



VIRGINIA RETIREMENT SYSTEM

REPORT ON AUDIT FOR THE YEAR ENDED JUNE 30, 2013

AUDIT SUMMARY

Our audit of the Virginia Retirement System for the year ended June 30, 2013, found:

- the financial statements are presented fairly, in all material respects;
- an internal control finding requiring management's attention; however, we do not consider it to be material weaknesses; and
- no instances of noncompliance or other matters required to be reported under Government Auditing Standards.

We have audited the basic financial statements of the Virginia Retirement System as of and for the year ended June 30, 2013, and issued our report thereon, dated December 2, 2013. Our report is included in the Virginia Retirement System's Annual Report that it anticipates releasing on or around December 5, 2013.

-TABLE OF CONTENTS-

	<u>Pages</u>
AUDIT SUMMARY	
INTERNAL CONTROL FINDING AND RECOMMENDATION	1
INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS	2-3
AGENCY RESPONSE	4-6
AGENCY OFFICIALS	7

INTERNAL CONTROL FINDING AND RECOMMENDATION

Improve Check Receipt and Deposit Controls

The Virginia Retirement System (Retirement System) is not handling checks in accordance with the Retirement System's procedures. The procedures state that checks must be stamped and logged when received; however, the audit found unstamped checks and checks not logged timely in the receipt log. In addition, multiple checks reviewed during the audit were not deposited timely.

It is important that the Retirement System log checks in the receipt log timely and with accurate information in order to create an audit trail and provide a reference for internal deposit tracking purposes. This process will minimize the risk of error and fraud. In addition, holding checks for extended periods may result in expired checks that are not eligible for deposit, errors, or misappropriation of funds. Although the Retirement Systems' policies and procedures do not provide guidance on timely deposits, industry best practice and the Commonwealth Accounting Policies and Procedures manual provide that checks should be deposited within three days of receipt.

Management should strengthen policies and procedures for receiving, researching, and depositing checks timely and ensure that these policies and procedures are followed. These policies and procedures should include guidelines for timely check deposits.



Commonwealth of Virginia

Auditor of Public Accounts

Martha S. Mavredes, CPA
Auditor of Public Accounts

P.O. Box 1295
Richmond, Virginia 23218

December 2, 2013

The Honorable Robert F. McDonnell
Governor of Virginia

The Honorable John M. O'Bannon, III
Chairman, Joint Legislative Audit
And Review Commission

Board of Trustees
Virginia Retirement System

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS

We have audited, in accordance with the 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, the financial statements of the **Virginia Retirement System** as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the Virginia Retirement System basic financial statements, and have issued our report thereon dated December 2, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Virginia Retirement System's internal control over financial reporting to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Virginia Retirement System's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Virginia Retirement System's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies and therefore, material weaknesses

or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify a deficiency in internal control over financial reporting entitled “Improve Check Receipt and Deposit Controls,” which is described in the section titled “Internal Control Finding and Recommendation,” that we consider to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Virginia Retirement System’s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

The Virginia Retirement System’s Response to Findings

We discussed this report with management at an exit conference held on December 4, 2013. The Virginia Retirement System’s response to the findings identified in our audit is described in the accompanying section titled “Agency Response.” The Virginia Retirement System’s response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity’s internal control or on compliance. This report is an integral part of an audit performed in accordance with Government Audit Standards in considering the entity’s internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

AUDITOR OF PUBLIC ACCOUNTS

MSM/alh



MEMORANDUM

TO: Martha S. Mavredes
Auditor of Public Accounts

FROM: Robert P. Schultze 
Director

DATE: December 4, 2013

SUBJECT: Response to APA's - VRS Report on Audit for the Year Ended June 30, 2013

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It is important that the Retirement System log checks in the receipt log timely and with accurate information in order to create an audit trail and provide a reference for internal deposit tracking purposes. This process will minimize the risk of error and fraud. In addition, holding checks for extended periods may result in expired checks that are not eligible for deposit, errors, or misappropriation of funds. Although the Retirement Systems' policies and procedures do not provide guidance on timely deposits, industry best practice and the Commonwealth Accounting Policies and Procedures manual provide that checks should be deposited within three days of receipt.

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VRS Response:

The Virginia Retirement System is aware of the deficiency and has implemented a number of alternative processes intended to correct this weakness. We recognize that an inadequate control of cash receipts and deposits provides opportunities for errors and introduces unnecessary risk. During the period under audit there were a number of extenuating circumstances. These are described below.

The System's primary process for handling checks and deposits for employer contributions has, for more than 30 years, been based on a system where a lockbox was set up and maintained by the System's bank and those checks were deposited daily by the bank into the VRS bank account. VRS was then provided with a daily file of the deposited items and supporting documentation for the posting of those deposited items into the System's accounting records. In addition to the lockbox, the System also used an in-house manual deposit process for checks received for the purchase of service, returned annuity payments, incoming wire transfers, and other special payments.

With the implementation of my VRS Navigator (VNav) in November 2012, the entire cash receipts process was changed. The goal was to move employers to electronic payments and have a less costly and more efficient process than the lock-box system provided. Within VNav, the employer accounts receivable was incorporated within the solution rather than in the accounting records. By design, the incoming payment information is recorded in VNav first and then updated in the accounting records by a file interface. As a result, VRS stopped the lockbox deposit process and had the bank forward all lockbox mail to VRS for processing. This allowed us to direct the pre-conversion payments to the accounting records directly and the post-conversion payments to VNav. At the same time, VRS began converting employers to ACH Debit as the preferred payment method. Using this process VRS would charge the employer's bank account on the specified date and would automatically allocate the payment within VNav. For a variety of reasons, a large number of employers continued to use checks for contribution payments during the implementation period and the early months of production for VNav. In some cases, the employers felt more comfortable making their payments by check until they became more confident in the ability to use VNav generally; and the payment scheduling and application process specifically. In other cases, the employer continued to generate the contribution payments as part of their payroll process rather than using the VNav processes to determine the amount due. As the transition progressed, staff has continued to work with employers to identify and resolve these concerns.

In June 2012, the VRS Board of Trustees was notified of a calculation problem with the Cost of Living Adjustment (COLA) applied to retiree benefits in July 2009. The calculation error in the COLA percentage resulted in an overpayment in approximately 128,992 annuity records for retirees and beneficiaries. The System took immediate action to adjust the COLA percentage and correct the current annuity benefits for those retirees. The System then began a process of collecting the overpaid amount for the period July 2009 through June 2012. Retirees were given the option of paying the full overpaid amount or having the overpaid amount

deducted from their Group Life Insurance benefit at their death. Retirees who had no Group Life Insurance and who did not repay the amount by the due date had their monthly annuity payments actuarially reduced. During the period ended June 30, 2013, VRS received more than 11,200 checks. This far exceeded any previous volumes of in-house checks. In addition, the documentation returned with the checks generally did not have the necessary identifying information for the payment to be applied to the retiree's account. As a result, each of these items had to be researched manually. Since the cutoff for the retirees to settle their obligation with a personal check, VRS has still continued to receive approximately 200 checks each month from Minnesota Life representing deductions from retiree death benefit payments. These checks are applied to the retiree's account to settle the overpayment.

VRS continues to work with employers to eliminate checks and convert to either ACH Debit or ACH Credit. We have recently contacted Minnesota Life about electronic payments and a file transfer for the COLA payments. We expect the COLA changes to be implemented by March 31, 2014 and the conversion of most of the remaining employer checks payments to ACH by June 30, 2014. In addition, we will review the written policies and procedures to ensure that they reflect the System's current processes, and comply with industry best practices and the CAPP manual.

We appreciate the thoroughness and competence of the review of our financial operations. We are confident that your suggestions will assist us in continuing to maintain a financial reporting process that complies with Commonwealth policies and standards and reflects best practices.

If you have any questions concerning the above items, please call me at 344-3120.

c: VRS Board of Trustees

VIRGINIA RETIREMENT SYSTEM

BOARD MEMBERS

As of June 30, 2013

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Vice Chairman

A. Marshall Acuff, Jr.

Edwin T. Burton III.

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Colette Sheehy

Robert P. Schultze
Director