

REPUBLIC OF PALAU
CIVIL SERVICE PENSION TRUST FUND

INDEPENDENT AUDITORS' REPORT ON
INTERNAL CONTROL AND ON COMPLIANCE

YEAR ENDED SEPTEMBER 30, 2018

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Board of Trustees
Republic of Palau Civil Service Pension Trust Fund:

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Republic of Palau Civil Service Pension Trust Fund (the Fund), which comprise the statement of fiduciary net position as of September 30, 2018, and the related statement of changes in fiduciary net position for the year then ended and the related notes to the financial statements, and have issued our report thereon dated March 25, 2019.

Internal Control Over Financial Reporting

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

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did identify a certain deficiency in internal control, described in the accompanying Schedule of Findings and Responses as item 2018-001 that we consider to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Fund's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed one instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and which is described in the accompanying Schedule of Findings and Responses as item 2018-001.

The Fund's Response to the Finding

The Fund's response to the finding identified in our audit is described in the accompanying Schedule of Findings and Responses. The Fund's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

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

Deloitte & Touche LLC

March 25, 2019

REPUBLIC OF PALAU
CIVIL SERVICE PENSION TRUST FUND

Schedule of Findings and Responses
Year Ended September 30, 2018

Actuarial Deficiency

Finding No. 2018-001

Criteria: Under the provisions of Republic of Palau Public Law (RPPL) No. 2-26, the Board adopted a Trust Fund Operation Plan (the Plan) which has the force and effect of law and which sets forth the procedures for the administration and coverage of the Plan. Amendments to the Plan are subject to the requirements of Title 6 of the Palau National Code.

Condition: The Fund's actuarial valuation has determined that the Fund has a net pension liability of \$259,395,005 which would cause the Fund's fiduciary net position to become negative in 2022. The Fund's Board of Trustees has adopted a formal funding plan to correct the potential funding deficiency; however, the funding plan has not yet been implemented.

Cause: The cause of the above condition is the lack of implementation of the funding plan.

Effect: The effect of the above condition is that the Fund may not be able to meet its benefit obligations.

Recommendation: We recommend that the Fund implement the formal funding plan to correct the potential funding deficiency.

Prior Year Status: The lack of a formal plan to fund the net pension liability was reported as a finding in the audits of the Fund for fiscal years 2014 through 2017.

Auditee Response and Corrective Action Plan:

Name of Contact Persons: Presley Etibek, Administrator/Chief Executive Officer and Everdil Rechebei, Chief Financial Officer

Corrective Action:

The Fund developed and adopted the Republic of Palau Civil Service Pension Plan Funding Plan in April 2017. The goals of the Republic of Palau Civil Service Pension Plan Funding Plan are: 1.) To move this Retirement Fund from an indebted state to a more funded status, and 2) To ensure longevity of the Civil Service Pension Retirement Fund for the current retirees/beneficiaries and current contributors who are the future retirees and beneficiaries. The activities and ideas set forth by this Funding Plan are strategic actions that guide the Board of Trustees and Management in moving this Retirement Fund from its current financial state to a more funded program. The main activities and ideas have been identified as follows:

- Provide amendments to enabling act (RPPL No. 2-26) to Increase contribution level from 12% to 20% in the next four years; Increase mandatory retirement age from 60 years of age to 62 years of age; Enact legislation to levy a reasonable administrative fee on CSPP benefits; Increase from five years to seven years contribution requirement per 33 PNC 2021; Lobby the Congress to enact a legislation to reduce benefit level.

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Schedule of Findings and Responses, Continued
Year Ended September 30, 2018

Finding No. 2018-001, Continued

Auditee Response and Corrective Action Plan, Continued:

Corrective Action, Continued:

On January 2018, The Fund, through the Administrative Procedure Act, sought to make these very changes but was rejected by the President of the Republic and requested to delay these changes another year to January 2019. The Fund, however, through RPPL No. 10-25 was appropriated \$150,000 to work in collaboration with the Olbiil Era Kelulau and the Ministry of Finance to commission an Actuarial Study that shall determine viable options toward a comprehensive reform.

In fiscal year 2018, Milliman Private Limited was tasked to conduct such study. Initial recommendations by the actuarial firm include 1) No change to current beneficiaries, active employees and inactive members 55 years of age and over, 2) Increase in the normal retirement age by one year every five years until it reaches 65, 3) Benefit formula remains at 2% for each year of service, however a defined contribution (DC) scheme will be integrated to provide 1% benefit through the DC Plan and 1% from the current plan Defined Benefit (DB) Plan, 4) Private sector employers/employees will be invited to participate in the DC Plan, while public employers/employees will participate in both the DB and DC Plans with 3% contribution to DB and 3% to DC Plan. Finalization of this study is underway and it should be completed in fiscal year 2019.

Proposed Completion Date: Ongoing

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Unresolved Prior Year Comments
Year Ended September 30, 2018

The status of unresolved findings is discussed in the Schedule of Findings and Responses section of this report.