

STATE OF WEST VIRGINIA

AUDIT REPORT

OF

CONSOLIDATED PUBLIC RETIREMENT BOARD
WEST VIRGINIA TEACHERS' DEFINED
CONTRIBUTION RETIREMENT SYSTEM

FOR THE PERIOD

JULY 1, 2002 - JUNE 30, 2004



OFFICE OF THE LEGISLATIVE AUDITOR

CAPITOL BUILDING

CHARLESTON, WEST VIRGINIA 25305-0610

CONSOLIDATED PUBLIC RETIREMENT BOARD
WEST VIRGINIA TEACHERS' DEFINED CONTRIBUTION RETIREMENT SYSTEM
FOR THE PERIOD
JULY 1, 2002 - JUNE 30, 2004

WEST VIRGINIA LEGISLATURE
Joint Committee on Government and Finance

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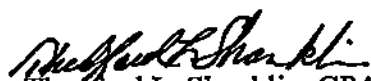
CHARLESTON, WEST VIRGINIA 25305-0610

To the Joint Committee on Government and Finance:

In compliance with the provisions of the West Virginia Code, Chapter 4, Article 2, as amended, we have examined the Teachers' Defined Contribution Retirement System as administered by the Consolidated Public Retirement Board (CPRB).

Our examination covers the period July 1, 2002 through June 30, 2004. The results of this examination are set forth on the following pages of this report.

Respectfully submitted,


Theodore L. Shanklin, CPA, Director
Legislative Post Audit Division

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CONSOLIDATED PUBLIC RETIREMENT BOARD

WEST VIRGINIA TEACHERS' DEFINED CONTRIBUTION RETIREMENT SYSTEM

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CONSOLIDATED PUBLIC RETIREMENT BOARD
WEST VIRGINIA TEACHERS' DEFINED CONTRIBUTION RETIREMENT SYSTEM
EXIT CONFERENCE

We held an exit conference on September 30, 2004 with the Executive Director and other representatives of the Consolidated Public Retirement Board (CPRB) and all findings and recommendations were reviewed and discussed. The agency's responses are included in bold and italics in the Summary of Findings, Recommendations and Responses and after our findings in the General Remarks section of this report.

CONSOLIDATED PUBLIC RETIREMENT BOARD

WEST VIRGINIA TEACHERS' DEFINED CONTRIBUTION RETIREMENT SYSTEM

INTRODUCTION

Consolidated Public Retirement Board

Effective July 1, 1991, Chapter 5, Article 10D of the West Virginia Code created the Consolidated Public Retirement Board (CPRB). The Board's duties are to administer all State Retirement Systems. It shall have all the powers, duties, responsibilities and liabilities of the Public Employees Retirement System (PERS); the Teachers Retirement System (TRS); the Teachers' Defined Contribution Retirement System (TDCRS or TDC Plan); the Death, Disability and Retirement System (Plan A) of the Division of Public Safety; and the Judges' Retirement System (JRS). Subsequent to July 1, 1991, the Board also began administering (in addition to the aforementioned retirement systems) the West Virginia State Police Retirement System (Plan B) on March 12, 1994 and the Death, Disability and Retirement Fund for Deputy Sheriffs on July 1, 1998. Additionally, the Board is responsible for administering a 457 Deferred Compensation Plan, which members of the other State Retirement Systems can utilize to supplement their regular retirement.

The Board consists of 14 members as follows: the Governor, State Treasurer; State Auditor; Secretary of the Department of Administration; four residents of the State who are not members, retirants or beneficiaries of any of the retirement systems; a member, annuitant or retirant of the Public Employees Retirement System who is or was a State employee; a member, annuitant or retirant of the Public Employees Retirement System who is not or was not a State employee; a member, annuitant or retirant of the Teachers Retirement System; a member, annuitant or retirant of

the Division of Public Safety Death, Disability and Retirement System; a member, annuitant or retirant of the Deputy Sheriff's Death, Disability and Retirement System; and, a member, annuitant or retirant of the Teachers' Defined Contribution Retirement System.

The Board elects from its own number a chairman and vice chairman. The Board is granted the authority under State law to appoint an executive director to be the chief administrative officer of all of the retirement systems. The executive director is responsible for employing, with the Board's approval, such administrative, technical and clerical employees as are required in the proper operation of the retirement systems. Also, the Board is authorized by State law to employ a state retirement actuary or actuarial firm and be represented by an attorney who is licensed to practice law in the state of West Virginia who is not a member of any of the retirement systems administered by the Board.

The Board is required by law to meet at least once every three months, with seven voting members constituting a quorum. All board meetings must be public. Members serve without compensation for their services, provided that each member is reimbursed, upon Board approval, for any necessary expenses incurred by them in carrying out their duties. No public employee member may suffer any loss of salary or wages on account of their service as a trustee.

West Virginia Teachers' Defined Contribution Retirement System

The West Virginia Teachers' Defined Contribution Retirement System was created by an Act of the 1990 Legislature during the Third Extraordinary Session. In addition to providing retirement benefits for regular retirants, TDCRS makes provision for members who suffer total and permanent disability and provides certain survivor benefits to the beneficiaries of deceased members. Members of this system contribute 4.5% of their gross wages and employers contribute a matching

amount equivalent to 7.5% of employees' gross salaries. Currently, the TDCRS has more than 21,000 members actively participating in the plan with over \$510,000,000 in plan assets.

Retirement benefits are based solely upon the amounts contributed by the employee and employer plus any earnings. Currently, there are ten investment options available to members for investment of their retirement contributions. The investment options from which members can choose include: money market fund, fixed annuity, bond fund, balanced fund, three large cap stock funds, mid cap stock fund, small cap stock fund, and international stock fund. The Board also offers three profile portfolios (conservative, moderate and aggressive) which members can utilize to meet their investment objectives. Once a member has selected a profile portfolio, the member can let the diversified investment mix in that profile portfolio help the member secure their investment objectives.

Milliman and Robertson, Inc. (Milliman) served as third party administrator for the TDCRS from the inception of the plan in July 1991 through the end of December 2003. Effective January 1, 2004, the Board contracted with Great-West Life and Annuity Insurance Company (Great-West) to serve as the new third party administrator for the Teachers' Defined Contribution Retirement System. Starting February 5, 2004, plan participants could access their account on a daily basis either through Great-West's website or its voice automated system called KeyTalk. Plan participants can utilize either the website or KeyTalk to move all or a portion of their existing investment balances between investment options and to change how their payroll contributions are invested in increments of one percent.

Upon retirement at age 55, participants may choose to receive a lump sum distribution from their participant account; rollover their participant account balance to an IRA; or purchase an annuity contract through the annuity shopping service offered by the Board. The participant has the

option of purchasing an annuity from the following three service providers: Great-West Life & Annuity Insurance Company, Metropolitan Life, and Travelers Life. The participant is encouraged to speak with a retirement counselor about the different annuity options. A participant may choose from the annuity shopping service offered by the Board or choose another distribution method.

Members who terminate their employment and file an application with the Board to withdraw from the system are eligible to receive a lump sum distribution consisting of 100% of their employee contributions and related earnings as well as the appropriate portion (if applicable) of employer contributions and related earnings. However, the amount of employer contributions and related earnings a member is eligible to receive depends on the number of years the member has vested in the system as illustrated by the following table:

Before completing 6 years	No employer contributions
After completing 6 years	1/3 of employer contributions
After completing 9 years	2/3 of employer contributions
After completing 12 years	All employer contributions

In the event of a member's death, the member's designated beneficiary shall be eligible to receive all funds contributed to or accumulated in the deceased member's annuity account regardless of years of service. Also, if a member is granted a permanent and total disability retirement by the Board, the member is entitled to receive all funds contributed to or accumulated in the member's annuity account regardless of years of service.

CONSOLIDATED PUBLIC RETIREMENT BOARD

WEST VIRGINIA TEACHERS' DEFINED CONTRIBUTION RETIREMENT SYSTEM

CONSOLIDATED PUBLIC RETIREMENT BOARD MEMBERS AND STAFF

AS OF JUNE 30, 2004

Governor Bob Wise Ex Officio

Tom Susman, Acting Secretary of
Department of Administration Ex Officio

Glen B. Gainer, III, State Auditor Vice Chairman - Ex Officio

John Perdue, Treasurer Ex Officio

William McGinley State Resident

Janet Wilson State Resident

David Wyant Chairman - State Resident

Carl Guthrie State Resident

Francis A. Hughes State Employee Member
Public Employees Retirement System

Jerry A. Weaver Non-State Employee Member
Public Employees Retirement System

E. Gene Davis Teachers Retirement System Member

David Anderson Teachers' Defined Contribution
Retirement System Member

F. Douglas Beasley Division of Public Safety's Death,
Disability and Retirement Fund Member

Donald T. Murray Deputy Sheriff's Death, Disability
and Retirement Fund Member

STAFF

Joseph J. Jankowski, Jr. Executive Director
Teresa Robertson Deputy Director
Amber L. Stansbury Plan Administrator
Paula Vanhorn Administrative Services Manager I
Janet Atkins Accounting Technician III
Kimberly Brown Administrative Services Assistant III
Lori Cottrill Accountant
Cynthia Boyd Internal Auditor

CONSOLIDATED PUBLIC RETIREMENT BOARD
WEST VIRGINIA TEACHERS' DEFINED CONTRIBUTION RETIREMENT SYSTEM
SUMMARY OF FINDINGS, RECOMMENDATIONS AND RESPONSES

Lack of Effective System of Internal Controls

1. During the course of our audit, it became apparent to us, based on the observed noncompliance with the West Virginia Code, the Consolidated Public Retirement Board did not have an effective system of internal controls in place to ensure compliance with applicable State laws, rules and regulations. Chapter 5A, Article 8, Section 9 of the West Virginia Code requires the agency head to have in place an effective system of internal controls in the form of policies and procedures set up to ensure the agency operates in compliance with the laws, rules and regulations which govern it.

Auditors' Recommendation

We recommend the CPRB comply with Chapter 5A, Article 8, Section 9(b) of the West Virginia Code, as amended, and establish a system of internal controls.

Agency's Response

First and foremost, the CPRB, respectfully, but categorically, disagrees with the blanket statement that concludes "...the Consolidated Public Retirement Board did not have an effective system of internal controls in place to ensure compliance with applicable State laws, rules and regulations." (See pages 17 - 20)

RFP Issued by Board for Third Party Administrator and Additional Investment Options

2. During the audit period, the Board contracted with a new third party administrator (Great-West Life and Annuity Insurance Company). At the same time, the Board added through

a competitive bidding process three new investment fund options and one replacement investment fund option from which plan participants could choose to invest their retirement contributions. Based on each investment fund option selection, the Purchasing Division issued a purchase order on behalf of the Board with each of the investment firms who would be providing the brokerage services for each investment fund option. However, we noted the Board decided to utilize Great-West's broker/dealer affiliate, GWFS Equities, Inc., to provide the brokerage services for these investment fund options rather than the investment firms awarded the contract for these investment fund options through the competitive bid process. Once this decision was made by the Board, the Board cancelled the purchase order issued to each investment firm by the Purchasing Division.

Auditors' Recommendation

Because litigation is pending on this matter, a recommendation is not offered.

Agency's Response

The CPRB disagrees with each and every finding, allegation, purported conclusion of law, and recommendation contained in this section of the report. Since this matter currently is the subject of litigation in the Circuit Court of Kanawha County, the CPRB has been informed by legal counsel that any public comment on the specific issues contained therein is inadvisable and possibly detrimental to the Board's case. Accordingly, no further commentary will be made. (See pages 21 - 29)

Payments to Third Party Administrator for Services Rendered

3. We noted a payment made to the third party administrator (Great-West) for services rendered which totaled \$221,757.75 was not paid from the Consolidated Retirement Board Expense Account. We also noted the participant fees collected from plan participants during the 2004 fiscal year to help fund the CPRB Expense Account along with the Board's share of the 12(b)(1) fees and other miscellaneous fees remitted by the mutual fund providers to Great-West were retained in the Plan Revenue Sharing Account maintained by the third party administrator. These revenues which totaled \$945,560.95 should have been remitted to the Board by Great-West and deposited to the Consolidated Retirement Board Expense Account rather than being maintained by Great-West in the Plan Revenue Sharing Account.

Auditors' Recommendation

We recommend the CPRB comply with Chapter 12, Article 2, Section 2(a) of the West Virginia Code, as amended; Chapter 12, Article 3, Section 1 of the West Virginia Code, as amended; and Title 162, Series 1, Section 5 of the Legislative Rule for the General Administration of the State Retirement Systems by requiring the third party administrator to transfer any monies due the Board (such as participant fees and 12(b)(1) fees) from the Plan Revenue Sharing Account to the CPRB Expense Account to help fund the expenses of the Board.

Agency's Response

We will comply with this audit recommendation. (See pages 30 - 37)

Excess Cash Being Maintained in State Accounts

4. Through discussions with agency personnel, we learned there is excess cash being maintained in both the Member Contribution Account and the Employers Contribution Account. The Member Contribution Account is utilized by the Board to deposit employee contributions remitted by participating employers, while the Employers Contribution Account is utilized by the Board to deposit employer contributions received from participating employers.

Auditors' Recommendation

We recommend the CPRB comply with Chapter 18, Article 7B, Sections 9 and 10 of the West Virginia Code, as amended, by developing written procedures for the monthly reconciliation of the cash balances maintained in their State accounts and outside bank account against their deposit records to ensure the proper amount of retirement contributions are being deposited to the appropriate accounts. We also recommend the CPRB comply with Chapter 5, Article 10C, Section 4(d) of the West Virginia Code, as amended, by working with the Department of Education to develop a format of supporting data to accompany the transfer of State Aid monies on a monthly basis which would assist the Board in determining how much of the monthly allotment of State Aid monies should be allocated between both the Teachers Retirement System and the Teachers' Defined Contribution Retirement System.

Agency's Response

This problem was identified and voluntarily disclosed by the Executive Director of the CPRB. It was reported to the Board members immediately. As noted in the report, the CPRB is in the process of developing written procedures for all TDC functions, including the monthly cash reconciliation. It is scheduled to be completed by November 15, 2004.

(See pages 37 - 43)

Retirement Contributions Not Transferred to Third Party Administrator in Timely Manner

5. During our review of retirement contributions processed by the Board between December 15, 2003 and June 30, 2004, we noted 47 instances out of 50 contribution remittances tested where the Board did not transfer in a timely manner the employee and employer contributions of 47 participating employers from its State accounts to the third party administrator (Great-West) for investment on behalf of plan participants. The contribution remittances relating to these 47 instances totaled \$2,417,389.10.

Auditors' Recommendation

We recommend the Consolidated Public Retirement Board comply with Chapter 18, Article 7B, Sections 9 and 10 of the West Virginia Code, as amended. We further recommend the CPRB consult with both the third party administrator and the Department of Education concerning the possibility of having participating employers remit their contribution remittances directly to the third party administrator rather than to the Board in an effort to reduce the amount of processing time for retirement contributions.

Agency's Response

The CPRB has implemented procedures whereby we receive payroll detail electronically via interfacing with the Department of Education. By the end of the calendar year, we are hoping to allow all participating employers to remit contributions either electronically through an ACH debit or via a lock box system. The procedures help to decrease our auditing and processing time and are in the developmental stages. Since each participating employer has a fiduciary duty to remit contributions timely, the CPRB has also proposed Legislative Rule changes that would allow employers to be assessed a penalty representing lost earnings for any contributions received after 15 days from the payroll interval. The penalty will be allocated to all participating employees of that employer. (See pages 43 - 49)

Processing of Retirement Contributions During
the Transition Between Third Party Administrators

6. During our review of retirement contributions processed by the Board between December 15, 2003 and June 30, 2004, we noted that the Board did not start to remit retirement contributions received from participating employers between December 15, 2003 and January 12, 2004 to the third party administrator for investment on behalf of plan participants until January 12, 2004 due to the transition between third party administrators. Between December 15, 2003 and January 12, 2004, agency records indicate the Board received a total of \$5,856,449.28 in retirement contributions from participating employers.

Auditors' Recommendation

We recommend the CPRB comply with Chapter 18, Article 7B, Sections 9 and 10 of the West Virginia Code, as amended, by ensuring that steps are taken in the future to ensure participant contributions continue to be invested without interruption even though a change in third party administrators is taking place. We further recommend the CPRB comply with Chapter 12, Article 2, Section 2(a) of the West Virginia Code, as amended, when depositing retirement contributions to its State accounts.

Agency's Response

Any change in a Third Party Administrator (TPA) requires a "quiet period" to ensure a proper cut off and transfer of assets. Plan participants were notified in writing about the "quiet period". Group meetings were held across the state to answer any questions from participants and to disseminate a guide explaining the transition. During the transition period, the CPRB worked with Great-West and Milliman to ensure that participant contributions were interrupted as little as possible. Given the short time frame in which we had to implement the transition, CPRB staff worked diligently to uphold our fiduciary duty. In sum, the CPRB could not invest the participant funds during the quiet period because there was no functional recordkeeper to properly account for the funds/contributions. (See pages 49 - 54)

Contributions Remitted to Investment Companies Paid from Wrong State Accounts

7. During our review of retirement contributions processed by the Board between July 1, 2002 and December 15, 2003, we noted one instance of the ten contribution remittances tested where the employee and employer contributions remitted to the investment companies were

paid from the wrong State accounts. As a result, the Board paid \$510,794.69 too much in employee contributions from the Member Contribution Account.

Auditors' Recommendation

We recommend the CPRB comply with Chapter 18, Article 7B, Sections 9 and 10 of the West Virginia Code, as amended.

Agency's Response

We will comply with this audit recommendation. (See pages 54 - 57)

Employee Not Enrolled in TDC Plan Upon Hire

8. During our review of retirement contributions processed by the Board between July 1, 2002 and December 15, 2003, there was one instance totaling \$1,204.11 where a participating employer did not remit the employee and employer contributions on behalf of one plan participant to the Board in a timely manner.

Auditors' Recommendation

We recommend the CPRB ensure participating employers comply with Chapter 18, Article 7B, Sections 9 and 10 of the West Virginia Code, as amended, as well as Chapter 5, Article 10C, Section 4(d) of the West Virginia Code, as amended, when enrolling newly hired employees in the TDC Plan.

Agency's Response

The CPRB has proposed a change to WVCSR §162-3-4.1 and §162-3-4.2 that would require any participating employer who fails to make any payment due the TDC Plan by the 15th day following the end of the pay period to pay earnings lost on the contributions at the actuarial rate of return as determined for the Teachers' Defined Benefit Retirement System. (See pages 58 - 60)

CONSOLIDATED PUBLIC RETIREMENT BOARD

WEST VIRGINIA TEACHERS' DEFINED CONTRIBUTION RETIREMENT SYSTEM

GENERAL REMARKS

INTRODUCTION

We have completed a post audit of the Teachers' Defined Contribution Retirement System as administered by the Consolidated Public Retirement Board. The audit covered the period July 1, 2002 through June 30, 2004.

SPECIAL REVENUE ACCOUNTS

During the audit period, the CPRB maintained several special revenue accounts to contain the retirement contributions received and to account for all expenditures related to the operation of the Teachers' Defined Contribution Retirement System as required by law. Monies collected were deposited with the State Treasurer in the following special revenue accounts:

<u>Account Number</u>	<u>Description</u>
2190	Member Contribution Account Contributions of members transferred to third party administrator for investment on behalf of plan participants.
2191	Employers Contribution Account Contributions of employers through State appropriations transferred to third party administrator for investment on behalf of plan participants.
2192	Suspension Account To receive forfeited contributions from terminated participant accounts to be utilized by participating employers to reduce employer contributions in future years.

LOCAL ACCOUNT

In order to have cash available for specific local operations, local bank accounts are used for managing funds required on a day-to-day basis. These local accounts are described as follows:

Teachers' Defined Contribution Retirement System Account

This account is utilized as a sweep account that is used to transfer member and employer contributions to the retirement plan's third party administrator (Great-West) for investment on behalf of plan participants with designated investment companies. The transfers of monies from this account are under the control of Great-West.

COMPLIANCE MATTERS

Chapter 18, Article 7B of the West Virginia Code generally governs the administration of the Teachers' Defined Contribution Retirement System. We tested applicable sections of the above plus other applicable chapters, articles, and sections of the West Virginia Code as they pertain to financial matters. Our findings are discussed below.

Lack of Effective System of Internal Controls

During the course of our audit, it became apparent to us, based on the observed noncompliance with the West Virginia Code, the Consolidated Public Retirement Board did not have an effective system of internal controls in place to ensure compliance with applicable State laws, rules and regulations. Chapter 5A, Article 8, Section 9 of the West Virginia Code, as amended, states in part:

"The head of each agency shall:... (b) Make and maintain records containing adequate and proper documentation of the organization, functions, policies, decisions, procedures and essential transactions

of the agency designed to furnish information to protect the legal and financial rights of the state and of persons directly affected by the agency's activities....”

This law requires the agency head to have in place an effective system of internal controls in the form of policies and procedures set up to ensure the agency operates in compliance with the laws, rules and regulations which govern it.

During our audit of the Teachers' Defined Contribution Retirement System as administered by the Consolidated Public Retirement Board, we found the following noncompliance with State laws or other rules and regulations: (1) While negotiating the contract for third party administrator services with Great-West Life and Annuity Insurance Company (Great-West), the Board decided to utilize Great-West's broker/dealer affiliate, GWFS Equities, Inc., to provide the brokerage services for the investment fund options offered by the TDC Plan. As a result of this decision by the Board, Wachovia Securities (formerly Prudential Securities) filed a law suit with the Kanawha County Circuit Court against the Board alleging breach of contract by the Board when the Board assigned the responsibility for providing brokerage services for two of the newly added investment funds (Growth Fund of America and Euro Pacific Growth) to Great-West rather than awarding the brokerage services to Wachovia Securities under the Purchase Order issued by the Purchasing Division. (2) We noted a payment made to the third party administrator (Great-West) for services rendered which totaled \$221,757.75 was not paid from the Consolidated Retirement Board Expense Account. We also noted the participant fees collected from plan participants during the 2004 fiscal year to help fund the CPRB Expense Account were retained in the Plan Revenue Sharing Account maintained by the third party administrator. (3) Through discussions with agency personnel, we learned there is excess cash being maintained in both the Member Contribution

Account and the Employers Contribution Account. As of June 30, 2004, the Board has transferred a total of \$2,713,000.00 from these two State accounts to a cash liquidity account maintained with the Treasurer's Office. (4) During our review of retirement contributions processed by the Board between December 15, 2003 and June 30, 2004, we noted 47 instances out of 50 contribution remittances tested where the Board did not transfer in a timely manner the employee and employer contributions of 47 participating employers from its State accounts to the third party administrator (Great-West) for investment on behalf of plan participants. The contribution remittances relating to these 47 instances totaled \$2,417,389.10. (5) During our review of retirement contributions processed by the Board between December 15, 2003 and June 30, 2004, we noted that the Board did not start to remit retirement contributions received from participating employers between December 15, 2003 and January 12, 2004 to the third party administrator for investment on behalf of plan participants until January 12, 2004 due to the transition between third party administrators. Between December 15, 2003 and January 12, 2004, agency records indicate the Board received a total of \$5,856,449.28 in retirement contributions from participating employers. (6) During our review of retirement contributions, we noted one instance where the employee and employer contributions remitted to the investment companies were paid from the wrong State accounts. (7) During our review of retirement contributions processed by the Board between July 1, 2002 and December 15, 2003, there was one instance totaling \$1,204.11 where a participating employer did not remit the employee and employer contributions on behalf of one plan participant to the Board in a timely manner.

We recommend the CPRB comply with Chapter 5A, Article 8, Section 9(b) of the West Virginia Code, as amended, and establish a system of internal controls.

Agency's Response

First and foremost, the CPRB, respectfully, but categorically, disagrees with the blanket statement contained on page 11 that concludes "...the Consolidated Public Retirement Board did not have an effective system of internal controls in place to ensure compliance with applicable State laws, rules and regulations."

Regarding the general information contained on page 11, the following should be noted:

Local Account

Per our contract with Great-West Life & Annuity Insurance Company (Great-West), "funds must be sent via the Automated Clearinghouse (ACH) within the BenLink system functionality." As part of this functionality, Great-West needed to ACH debit our accounts held by the State Treasurer. The State Treasurer does not allow ACH debits of State accounts; therefore, it was imperative that the CPRB establish one local account which would allow ACH debits. After receiving approval from the State Treasurer and State Auditor, the CPRB established the local account with BB&T Bank on December 29, 2003. This account is in the name of the "State of West Virginia Teachers' Defined Contribution System" and is under the sole control of the CPRB.

Teachers' Defined Contribution Retirement System Account

Contrary to what is stated in the report, the transfers of monies from the local account are under the sole control of the CPRB. On a daily basis, the CPRB authorizes Great-West to ACH debit the account for specified dollar amounts that represent participant contributions. To further safeguard this account, we only transfer money into the local account once it has been authorized and is ready to be swept. In theory, it is a "zero balance" account.

**RFP Issued by Board for Third Party Administrator
and Additional Investment Options**

During the audit period, the Board contracted with a new third party administrator (Great-West Life and Annuity Insurance Company). At the same time, the Board added through a competitive bidding process three new investment fund options and one replacement investment fund option from which plan participants could choose to invest their retirement contributions. Based on each investment fund option selection, the Purchasing Division issued a purchase order on behalf of the Board with each of the investment firms who would be providing the brokerage services for each investment fund option. However, we noted the Board decided to utilize Great-West's broker/dealer affiliate, GWFS Equities, Inc., to provide the brokerage services for these investment fund options rather than the investment firms awarded the contract for these investment fund options through the competitive bid process. Once this decision was made by the Board, the Board cancelled the purchase order issued to each investment firm by the Purchasing Division.

During September 2002 the Board issued an RFP through the Purchasing Division soliciting proposals from interested firms to offer third party administrator services and/or one or more of three new investment fund options, plus one investment fund replacement. Following the competitive bidding process, the contract for third party administrator services was awarded to Great-West Life and Annuity Insurance Company in August 2003. Also, the following table details the additional investment fund options added to the TDC Plan for which a blanket release purchase order was issued in October 2003.

<u>Investment Fund Option</u>	<u>Additional or Replacement Fund Option</u>	<u>Type of Investment Fund</u>	<u>Name of Investment Firm</u>
Lord Abbott Small Cap Value Fund A	Replacement*	Small Cap Blend Fund	Prudential Financial
AIM Mid-Cap Core Equity Fund	Additional	Mid Cap Blend Fund	Citistrect
American Funds Growth Fund of America A	Additional	Large Cap Growth Fund	Prudential Securities / Prudential Financial
American Funds Euro Pacific Growth A	Additional	International Fund	Prudential Securities / Prudential Financial

* This fund option was initially selected to replace the Fidelity Advisors Growth Opportunity Fund. However, the Board was subsequently unable to offer this investment option to plan participants since the fund was closed to new investors.

At a meeting of the Consolidated Public Retirement Board held on November 12, 2003, the Board voted unanimously to authorize the executive director of the CPRB to negotiate a contract with Great-West. This decision by the Board was reflected in the Board minutes as follows:

“...made a motion to authorize the Executive Director the authority to negotiate with Great West, within the parameters of the RFP, to effectuate the intent of the Board to maintain financial efficiencies. The motion was seconded by...A vote was taken and motion carried unanimously....”

As part of the contract, the Board negotiated with Great-West to provide the brokerage services for these newly added investment fund options as well as for the existing investment fund plan options even though Great-West had not bid on that portion of the RFP relating to the additional investment fund options. This service to be provided by Great-West is reflected in the contract agreement as follows:

“Purchases and sales of securities at the direction of Participants shall be effected through Great-West’s broker/dealer affiliate, GWFS Equities, Inc. or such other broker/dealer selected by Great-West. Instructions for the purchase, sale, exchange or transfer of shares on behalf of the Plan shall be promptly transferred by Great-West to GWFS Equities, Inc. for processing.”

The following table reflects each investment fund option along with the investment firm providing brokerage services which were offered for investment to plan participants prior to the addition of the aforementioned investment fund options.

<u>Investment Fund Option</u>	<u>Name of Investment Firm</u>
American Funds Washington Mutual Investors A	Prudential Securities
Federated Max Cap Institutional	Federated Investors
Fidelity Advisor Growth Opportunities*	Wachovia Securities
Franklin Income Fund - A	A. G. Edwards
American Funds Bond Fund A	Prudential Securities
Valic Fixed Annuity Option	VALIC
Vanguard Money Market Prime Portfolio	The Vanguard Group

*Note: This investment fund option selection was replaced with a new investment fund option selection during the aforementioned competitive bid process.

At the end of November 2003, the Executive Director sent a letter to the investment firm serving as broker/dealer for each of the existing investment fund options as well as the newly added investment fund options to notify them that Great West's affiliate GWFS Equities, Inc. had been appointed as the new broker for the TDC Plan effective January 1, 2004. This letter served as authorization from the Board terminating the brokerage services of these investment firms and transferring the fund account handled by each investment firm to Great-West. After the decision by the Board, Wachovia Securities (formerly Prudential Securities) filed a law suit in the Kanawha County Circuit Court against the Board alleging breach of contract by the Board when the Board assigned the responsibility for providing brokerage services for two of the newly added investment funds (Growth Fund of America and Euro Pacific Growth) to Great-West rather than awarding the brokerage services to Wachovia Securities under the Purchase Order issued by the Purchasing

Division. As of June 30, 2004, this case has been referred to the Board of Risk and Insurance Management by the Board.

Since the Lord Abbott Small Cap Value Fund A was closed to new investors, the Board had to find another small cap fund to replace this investment fund option. Instead of selecting the next lowest bidder as determined by the evaluation committee, the Board decided to utilize a small cap fund called the Columbia Small Cap Fund - Z which was offered through the trading alliance of Great-West's affiliate GWFS Equities, Inc. with various mutual fund providers. Thus, this investment fund option was not competitively bid. We believe only through some competitive process could the CPRB comply with Chapter 18, Article 7B, Section 6 of the West Virginia Code which states:

"The board has all powers necessary to effectuate the purposes of this article. The board shall contract with a private pension, insurance, annuity, mutual fund or other qualified company or companies to administer the day-to-day operations of the system. In selecting such company or companies the board shall take into account as its highest duty, the proper safeguard and protection of the member and employer contributions and the interest dividends, or other return thereon. The board shall promulgate rules regarding the proper investment of funds notwithstanding the provisions of article six [§ 12-6-1 et seq.], chapter twelve of this code."

Section 8 of the General Terms and Conditions reflected on the back of the Purchase Order/Contract Form issued to each investment firms states:

"CANCELLATION: The Director of Purchasing may cancel any Purchase Order/Contract upon 30 days written notice to the Seller."

Upon reviewing additional documentation provided by the Board relating to the lawsuit brought against the Board, we noted that a representative of Wachovia Securities had filed a formal protest in December 2003 with the Division of Purchasing protesting the cancellation of their purchase

orders by the Board. However, the Director of the Purchasing Division wrote a letter back to Wachovia dismissing Wachovia's protest since Wachovia's contract had not been officially cancelled by the Purchasing Division. This response is evidenced by the following excerpt from the letter sent to Wachovia's representative:

"...This letter is in response to your December 12, 2003 letter protesting the potential cancellation of subject contract. Please be advised that the Department of Administration's Purchasing Division has not canceled this contract. Since the contract has not been canceled, your protest will not be considered...."

Based on the aforementioned criteria and the written response from the Director of the Purchasing Division, we believe the Board did not have the statutory authority to cancel these purchase orders without the concurrence of the Purchasing Division and that a valid contract still exists between the Board and each of the investment firms to which a purchase order was issued by the Purchasing Division.

Also, Section 3.1 of the RFP issued by the Board, which addresses the services requested, states:

"SERVICES REQUESTED

This RFP incorporates the request for both the TPA and the investment services in one document; however, each service proposal will be evaluated independently. Companies proposing investment services may bid to provide one or more of the three new investment fund options or the Fidelity fund replacement for which it satisfies the listed criteria.

Companies proposing TPA services are permitted to propose to provide investment services; however, the decisions on each of the investment options will be made independently of the decision for TPA services and based on the individual merits of each proposal. Fee proposals for each service must be priced independently; however, respondents to this RFP can identify any financial benefit

to the WVTDC in combining TPA and/or investment services. In short, respondents may bid on any of the requested services in any combination; however, the Board will consider each service proposal independently in its evaluation process.”

Additionally, Section 3.2.12 of the General Terms and Conditions of the RFP addresses Contract

Termination as follows:

“3.2.12 Contract Termination:

The State may terminate any contract resulting from this RFP immediately at any time the Vendor fails to carry out its responsibilities or to make substantial progress under the terms of this RFP and resulting contract. The State shall provide the Vendor with advance notice of performance conditions which are endangering the contract’s continuation. If after such notice the Vendor fails to remedy the conditions contained in the notice, within the time period contained in the notice, the State shall issue the Vendor an order to cease and desist any and all work immediately. The State shall be obligated only for services rendered and accepted prior to the date of the notice of termination.

The contract may also be terminated upon mutual agreement of the parties with thirty (30) days prior notice.”

We believe that if the Executive Director had negotiated the contract with Great-West within the aforementioned parameters of the RFP, then the Board may have avoided unnecessary civil litigation being brought against the Board by investment firms dissatisfied with the way in which the Executive Director negotiated the contracts under the RFP.

Upon speaking with the Executive Director, he told us the Board’s decision to transfer the responsibility for providing brokerage services for the TDC Plan investment fund options was done to achieve a more efficient consolidation of services and significant cost savings to the TDC Plan. Regarding the significant cost savings which would be achieved by this decision, he explained that 25% of the 12(b)(1) fees (sales rebates or commissions paid by the mutual fund companies back

to the investment firms acting as brokers of record) received by the third party administrator from the mutual fund providers would go to the TDC Plan rather than to the brokerage firms, while 75% of the 12(b)(1) fees would go to Great-West. Section 9C of the contract between the Board and Great-West addresses 12b-1 fees as follows:

“Great-West shall retain all shareholder service fees and other expense allowances and 75% of all 12(b)(1) fees payable under the Plan. Great-West shall pay to the Plan Revenue Sharing Account 25% of the 12(b)(1) fees actually paid by the fund providers under the Plan. Great-West will issue payments from the Plan Revenue Sharing Account to the Board, on a basis no more frequently than monthly. The Board agrees that any such payments from the Plan Revenue Sharing Account must be with respect to services for the benefit of the Plan Participants and their beneficiaries.”

The Executive Director further explained the Board's share of the 12(b)(1) fees credited to the aforementioned Plan Revenue Sharing Account are used to offset the administrative fees due to Great-West as third party administrator, thus, resulting in cost savings to the TDC Plan.

We noted the Board had a similar arrangement with the former third party administrator (Milliman) as evidenced by the following excerpt from the General Requirements Section of the Board's contract with Milliman:

“The Administrator will enter into agreements with the investment providers to obtain rebates of 12-b(1) fees and/or other fees which will be used either to pay for educational material provided to plan participants or to reduce the cost of the Third Party Administrator.”

Generally, 75% of the 12(b)(1) fees received by the investment firms from the mutual fund providers would go to Milliman and be used to offset the administrative fees owed to Milliman by the Board for recordkeeping duties as third party administrator. The remaining 25% of 12(b)(1) fees would be retained by the investment firms. The following table details during the audit period the amount of 12(b)(1) fees/other fees received by Milliman which were used to offset Milliman's administrative

fees as well as the Board's share of 12(b)(1) fees/other fees received by Great-West which were available to the Board to offset any administrative fees due Great-West.

<u>Third Party Administrator</u>	<u>Amount of 12(b)(1) Fees/Other Fees for FY 2003*</u>	<u>Amount of 12(b)(1) Fees/Other Fees for FY 2004*</u>	<u>Total*</u>
Great-West	-0-	\$ 24,033.45	\$ 24,033.45
Milliman	\$288,077.49	\$233,866.52	\$521,944.01

*Note: To ensure a fair comparison, this table reflects the fees received by the third party administrator from only those investment fund options which plan participants could invest their retirement contributions in prior to the addition of the aforementioned investment fund options.

As the above table reflects, the Board achieved more cost savings from the fees received while Milliman was third party administrator as opposed to Great-West.

We have no recommendation, because litigation is pending on the above matter.

Agency's Response

The CPRB disagrees with each and every finding, allegation, purported conclusion of law, and recommendation contained in this section of the report.

Since this matter currently is the subject of litigation in the Circuit Court of Kanawha County, the CPRB has been informed by legal counsel that any public comment on the specific issues contained therein is inadvisable and possibly detrimental to the Board's case. (See attached Exhibit A) Accordingly, no further commentary will be made.

However, the Board feels that many of the conclusions contained herein (and in other sections as well) are the result of the audit team's unfamiliarity with and/or lack of understanding of investments, securities law and procedures, administration methods of a large public sector defined contribution plan, and the fiduciary obligations of the CPRB.

For example, the illustration contained on p. 21 concerning the application of 12(b)(1) fees and other reimbursements to the revenue sharing account is blatantly inaccurate and inapplicable to the issue being discussed. The correct illustration should be as follows:

<u>Third Party Administrator</u>	<u>Amounts of 12(b)(1) Fees/Other Fees for FY 2003</u>	<u>Amounts of 12(b)(1) Fees/Other Fees for FY 2004</u>	<u>Totals</u>
Great-West	-0-	\$ 63,360.65	\$ 63,360.65
Milliman	\$304,307.26	\$135,445.68	\$439,752.94

Furthermore, the pertinent comparison in this controversy is not what are the relative amounts of 12(b)(1) and other fees paid to the respective TPA's (since they are paid from the mutual fund companies to broker-dealers, they would be the same regardless of who the TPA was), but rather what amounts in revenue sharing can be expected to be received by the TDC from the broker-dealers. Thus, the valid and pertinent comparison is as follows:

<u>Broker-Dealer</u>	<u>Revenue Sharing FY 2004</u>	<u>Expected in Remaining 4.5 years of Contract</u>	<u>Total</u>
GWFS Equities	\$ 246,338.72	\$ 2,004,661.28	\$ 225,000.00
Multiple Retail Brokers	\$ 0.00	\$ 0.00	\$ 0.00

In addition, the investment schedule on p.15 states that the Lord Abbott Small Cap Value Fund A was the replacement fund for the Fidelity Advisors Growth Opportunity Fund; however the American Funds Growth Fund of America A was the actual replacement fund. Consistent with the investment schedule, The Lord Abbott Small Cap Value Fund A was closed to new investors; therefore, upon approval of the Board it was replaced by the Columbia Small Cap Z Fund.

Payments to Third Party Administrator for Services Rendered

We noted a payment made to the third party administrator (Great-West) for services rendered which totaled \$221,757.75 was not paid from the Consolidated Retirement Board Expense Account. We also noted the participant fees collected from plan participants during the 2004 fiscal year to help fund the CPRB Expense Account along with the Board's share of the 12(b)(1) fees and other miscellaneous fees remitted by the mutual fund providers to Great-West were retained in the Plan Revenue Sharing Account maintained by the third party administrator. These revenues which totaled \$945,560.95 should have been remitted to the Board by Great-West and deposited to the Consolidated Retirement Board Expense Account rather than being maintained by Great-West in the Plan Revenue Sharing Account.

Effective January 1, 2004, the Board entered into a contract with Great-West to serve as third party administrator for the Teachers' Defined Contribution Retirement System. Under the terms and conditions of this contract, Great-West is to be compensated by the Board for services rendered as third party administrator in accordance with Section IX of the contract as follows:

*IX. Fees

1. Great-West shall provide the recordkeeping and administrative services described in this Agreement for an annual fee of \$31.50 per Participant per year.

Great-West shall provide the on-going in-person education services described in this Agreement for an annual fee of \$10.44 per Participant per year.

The above fees will be collected from Participant account balances as mutually agreed upon by the parties to this Agreement.

2. Board acknowledges and agrees to pay \$335,300.00 in start up costs upon termination of this Agreement. Great-West agrees

to forgive \$67,060 of the start up costs for each year that this Agreement, or any subsequent agreement, is in effect. The effect of this provision is to reduce the start up costs due to Great-West to zero at the end of the fifth year of the Agreement. Should the Board terminate this Agreement, or any subsequent agreement, between the parties for cause upon the part of Great-West, then, and in that event, Great-West agrees to waive any claim for start up costs.

3. Great-West shall retain all shareholder service fees and other expense allowances and 75% of all 12(b)(1) fees payable under the Plan. Great-West shall pay to the Plan Revenue Sharing Account 25% of the 12(b)(1) fees actually paid by the fund providers under the Plan. Great-West will issue payments from the Plan Revenue Sharing Account to the Board, on a basis no more frequently than monthly. The Board agrees that any such payments from the Plan Revenue Sharing Account must be with respect to services for the benefit of the Plan Participants and their beneficiaries.
4. If the Board requests that more than twelve (12) unallocated investment accounts and three (3) pre-mixed asset allocation funds be opened, Great-West reserves the right to modify the fees referenced in this Section with the prior consent and approval of the Board.
5. The parties agree that any services which are requested to perform beyond the scope of the services described in this Agreement shall be provided at a mutually agreed upon price negotiated prior to the performance of such services with the prior consent and approval of the Board.
6. Great-West agrees to pay the Purchasing Division the \$45 annual required registration fee to the State of West Virginia.”

When initially established by the third party administrator, the Plan Revenue Sharing Account was maintained as part of the participant contributions being invested with the Bond Fund of America. At a Board meeting held on February 25, 2004, the Board voted unanimously to transfer the Plan Revenue Sharing Account to the Conservative Profile Portfolio. The Conservative Profile

Portfolio is composed of a diversified mix of investment options offered by the TDC Plan. Once approved by the Board, the Plan Revenue Sharing Account was transferred over to become part of the participant contributions comprising the Conservative Profile Portfolio Account.

Between January 1, 2004 and June 30, 2004, the Plan Revenue Sharing Account was funded through mutual fund reallowances (finder's fees or sales commissions) and 12(b)(1) fees provided by mutual fund providers and credited to this account by the third party administrator. Also, a quarterly administrative fee of \$8.75 (or \$35.00 annually) was deducted against each participant's account by the third party administrator on behalf of the Board and credited to the Plan Revenue Sharing Account. These monies are required by State law to be assessed plan participants and then transferred to the CPRB Expense Account to help fund the expenses of the Board.

Through discussions with agency personnel, we learned the Board and the third party administrator agreed that the monies residing in the Plan Revenue Sharing Account would be utilized to offset the administrative fees owed to the third party administrator. Once each quarterly invoice received from Great-West has been reviewed and approved for payment by the appropriate agency personnel, the Plan Administrator for the TDC Plan will email her contact at Great-West authorizing the third party administrator to withdraw the administrative fees owed from the Plan Revenue Sharing Account. However, we believe the aforementioned invoice for services rendered as third party administrator should have been paid from the Consolidated Retirement Board Expense Account and not the Plan Revenue Sharing Account maintained by the third party administrator. We further believe both the participant fees collected from plan participants during the 2004 fiscal year and the Board's share of 12b-1 fees and other miscellaneous fees which were retained in the Plan Revenue Sharing Account should have been transferred to the CPRB Expense Account in accordance with State law.

Title 162, Series 1, Section 5 of the Legislative Rule promulgated for the General Administration of the Retirement Systems addresses payment of expenses of the Board as follows:

“5.1. The Consolidated Public Retirement Board shall create an Expense Fund which shall be funded by an assessment against the Teachers Defined Benefit Retirement System, the Public Employees Retirement System, the Judges’ Retirement System, the Public Safety Death, Disability and Retirement Fund, the West Virginia State Police Retirement System and the West Virginia Deputy Sheriff Retirement System, with payment out of earnings and the employers part of the Teachers Defined Contribution Plan in an amount determined by the Board, per year, for each active employee, retirant and beneficiary receiving benefits.

5.2. All administrative costs of the Board, including, but not limited to, salaries and employee benefits, shall be paid from the expense fund. However, any indemnification required pursuant to subsection 5.4 of this Rule shall be paid from the particular Retirement System affected.

5.3 The administrative expense fund is not subject to satisfaction of any judgment or award against any of the Retirement Systems, and the judgment or award shall be satisfied from assets of the particular Retirement System against which it is levied.”

Also, Chapter 12, Article 3, Section 1 of the West Virginia Code, as amended, addresses the payment of vendor invoices. This Code section states in part:

“Every person claiming to receive money from the treasury of the state shall apply to the auditor for a warrant for same. The auditor shall thereupon examine the claim, and the vouchers, certificates and evidence, if any, offered in support thereof, and for so much thereof as he or she finds to be justly due from the state, if payment thereof is authorized by law, and if there is an appropriation not exhausted or expired out of which it is properly payable, the auditor shall issue his or her warrant on the treasurer, specifying to whom and on what account the money mentioned therein is to be paid, and to what appropriation it is to be charged. The auditor shall present to the treasurer daily reports on the number of warrants issued, the amounts of the warrants and the dates on the warrants for the purpose of effectuating the investment policy of the investment management

board. On the presentation of the warrant to the treasurer, the treasurer shall ascertain whether there are sufficient funds in the treasury to pay that warrant, and if he or she finds it to be so, he or she shall in that case, but not otherwise, endorse his or her check upon the warrant, directed to some depository, which check shall be payable to the order of the person who is to receive the money therein specified....”

Additionally, the proper handling of cash receipts by State agencies is addressed by Chapter 12, Article 2, Section 2(a) of the West Virginia Code, as amended, which states:

“(a) All officials and employees of the state authorized by statute to accept moneys due the state of West Virginia shall keep a daily itemized record of moneys so received for deposit in the state treasury and shall deposit within twenty-four hours with the state treasurer all moneys received or collected by them for or on behalf of the state for any purpose whatsoever. The treasurer shall be authorized to review the procedures and methods used by officials and employees authorized to accept moneys due the state and change such procedures and methods if he or she determines it to be in the best interest of the state: *Provided*, That the treasurer shall not be authorized to review or amend the procedures by which the department of tax and revenue accepts moneys due the state. The treasurer shall propose rules, in accordance with the provisions of article three, chapter twenty-nine-a of this code governing the procedure for deposits.

The official or employee making such deposits with the treasurer shall prepare deposit lists in the manner and upon report forms as may be prescribed by the treasurer. Certified or receipted copies shall be immediately forwarded by the state treasurer to the state auditor and to the secretary of administration. The original of the deposit report shall become a part of the treasurer’s permanent record.”

Records provided by the third party administrator to the Board indicate the Plan Revenue Sharing Account had an account balance of \$723,803.20 as of June 30, 2004. The monies residing in this account as of June 30, 2004 represent monies belonging to the Board. Since these monies have not been transferred to the CPRB Expense Account in accordance with State law, the Board is without the use of these funds to pay for other expenses of the CPRB as they arise. The

Plan Administrator for the TDC Plan told us the method of paying the administrative fees owed to the third party administrator through the Plan Revenue Sharing Account was agreed to by both the Board and Great-West due to both parties believed this to be the most efficient way to compensate the third party administrator.

We recommend the CPRB comply with Chapter 12, Article 2, Section 2(a) of the West Virginia Code, as amended; Chapter 12, Article 3, Section 1 of the West Virginia Code, as amended, and Title 162, Series 1, Section 5 of the Legislative Rule for the General Administration of the State Retirement Systems by requiring the third party administrator to transfer any monies due the Board (such as participant fees and 12(b)(1) fees) from the Plan Revenue Sharing Account to the CPRB Expense Account to help fund the expenses of the Board.

Agency's Response

WVCSR § 162-1-5.1 states:

"The Consolidated Public Retirement Board shall create an Expense Fund which shall be funded by an assessment against the ... Teachers Defined Contribution Plan in an amount determined by the Board, per year, for each active employee..."

In accordance with WVCSR §162-1-5.1, the CPRB has established an Expense Fund. This Fund is subdivided into an expense account held with the State Treasurer (which earns no interest) and a revenue sharing expense account held with Great-West (which includes earnings). Both accounts remain under our control, and the CPRB Executive Director, TDC Plan Administrator, and CPRB Accountant authorize all payments made out of both sub-expense accounts. Please note, the legislative rule does not specify that all expense funds must be held with the State Treasurer. Therefore, the CPRB is in compliance with WVCSR §162-1-5.1.

The report also references WV Code §12-3-1 and §12-2-2a regarding payment of vendor invoices and procedures for depositing monies due the State. In practice, the CPRB does follow many of the procedures outlined in these Code sections. For example, we ensure that all contributions are remitted within 24 hours of receipt. However, all monies of the Teachers' Defined Contribution System are assets of the Trust Fund and are not part of the State Treasury. Therefore, WV Code § 12-3-1 and §12-2-2a are inapplicable. (See attached Exhibit B)

Per our contract with Great-West, the revenue sharing expense account was established to monitor participant fees collected and fees paid to Great-West. It provides a record and audit trail of all transactions relating to expenses. In our opinion, this is a smart business practice because:

- the CPRB receives earnings on the money while it is invested*
- it eliminates the need for unnecessary "paper" checks*
- it reduces the delay in writing and mailing "paper" checks, both for the CPRB and Great-West, and*
- it is consistent with our administration of the expense accounts for the defined benefit plans where all monies are invested with the West Virginia Investment Management Board (WVIMB) until needed to pay expenses. At that time, the money is transferred to the related expense account with the Treasurer's Office.*

Furthermore, the establishment of the revenue sharing expense account is consistent with the CPRB's fiduciary obligation under WV Code §18-7B-6 which gives the Board "all powers necessary...to contract with a private pension, insurance, annuity, mutual fund or other qualified company or companies to administer the day-to-day operations of the system. In selecting such company or companies the board shall take into account as its highest duty, the proper safeguard and protection of the member and employer contributions and the interest dividends, or other return thereon."

Contrary to p. 23 of the report, the revenue sharing expense account is not maintained as part of the participant contribution accounts. The revenue sharing expense account is a completely separate account. Funds are not commingled.

In addition to the information on p.24, both the Executive Director and the TDC Plan Administrator review the quarterly invoice from Great-West. Once the Executive Director and the TDC Plan Administrator agree to the invoice amount, the Plan Administrator will authorize Great-West to transfer the invoice amount from the revenue sharing expense account.

- ▶ Great-West will deposit administrative fees deducted from participant's accounts, 12(b)(1) fees and other fees into the revenue sharing expense account*
- ▶ Great-West will invoice CPRB for services*
- ▶ The appropriate amount owed Great-West will be transferred from the revenue sharing expense account to the CPRB Expense Fund (Fund 2120) held at the Treasurer's Office*
- ▶ CPRB will prepare a FIMS invoice cover sheet along with the necessary backup documentation to be sent to the Auditor's Office for electronic approval for payment*
- ▶ Payment, either by check or electronic transfer, will then be made to Great-West*

Excess Cash Being Maintained in State Accounts

Through discussions with agency personnel, we learned there is excess cash being maintained in both the Member Contribution Account and the Employers Contribution Account. Each of these accounts is a Special Revenue Account maintained with the State Treasury. The Member Contribution Account is utilized by the Board to deposit employee contributions remitted by participating employers, while the Employers Contribution Account is utilized by the Board to deposit employer contributions received from participating employers.

While the Board was undergoing a transition process between third party administrators for the TDC Plan in December 2003, CPRB personnel noticed significant cash balances being maintained in each of these State accounts. Currently, the Board's internal auditor is researching the Board's accounting records to try and account for the large balances. Based on the work performed to date by the Board's internal auditor, the Board established a cash liquidity account through the Treasurer's Office for the purpose of transferring any excess monies residing in each State account. As of June 30, 2004, the Board has transferred a total of \$2,713,000.00 from these two State accounts to the cash liquidity account. Of this amount, \$955,000.00 was transferred from the Member Contribution Account while \$1,758,000.00 was transferred from the Employers Contribution Account. According to Accounting Department personnel, these monies will remain in the cash liquidity account until the Board clearly identifies the appropriate State accounts to which these excess monies should be transferred.

Through discussions with the Board's internal auditor and other agency personnel, we learned the excess cash balance being maintained in the Member Contribution Account was generally due to employer contributions received from participating employers or the investment companies were erroneously deposited to this account rather than the Employers Contribution Account. Thus, the excess cash maintained in this account resulted from the cumulative effect of clerical errors committed by agency personnel responsible for processing deposits since the inception of the TDC Plan in July 1991.

Regarding the Employers Contribution Account, we learned the excess cash balance being maintained in this account was generally due to too much State Aid monies received from the Department of Education being transferred to this account. Based on discussions with agency

personnel, the CPRB was not properly allocating the monthly allotment received from the Department of Education representing employer contributions for both the Teachers Retirement System and Teachers' Defined Contribution Retirement System between the appropriate State accounts maintained by the Board for each retirement system. Thus, the cumulative effect of these errors since the inception of the TDC Plan in July 1991 resulted in an excess cash balance being maintained in the Employers Contribution Account.

Monthly, the State Board of Education transfers a large sum of money into the School Aid Formula Funds Holding Account representing employer contributions for both the Teachers Retirement System and the Teachers' Defined Contribution Retirement System. The Board does not receive any detail from the Department of Education on how to allocate the monies transferred between the two systems. To determine the amount of employer contributions to transfer to the TDC Plan, the Board's Accounting Department must rely on deposit information provided by agency personnel responsible for administering the TDC Plan. Once this amount is determined, Accounting Department personnel will transfer the appropriate amount of employer contributions from the School Aid Formula Funds Holding Account to the Employers Contribution Account. The remaining monies in the School Aid Formula Funds Holding Account are then transferred to the Teachers Retirement System. The Board's internal auditor noted that over the last several years there were numerous instances where the incorrect amount of State Aid monies were transferred to the TDC Plan due to incorrect deposit information was relayed from agency personnel who administered the TDC Plan to the Accounting Department.

The Board's internal auditor has not completed researching the Board's records; thus, additional excess monies may be found through further research. Since the Board has not fully

identified the total amount of excess cash being maintained in these accounts, we were unable to verify the reasonableness of the amounts transferred to the cash liquidity account.

The following sections of the West Virginia Code address the proper handling of employee and employer contributions received by the Board for the TDC Plan. Chapter 18, Article 7B, Section 9 of the West Virginia Code, as amended, states in part,

“Each employee who is a member of the defined contribution system shall contribute four and one-half percent of his or her gross compensation by salary reduction. Such salary reductions shall be made by the employer at the normal payroll intervals and shall be remitted within five working days to the private pension, insurance, annuity, mutual fund, or other qualified company or companies designated by the board to administer the day-to-day operations of the system...”

Also, Chapter 18, Article 7B, Section 10 of the West Virginia Code, as amended, states in part,

“Each participating employer shall annually make a contribution equal to seven and one-half percent of each member’s gross compensation. The pro rata share of this amount shall be paid upon each date that a member contribution is made and shall be remitted as provided for in section nine [18-7B-9] of this article for credit to the member’s annuity account. Each participating employer has a fiduciary duty to its employees to ensure that the employer contributions are timely made...”

Additionally, Chapter 5, Article 10C, Section 4(d) of the West Virginia Code, as amended, states,

“(d) The amount of employee contributions picked up by the participating public employer shall be paid to the retirement system in the manner and form, and in the frequency required by the board of trustees and shall be accompanied by supporting data that the board of trustees may prescribe. When paid to the retirement system, each of these amounts shall be credited to the deposit fund account of the member for whom the contribution was picked up and paid by the participating public employer.”

Allocating too much of the State Aid monies received monthly from the Department of Education to the Teachers' Defined Contribution Retirement System may result in there not being enough monies available within the State accounts for the Teachers Retirement System to fund the retirement annuities paid to TRS members.

Through our discussions with agency personnel, we learned the Board had not implemented any procedures prior to January 2004 whereby the Board would reconcile on a monthly basis the cash balance for each of these State accounts per the State Auditor's Account Status Report against the Board's deposit records. We believe these clerical errors resulting in excess cash balances being maintained in each State account would have been detected in a timely manner had the Board implemented reconciliation procedures prior to January 2004. Since January 2004, the Board has begun reconciling on a monthly basis the cash balances being maintained in both State accounts against the Board's deposit records.

We recommend the CPRB comply with Chapter 18, Article 7B, Sections 9 and 10 of the West Virginia Code, as amended, by developing written procedures for the monthly reconciliation of the cash balances maintained in their State accounts against their deposit records to ensure the proper amount of retirement contributions are being deposited to the appropriate accounts. We also recommend the CPRB comply with Chapter 5, Article 10C, Section 4(d) of the West Virginia Code, as amended, by working with the Department of Education to develop a format of supporting data to accompany the transfer of State Aid monies on a monthly basis which would assist the Board in determining how much of the monthly allotment of State Aid monies should be allocated between both the Teachers Retirement System and the Teachers' Defined Contribution Retirement System.

Agency's Response

As of December 31, 2003, the CPRB identified approximately \$4.4m in funds that could be considered excess cash. Since January 2004, the CPRB's Internal Auditor has spent approximately 95% of her time researching this issue. As of August 13, 2004, \$2.65m remains unreconciled and is invested in a cash liquidity account with the State Treasurer. To date, the Internal Auditor has researched transactions from 1995 to the present and continues to research transactions from 1991 to 1994.

This problem was identified and voluntarily disclosed by the Executive Director of the CPRB. It was reported to the Board members immediately.

Please note: During the previous 12 years of the TDC Plan, no CPRB staff or any legislative or external audit identified this issue.

To prevent this error in the future, the following internal control procedures were implemented as of January 1, 2004:

- Deposits and remittances (I-doc) are prepared by one staff member.*
- Either the TDC Plan Manager or Plan Administrator review the deposits and remittances and approve electronically via IRMA.*
- The CPRB Accountant also reviews the deposits and remittances.*
- Monthly cash reconciliations are performed to ensure any errors not identified previously are identified and corrected promptly.*

As noted in the report, the CPRB is in the process of developing written procedures for all TDC functions, including the monthly cash reconciliation. It is to be scheduled to be completed by November 15, 2004.

Another recommendation in the report is to work with the Department of Education to develop a format of supporting documentation for the transfer of State Aide monies

to assist in the allocation of those monies between the Teachers Retirement System and the Teachers' Defined Contribution System. On multiple occasions, we have worked with the Department of Education to develop supporting documentation separated by county and by participant. To date, the Department of Education does not have the ability to provide such documentation due to the complexity of the State Aide calculation.

**Retirement Contributions Not Transferred to
Third Party Administrator in Timely Manner**

During our review of retirement contributions processed by the Board between December 15, 2003 and June 30, 2004, we noted 47 instances out of 50 contribution remittances tested where the Board did not transfer in a timely manner the employee and employer contributions of 47 participating employers from its State accounts to the third party administrator (Great-West) for investment on behalf of plan participants. The contribution remittances relating to these 47 instances totaled \$2,417,389.10. This same finding was reported in the previous audit.

Chapter 18, Article 7B, Section 9 of the West Virginia Code, as amended, states in part:

"Each employee who is a member of the defined contribution system shall contribute four and one-half percent of his or her gross compensation by salary reduction. Such salary reductions shall be made by the employer at the normal payroll intervals and shall be remitted within five working days to the private pension, insurance, annuity, mutual fund, or other qualified company or companies designated by the board to administer the day-to-day operations of the system.

All member contributions shall be immediately deposited to an account or accounts established in the name of the member and held in trust for the benefit of the member...." [Emphasis added.]

In addition, Chapter 18, Article 7B, Section 10 of the West Virginia Code, as amended, states in part:

“Each participating employer shall annually make a contribution equal to seven and one-half percent of each member’s gross compensation. The pro rata share of this amount shall be remitted as provided for in section nine [§18-7B-9] of this article for credit to the member’s annuity account. **Each participating employer has a fiduciary duty to its employees to ensure that the employer contributions are timely made.** In the case of an officer or employee of the state, any unpaid contribution shall be a state debt, contracted as a result of a casual deficit in state revenues; to be accorded preferred status over other expenditures....” [Emphasis added.]

Using average annual rates of return of all the available investment options, we estimated plan participants lost approximately \$4,000 in investment earnings due to the time lag between the date employees were actually paid and remittance of related retirement contributions to the third party administrator. Further detailed information on the amount of investment earnings lost is provided in the following table.

<u>Number of Days Elapsed Before Monies Transferred to TPA</u>	<u>Number of Remittances</u>	<u>Percent</u>	<u>Average Number of Days Processed Late</u>	<u>Estimated Dollar Amount of Lost Earnings</u>
0 - 30	43	91.49%	9	\$3,000
Over 30	<u>4</u>	<u>8.51%</u>	35*	<u>\$1,000</u>
	<u>47</u>	<u>100.00%</u>		<u>\$4,000</u>

* Note: These contribution remittances were received by the Board while the Board was changing over to a new third party administrator to administer the TDC Plan. During the transition between third party administrators, no monies collected by the Board were transferred to the new third party administrator to be invested on behalf of plan participants. This period lasted from December 15, 2003 through January 12, 2004. Thus, the transition between third party administrators is the reason there was a lengthy delay in processing these retirement contributions.

The situation referred to above where some remittances were processed late due to the transition between third party administrators is discussed in further detail in a subsequent finding.

We believe these retirement contributions were not remitted to the third party administrator on behalf of plan participants within five working days of the participating employer's normal pay date due to timing delays caused by the system utilized by the Board to process retirement contributions. Under this system, participating employers will mail their remittance of employee and employer contributions to the Board on their normal payroll intervals. For these 47 contribution remittances, we noted that an average of four days elapsed between the participating employer's normal pay date and the date these monies were received by the Board. Once received by the Board, CPRB personnel will audit the Payroll Remittance Report submitted by the participating employer and then deposit the check payment representing employee and employer contributions received to the appropriate State accounts. Generally, each participating employer will only pay a portion of the employer contributions with the remaining amount being funded through a monthly transfer of State Aid monies to the Board's State accounts from the Department of Education.

Next, the employee and employer contributions along with any applicable State Aid monies are transferred by the Board to an outside bank account set up by the Board to help facilitate the transfer of retirement contributions to the third party administrator. A contribution data file which corresponds to the retirement contributions remitted to the Board by the participating employer will usually be e-mailed to the Board by the Regional Education Service Agency (RESA) servicing that county board of education one or two days following the receipt of this remittance by the Board. This contribution data file, which contains a listing of all participants and their related employee and employer contribution information, is uploaded as soon as possible to the third party administrator's website. Once the third party administrator receives this information, the third party

administrator will initiate a wire transfer to transfer the appropriate amount of employee and employer contributions from the outside bank account to their accounts for investment of the monies on behalf of plan participants. Each participant's annuity account as maintained by the third party administrator is credited for these contributions as soon as the third party administrator successfully receives the contribution data file through its website.

In an effort to reduce the amount of time it takes to process a contribution remittance received by the Board, the Plan Administrator for the TDC Plan told us the Board is working with IS&C to develop a process which would allow the Board to receive a participating employer's contribution data file at the same time as the Board receives the contribution remittance from the participating employer. The Plan Administrator stated that the contribution data file would be electronically transmitted directly to the CPRB personnel responsible for processing contributions via the IS&C's computer system. She further explained the IS&C's computer system would act as an interface between the participating employer's computerized payroll system and the Board's computer system. According to the Plan Administrator, this transmission process for payroll data files was to be implemented effective July 1, 2004.

We recommend the Consolidated Public Retirement Board comply with Chapter 18, Article 7B, Sections 9 and 10 of the West Virginia Code, as amended. We further recommend the CPRB consult with both the third party administrator and the Department of Education concerning the possibility of having participating employers remit their contribution remittances directly to the third party administrator rather than to the Board in an effort to reduce the amount of processing time for retirement contributions.

Agency's Response

WV Code §18-7B-9 states:

"Each employee who is a member of the defined contribution system shall contribute 4.5% of his/her gross compensation by salary reduction. Such salary reductions shall be made by the employer at the normal payroll intervals and shall be remitted within 5 working days to the private pension, insurance, annuity, mutual fund, or other qualified company or companies designated by the board to administer the day-to-day operations of the system."

WV Code §18-7B-10 states:

"Each participating employer has a fiduciary duty to its employees to ensure that the employer contributions are timely made."

In regard to WV Code §18-7B-9, the CPRB has always interpreted this code to mean that participant contributions shall be remitted within 5 days after receipt to our TPA. It is impossible to remit contributions within 5 days of the payroll interval (i.e. pay date) given that we are dependent upon each of the 65 payroll locations to provide the necessary funds and information. As stated on p. 33 of the report, it takes on average 4 days for us to receive the contributions from the payroll locations via the mail. Once the contributions are received, the CPRB must audit the payroll remittance report, receive and agree the payroll detail to the contributions received, deposit the funds, transfer the funds, and then remit the payment to Great-West. This process takes a minimum of 5 working days. Thus, the CPRB will propose statutory changes to codify our current procedures.

Furthermore, the CPRB has implemented procedures whereby we receive payroll detail electronically via interfacing with the Department of Education. By the end of the calendar year, we are hoping to allow all participating employers to remit contributions either electronically through an ACH debit or via a lock box system. These procedures help to decrease our auditing and processing time and are in the developmental stages.

In regard to WV Code §18-7B-10, the CPRB considers it part of our fiduciary duty to ensure employer contributions are made in a timely manner. As part of this duty, we track when contributions are received by each of the 65 payroll locations. If a contribution is not received in accordance with the normal payroll interval, CPRB staff will contact the payroll location. Additionally, the TDC Plan Administrator reviews the tracking report on a monthly basis as an additional control procedure.

Since each participating employer also has a fiduciary duty to remit contributions timely, the CPRB has proposed Legislative Rule changes that would allow employers to be assessed a penalty representing lost earnings for any contributions received after 15 days from the payroll interval. This penalty will be allocated to all participating employees of that employer.

The CPRB reviewed all 47 instances purported to be remitted in an untimely manner. By using our interpretation of WV Code §18-7B-9, the chart on p. 32 of the report should be as follows.

<u># of Days Until Transfer</u>	<u>Number of Remittances</u>	<u>Percent</u>	<u>Avr. # of Days Processed Late</u>	<u>Total Est. Lost Earnings</u>
0-5 days	6	13%	0	\$ 205
6-10 days	29	62%	2	\$2,204
11-25 days	11	23 %	12	\$1,648
25+ days	<u>1</u>	<u>2%</u>	27	<u>\$ 1</u>
	47	100%		\$4,058

Note, the number of business days, excluding holidays, starts with receipt of the contribution and ends the day the contribution is transferred to Great-West.

Therefore, 6 of the 47 remittances were processed timely. Twenty-nine of the 47 remittances were processed on average only 2 days late. Of the remaining 12 remittances, 7 occurred during December 15, 2003 and January 12, 2004 when no remittances could be processed. In addition, 18 of the 47 remittances were processed during January 2004 when we were working overtime to process approx. 200 remittances received from December 15, 2003 through January 31, 2004.

The recommendation that we have participating employers remit directly to Great-West to reduce processing time (p. 35) is in complete opposition with our fiduciary duty. We must verify each remittance to ensure contributions are in accordance with State statutes and we must ensure the appropriate audit trail is maintained. If this recommendation were to be negotiated with Great-West, participant fees would need to be increased to pay for the additional services provided by Great-West. This certainly is not a prudent decision for the participants.

**Processing of Retirement Contributions During
the Transition Between Third Party Administrators**

During our review of retirement contributions, we noted the Board did not start to remit retirement contributions received from participating employers between December 15, 2003 and January 12, 2004 to the new third party administrator for investment on behalf of plan participants until January 12, 2004. This was due to the transition between third party administrators. Between December 15, 2003 and January 12, 2004, agency records indicate the Board received a total of \$5,856,449.28 in retirement contributions from participating employers. We noted an average of 39 days had elapsed from the time these monies were received by the Board until these monies were transferred to the third party administrator for investment on behalf of plan participants. Using average annual rates of return of all the available investment options, we

estimated plan participants lost approximately \$32,000 in investment earnings as a result of these monies not being transferred to the third party administrator in a timely manner.

Chapter 18, Article 7B, Section 9 of the West Virginia Code, as amended, addresses the timely remittance of retirement contributions to the third party administrator. This section states in part:

“Each employee who is a member of the defined contribution system shall contribute four and one-half percent of his or her gross compensation by salary reduction. Such salary reductions shall be made by the employer at the normal payroll intervals and shall be remitted within five working days to the private pension, insurance, annuity, mutual fund, or other qualified company or companies designated by the board to administer the day-to-day operations of the system.

All member contributions shall be immediately deposited to an account or accounts established in the name of the member and held in trust for the benefit of the member....”

Additionally, Chapter 18, Article 7B, Section 10 of the West Virginia Code, as amended, states in part:

“Each participating employer shall annually make a contribution equal to seven and one-half percent of each member’s gross compensation. The pro rata share of this amount shall be remitted as provided for in section nine [§ 18-7B-9] of this article for credit to the member’s annuity account. Each participating employer has a fiduciary duty to its employees to ensure that the employer contributions are timely made. In the case of an officer or employee of the state, any unpaid contribution shall be a state debt, contracted as a result of a casual deficit in state revenues, to be accorded preferred status over other expenditures....”

During our review of retirement contributions we also noted four instances out of 50 contribution remittances tested where the Board did not deposit to the Board’s State accounts in a timely manner employee and employer contributions totaling \$74,921.19 remitted by four participating employers. These four instances are detailed in the following table.

<u>Participating Employer</u>	<u>Total Amount Received</u>	<u>Date Funds Received</u>	<u>Date Monies Were Deposited</u>	<u># of Days Late</u>
1	\$18,414.69	12/16/2003	12/29/2003	12
2	43,700.26	12/17/2003	12/29/2003	11
3	12,564.72	12/17/2003	12/30/2003	12
4	<u>241.52</u>	12/16/2003	12/31/2003	14
Total	<u>\$74,921.19</u>			

Chapter 12, Article 2, Section 2(a) of the West Virginia Code, as amended, states:

"All officials and employees of the state authorized by statute to accept moneys due the state of West Virginia shall keep a daily itemized record of moneys so received for deposit in the state treasury and shall deposit within twenty-four hours with the state treasurer all moneys received or collected by them for or on behalf of the state for any purpose whatsoever. The treasurer shall be authorized to review the procedures and methods used by officials and employees authorized to accept moneys due the state and change such procedures and methods if he or she determines it to be in the best interest of the state: Provided, That the treasurer shall not be authorized to review or amend the procedures by which the department of tax and revenue accepts moneys due the state. The treasurer shall propose rules, in accordance with the provisions of article three [§29A-3-1et seq.], chapter twenty-nine-a of this code governing the procedure for deposits.

The official or employee making such deposits with the treasurer shall prepare deposit lists in the manner and upon report forms as may be prescribed by the treasurer. Certified or receipted copies shall be immediately forwarded by the state treasurer to the state auditor and to the secretary of administration. The original of the deposit report shall become a part of the treasurer's permanent record."

After a competitive bid process, the Board elected to change third party administrators for the TDC Plan. The CPRB changed third party administrators from Milliman to Great-West effective January 1, 2004. The transition process between third party administrators started December 1, 2003 and ended February 5, 2004. According to agency personnel, transitioning the

TDC Plan to a new service provider was a complex process which involved the moving of individual participant account records from the then current system maintained by Milliman to Great-West. To ensure efficient and accurate processing and verification of every participant account, the transition required a brief "quiet" period. During this time, account transactions and withdrawals could not be made. Also, Great-West was not ready to start investing member contributions with the appropriate investment companies until January 12, 2004. As a result, member contributions received by the Board between December 15, 2003 and January 12, 2004 resided in the Board's FIMS accounts without being invested until January 12, 2004. When Great-West began processing contributions on January 12, 2004, these contributions were invested based on each participant's designated investment options as of December 1, 2003.

Regarding the retirement contributions deposited late, the Plan Administrator told us the CPRB was awaiting permission from the State Auditor's Office about whether or not the CPRB would be able to directly deposit contribution remittances received from participating employers to the outside bank account being established by the Board for the TDC Plan. Thus, for one week during the transition period the CPRB did not deposit any contribution remittances received to the Board's State accounts. The purpose of this account was to help facilitate the transfer of retirement contributions from the Board to the third party administrator. However, the State Auditor's Office instructed the CPRB to deposit any contributions received to the Board's State accounts before transferring these monies to the outside bank account. The Plan Administrator further stated the Christmas holiday also accounted for some of the time lag.

We recommend the CPRB comply with Chapter 18, Article 7B, Sections 9 and 10 of the West Virginia Code, as amended, by ensuring that steps are taken in the future to ensure

participant contributions continue to be invested without interruption even though a change in third party administrators is taking place. We further recommend the CPRB comply with Chapter 12, Article 2, Section 2(a) of the West Virginia Code, as amended, when depositing retirement contributions to its State accounts.

Agency's Response

Any change in a Third Party Administrator (TPA) requires a "quiet period" to ensure a proper cut off and transfer of assets. Under our previous TPA, contributions were only invested twice a month on the 15th and 30th/31st. Great-West processes contributions daily. Therefore, participants monies are invested more promptly enabling them to earn more on their investments over time.

During the transition period, Milliman USA processed our final contributions as of the December 15, 2003 split. On December 29, 2003, the CPRB established the local account with BB&T. During this time, the CPRB worked with the State Treasurer and State Auditor to determine the method for which funds would be transferred from our Treasury accounts to the local account. On January 8, 2004, the CPRB requested the first transfer of funds to the local account. On January 12, 2004, the funds were transferred to the local account. On January 13, 2004, the data files were transmitted to Great-West and we authorized Great-West to ACH debit our local account. In accordance with our fiduciary responsibilities, this schedule of events helped us ensure that the newly established procedures for processing contributions were operating effectively. Thus we began processing the remaining contributions on January 14, 2004.

Between December 15, 2003 and January 12, 2004, CPRB received approx. \$5.9m in contributions; however, the reported average of 39 days lapsing between receipt of the contributions and transfer to the TPA is inaccurate. Participants at most lost 25 working days of earnings from January 2, 2004 to January 30, 2004. This is based on the following facts:

- Participants did not lose out on earnings from December 15, 2003 to December 31, 2003 because contributions could not be processed by Milliman USA on days between those dates whether or not we were transitioning to a new TPA.

- Due to the magnitude of contributions that needed to be processed beginning on January 14, 2004, we worked overtime to ensure that the remaining contributions were processed by the end of January or early February 2004.

This is consistent with our findings in the previous section where we found only one instance where contributions weren't remitted within 25 days.

Additionally, plan participants were notified in writing about the "quiet period".

Group meetings were held across the state to answer any questions from participants and to disseminate a guide explaining the transition.

During the transition period, the CPRB worked with Great-West and Milliman to ensure that participant contributions were interrupted as little as possible. Given the short time frame in which we had to implement the transition, CPRB staff worked diligently to uphold our fiduciary duty.

In sum, the CPRB could not invest the participant funds during the quiet period because there was no functional recordkeeper to properly account for the funds/contributions.

**Contributions Remitted to Investment
Companies Paid from Wrong State Accounts**

During our review of retirement contributions processed by the Board between July 1, 2002 and December 15, 2003, we noted one instance of the ten contribution remittances tested

where the employee and employer contributions remitted to the investment companies were paid from the wrong State accounts. As a result, the Board paid \$510,794.69 too much in employee contributions from the Member Contribution Account.

We traced the remittance received from Logan County on February 3, 2003 to the February 1, 2003 through February 15, 2003 split letter from Milliman directing the Board how much of the employee and employer contributions collected during the first half of February 2003 to distribute to each investment company. The split letter directed the Board to transfer a total of \$2,043,174.41 to the investment companies. This amount was comprised of employee contributions totaling \$766,189.86 and employer contributions totaling \$1,276,984.55. Employee contributions of \$18,228.44 and employer contributions of \$30,380.86 attributed to Logan County were included in these amounts.

Based on this split letter, \$766,189.86 should have been paid from the Member Contribution Account to the investment companies and \$1,276,984.55 should have been paid from the Employers Contribution Account to the investment companies. However, we noted the Board erroneously paid the employer contributions amounting to \$1,276,984.55 from the Member Contribution Account and the employee contributions amounting to \$766,189.86 from the Employers Contribution Account.

While Milliman served as the third party administrator for the TDC Plan between July 2002 through December 2003, the Board would make investment purchases with the retirement contributions remitted by participating employers from the appropriate investment companies once during each half of the month (called a "split period"). Based on a record of contribution remittances received as provided by the Board and payroll reports (itemizing each employee and their related

contribution data) which were electronically transmitted to Milliman by the participating employers, Milliman would determine the amount of contributions received during the split periods and calculate the amounts of employee and employer contributions to be allocated to the various investment companies in accordance with the investment options selected by plan participants. Once this determination had been made, Milliman would send the Board a letter noting the total amount of contributions received and how these monies should be disbursed to the various investment companies on the "split days" which were the 15th and 30th or 16th and 31st of each month.

Chapter 18, Article 7B, Section 9 of the West Virginia Code, as amended, states in part,

"Each employee who is a member of the defined contribution system shall contribute four and one-half percent of his or her gross compensation by salary reduction. Such salary reductions shall be made by the employer at the normal payroll intervals and shall be remitted within five working days to the private pension, insurance, annuity, mutual fund, or other qualified company or companies designated by the board to administer the day-to-day operations of the system...."

Furthermore, Chapter 18, Article 7B, Section 10 of the West Virginia Code, as amended, states in part,

"Each participating employer shall annually make a contribution equal to seven and one-half percent of each member's gross compensation. The pro rata share of this amount shall be paid upon each date that a member contribution is made and shall be remitted as provided for in section nine [18-7B-9] of this article for credit to the member's annuity account. Each participating employer has a fiduciary duty to its employees to ensure that the employer contributions are timely made...."

Utilizing monies from the Member Contribution Account to pay a portion of the employer contributions to be remitted to the investment companies for investment on behalf of plan

participants results in the employee contributions remitted by various participating employers being used to subsidize the employer contributions to be funded by other participating employers. When we spoke with the Board's accountant, we learned this error occurred as the result of agency personnel responsible for administering the TDC Plan provided erroneous account information to the Accounting Department for entering into FIMS. This account information detailed the State accounts from which the employee and employer contributions per the split letter should be paid. The Accounting Department subsequently corrected this error in FIMS once we brought this error to their attention.

We recommend the CPRB comply with Chapter 18, Article 7B, Sections 9 and 10 of the West Virginia Code, as amended.

Agency's Response

In reference to the one instance from FY 2003 which was mentioned in the report, we agree that contributions were remitted from the wrong account. This was due to a clerical error where one employee coded the remittance from account 2190 instead of 2191. Once this error was identified by the legislative audit, it was corrected immediately.

As of January 1, 2004, the following internal control procedures were implemented to ensure clerical errors are identified and corrected immediately:

- Deposits and remittances (I-doc) are prepared by one staff member.*
- Either the TDC Plan Manager or Plan Administrator review the deposits and remittances and approve electronically via IRMA.*
- The CPRB Accountant also reviews the deposits and remittances.*
- Monthly cash reconciliations are performed to ensure any errors not identified previously are identified and corrected promptly.*

Employee Not Enrolled in TDC Plan Upon Hire

During our review of retirement contributions processed by the Board between July 1, 2002 and December 15, 2003, there was one instance totaling \$1,204.11 where a participating employer did not remit the employee and employer contributions on behalf of one plan participant to the Board in a timely manner. Upon reviewing the documentation supporting this contribution remittance, we noted the amount remitted by this participating employer represented the total amount of employee and employer contributions which should have been remitted during the 2002-2003 academic year on behalf of an employee who was hired on August 20, 2002. Based on a letter from the benefits coordinator for Morgan County Schools, this employee apparently was not enrolled in the TDC Plan by the participating employer upon her hire. The fiscal year 2002-2003 salary for 200 days of employment by this employee was approximately \$10,034.28. The total 12% retirement contribution for this salary as remitted by Morgan County Schools to the Board amounted to \$1,204.11.

Chapter 18, Article 7B, Section 9 of the West Virginia Code, as amended, states in part,

“Each employee who is a member of the defined contribution system shall contribute four and one-half percent of his or her gross compensation by salary reduction. Such salary reductions shall be made by the employer at the normal payroll intervals and shall be remitted within five working days to the private pension, insurance, annuity, mutual fund, or other qualified company or companies designated by the board to administer the day-to-day operations of the system....”

Also, Chapter 18, Article 7B, Section 10 of the West Virginia Code, as amended, states in part,

“Each participating employer shall annually make a contribution equal to seven and one-half percent of each member’s gross compensation. The pro rata share of this amount shall be paid upon each date that a member contribution is made and shall be remitted as provided for in section nine [18-7B-9] of this article for credit to the member’s annuity account. Each participating employer has a fiduciary duty to its employees to ensure that the employer contributions are timely made....”

Additionally, Chapter 5, Article 10C, Section 4(d) of the West Virginia Code, as amended, states,

“(d) The amount of employee contributions picked up by the participating public employer shall be paid to the retirement system in the manner and form, and in the frequency required by the board of trustees and shall be accompanied by supporting data that the board of trustees may prescribe. When paid to the retirement system, each of these amounts shall be credited to the deposit fund account of the member for whom the contribution was picked up and paid by the participating public employer.”

Since this participant’s employer failed to properly enroll the participant in the TDC Plan at the time of her hire, the participant was denied the opportunity to earn investment earnings on the employee and employer contributions which her employer had a fiduciary responsibility under the aforementioned Code sections to remit to the TDC Plan in a timely manner. We believe the Board should prescribe procedures to be followed by all participating employers which would ensure any employee newly hired by a participating employer is properly enrolled in the TDC Plan in a timely manner.

We recommend the CPRB ensure participating employers comply with Chapter 18, Article 7B, Sections 9 and 10 of the West Virginia Code, as amended, as well as Chapter 5, Article

10C, Section 4(d) of the West Virginia Code, as amended, when enrolling newly hired employees in the TDC Plan.

Agency's Response

Per conversation with the Morgan County Treasurer on September 27, 2004, this participant was not enrolled upon hire due to human error. This participant had previously been on the payroll as a substitute teacher. When the participant became a full-time employee, the payroll department failed to remit retirement contributions. The error was discovered by the payroll department and immediately remitted to the CPRB.

The CPRB has proposed a change to WVCSR §162-3-4.1 and §162-3-4.2 that would require any participating employer who fails to make any payment due the TDC Plan by the 15th day following the end of the pay period to pay earnings lost on the contributions at the actuarial rate of return as determined for the Teachers' Defined Benefit Retirement System.

Additional control procedures include:

- performing annual internal audits of selected participating employers, and*
- educating payroll coordinators of participating employers through annual seminars*

INDEPENDENT AUDITORS' OPINION

The Joint Committee on Government and Finance:

We have audited the statement of cash receipts, disbursements and changes in cash balances of the Teachers' Defined Contribution Retirement System as administered by the West Virginia Consolidated Public Retirement Board (the "Board") for the years ended June 30, 2004 and June 30, 2003. The financial statement is the responsibility of the management of the West Virginia Consolidated Public Retirement Board. Our responsibility is to express an opinion on the financial statement based on our audit.

Except as discussed in the following paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statement is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The Board is maintaining excess cash in both the Member Contribution Account and Employers Contribution Account resulting in an overstated cash balance for each account. These State accounts are utilized by the Board to deposit the employee and employer contributions received from participating employers. Generally, the excess cash being maintained in each State account was the result of the Board not properly allocating the employee and employer contributions received from participating employers on a consistent basis to the appropriate State account from the inception of the TDC Plan in July 1991 through the present. Also, the Board not reconciling the FIMS records for each State account to their deposit records prevented the timely detection of these allocation errors. Currently, the Board's internal auditor is researching the Board's accounting records in an effort to identify the total amount of excess cash being maintained in each State account. During our audit period, we were able to determine through WVFIMS a total of \$2,713,000.00 representing excess cash monies that was transferred by the Board to a cash liquidity account for the year ended June 30, 2004. However, we were unable to verify the reasonableness of the amounts transferred to the cash liquidity account since the Board has not fully identified the total amount of excess cash being maintained in these accounts.

In our opinion, except for the effect of such adjustments, if any, as might have been determined to be necessary had we been able to fully identify the total amount of excess cash being maintained in each State account, the financial statement referred to above presents fairly, in all material respects, the revenues collected and expenses paid of the Teachers' Defined Contribution Retirement System as administered by the Consolidated Public Retirement Board for the years ended June 30, 2004 and June 30, 2003, on the basis of accounting described in Note A.

Our audit was conducted for the purpose of forming an opinion on the basic financial statement taken as a whole. The supplemental information is presented for the purpose of additional analysis and is not a required part of the basic financial statement. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statement and, in our opinion, is fairly stated in all material respects in relation to the basic financial statement taken as a whole.

Respectfully submitted,


Theford L. Shanklin, CPA, Director
Legislative Post Audit Division

August 20, 2004

Auditors: Ethelbert Scott, CPA, Supervisor
Neil M. McEachron, Jr., CPA, Auditor-in-Charge
William H. J. Spencer III, CPA
Brandy L. McNabb

**CONSOLIDATED PUBLIC RETIREMENT BOARD
WEST VIRGINIA TEACHERS' DEFINED CONTRIBUTION RETIREMENT SYSTEM
STATEMENT OF CASH RECEIPTS, DISBURSEMENTS
AND CHANGES IN CASH BALANCES**

	<u>Year Ended June 30, 2004</u>		
	<u>Special Revenue</u>	<u>Cash Liquidity Account</u>	<u>Combined Totals</u>
Cash Receipts:			
Receipt of Employee and Employer Contributions	\$84,323,645.69	\$ 0.00	\$84,323,645.69
Transfer from Member/Employers Contribution Account	0.00	2,713,000.00	2,713,000.00
Forfeiture Monies Received from Investment Firms	747,717.29	0.00	747,717.29
Transfers from Teachers Retirement System	36,637.75	0.00	36,637.75
Miscellaneous	<u>3,058.71</u>	<u>0.00</u>	<u>3,058.71</u>
Total Cash Receipts	85,111,059.44	2,713,000.00	87,824,059.44
Disbursements:			
Remittance of Contributions to Investment Firms	40,774,250.86	0.00	40,774,250.86
Refunds of Retirement Contributions	440,238.04	0.00	440,238.04
Withdrawal from Retirement Funds	3,755,139.06	0.00	3,755,139.06
Transfers to Teachers Retirement System	2,119,432.92	0.00	2,119,432.92
Transfer to Cash Liquidity Account	2,713,000.00	0.00	2,713,000.00
Transfer of Administrative Fees to CPRB Expense Account	<u>795,725.00</u>	<u>0.00</u>	<u>795,725.00</u>
Total Cash Disbursements	<u>50,597,785.88</u>	<u>0.00</u>	<u>50,597,785.88</u>
Cash Receipts Over Disbursements	34,513,273.56	2,713,000.00	37,226,273.56
Transfers to Third Party Administrator (Great-West)	(39,317,196.57)	0.00	(39,317,196.57)
Beginning Balance	<u>6,467,674.87</u>	<u>0.00</u>	<u>6,467,674.87</u>
Ending Balance	<u>\$ 1,663,751.86</u>	<u>\$2,713,000.00</u>	<u>\$ 4,376,751.86</u>

See Notes to Financial Statement

Year Ended June 30, 2003

<u>Special Revenue</u>	<u>Cash Liquidity Account</u>	<u>Combined Totals</u>
\$90,890,369.31	\$0.00	\$90,890,369.31
0.00	0.00	0.00
1,029,758.75	0.00	1,029,758.75
130,473.44	0.00	130,473.44
<u>46,657.71</u>	<u>0.00</u>	<u>46,657.71</u>
92,097,259.21	0.00	92,097,259.21
83,349,720.50	0.00	83,349,720.50
3,153,868.60	0.00	3,153,868.60
4,647,623.44	0.00	4,647,623.44
0.00	0.00	0.00
0.00	0.00	0.00
<u>744,940.00</u>	<u>0.00</u>	<u>744,940.00</u>
<u>91,896,152.54</u>	<u>0.00</u>	<u>91,896,152.54</u>
201,106.67	0.00	201,106.67
0.00	0.00	0.00
<u>6,266,568.20</u>	<u>0.00</u>	<u>6,266,568.20</u>
<u>\$ 6,467,674.87</u>	<u>\$0.00</u>	<u>\$ 6,467,674.87</u>

CONSOLIDATED PUBLIC RETIREMENT BOARD

WEST VIRGINIA TEACHERS' DEFINED CONTRIBUTION RETIREMENT SYSTEM

NOTES TO FINANCIAL STATEMENT

Note A - Accounting Policy

Accounting Method: The cash basis of accounting was followed for all accounts. Therefore, certain revenues and the related assets are recognized when received rather than when earned and certain expenses are recognized when paid rather than when the obligation is incurred. Accordingly, the financial statement is not intended to present financial position and results of operations in conformity with generally accepted accounting principles.

Combined Totals: The combined totals contain the totals of similar accounts. Since the cash receipts of certain accounts are restricted by various laws, rules and regulations, the totaling of the accounts is for memorandum purposes only and does not indicate that the combined totals are available in any manner other than that provided by such laws, rules and regulations.

Note B - Investments

The following table details the account balance maintained with each investment fund option per the agency's records as of June 30, 2004 and 2003:

<u>Investment Fund Option</u>	<u>Year Ended June 30,</u>	
	<u>2004</u>	<u>2003</u>
Aggressive Profile	\$ 2,415,703.26	-0-
Moderate Profile	3,005,366.11	-0-
Conservative Profile	1,465,753.61	-0-
American Funds Europacific A	1,491,697.21	-0-
Columbia Small Cap Fund - Z	1,952,665.17	-0-
AIM Mid Cap Core Equity Fund	1,206,775.45	-0-
American Funds Growth Fund A	79,089,824.15	-0-
American Funds Washington Mutual Investors A	48,090,386.73	34,502,256.35
Federated Max Cap Institutional	44,700,232.50	34,622,591.48

	<u>Year Ended June 30,</u>	
	<u>2004</u>	<u>2003</u>
<u>Investment Fund Option</u>		
Fidelity Advisor Growth Opportunities	-0-	58,266,253.18
Franklin Income Fund - A	57,098,441.39	41,152,369.17
American Funds Bond Fund A	56,977,194.66	48,792,041.20
Valic Fixed Annuity Option	199,329,998.59	180,571,496.55
Vanguard Money Market Prime Portfolio	<u>33,320,493.19</u>	<u>30,147,622.68</u>
Total	<u>\$530,144,532.02</u>	<u>\$426,054,630.61</u>

Note C - Pending Litigation

During the audit period, the Board contracted with a new third party administrator (Great-West Life and Annuity Insurance Company). At the same time, the Board added through a competitive bidding process three new investment fund options and one replacement investment fund option from which plan participants could choose to invest their retirement contributions. Based on each investment fund option selection, the Purchasing Division issued a purchase order on behalf of the Board with each of the investment firms who would be providing the brokerage services for each investment fund option. However, the Board decided to utilize Great-West's broker/dealer affiliate, GWFS Equities, Inc., to provide the brokerage services for these investment fund options rather than the investment firms properly awarded the contract for these investment fund options through the competitive bid process. Once this decision was made by the Board, the Board cancelled the purchase order issued to each investment firm by the Purchasing Division.

In April 2004, Wachovia Securities (formerly Prudential Securities) filed a law suit with the Kanawha County Circuit Court against the Board alleging breach of contract by the Board when the Board assigned the responsibility for providing brokerage services for two of the newly added investment funds (Growth Fund of America and Euro Pacific Growth) to Great-West rather than awarding the brokerage services to Wachovia Securities under the Purchase Order issued by the Purchasing Division. Currently, this matter is still pending before the Circuit Court. The management of the CPRB believes the Board's position is very strong and that the eventual resolution of the matter will produce a favorable outcome for the Board. However, if this matter results in an unfavorable outcome for the Board, then management estimates the maximum amount of damages which may be assessed against the Board to be approximately \$300,000.

SUPPLEMENTAL INFORMATION

CONSOLIDATED PUBLIC RETIREMENT BOARD
WEST VIRGINIA TEACHERS' DEFINED CONTRIBUTION RETIREMENT SYSTEM
STATEMENT OF CASH RECEIPTS, DISBURSEMENTS
AND CHANGE IN CASH BALANCE
SPECIAL REVENUE

	<u>Year Ended June 30,</u>	
	<u>2004</u>	<u>2003</u>
<u>Member Contribution Account -Account 2190-099/640</u>		
Cash Receipts:		
Member Contributions	\$31,810,840.13	\$34,713,484.76
Less: Refunds	<u>291,778.31</u>	<u>1,230,535.22</u>
	31,519,061.82	33,482,949.54
Transfer from TRS	36,637.75	130,473.44
Miscellaneous	<u>3,012.34</u>	<u>26,178.98</u>
	31,558,711.91	33,639,601.96
Disbursements:		
Remittance of Contributions to Investment Firms	14,493,237.96	31,447,216.42
Withdrawal from Retirement Funds	2,548,352.89	2,876,900.08
Transfer to Cash Liquidity Account	<u>955,000.00</u>	<u>0.00</u>
	<u>17,996,590.85</u>	<u>34,324,116.50</u>
Cash Receipts Over/(Under) Disbursements	13,562,121.06	(684,514.54)
Transfers to Third Party Administrator (Great-West)	(14,775,046.12)	0.00
Beginning Balance	<u>1,368,156.47</u>	<u>2,052,671.01</u>
Ending Balance	<u>\$ 155,231.41</u>	<u>\$ 1,368,156.47</u>

CONSOLIDATED PUBLIC RETIREMENT BOARD
WEST VIRGINIA TEACHERS' DEFINED CONTRIBUTION RETIREMENT SYSTEM
STATEMENT OF CASH RECEIPTS, DISBURSEMENTS
AND CHANGE IN CASH BALANCE
SPECIAL REVENUE

	<u>Year Ended June 30,</u>	
	<u>2004</u>	<u>2003</u>
<u>Employers Contribution Account - Account 2191-099/640</u>		
Cash Receipts:		
Employer Contributions	\$18,734,462.08	\$27,343,471.77
Less: Refunds	<u>148,459.73</u>	<u>1,923,333.38</u>
	18,586,002.35	25,420,138.39
Transfer of School Aid Monies from Dept. of Education	34,364,862.88	29,683,585.59
Miscellaneous	<u>46.37</u>	<u>20,478.73</u>
	52,950,911.60	55,124,202.71
Disbursements:		
Remittance of Contributions to Investment Firms	26,281,012.90	51,902,504.08
Withdrawal from Retirement Funds	1,206,786.17	1,770,723.36
Transfer to TRS	2,119,432.92	0.00
Transfer to Cash Liquidity Account	1,758,000.00	0.00
Transfer of Administrative Fees to CPRB Expense Acct.	<u>795,725.00</u>	<u>744,940.00</u>
	<u>32,160,956.99</u>	<u>54,418,167.44</u>
Cash Receipts Over Disbursements	20,789,954.61	706,035.27
Transfers to Third Party Administrator (Great-West)	(24,476,934.36)	0.00
Beginning Balance	<u>4,728,389.26</u>	<u>4,022,353.99</u>
Ending Balance	<u>\$ 1,041,409.51</u>	<u>\$ 4,728,389.26</u>

CONSOLIDATED PUBLIC RETIREMENT BOARD
WEST VIRGINIA TEACHERS' DEFINED CONTRIBUTION RETIREMENT SYSTEM
STATEMENT OF CASH RECEIPTS, DISBURSEMENTS
AND CHANGE IN CASH BALANCE
SPECIAL REVENUE

	<u>Year Ended June 30,</u>	
	<u>2004</u>	<u>2003</u>
<u>Suspension Account - Account 2192-099/640</u>		
Cash Receipts:		
Forfeiture Monies Received from Investment Firms	\$747,717.29	\$1,029,758.75
Disbursements:		
Transfers to Employers Contribution Account	<u>586,519.40</u>	<u>850,172.81</u>
Cash Receipts Over Disbursements	161,197.89	179,585.94
Transfers to Third Party Administrator (Great-West)	(65,216.09)	0.00
Beginning Balance	<u>371,129.14</u>	<u>191,543.20</u>
Ending Balance	<u>\$467,110.94</u>	<u>\$ 371,129.14</u>

CONSOLIDATED PUBLIC RETIREMENT BOARD
WEST VIRGINIA TEACHERS' DEFINED CONTRIBUTION RETIREMENT SYSTEM
STATEMENTS OF CASH RECEIPTS AND DISBURSEMENTS
LOCAL ACCOUNTS


	<u>Year Ended June 30,</u>	
	<u>2004</u>	<u>2003</u>
<u>TDCRS Account</u>		
Beginning Balance	\$ 0.00	\$0.00
Cash Receipts	<u>38,799,632.74</u>	0.00
TOTAL CASH TO ACCOUNT FOR	<u>\$38,799,632.74</u>	<u>\$0.00</u>
Cash Disbursements	\$37,582,870.38	\$0.00
Ending Balance	<u>1,216,762.36</u>	<u>0.00</u>
TOTAL CASH ACCOUNTED FOR	<u>\$38,799,632.74</u>	<u>\$0.00</u>

STATE OF WEST VIRGINIA

OFFICE OF THE LEGISLATIVE AUDITOR, TO WIT:

I, Thedford L. Shanklin, CPA, Director of the Legislative Post Audit Division, do hereby certify that the report appended hereto was made under my direction and supervision, under the provisions of the West Virginia Code, Chapter 4, Article 2, as amended, and that the same is a true and correct copy of said report.

Given under my hand this 10th day of October 2004.



Thedford L. Shanklin, CPA, Director
Legislative Post Audit Division

Copy forwarded to the Secretary of the Department of Administration to be filed as a public record. Copies forwarded to the Consolidated Public Retirement Board; Governor; Attorney General; State Auditor; and, Director of Finance Division, Department of Administration.