had been paid off; (5) loans that were recorded in the incorrect members' names; and (6) retirement contribution payments that were recorded to the incorrect accounts.

In July 1998, the Retirement System began to convert its loan account files to off-the-shelf, personal computer-based software. Retirement System officials said that when this conversion is fully implemented, the software is expected to handle all of the Retirement System's loan operations, including loan processing and reporting. The officials further stated that the software will be able to produce specialized reports, immediately provide loan payoff amounts, and identify delinquent and uninsured accounts. However, these officials were uncertain as to whether the new software would be able to interface and share information with the Retirement System's main financial accounting software. As such, some manual intervention may be necessary to transfer consolidated loan balance information from the new loan management software to the financial accounting software.

To ensure the accuracy of loan account information on the new loan management system, we believe that the Retirement System should ensure that all loan account data, including identifying information, payment methods, interest rates, and outstanding loan balances, are verified prior to entry into the new system. At the November 24, 1998, exit conference on the preliminary draft of this report, Retirement System officials stated that they were carefully reviewing the accuracy of loan information as part of the conversion process and that they had drafted several proposed changes to strengthen the Retirement System's internal operating procedures with regard to loan administration.

Loan Processing Procedures

The Retirement System did not establish formal standardized procedures for processing loans. Although the maximum loan amounts, interest rates, and service eligibility requirements are prescribed in Title 3, Chapter 27, of the Virgin Islands Code, the Retirement

System did not have detailed guidelines for issues such as income requirements, outstanding debt limitations, loan processing time frames, and collection procedures. For example, although Retirement System officials said that they had a verbal policy of approving automobile loans if the applicant had residual monthly income of at least \$250 per month, this policy was not documented.

We also found that although the Retirement System's office on St. Croix maintained detailed logbooks of the automobile and mortgage loan applications, including the date received and the date approved or closed, such logbooks or other similar processing records were not maintained at the St. Thomas office. Based on our review of the St. Croix logbooks, we found that the automobile loan approval process took from 6 to 24 days (average of 13 days) and that the mortgage loan approval process took from 5 to 14 months (average of 8 months) through the closing date. At the November 24, 1998, exit conference, Retirement System officials stated that sometimes title problems outside the control of the Retirement System delayed the closing of mortgage loans.

In addition, we determined that an individual who was not a member of the Retirement System had an outstanding mortgage loan. The applicant, who was a member of the Retirement System at the time of the application, and his spouse were co-borrowers on the loan. The couple were later divorced, and the loan was transferred to the spouse, who was not a Retirement System member. Retirement System officials told us that they had questioned the propriety of this loan but that the loan had been approved by the Board of Trustees. The loan has been delinquent for more than 2 years. We believe that formal guidelines for loan administration would have precluded approval of a loan for an individual who was not a member of the Retirement System.

Insurance Coverage

The Retirement System did not ensure that recipients of automobile and mortgage loans financed by the Retirement System maintained automobile and property damage insurance coverage, as required by Title 3, Section 717, of the Virgin Islands Code, to protect the Retirement System's interests. Of 35 loans included in our review that required automobile or property damage insurance, only 3 loans had insurance coverage. We found that this deficiency existed in part because the Retirement System did not have an employee who monitored the status of insurance coverage. Retirement System officials told us that a vacancy announcement to fill the position of Insurance Monitor was not successful because the position's salary was too low to attract qualified candidates, but they stated that filling this position was critical to improving the Retirement System's administration of loans.

At the November 24, 1998, exit conference, Retirement System officials stated that they were planning to implement a "force placed" insurance program (that is, the Retirement System would obtain insurance for the borrower) for mortgage and automobile loans and that the proposed insurance carrier would have the ability, through its computerized insurance database, to identify borrowers whose insurance policies had lapsed. Retirement System officials also stated that they were reviewing proposals for providing disability and income protection insurance coverage for borrowers.

Recommendations

We recommend that the Board of Trustees of the Government Employees Retirement System direct the Administrator to:

1. Reconsider the recommendations in the September 1991 report which have not been fully implemented (see Appendix 2) and develop a plan of action which identifies the corrective actions to be taken and includes target dates and titles of officials responsible for implementation of these recommendations.

2. Establish a collection enforcement program which includes procedures to ensure that automatic deductions for required loan payments are made from the salaries of all active and retired members who have outstanding loans; delinquent loan amounts are deducted from the refunded retirement contributions due members who leave government service; foreclosure is initiated on the automobiles, land, or homes of members who have defaulted on their loans and who have not made reasonable efforts to repay the delinquent amounts; and all delinquent loans are reported to the major credit bureaus.

3. Obtain periodic updates **from** the Motor Vehicle Bureau, Virgin Islands Police Department, on the ownership status of automobiles purchased with loans that are delinquent to determine whether the vehicles are registered in the names of the individuals who have the delinquent loans.

4. Establish and implement a plan of action to ensure that all loan data are verified, corrected, and updated as part of the conversion to the new personal computer-based loan management system.

5. Develop and implement formal written guidelines for all loan application, processing, administration, and collection functions of the Retirement System's Loan Section.

6. Expedite the hiring of an Insurance Monitor so that mandatory insurance coverage for automobile and mortgage loans financed by the Retirement System is enforced.

Government Employees Retirement System Board of Trustees Response and Office of Inspector General Reply

In the January 28, 1999, response (Appendix 3) to the draft report from the Chairperson of the Government Employees Retirement System's Board of Trustees, the Board addressed the recommendations from our September 1991 **followup** report on the Retirement System (the status of which is summarized in Appendix 2 of this report). However, **theBoard** did not address the new recommendations made as a result of our current audit. Therefore, we consider Recommendations A.2 to A.6 unresolved and request additional information for Recommendation A. 1 (see Appendix 4).

General Comments on Prior Audit Recommendations

The Retirement System's January 28, 1999, response provided information on concurrence or nonconcurrence with the prior audit recommendations (see Appendix 2) and proposed actions to implement those recommendations with which the Retirement System concurred. In summary, the response indicated concurrence with the September 1991 report's Recommendations 1.3, 1.5, 2.1, 2.3, 2.4, 2.7, 2.8, 5.3, B.1, B.2, and B.3 and provided information on proposed corrective actions. However, the response did not provide target dates or titles of the officials responsible for implementing the proposed actions. In addition, the Board nonconcurred with Recommendations 2.2, 2.9, 2.11, and 4.3, as discussed in the paragraphs that follow.

Prior Recommendation 2.2. Nonconcurrence.

Board of Trustees Response. The Board stated that the Retirement System did not agree that a "credit history is necessary" for personal loans to Retirement System members, "since the loans are fully collateralized by the contributions."

Office of Inspector General Reply. While we agree that personal loans to Retirement System members are collateralized by the members' retirement contributions, we believe that because of the large number of delinquent personal loans (816 delinquent loans, with outstanding balances totaling \$2.1 million, according to Retirement System records as of February 1998), the Retirement System should take additional precautions to ensure that there will be a high probability that members will pay off new personal loans. In our opinion, a review of the credit histories of loan applicants is an additional step the Retirement System can take as part of its loan approval process to ensure that loans are not given to individuals who have a history of delinquent loans and other debts.

Prior Recommendations 2.9 and 2.11. Nonconcurrence.

Board of Trustees Response. Regarding Recommendation 2.9, the Board stated that the Retirement System "lacks any authority or jurisdiction to compel the Office of Management and Budget or the Commissioner of Finance to source the [Mortgage Loan Fund] in accordance with the statutory mandate." Regarding Recommendation 2.11, the Board stated that "it is our position that this recommendation be withdrawn because it [the recommendation] falls beyond any reasonable scope of authority wherein [the Retirement System] can be expected to exercise corrective action."

Office of Inspector General Reply. We agree that the Retirement System does not have the authority to compel the Executive or Legislative Branches of the Government of the Virgin Islands to provide funding for activation of the Mortgage Loan Fund. To that extent, we will refer these recommendations to the Governor and the Legislature of the Virgin Islands. However, because it would be in the best interest of the Retirement System to have the Mortgage Loan Fund activated as a resource to compensate the System for defaulted loans to members, we also believe that the Retirement System could submit to the newly

elected Governor and Legislature documentation presenting its support for activation of the Mortgage Loan Fund.

Prior Recommendation 4.3. Nonconcurrency.

Retirement System Response. The Board stated that “corrective action on this recommendation. was implemented as far back as July 1, 1994, when the [Retirement System] contracted with [a bank] to perform Global Custodial Services. That contract bound [the bank] as custodian, to perform a number of custodial services which required [the bank] to reconcile transactions, examine transactions for unauthorized trades, notify the investment managers of all unauthorized trades and initiate appropriate actions to cancel unauthorized trades as soon as they are discovered.” The Board also stated that the Retirement System “is in the transition of changing its Global Custodian ... [to] an institution whose primary services are custodial trust services for private and public trust institutions” and that the proposed custodian “has the ability to deliver a vast range of reports within 24 hours of month end closings, and they have the ability to have audited reports available which can be accessed on-line, within three days of the monthly closing.”

Office of Inspector General Reply. At the time of the audit, detailed information was not provided to our auditors on the level of custodial services provided by the Retirement System’s current custodian. Further, as we stated in Appendix 2, Retirement System **officials** told us at the exit conference on the **draft** of this report that they were evaluating proposals for new investment brokers and that the candidate firm would have the capability to implement the prior audit recommendations. Based on the response, we consider prior Recommendation 4.3 resolved and implemented and have revised Appendix 2 accordingly.

B. RETIREMENT CONTRIBUTIONS

We found that the Retirement System did not effectively manage and monitor employer and employee contributions, which are the primary investment capital used to fund the Retirement System's activities and benefits. Specifically, (1) incorrect retirement contribution amounts were deducted from members' salaries, (2) employer and employee contributions were not submitted to the Retirement System within the court-ordered time frames, and (3) bank reconciliations were not performed for the Retirement System's bank account. The laws related to the Retirement System's operations are contained in the Title 3, Chapter 27, of the Virgin Islands Code. In addition, a consent judgment issued by the U.S. District Court requires that employer and employee contributions be received by the Retirement System within 21 days of the end of each applicable pay period. The deficiencies occurred because the Retirement System, the Department of Finance, and the Division of Personnel did not adequately coordinate with each other (as appropriate) to develop and implement procedures to ensure that changes to employees' retirement deduction rates were processed correctly, retirement contribution payments and applicable interest were submitted to the Retirement System within required time frames, and bank reconciliations were performed on a monthly basis. In addition, the Retirement System did not establish procedures to ensure that members' retirement deductions were accurately computed and that members were provided with annual statements of their retirement accounts. As a result, the Retirement System (1) had to issue retirement contribution refunds of \$104,000 to members during fiscal years 1996 to 1998; (2) lost investment income of at least \$1 million during fiscal years 1996, 1997, and 1998; and (3) had a \$15 million difference between its internal records and the bank statement balance.

Retirement Deductions

According to the Government Employee Retirement System Handbook, a new Government employee becomes a member of the Retirement System after 1 month of employment and immediately starts contributing to the Retirement System. The retirement contribution is computed as a percentage of the employee's salary based on job classification and is deducted in biweekly increments. Regular employees contribute at a rate of 8 percent, legislators contribute at a rate of 9 percent, and **employees** in hazardous duty jobs contribute at a rate of 10 percent.

Based on our review of a sample of 41 retirement contribution refunds, totaling \$218,138, issued to 30 employees, we found that 12 **refunds**, totaling \$2,969, were inappropriate because incorrect percentage rates were used to compute employees' retirement deductions. For example:

- A police detective had 16 percent of his salary deducted (twice the 8 percent regular employee rate) for the period of September 1994 through November 1995, although the deductions should have been at the 10 percent hazardous duty rate. In September 1996, the employee was refunded \$1,226, which was the total amount erroneously deducted.

- A corrections officer had deductions at both the 8 percent regular employee rate and the 10 percent hazardous duty rate for four pay periods in April and May 1997, even though the deductions should have been at the 10 percent rate. In September 1997, the employee was refunded \$259, which was the amount erroneously deducted. We found that duplicate deductions had also been reported by the employee in June and July 1996.

- A police radio dispatcher, who was not considered by job position to be a law enforcement officer, had deductions at both the 8 percent regular employee rate and the 10 percent hazardous duty rate for three pay periods in March 1996, although the deductions should have been made at the 8 percent regular employee rate. Although the employee's retirement files did not contain documentation that a refund was issued, we estimated that the employee was due a refund of \$194. The tiles showed that duplicate deductions had also been reported by the employee in February and July 1996 and in April 1997.

Because of incorrect deduction rates, the Retirement System had to pay refunds to members of the Retirement System totaling \$104,000 in fiscal years 1996, 1997, and 1998. Also, in those cases where deductions were made at both the 8 percent and the 10 percent rates, only one deduction amount (usually the 8 percent regular employee deduction) was posted to the employees' Retirement System accounts. Therefore, the potential existed for an employee who applied for retirement from a hazardous duty position to be denied retirement benefits at the hazardous duty level unless the employee either had documents to substantiate that excess retirement contributions had been deducted or had paid to the Retirement System an additional retirement contribution amount representing the 2 percent difference between the 8 percent regular duty contribution shown in the Retirement System records and the 10 percent hazardous duty contribution amount that should have been recorded.

We found that incorrect deduction amounts usually resulted when an employee transferred between different job categories (such as from regular duty to hazardous duty) and the prior deduction was not stopped before the new deduction was started. Further, although the Department of Finance provided the Retirement System with biweekly summaries of retirement deductions, these summaries were not reviewed by Retirement System personnel to identify any errors. Consequently, the errors may not have been corrected if the employees had not informed Retirement System officials of the incorrect deductions.

Retirement System **officials** told us that the incorrect deductions were caused by a programming or procedural problem at the Department of Finance which resulted in Notices of Personnel Action for changes in the employees' retirement deduction rates not being captured in the Department of Finance's computer. However, Department of Finance officials said that the problem was procedural because Retirement System and/or Division of Personnel employees did not deactivate the previous deduction rate. We believe that representatives of the Retirement System, the Department of Finance, and the Division of Personnel should jointly develop procedures to eliminate the incorrect retirement deductions.

Retirement Contribution Payments

Retirement contributions for Government employees are submitted to the Retirement System by the Department of Finance through lump-sum checks for each biweekly pay period. Each check includes deductions made from employees' salaries and the Government's 14.5 percent contribution. The 199-I consent judgment issued by the U.S. District Court requires such contributions to be received by the Retirement System within 21 days of the end of the pay period for which the contributions are applicable. However, we found that the Government did not always comply with this requirement. Specifically, for fiscal year 1996, none of the 25 biweekly checks (excluding 1 check that was lost in transit and had to be reissued) were issued to the Retirement System within the 21-day time frame specified by the Court. The processing times ranged from 4 to 155 days late, with an average of 70 days late. Similarly, during fiscal year 1997, none of the 26 biweekly checks were issued within the 21-day time frame. The processing times ranged from 5 to 51 days late, with an average of 25 days late. However, we noted a significant improvement for fiscal year 1998, in which only 4 of the 26 checks were issued late, with a range of 5 to 11 days, or an average of 7 days late. Department of Finance officials attributed the late contribution payments to cash flow problems that prevented timely payment to the Retirement System.

We estimated, based on a conservative 6.9 percent rate of return (as proposed by Retirement System officials), that the late contribution payments resulted in lost interest income to the Retirement System of at least \$722,529 in fiscal year 1996, \$272,214 in fiscal year 1997, and \$5,317 in fiscal year 1998, for a total of \$1 million over the 3 years. Although Retirement System officials provided us with copies of numerous letters sent to the Department of Finance during the period of September 1995 to July 1997 urging the Department to submit retirement contribution payments in a timely manner, the Retirement System and the Department of Finance had not jointly adopted comprehensive procedures to ensure that contribution payments were submitted within the 21-day time frame established by the District Court. We believe that Retirement System and Department of Finance officials should consult with the District Court to establish formal policies and procedures, including applicable interest rates for late payments, to ensure compliance with the 21-day payment time frame.

Bank Reconciliations

Title 3, Section 716, of the Virgin Islands Code designates the Commissioner of Finance as the treasurer of the Retirement System. However, despite documented attempts by Retirement System officials and their independent auditors, the Retirement System had not been able to obtain from the Department of Finance an up-to-date, reconciled cash balance for the Retirement System's bank account. Also, Retirement System personnel had not been able to perform their own reconciliations between the Retirement System's internal records and the bank statements.

The most recent bank reconciliations were performed by the Department of Finance for fiscal years 1994 and 1995. For fiscal year 1994, the Department had to adjust its book balance upward by \$25.4 million to match the \$32.6 million bank balance, and for fiscal year 1995,

the Department had to adjust its book balance downward by \$44.7 million to match the negative \$28.5 million bank balance. The adjustments to the book balances resulted from debit and credit memoranda issued by the bank, interest income that had not been recorded in the financial records, and data entry errors by the Department of Finance that resulted in underposted and unrecorded deposits and overposted checks.

For fiscal year 1,996, the Retirement System began to maintain an internal cash flow statement (called an "inflow/outflow statement" by the Retirement System). However, the Retirement System had not reconciled these cash flow statements to the monthly bank statements. Specifically, we found that for fiscal year 1996, there was an unreconciled difference of \$14.5 million, for fiscal year 1997 there was an unreconciled difference of \$14.9 million, and for fiscal year 1998 (as of March 1998) there was an unreconciled difference of \$15 million. Retirement System officials said that the bank account could not be reconciled because the Department of Finance could not confirm a cash balance for the account and canceled checks were not available to the Retirement System because they were sent to the Department of Finance by the bank. Department of Finance officials acknowledged that differences existed between the book and the bank balances for the Retirement System's account and that Department and Retirement System personnel had tried unsuccessfully to reconcile the account.

At the November 24, 1998, exit conference, Retirement System officials suggested that the System's bank account be transferred from the Department of Finance to the Retirement System. We concur with this suggestion because it would give the Retirement System direct control of its bank account and allow Retirement System personnel to concentrate their efforts on reconciling their own bank account. At the time of our audit, the Department of Finance was responsible for managing and reconciling all of the main bank accounts of the Government of the Virgin Islands. Therefore, Finance personnel could not concentrate their efforts on reconciling the Retirement System account. The suggested change of custodianship would also allow the Retirement System to make transfers between the bank account and various investment accounts without the delays inherent in having to request that such transfers be processed by the Department of Finance.

Prior Service Payments

During the audit, we noted that nine members of the Retirement System who had applied for retirement benefits were required to make lump-sum payments of retirement contributions totaling \$23,698 for prior service before becoming eligible to receive retirement annuities. In one instance, the member had to pay \$15,514 in prior service contributions. Title 3, Section 704(i), of the Virgin Islands Code allows members of the Retirement System to make payment of retirement contributions for prior creditable service, with the provision that such payments should be made over a period not to exceed 5 years prior to retirement. In the nine cases identified during our review, it appeared that the members were not aware that they had not made full retirement contributions. We found that the Retirement System did not send periodic (at least **annual**) retirement account statements to members so that they could review the status of their retirement accounts and contact the Retirement System to make any adjustments, corrections, or additional contribution payments which were necessary.

Recommendations

We recommend that the Board of Trustees of the Government Employees Retirement System direct the Administrator to:

1. Coordinate with officials of the Department of Finance and the Division of Personnel to develop and implement procedures to ensure that changes and updates to employees' retirement deduction rates are properly made in the Government's payroll system.

2. Review the files pertaining to all active members of the Retirement System to identify any employees who have incorrect retirement deductions and take actions to correct the deduction rates.

3. Coordinate with officials of the Department of Finance and the U.S. District Court to develop procedures to ensure that retirement contribution payments are submitted to the Retirement System within the time frames required by the U.S. District Court consent judgment. The procedures should include a provision for the Government to compensate the Retirement System for interest income lost by late submission of contribution payments at an interest rate approved by the District Court.

4. Propose legislation to transfer custodianship of the Retirement System's bank account to the Retirement System and coordinate with officials of the Department of Finance and the bank to reconcile the bank account and to develop and implement procedures to ensure that future reconciliations are performed on a monthly basis.

5. Implement procedures to provide members of the Retirement System with periodic (at least annual) statements of their retirement accounts.

Government Employees Retirement System Board of Trustees Response and Office of Inspector General Reply

In the January 28, 1999, response to the draft report from the Chairperson of the Government Employees Retirement System's Board of Trustees, the Board addressed the recommendations contained in our September 1991 audit report, the status of which is summarized in Appendix 2 of this report. However, the Board did not address the recommendations made as a result of our current audit. Therefore, we consider Recommendations B.1, B.2, B.3, B.4, and B.5 unresolved (see Appendix 4).

CLASSIFICATION OF MONETARY AMOUNTS

Finding Area	Unrealized Revenues*
A. Loans to Members	
Collection Enforcement	\$5.3 million
B. Retirement Contributions	
Contribution Payments	<u>\$1 .0 million</u>
Total	<u>\$6.3 million</u>

*Amounts represent local funds.

**STATUS OF RECOMMENDATIONS
AND CORRECTIVE ACTIONS
FOR AUDIT REPORT
“FOLLOWUP OF RECOMMENDATIONS CONCERNING
THE GOVERNMENT EMPLOYEES’ RETIREMENT SYSTEM,
GOVERNMENT OF THE VIRGIN ISLANDS”
(No. 91-I-1431)**

Recommendations

Status of Corrective Actions

Prior Audit Recommendations

1.3. Submit a bill to the Legislature which makes it unlawful to (1) increase benefits without making compensations to cover the present and future costs of such benefits and (2) reduce contributions without eliminating benefits which would no longer be financed.

Not implemented. Retirement System officials stated that the recommended legislation had not been submitted to the Legislature. The Retirement System’s unfunded pension liability was \$388 million as of fiscal year 1996 (the latest actuarial report available). At the exit conference, Retirement System **officials** stated that they will propose legislation to require that a financial assessment be performed before **future** changes are made to the benefit and contribution levels of the Retirement System.

1.5. Consider the establishment of a temporary moratorium on the issuance of new personal loans until (1) a complete evaluation is made of the status of existing personal loans, (2) loan records are brought up to date, (3) collection actions are begun for delinquent loans, and (4) loan administration procedures are implemented to ensure proper management of the personal loan program.

Not implemented. The Retirement System has not brought loan records up to date. We found that the loan records contained duplicate names (accounts), inaccurate account balances, and other errors. In addition, there were no formal procedures for enforcing the collection of delinquent loans. According to Retirement System records, there were 1,054 delinquent loans, with outstanding balances totaling about \$5.3 million. At the exit conference, Retirement System officials stated that they believed loan administration could be improved without implementing a moratorium on new loans. They also noted that prior attempts to place a moratorium on new loans were disapproved by the Legislature. In our opinion, regardless

Recommendations

Status of Corrective Actions

2.1, Immediately initiate collection efforts on all automobile and mortgage loans currently delinquent over 6 months. Specifically, (1) determine whether a delinquent borrower is receiving retirement annuities and, in such instances, initiate collection efforts through semimonthly annuity deduction and notify the borrower of the action and (2) for all other borrowers, issue a new letter informing each borrower that repossession or foreclosure actions will be taken if settlement is not immediately made. For nonresponsive borrowers, forward the account to the System's attorney and follow up on each account to ensure that timely legal actions were taken by the attorney.

2.2. In conjunction with Recommendation 1 .5, reduce the risk associated with personal loans by (1) basing each approval on the applicant's prior credit history, continuity of employment, intent, and ability to meet financial obligations and (2) requiring a valid need to be stated and evidence submitted to verify that funds were used for their approved purpose. If funds are not used for their stated purpose, disapprove all future loans to the member.

of whether a moratorium on new loans is implemented, the recommended actions to improve controls over existing outstanding loans should be implemented.

Not implemented., We found three mortgage loans that had been delinquent since 1987 and one auto loan that had been delinquent since 1988 but for which no collection action had been taken by the Retirement System. In addition, we identified a retired member who had a mortgage loan that was 6 1/2 years delinquent but did not have loan payment amounts deducted from his retirement annuity.

Not implemented. Retirement System officials stated that personal loans are approved provided the member has at least 2 years of credited service. The officials also said that they believed that a member's signature on the loan application was sufficient to support that the funds will be used for the stated purpose. Retirement System officials also stated that the Retirement System's interests were protected because personal loans were secured by the member's retirement contributions and that prior attempts to require applicants to state the purpose of personal loans were disapproved by the Legislature. However, we believe that, at a minimum, the Retirement System should consider an applicant's prior credit history and

Recommendations

Status of Corrective Actions

2.3. Minimize delinquent accounts by implementing procedures to immediately initiate collection efforts when automobile and mortgage loans become delinquent. When borrowers are nonresponsive to inquiries, ensure that accounts are forwarded to the System's attorney and repossession and foreclosure efforts are timely performed.

ability to repay the loan as part of the personal loan approval process.

Not implemented. The Retirement System did not have formal procedures for handling delinquent loans, including the referral of delinquent mortgage and automobile loans to the Retirement System's attorney. Further, no one was specifically assigned to enforce the collection of delinquent automobile loans, and the employee assigned to enforce the collection of mortgage loans was also responsible for processing loan applications.

2.4. Monitor the accumulation of interest and penalties on personal loans, and immediately initiate collection efforts when accumulated amounts exceed a member's contribution.

Not implemented. The Retirement System did not monitor the accumulation of interest on the personal loans. As a result, we found four personal loans for which the interest, totaling \$6,515, exceeded the members' contributions. In addition, the Retirement System did not charge penalties to members who had delinquent loans.

2.7. Establish an escrow account for each mortgage holder so that funds are accumulated toward the payment of insurance premiums and property taxes.

Partially implemented. The Retirement System established escrow accounts for mortgage holders whose loans were approved since 1990. However, there are no escrow accounts for mortgage loans issued prior to 1990. As a result, only 2 of 19 mortgage loans reviewed had insurance policies.

2.8. Satisfy the legal requirement for insurance against a mortgage holder's death or disability by (1) amending the current life insurance policy to include insurance against the total disability of a mortgage holder, (2) ensuring insurance premiums for the policy are paid within the established grace period, and (3) passing the cost of insurance to mortgage

Not implemented. Retirement System officials stated that the life insurance policies have not been amended to include insurance against the total disability of mortgage holders. Additionally, the Retirement System still pays for the cost of life insurance. The officials stated that because the 10 percent interest rate charged by the

Recommendations

holders by adding a charge to biweekly payroll deductions.

2.9. Seek reimbursement from the Mortgage Loan Fund for all losses resulting from mortgage loans.

2.11. Submit a bill to the Legislature which appropriates sufficient funds to finance and establish the Mortgage Loan Fund as outlined in Title 33 of the Virgin Islands Code. Replenish the fund through annual appropriations.

4.3. For each quarterly statement received from the custodian, reconcile trade transactions to broker confirmation receipts. Investigate and correct all variances prior to 180 days elapsing after receipt of each statement. During the reconciliation, examine transactions for trades not authorized by the Virgin Islands Code. Notify appropriate investment managers of all unauthorized trades, and initiate administrative actions if unauthorized trades continue.

4.4. Pursue a conservative investment strategy so that risk is minimized in conjunction with maximum returns. Specifically, reevaluate investment guidelines given to managers for possible reduction of the 40 percent limitation established for stock investments. Any reduction should be moved into fixed income investments.

Status of Corrective Actions

Retirement System is higher than the rates for commercial mortgages, the higher interest rate is justified by paying the cost of life insurance. Based on this explanation, we withdrew the portion of the prior recommendation relating to adding a charge to biweekly payroll deductions.

Not implemented. Retirement System officials stated that since the Mortgage Loan Fund has never been funded, they have not been able to seek reimbursement **from** the Fund.

Partially implemented. The Legislature established the Mortgage Loan Fund in Title 33, Section 3026, of the Virgin Islands Code. However, the 'Fund is inactive because it has not received any appropriations.

Implemented. The Retirement System's response to the draft report stated that, since July 1994, the System's custodian has reconciled trade transactions, examined transactions for unauthorized trades, and taken action to cancel unauthorized trades as soon as they are discovered. The response also stated that the Retirement System was in the process of changing to a new custodian firm, which has **the** ability to provide enhanced services to the Retirement System.

Withdrawn. Retirement System officials stated that the Legislature raised the limitation on stock investments from 40 percent to 50 percent rather than reduce the limitation, as had been recommended.

Additionally, at the exit conference, Retirement System officials stated that the Retirement System's investment

Recommendations

Status of Corrective Actions

5.3. Perform a 100 percent review of all annuities when computed at time of retirement. Systematically spot-check the computation for annual increments and cost-of-living allowances to minimize computation errors.

portfolio was consistent with that of other retirement systems of similar size and was diverse enough to protect the Retirement System's interests. Based on information provided to us on the breakdown of the Retirement System's investment portfolio, we have withdrawn the recommendation.

Partially implemented. All annuity calculations are subjected to a supervisory review. We selected a sample of 52 annuities and found that 6 were initially incorrect. However, five of the six errors were later detected and corrected by Retirement System officials. Retirement System officials stated that the remaining error, which resulted in overpayments totaling \$9,602, will be corrected. However, the Retirement System does not spot-check **annual** increments and cost-of-living allowances for accuracy.

New Recommendations

B. 1. Require that the independent agencies submit payroll deduction information on a biweekly basis and in a format specified by the Retirement System to meet its processing needs. If any of the independent agencies do not voluntarily meet the Retirement System's requirements, consideration should be given to refusing to process loans for employees of that agency until the requirements are met.

Partially implemented. Retirement System officials stated that agencies are required to submit deduction information within 21 days of each pay period, which is in accordance with the District Court's consent judgment. In addition, the officials stated that the format used by the agencies was suitable for use by the Retirement System. However, the Retirement System did not receive salary information for the members to verify the accuracy of deductions.

B.2. Institute procedures to ensure that loan transactions, including those related to loans to retirees, are processed in a timely manner.

Not implemented. The Retirement System did not institute procedures to ensure that loan transactions are processed in a timely manner. Based on our review, we determined that it took an average of 29 days between the date a loan payment was received and the date

Recommendations

Status of Corrective Actions

B.3. Expedite the hiring of additional staff needed to undertake a special project to bring all loan records up to date.

the payment information was entered into the Retirement System's computer files. Additionally, it took an average of 13 days for automobile loans to be approved and an average of 8 months for mortgage loans to be closed.

Not implemented. Retirement System officials stated that rather than using temporary employees to bring loan records up to date, they were attempting to use existing staff to update the loan records as part of the conversion to the new computer system. However, because we found that the Retirement System's loan records were not accurate and up to date at the time of our review, we believe that additional actions are needed to ensure that all loan records are updated prior to the new computerized loan administration system being fully implemented.

CHARLES W. TURNBULL
Governor



EMPLOYEES' RETIREMENT SYSTEM

Mrs. Corine D. King
Chairperson

Ms. Eleanor D. Josiah
Vice Chairperson

Mr. Vincent G. Liger
Member

Ms. Lenna F. Smith
Member

Mr. Francisco Stapleton
Member

January 28, 1999

Mr. Eljay B. Bowron
Inspector General
United States Department of Interior
Office of the Inspector General
Washington, D.C. 20240

SUBJECT: Response to Audit Report on the Government Employees' Retirement System (Assignment No. V-IN-US-002-98)

Dear Inspector General Bowron:

The following represents the Government Employees' Retirement System's Board of Trustees responses to the above subject audit of the Government Employees' Retirement System. The responses are prefaced on the objective recommendations and findings contained in the December 8, 1998, audit report.

We have addressed with particularity the findings and the detailed recommendations of your office and established appropriate courses of corrective action for implementation that are Year 2000 Compliant. At present, the GERS is in a transition state of implementing substantial organizational and system resources upgrade, which when completed, will eliminate all the negative findings of inadequate controls over our loan programs, the accounting deficiencies for employer and employee contributions, and the inefficiencies of the benefit programs of the System.

For the sake of brevity, we are presently in the process of converting our Loan Department's processing operations to a new computer system and converting our Benefits Department's data processing to a new computer program which will eliminate the inefficient operations of the past.

Our accounting and financial systems have been recently replaced to ensure that a proper system of accountability and control* will be maintained, which will meet the specifications and qualifications requirements of the Government Accounting Standards Board regulations in accordance with generally acceptable accounting principles. The new technological computer system enhancements coupled with a

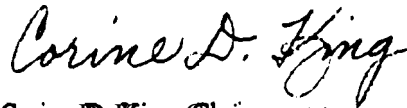
GOVERNMENT
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substantial training **program for the** staff, will ensure timely and accurate reporting and will enable **the** institution of **additional controls** of our **accounting** and financial **systems**, making available total **financial** data for planning and policy making readily available to management and the **GERS** Board

Sincerely,



Corine D. King, Chairperson
GERS Board of Trustees

pc: Honorable Charles **W. Turnbull**
Governor of the U.S. Virgin Islands

EMPLOYEES RETIREMENT SYSTEM
OF THE GOVERNMENT OF THE VIRGIN ISLANDS
Response to Draft Audit Report No. V-IN-VIS00298
January 28, 1999

Recommendation 1.3: Submit a bill to the Legislature which makes it unlawful to (1) increase benefits without making compensations to cover the present and future costs of such benefits and (2) reduce contributions without eliminating benefits which would no longer be financed.

We propose the following draft legislation:

Virgin Islands Code, Title 3, Chapter 27, Section 701 is amended by adding a new Subsection (i) to read as follows:

“(i) The Board shall provide the Legislature with an analysis of the assets and liability implications of each bill that would affect the investment strategy of this System, the funding of this System, or the benefit structure of this System. The analysis shall include an explanation of the methodology employed and the assumptions used in its preparation. Neither the Rules Committee, the Committee on Government Operations, nor the Committee of the Whole shall hear any such bill until the analysis required by this section has been provided to the Legislature. There is, hereby, continuously appropriated, without regard to fiscal years, from the Legislature’s budget, an amount sufficient to pay all costs arising from preparation of such analysis reports, not to exceed ONE HUNDRED THOUSAND DOLLARS (\$100,000) in any one fiscal year.”

“(1) Notwithstanding any other provision of this Chapter, it shall be unlawful for the Virgin Islands Legislature to pass any act or law which increases benefits without making compensations to cover the present and future cost of such benefits and reduce contributions without eliminating benefits which would no longer be finance.”

Recommendation 1.5: Consider the establishment of a temporary moratorium on the issuance of new personal loans until (1) a complete evaluation is made of the status of existing personal loans, (2) loan records are brought up to date, (3) collection actions are begun for delinquent loans, and (4) loan administration procedures are implemented to ensure proper management of the personal loan program.

We are working on correcting and bringing the loan records up to date prior to converting to the new loan system, This should be completed by the end of September, 1999. There are procedures in place for collection of delinquent loans. However, these ptocedures will be reviewed and improved before formally presented as the official policy.

The following procedures are recommended to be followed for delinquent loans until such time that an official regulation is promulgated:

- ▶ Arty account that is 30 days past due shall be identified as a delinquent account.
- ▶ Collectors shall first attempt to contact the delinquent member by telephone and inform him that his account is past due and that an immediate payment is required to bring the account current within five (5) days.
- ▶ If no payment is received after telephone notice is given, a written demand for payment shall be forwarded to the member demanding immediate payment within 48 hours after receipt of demand.
- ▶ If no payment is received following the written notice, the collector shall make a second written demand for payment within 96 hours.
- ▶ After the third notice is given and the member fails to pay the delinquent amount, the collector shall forward the account with notice to the Loan Supervisor for debit action on the member's contributions.
- ▶ The collector shall, after the account has been debited, forward a copy of the debit memorandum to the member advising that his/her contribution account has been debited.
- ▶ In the event that a retiree or member's account becomes deficient or delinquent during the loan repayment period, the account shall be referred to small claims court for collection, to a collection agency, or to civil court for a civil suit to collect the deficient amount.
- ▶ At all times the collector shall keep a record of all activities undertaken with a collection account.
- ▶ On a regular monthly basis, the payment history of delinquent members shall be forwarded to the Credit Bureau for recording on the credit record of the member.

Recommendation 2.1: Immediately initiate collection efforts on all automobile and mortgage loans currently delinquent over 6 months. Specifically, (1) determine whether a delinquent borrower is receiving retirement annuities and, in such instances, initiate collection efforts through semimonthly annuity deductions and notify the borrower of the action and (2) for all other borrowers, issue a new letter informing each borrower that repossession or foreclosure actions will be taken if settlement is not immediately made. For nonresponsive borrowers, forward the account to the System's attorney and follow up on each account to ensure that timely legal actions were taken by the attorney.

Collection efforts have begun with the mortgage and auto loan accounts since these accounts are being cleaned and updated for conversion to the new software. Initial letters are currently being sent to delinquent borrowers. Some accounts have already been referred to the Legal Section for collection. In the past, the Benefits Section did the research to determine if retirees had loans before being placed on the payroll. Because of the serious problems with the System 36, and not being involved with the loan operations on a day to day basis, outstanding loans were not found at the time of their research or erroneous loan balances were picked up. The Loan Section is now completely responsible for research and submitting loan information on retirees to the Benefits Section upon request to avoid the problems that existed in the past.

Recommendation 2.2: In conjunction with Recommendation 1.5, reduce the risk associate& with personal loans by (1) basing each approval on the applicant's prior credit history, continuity of employment, intent, and ability to meet financial obligations and (2) requiring a valid need to be stated and evidence submitted to verify that funds were used for their approved purpose. If funds are not used for their stated purpose, disapprove all future loans to the member.

Personal loans are approved based on 2 years of contributed service. We do not agree that a credit history is necessary for this type of loan since the loans are fully collateralized by the contributions.

Recommendation 2.3: Minimize delinquent accounts by implementing procedures to immediately initiate collection efforts when automobile and mortgage loans become delinquent. When borrowers are nonresponsive to inquiries, ensure that accounts are forwarded to the System's attorney and repossession and foreclosure efforts are timely performed.

There are procedures in place for handling delinquent accounts. The establishment of a collection section, solely responsible for the collection of all loans will be considered, however, after the conversion is completed.

Proposed procedure for referral of delinquent accounts to Staff Attorney:

- ▶ All accounts that exceed \$5,000 and which are 120 days past due and after which three (3) notices have been provided to the member and where there are no contributions available to be debited shall be forwarded to the System Attorney for collection through the courts.
- Accounts which are less than \$5,000 total (principal and interest) the collection department shall attempt to collect the delinquent accounts through small claims court or by forwarding such accounts to a collection agency

Proposed procedure **for** repossession of automobiles.

- ▶ Whenever any auto loan remains delinquent for **a period of ninety (90) days and the delinquent account procedures have been exhausted and the member fails to make payment, the Loan Department shall forward such accounts for repossession to a licensed agent or agency**
- ▶ **Repossessed vehicles shall be stored in a secured enclosure by the repossession agent. The delinquent member shall be given fifteen (15) days to redeem the vehicle by making payment in full of the outstanding delinquent amount.**
- ▶ The repossession agent shall **give five (5) days notice to debtor in accordance with 11A V.I.C. §9-503 et. seq.** The collector shall cause a **copy of said notice to the delinquent member's file.**
- ▶ **All repossessed vehicles shall be advertised and sold in accordance with 11A V.I.C. §9-504.**
- ▶ The System shall not release any vehicles or **re-instate** any delinquent loan after a repossession has taken **place.**

Proposed **Foreclosure** of Real **Estate** Property:

- ▶ For **delinquent mortgage** accounts, foreclosure action **shall be commenced in accordance with Title 28, V.I.C., §53 1-538 within ninety (90) days after a mortgage loan remains unpaid.**

Recommendation 2.4: Monitor the accumulation of interest and penalties on personal loans, and immediately initiate collection efforts when accumulated amounts exceed a member's contribution.

With collection being **done on** the personal loans, the high accumulation of interest on personal loans will be **eliminated. Because** there was no serious effort on personal loans before 1995, there are old loans (6%) **that have accumulated interest** exceeding contributions.

Recommendation 2.7: Establish an escrow account for each mortgage holder so that funds are accumulated toward the payment of insurance premiums and property taxes.

The System is currently looking at establishing forced **placed** insurance. **We believe that** if this is done, many **borrowers** whose loans are **prior to 1990** would opt for escrow payments. **If not,** forced placed insurance will protect the System's **interest.**

Recommendation 2.1: Satisfy the legal requirement for insurance ● eninst a mortgage holder's death or disability by (1) amending the current life insurance policy to include insurance against the total disnbility of a morterec holder, (2) ensuring insurance premiums for the policy are paid within the established grace period, and (3) passing the cost of insurance to mortgage holders by adding a charge to biwckkly payroll deductions.

There are no specific provisions in Title 3, V.I.C., Chapter 27 which provides for mandatory life insurance on mortgage loans. 3 V.I.C. §717(b)11, (b)11(h) 'The statute at 3 V.I.C. §717(b)(10) provides (discretion for the Board to elect such as an option) that life insurance is authorimd and that the System can pass on the charge. There is no mandatory requirement for GERS to impose or require credit life coverage on auto loans

At this point in time. GERS is in the process of acquiring mortgage life insurance with a rider which would include disability and employment protection for ninety (90) days. The 90-day period on the employment protection is standard within the banking industry Under the 90-day employment, the policy will make payments to the System if a member loses his job. Gncrally, these payments are for the limited period of 90 days. however, we are seeking to enlarge that period to 180 days.

The cost of the loan credit life will be passed on pursuant to the provision cited in 3 V.I.C. §717(b)(10), (b)11, (b)(11)(h), however, a statutory amendment is required to enable GERS to pass on the cost for auto loans:

The following amendment is proposed to enable GERS to pass these costs:

Virgin Islands Code, Title 3, Chapter 27, Section 717 (b)(11) is amended by adding a new sentence following the sentence containing the word "dollars" to read:

"In addition to interest, the Board shall charge for credit life insurance on each loan against the eventuality of death, or the total and permanent disability, and the loss of employment of the member, which eventually shall result in a cancellation of any unpaid principal of the loan and any accrued interest thereon as a condition to granting the loan."

Recommendation 2.2: Seek reimbursement from the Mortgage Loan Fund for all losses resulting from mortgage loans.

We do not concur with this finding. We have attached a copy of the GERS correspondence to the former Commissioner of Finance dated August 6, 1997, wherein inquiry was made requesting verification of funding and requesting funding pursuant to Title 33, Section 3026. Title 33, Section 3026 was enacted in 1966 and the sum of \$50,000 was appropriated for the purpose of this section; however, since the passage of the legislation. no funds have been allocated for the Mortgage Loan Fund.

GERS lacks any authority or jurisdiction to compel the Office of Management and Budget or the Commissioner of Finance to source the fund in accordance with the statutory mandate. Although advised about the unfunded situation, the Legislature failed to take appropriate action to ensure that the Administration complied with the spirit and letter of the law.

Recommendation 2.11: Submit a bill to the Legislature which appropriates sufficient funds to finance and establish the Mortgage Loan Fund as outlined in Title 33 of the Virgin Islands Code. Replenish the fund through annual appropriations.

We do not concur with this finding. It is our position that this recommendation be withdrawn because it falls beyond any reasonable scope of authority wherein GERS can be expected to exercise corrective action.

The GERS has implemented this recommendation to the extent of its administrative ability. Appropriate legislation was submitted to the V.I. Legislature and subsequently became law. The Legislature enacted Title 33, Section 3026 of the Virgin Islands Code. Since 1966, the Legislature appropriated \$50,000 for the purpose of funding the Mortgage Loan Fund, however, since that time, the Fund has remained inactive because no funds were allocated. There is nothing within the statutory scope of the GERS that can compel the funding. The continual findings by the Inspector General relative to this recommendation are inappropriate and unfair, and should be discontinued given the fact that GERS has taken appropriate action to implement the recommendation. There is nothing further that GERS can do to compel the V.I. Legislature or the Administration to fund the Mortgage Loan Fund.

Recommendation 4.3: For each quarterly statement received from the custodian, reconcile trade transactions to broker confirmation receipts. Investigate and correct all variances prior to 180 days elapsing after receipt of each statement. During the reconciliation, examine transactions for trades not authorized by the Virgin Islands Code. Notify appropriate investment managers of all unauthorized trades, and initiate administrative actions if unauthorized trades continue.

We do not concur with this finding. Corrective action on this recommendation was implemented as far back as July 1, 1994, when the GERS contracted with the Chase Manhattan Bank to perform Global Custodial Services. That contract bound Chase Manhattan Bank as custodian, to perform a number of custodial services which required Chase to reconcile transactions, examine transactions for unauthorized trades, notify the investment managers of all unauthorized trades, and initiate appropriate actions to cancel unauthorized trades as soon as they are discovered. Such were the responsibilities of the Custodian and those responsibilities were to be performed monthly, prior to the Custodian reports being submitted to the GERS.

Findings that the **GERS** did not have formal procedure³ for reconciling trade transactions to broker confirmation receipts is an inaccurate conclusion. The Custodian **was hired specifically** to perform **those** reconciliations for the GUS. **The** Custodian's monthly reports were closely reviewed to ensure that no unauthorized trades were approved in contravention of **the** Custodian contract provisions.

Each Investment Manager *Contract* incorporates specific language **which** stipulates the types of **investment authorized** by **the** provision of Title 3 V.I.C. §717. All **trade** transactions are **inspected** and scrutinized by the Custodian on a monthly basis. Any discovery of authorized trades are **corrected** within **the** monthly **reporting period** which is **audited** by **the** Custodian. **The** Custodian's audit verified each trade transaction relative to the V.I Code requirements. The Custodian maintained appropriate software programs for evaluating trade transactions as part of their monthly audit process.

There are **several other** levels of audits performed by **request** of the GERS to **ensure** that unauthorized trade transactions do not go undetected. Besides the **monthly** Custodian Audit, the **GERS** has commissioned a **specific Investment Fund** Audit annually that is **performed** by the GERS' Independent Auditor to **ensure** that the **System's** investments are made in conformity with the provisions of Title 3 V.I.C. §717.

There have **been** no recent findings **reported which** would indicate that **unauthorized** trades **were being** conducted by **the Investment Managers**, or that **such** were going undetected by the Global Custodian, Chase Manhattan Bank, or **the GERS**. There is no logical rationale, given the **levels** of additional controls established by **GERS**, **which would imply that there is** a compelling need for **GERS** to **become further involved** in performing additional monthly audits of trade **transactions** beyond those audit **controls** which are made a part of the contractual duties of the **Custodian**.

At the present, GERS is in the transition **process** of changing its Global Custodian **from** Chase **Manhattan Bank** to State **Street** Bank and Trust Company, an institution whose primary services are custodial trust **services** for private and public trust institutions. **State Street** was selected because in addition to all **the** other **global custodial functions they were contracted to perform**, they are **globally recognized** for maintaining an **excellent system** for monitoring trade transactions, and for the submission of **timely** monthly **reports to their** clients. State Street has the ability to deliver a vast range of reports within 24 hours of month-end closings, and they have the technical ability to have **audited reports** available which can be **accessed on-line**, within **three** days of **the** monthly closing.

With these high levels of technological **reporting** and accountability controls, the entire system of controls of the **GERS** will be completely revolutionized to insure against **future unauthorized** trade transactions in the **GERS** investment portfolio.

Recommendation 5.3: Perform a 100 percent review of all annuities when computed at time of retirement. Systematically spot-check the computation for annual increments and cost-of-living allowances to minimize computation errors.

We will begin doing spot checks on annual increments and COLA for accuracy

Recommendation B.1: Require that the independent agencies submit payroll deduction information on a biweekly basis and in a format specified by the Retirement System to meet its processing needs. If any of the independent agencies do not voluntarily meet the Retirement System's requirements, consideration should be given to refusing to process loans for employees of that agency until the requirements are met.

We propose the following statutory amendment:

Virgin Islands Code, Title 3, Chapter 27 is amended by adding a new Section 734 to read as follows:

- “(a) Notwithstanding any other provision of law, neither the Government nor any agency, department, instrumentality, or employer shall fail or refuse to pay the employer's contributions when due to the Employees' Retirement System of the Government of the Virgin Islands, and said agency, department, instrumentality, or employer shall submit payroll deduction information on a biweekly basis and in a format specified by the Retirement System to meet its processing needs.”
- “(b) Whenever any agency, department, instrumentality, or employer shall fail to make timely contributions or submit payroll deduction information, interest shall accrue on the amount of the contributions not paid based on the System's average fixed income investment rate of return for the period that the payment is delinquent, and the System shall refuse to process loans to the employees of the delinquent agency, department, instrumentality, or employer as an additional penalty until the above requirements are met.”

Recommendation R.2: Institute procedures to ensure that loan transactions, including those related to loans to retirees are processed in a timely manner.

Except for those loans which are in the process of being converted, we aim to process payments as soon as we receive them from the paying agencies. Occasionally, there are delays in submission from the respective agencies or there are technical errors beyond our control. We are working on new procedures which will be implemented when the conversion project is completed.

We try to approve all loans expeditiously-- auto loans weekly and mortgages monthly. However, from time to time the applications are received incomplete and we are not always successful in getting additional information in a timely manner.

We are now working with the Legal Section to close mortgages within a reasonable time.

Recommendation 8.3: Expedite the hiring of additional staff to undertake a special project to bring all loan records up to date.

Additional resources are indeed necessary to update loans as well as assist in other areas of the loan conversion. Staff from the St. Croix Office, Benefits, Accounting, and Operations Sections are now assisting with the research of loans prior to conversion.

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ROYL SCHNEIDER
Governor

MEMBER, NASNA
MEMBER, IFEBP

EMPLOYEES' RETIREMENT SYSTEM



August 6, 1997

Honorable Juan Centeno
Acting Commissioner
Department of Finance
#76 Kronprindsens Gade
St. Thomas, Virgin Islands 00802

Dear Commissioner Centeno:

This is to request your **assistanc** in **determining** the current status of the **Mortgage Loan Fund**.

Title 3, Section 717 (1 I) (i) and Title 33, Section 3026 of the Virgin Islands Code authorizes the GERS Board of Trustees to have transferred **from** the Treasury of the Virgin Islands such amounts as are necessary to **restore** to the System any losses **suffered** as a result of defaults on any loans or of any other **cause** incidental to the administration or **operation** of the loan program. Pursuant to Title 33, Section 3026, the Commissioner of **Finance** shall maintain and **provide** for **the** administration of said fund.

According to the annotations, when Section 3026 was enacted in 1966 \$50,000 was appropriated for the purpose of **this** section. I would like to know whether **GERS** received these funds and also if you are **awarc** of the Board authorizing the transfer of additional funds for these purposes?

Further, what procedures or policies are to be **followed** in or&r to have funds transferred to cover losses under the above-mentioned sections.


GOVERNMENT
EMPLOYEES
RETIREMENT
SYSTEM
GERS COMPLEX
VETERAN'S DRIVE
ST. THOMAS, V.I. 00802
PHONE 736-7700
FAX 736-7700

Commissioner Juan Centeno
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August 6, 1997

We are anxious to have this **fund** in place, since we are currently upgrading our loan portfolio and will be completing **this task** no later than December of this year.

Your assistance in this matter will be greatly **appreciated**.

Sincerely,


Willis C. Todmann
Acting Administrator

WCT/CPSI/lss

cc: Board of Trustees

Laurenc E. Bryan, Jr., Administrator

Cecilia P. S. Harrigan, Asst. Administrator

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STATUS OF AUDIT REPORT RECOMMENDATIONS

Finding/Recommendation Reference	Status	Action Rewired
A.1	Management concurs; additional information needed.	Provide target dates and the titles of the officials responsible for implementation of the corrective actions on the outstanding prior audit recommendations, as described in the Retirement System's January 28, 1999, response to the draft report.
A.2, A.3, A.4, A.5, and A.6	Unresolved.	Reconsider the recommendations, and provide action plans that include target dates and titles of officials responsible for implementation,
B.1, B.2, B.3, B.4, and B.5	Unresolved.	Reconsider the recommendations, and provide action plans that include target dates and titles of officials responsible for implementation.

**ILLEGAL OR WASTEFUL ACTIVITIES
SHOULD BE REPORTED TO
THE OFFICE OF INSPECTOR GENERAL**

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