Audit Report

Magistrates Retirement Fund of Georgia
Fiscal Year Ended June 30, 2016

The photograph on the cover was taken by Lacey Mitchell at Jekyll Island, Georgia.

MAGISTRATES RETIREMENT FUND OF GEORGIA
(A Component Unit of the State of Georgia)

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SECTION I - FINANCIAL

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DEPARTMENT OF AUDITS AND ACCOUNTS

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GREG S. GRIFFIN
STATE AUDITOR
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Independent Auditor's Report

The Honorable Nathan Deal, Governor of Georgia
Members of the General Assembly of the State of Georgia
Board of Commissioners of the Magistrates Retirement Fund of Georgia
Mr. Robert Carter, Secretary/Treasurer

Report on the Financial Statements

We have audited the accompanying financial statements of the Magistrates Retirement Fund of Georgia (the Fund), a component unit of the State of Georgia, as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the Fund's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net position of the Fund as of June 30, 2016, and the changes in fiduciary net position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 2 to the basic financial statements, in 2016 the Fund adopted Governmental Accounting Standards Board (GASB) Statement No. 72, *Fair Value Measurement and Application*. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Schedule of Employers' and Nonemployers' Net Pension Liability, Schedule of Changes in Employers' and Nonemployers' Net Pension Liability, Schedule of Employer and Nonemployer Contributions, and Schedule of Investment Returns on pages 18-21 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Management has omitted the management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated May 31, 2017, on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Fund's internal control over financial reporting and compliance.

Respectfully submitted,

Greg S. Griffin
State Auditor

May 31, 2017

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BASIC FINANCIAL STATEMENTS

MAGISTRATES RETIREMENT FUND OF GEORGIA
(A Component Unit of the State of Georgia)

Statement of Fiduciary Net Position

June 30, 2016

Assets:			
Cash and cash equivalents			$ 1,165,159
Investments - at fair value:			
Obligations:			
Exchange-traded funds		$ 7,544,867	
Equities:			
Exchange-traded funds	$ 1,178,751		
Stocks			
Domestic	11,790,830		
International	224,254	13,193,835	
Total investments			20,738,702
Total assets			21,903,861
Liabilities:			
Withholdings payable			28,337
Total liabilities			28,337
Net position restricted for pensions			$ 21,875,524

See accompanying notes to financial statements.

MAGISTRATES RETIREMENT FUND OF GEORGIA
(A Component Unit of the State of Georgia)

Statement of Changes in Fiduciary Net Position

Year ended June 30, 2016

Additions:		
Contributions:		
Nonemployer		$ 1,532,736
Member		171,939
Net investment income:		
Net increase in fair value of investments	$ 40,329	
Interest, dividends, and other	412,932	
Less investment expense	(285,087)	168,174
Total additions		1,872,849
Deductions:		
Benefit payments		122,113
Administrative expenses, net		107,437
Total deductions		229,550
Net increase in net position		1,643,299
Net position restricted for pensions:		
Beginning of year		20,232,225
End of year		$ 21,875,524

See accompanying notes to financial statements.

Note 1: Plan Description

The Magistrates Retirement Fund of Georgia (the Fund) was created July 1, 2006, by the Georgia General Assembly to provide retirement benefits to chief magistrates of the magistrate courts of the State of Georgia. The Fund administers a cost-sharing, multiple-employer defined benefit pension plan as defined in Governmental Accounting Standards Board (GASB) Statement No. 67, *Financial Reporting for Pension Plans – an amendment of GASB Statement No. 25.*

The Fund is governed by its Board of Commissioners. The Board is comprised of the Governor of the State of Georgia or his designee; an appointee of the Governor other than the Attorney General; and five full-time chief magistrates who are members of the Fund. The Board of Commissioners is ultimately responsible for the administration of the Fund.

Eligibility and Membership

Individuals eligible to apply for membership in the Fund are defined in the *Official Code of Georgia Annotated* (O.C.G.A.) 47-25-40 and generally include all duly qualified and commissioned magistrates of a county of the State of Georgia and any person serving as secretary-treasurer of the Board of Commissioners.

As of June 30, 2016, participation in the Fund is as follows:

Inactive plan members and beneficiaries currently receiving benefits	9
Inactive plan members not yet receiving benefits, vested	1
Active plan members	127
Total	137

Participating Employers and Other Contributing Entities

At June 30, 2016, the active members of the Fund were employed by 127 employers. The Fund also had one nonemployer contributing entity, which is the State of Georgia.

Retirement Benefits

The Fund provides retirement as well as disability and death benefits. Title 47 of the O.C.G.A. assigns the authority to establish and amend the provisions of the Fund to the General Assembly. Members are eligible for retirement at age 60 and must have served at least eight years in a position eligible for membership in the Fund. A member must have terminated his or her official capacity as a chief magistrate or as a secretary-treasurer of the Board to receive benefits.

A member who is approved for retirement benefits is paid a monthly benefit equal to 4% of his or her average final monthly compensation (subject to a salary cap) for each year served up to, but not exceeding, a total of 20 years, with exceptions.

Death and Disability Benefits
Any member who becomes totally and permanently disabled after completing four years of creditable service is entitled to receive retirement benefits in the amount that the member would receive if their retirement were effective at the time the member became disabled.

If a member dies before retirement, the member's spouse may withdraw the dues paid into the Fund plus interest and thus waive any rights to any benefits through the Fund. The surviving spouse may also elect to receive benefits through an optional payment offered by the Fund. If a member who is receiving benefits dies, the surviving spouse, upon reaching age 60, may elect to receive a benefit equal to 50% of the monthly retirement benefit being paid to the deceased member at the time of death. These benefits will be paid for the remainder of the surviving spouse's life.

Terminations
In the event of termination, a member is entitled to any retirement benefits that may have been earned. However, the member may waive the right to these benefits and receive all dues paid plus interest.

Contributions
The Fund is funded by member and nonemployer contributing entity (Nonemployer) contributions. Contribution provisions are established by statute and may be amended only by the General Assembly.

Member Contributions: Member contribution requirements are set forth in O.C.G.A. 47-25-41 and are not actuarially determined. Members must contribute 3.42% of their salary each month, subject to a limit that is based on the population of the member's county.

Nonemployer Contributions: In accordance with O.C.G.A. 47-25-60, the State of Georgia provides nonemployer contributions to the Fund through the collection of court fees. For each civil matter or proceeding filed in magistrate courts, $3 is collected by the court and remitted directly to the Fund.

The court fees are considered employer contributions for the purpose of determining whether the Fund has met minimum funding requirements specified in O.C.G.A. 47-20-10. This statute also prohibits any action to grant a benefit increase until such time as the minimum annual contribution requirements meet or exceed legislative requirements. The actuarial valuation as of July 1, 2015, calculated the minimum employer contribution for the fiscal year ended June 30, 2016, as $0. The court fees revenue of $1,532,736 for the fiscal year ended June 30, 2016, meets the minimum required fund contribution.

Administrative Expenses
Administrative expenses are generally funded from current member and court fee contributions. Investment earnings may be utilized to fund any expenses in excess of contributions.

Note 2: Summary of Significant Accounting Policies and Plan Asset Matters

Basis of Accounting
The Fund's financial statements are prepared on the accrual basis of accounting, except for the collection of contributions, which are recognized when collected from the members and the courts. Any accrual of these contributions would be immaterial to the Fund's financial statements. Retirement and refund payments are recognized as deductions when due and payable.

Reporting Entity
The Fund is a component unit of the State of Georgia; however, it is accountable for its own fiscal matters and presentation of its separate financial statements. The Fund has considered potential component units under GASB Statements No. 61, *The Financial Reporting Entity's Omnibus – an amendment of GASB Statement No. 14 and No. 34*, and GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units*, and determined there were no component units of the Fund.

Cash and Cash Equivalents
Cash and cash equivalents, reported at cost, include cash in banks, cash on deposit with the investment custodian earning a credit to offset fees, and short-term highly liquid financial securities with original maturities of three months or less from the date of acquisition.

Investments
Investments are reported at fair value. Equity securities traded on a national or international exchange are valued at the last reported sales price. Fixed income securities are valued based primarily on quoted market prices provided by independent pricing sources. Investment income is recognized as earned by the Fund. There are no investments in, loans to, or leases with parties related to the Fund.

The Fund utilizes various investment instruments. Investment securities, in general, are exposed to various risks, such as credit, interest rate, and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the financial statements.

The Fund maintains an investment policy that may be amended by its Board of Commissioners both upon its own initiative and upon consideration of the advice and recommendations of its investment managers. There were no significant changes in the investment policy for the Fund during the fiscal year.

The Fund's policy in regard to the allocation of invested assets is established on a cost basis in compliance with State law. Plan assets are managed on a total return basis with a long-term objective of achieving and maintaining a fully funded status for the benefits provided through the pension plan. The following was the Fund's adopted asset allocation policy as of June 30, 2016:

Asset Class	Target Allocation
Fixed income	30% - 50%
Equities	50% - 70%
Cash and cash equivalents	0% - 15%
Total	100%

The Fund has no investments in any one organization, that represent 5% or more of the Fund's net position restricted for pensions.

For the year ended June 30, 2016, the annual money-weighted rate of return on pension plan investments, net of pension plan investment expense, was 1.13%. The money-weighted rate of return expresses investment performance, net of investment expense, adjusted for the changing amounts actually invested.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of fiduciary net position and changes therein. Actual results could differ from those estimates.

New Accounting Pronouncements

During fiscal year 2016, the Fund adopted the provisions of GASB Statement No. 72, *Fair Value Measurement and Application.* This Statement addresses accounting and financial reporting issues related to fair value measurements and requires disclosures to be made about fair value measurements, the level of fair value hierarchy and valuation techniques. See note 3 for disclosures related to GASB Statement No. 72.

During fiscal year 2016, the Fund adopted the provisions of GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets that are Not Within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68.* The objective is to improve the usefulness of information about pensions included in external financial reports for making decisions and assessing accountability. The implementation of GASB Statement No. 73 did not impact the recorded amounts in the financial statements. However, this statement did provide additional clarification on the reporting requirements of the Fund's required supplementary information.

During fiscal year 2016, the Fund adopted the provisions of GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments* which supersedes GASB Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments.* The objective of this Statement is to identify the hierarchy of generally accepted accounting principles (GAAP) used to prepare financial statements for the purpose of improving the usefulness and comparability of those statements among governments. The implementation of GASB Statement No. 76 did not impact the recorded amounts in the financial statements.

Note 3: Investment Program

The Fund maintains sufficient cash to meet its immediate liquidity needs. Cash not immediately needed is invested as directed by the investment policy of the Fund. All investments are held by agent custodial banks in the name of the Fund. State law (O.C.G.A. 47-20-83) and the Fund's investment policy authorize the Fund to invest in a variety of short-term and long-term securities.

Cash and Cash Equivalents

The carrying amount of the Fund's operating account totaled $26,971 at June 30, 2016, which is also the actual bank balance. The Fund's cash balance is fully insured through the Federal Deposit Insurance Corporation, an independent agency of the U.S. Government.

The carrying amount of the Fund's cash balances maintained within an investment account is $1,138,188, at June 30, 2016. This balance includes $495,004, which is fully insured through the Federal Deposit Insurance Corporation, an independent agency of the U.S. Government. This balance also includes $643,184, which is uncollateralized.

Investments

Fixed income investments are maintained in exchange-traded funds.

Equity investments are maintained in exchange-traded funds, domestic equities, and international equities. Domestic equities are those securities considered by the O.C.G.A. to be domiciled in the United States. International equities are not considered by the O.C.G.A to be domiciled in the United States.

The equity portfolio is managed by the Fund in conjunction with independent advisors. Buy/sell decisions are based on securities meeting rating criteria established by the investment policy of the Fund. Equity trades are approved and executed by the independent advisors. Common stocks eligible for investment must meet the Objectives and Guidelines of the Fund's investment policy.

State law limits the total investment in equity securities to 75% of the total invested assets calculated on a historical cost basis.

Credit Risk
Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations to the Fund. State law limits investments to investment grade securities. The Fund's investment policy requires that purchases of bonds be restricted to bonds rated as investment grade rated BAA (or equivalent) or better as defined by a national recognized rating agency. Obligations of the U.S. Government or obligations explicitly guaranteed by the U.S. Government are not considered to have credit risk and do not require disclosure of credit quality. At June 30, 2016, the investment held by the Fund in exchange-traded funds have not been rated by Standard & Poor's, which is a nationally recognized statistical rating organization.

Interest Rate Risk
Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Fund does not have a formal policy for managing interest rate risk. At June 30, 2016, the investment held by the Fund in exchange-traded funds had a weighted average maturity of 7.40 years.

Fair Value Measurement
The Fund categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the inputs used in valuation and gives the highest priority to unadjusted quoted prices in active markets and requires that observable inputs be used in the valuations when available. The disclosure of fair value estimates in the hierarchy is based on whether the significant inputs into the valuation are observable. In determining the level of the hierarchy in which the estimate is disclosed, the highest level, Level 1, is given to unadjusted quoted prices in active markets and the lowest level, Level 3, to unobservable inputs. These guidelines recognize a three-tiered hierarchy, as follows:

Level 1 – Valuations based on unadjusted quoted prices for identical instruments in active markets that the Fund has the ability to access.

Level 2 – Valuations based on quoted prices for similar instruments in active markets; quoted prices for identical or similar instrument in markets that are not active; and model-derived valuations in which all significant inputs are observable.

Level 3 - Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

In instances where inputs used to measure fair value fall into different levels in the fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The Fund's assessment of the significance of particular inputs to these fair value measurements requires judgement and considers factors specific to each investment. All investments held by the Fund are classified in Level 1 and have been valued using prices quoted in active markets.

Note 4: Net Pension Liability of Employers and Nonemployers

The components of the collective net pension liability of the participating employers and nonemployers at June 30, 2016, were as follows:

Total pension liability	$	16,767,742
Plan fiduciary net position		(21,875,524)
Net pension liability (asset)	$	(5,107,782)

Plan fiduciary net position as a percentage of total pension liability	130.46%

Actuarial assumptions
The total pension liability was determined by an actuarial valuation as of June 30, 2016, using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.0%
Salary increases	N/A
Investment rate of return	6.50%, net of pension plan investment expense, including inflation

Mortality rates were based on the RP 2014 Healthy Mortality Table with generational mortality projection using the Buck modified MP 2016 scale for healthy lives and the RP 2014 Disabled Retiree Mortality Table with generational mortality projection using the Buck modified MP 2016 for disabled lives.

The long-term expected rate of return on pension plan investments was calculated by the Fund's investment manager as 8.48% using a building block method by weighting the expected future rates of return for each asset class by the fund's current / target asset allocation percentages within each asset class. These allocations are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage. The Fund's administrator determined that 6.50% was a reasonable assumption for the long-term rate of return on plan assets based on the calculation by the Fund's investment manager. The target asset allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

Asset class	Target allocation	Long term expected real rate of return
Short-term Treasury bills	1.0 %	3.3 %
Domestic fixed income	34.0	5.0
International equities developed markets	7.5	9.9
Emerging market equities	2.0	11.8
Large cap core domestic equities	32.2	10.0
Large cap growth domestic equities	2.5	10.3
Large cap value domestic equities	5.7	10.0
Mid cap core domestic equities	3.5	10.7
Small cap growth domestic equities	6.7	12.2
Small cap value domestic equities	3.7	11.3
Domestic real estate investment trust	1.2	9.2
	100.0 %	

Discount Rate
The discount rate used to measure the total pension liability was 6.50%. The projection of cash flows used to determine the discount rate assumes revenues will remain level. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of the net pension liability to changes in the discount rate
The following table presents the net pension liability of the Fund, calculated using the discount rate of 6.50%, as well as what the Fund's net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (5.50%) or 1-percentage-point higher (7.50%) than the current rate:

	1% Decrease (5.50%)	Current discount rate (6.50%)	1% Increase (7.50%)
Employers' and nonemployers' net pension liability (asset)	$ (3,148,181)	(5,107,782)	(6,764,250)

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REQUIRED SUPPLEMENTARY INFORMATION (UNAUDITED)

MAGISTRATES RETIREMENT FUND OF GEORGIA
(A Component Unit of the State of Georgia)

Required Supplementary Information

Schedule of Employers' and Nonemployers' Net Pension Liability

For the year ended June 30

(Unaudited)

	2016	2015	2014
Total pension liability	$ 16,767,742	14,287,045	12,005,486
Plan fiduciary net position	21,875,524	20,232,225	18,139,625
Employers' and nonemployers' net pension liability (asset)	$ (5,107,782)	(5,945,180)	(6,134,139)
Plan fiduciary net position as a percentage of the total pension liability	130.46%	141.61%	151.09%
Covered-employee payroll	N/A	N/A	N/A
Employers' and nonemployers' net pension liability as a percentage of covered-employee payroll	N/A	N/A	N/A

Note: Schedule is intended to show information for 10 years. Additional years will be displayed as they become available.

See accompanying notes to required supplementary information and accompanying independent auditor's report.

MAGISTRATES RETIREMENT FUND OF GEORGIA
(A Component Unit of the State of Georgia)

Required Supplementary Information

Schedule of Changes in Employers' and Nonemployers' Net Pension Liability

For the year ended June 30

(Unaudited)

		2016	2015	2014
Total pension liability:				
Service cost	$	1,337,201	1,342,981	1,320,295
Interest		1,089,423	930,688	675,478
Changes of benefit terms		238,720	0	1,170,096
Differences between expected and actual experience		(479,969)	113,737	(173,451)
Changes of assumptions		417,435	0	686,668
Benefit payments		(122,113)	(91,519)	(5,989)
Refunds of member contributions		0	(14,328)	0
Net change in total pension liability		2,480,697	2,281,559	3,673,097
Total pension liability - beginning		14,287,045	12,005,486	8,332,389
Total pension liability - ending (a)		16,767,742	14,287,045	12,005,486
Plan fiduciary net position:				
Contributions - nonemployer		1,532,736	1,563,301	1,666,281
Contributions - member		171,939	169,399	151,155
Net investment income		168,174	510,933	2,347,662
Miscellaneous		0	0	0
Benefit payments		(122,113)	(91,519)	(5,989)
Refund of member contributions		0	(14,328)	0
Administrative expense		(107,437)	(45,186)	(98,767)
Net change in plan fiduciary net position		1,643,299	2,092,600	4,060,342
Plan fiduciary net position - beginning		20,232,225	18,139,625	14,079,283
Plan fiduciary net position - ending (b)		21,875,524	20,232,225	18,139,625
Net pension liability (asset) - ending (a) - (b)	$	(5,107,782)	(5,945,180)	(6,134,139)

Note: Schedule is intended to show information for 10 years. Additional years will be displayed as they become available.

See accompanying notes to required supplementary information and accompanying independent auditor's report.

MAGISTRATES RETIREMENT FUND OF GEORGIA

(A Component Unit of the State of Georgia)

Required Supplementary Information

Schedule of Employer and Nonemployer Contributions

For the year ended June 30

(Unaudited)

	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007
Actuarially determined employer and nonemployer contribution	$ 0	0	0	814,380	825,300	820,155	839,254	587,777	610,141	610,141
Contributions in relation to the actuarially determined contribution	1,532,736	1,563,301	1,666,281	1,681,846	1,580,303	1,739,235	1,434,683	1,446,566	1,481,714	1,396,879
Contribution deficiency (excess)	$ (1,532,736)	(1,563,301)	(1,666,281)	(867,466)	(755,003)	(919,080)	(595,429)	(858,789)	(871,573)	(786,738)
Covered-employee payroll	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Contributions as a percentage of covered-employee payroll	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

See accompanying notes to required supplementary information and accompanying independent auditor's report.

MAGISTRATES RETIREMENT FUND OF GEORGIA
(A Component Unit of the State of Georgia)

Required Supplementary Information

Schedule of Investment Returns

For the year ended June 30

(Unaudited)

	2016	**2015**	**2014**
Annual money-weighted rate of return, net of investment expense	1.13%	3.07%	17.33%

Note: Schedule is intended to show information for 10 years. Additional years will be displayed as they become available.

See accompanying notes to required supplementary information and accompanying independent auditor's report.

Note 1: Schedule of Employers' and Nonemployers' Net Pension Liability
The components of the net pension liability as of the fiscal year end and the fiduciary net position as a percentage of the total pension liability as of that date are presented in this schedule. This trend information will be accumulated to display a ten year presentation.

Note 2: Schedule of Changes in Employers' and Nonemployers' Net Pension Liability
Net pension liability which is measured as the total pension liability less the amount of the fiduciary net position is presented in this schedule. This trend information will be accumulated to display a ten year presentation.

Note 3: Schedule of Employer and Nonemployer Contributions
The schedule presents the required contributions and the percentage of required contributions actually contributed.

Note 4: Schedule of Investment Returns
The schedule presents historical trend information about the annual money-weighted rate of return on plan investments, net of plan investment expense. This trend information will be accumulated to display a ten year presentation.

Note 5: Actuarial Methods and Assumptions
Benefit changes: During fiscal year 2014, the maximum average compensation used to calculate retirement benefits changed from a uniform maximum of $42,781 to maximums that vary according to population size, ranging from $42,781 to $86,974; member dues increased from $105 per month to 3.42% of maximum average monthly compensation.

Part-time chief magistrates became eligible to participate in the plan effective July 1, 2014. No past service benefits were granted to these part-time chief magistrates.

A 1.5% cost-of-living adjustment was granted to retirees and surviving spouses effective January 1, 2016. The earnings caps used to calculate retirement benefits were increased by 1.5% effective January 1, 2016.

Changes of assumptions: During fiscal year 2014, the mortality table for healthy lives was changed from the IRS 2013 Static Mortality Table (separate for annuitants and non-annuitants) to the RP 2014 Healthy Mortality Table with generational mortality projection using Scale MP 2014 for healthy lives and to RP 2014 Disabled Retiree Mortality Table with generational mortality projection using Scale MP 2014 for disabled lives. In addition, the load for administrative expenses was changed from $50,000 to $100,000 per annum to better reflect the actual administration expenses expected to be paid from the Fund.

During fiscal year 2016, the mortality table was updated to the RP-2014 Health Mortality Table with generational mortality projection using the Buck modified MP-2015 scale for healthy lives. For disabled lives, the mortality tabled was updated to the RP-2014 Disabled Retiree Mortality table with generational mortality projection using the Buck modified MP-2015 scale.

During fiscal year 2016, the discount rate was changed from 7.00% to 6.50%.

Methods and assumptions used in calculations of actuarially determined contributions: The following actuarial methods and assumptions were used to determine the most recently calculated actuarially determined contribution reported in the Schedule of Employer and Nonemployer Contributions:

Valuation date	June 30, 2015
Actuarial cost method	Entry age normal
Amortization method	Level dollar, open
Remaining amortization period	30 years
Asset valuation method	Actuarial value
Inflation rate	3.0%
Salary increases	N/A
Investment rate of return	7.0%, net of pension plan investment expense, including inflation

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SECTION II – 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*

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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*

Independent Auditor's Report

The Honorable Nathan Deal, Governor of Georgia
Members of the General Assembly of the State of Georgia
Board of Commissioners of the Magistrates Retirement Fund of Georgia
Mr. Robert Carter, Secretary/Treasurer

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 Magistrates Retirement Fund of Georgia (the Fund), a component unit of the State of Georgia, which include the statement of fiduciary net position as of June 30, 2016, the related statement of changes in fiduciary net position for the year then ended, and the related notes to the financial statements, which collectively comprise the Fund's basic financial statements, and have issued our report thereon dated May 31, 2017.

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 opinions 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. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control, described in the accompanying *Schedule of Findings and Questioned Costs* as FS-991-16-01 and FS-991-16-02 that we consider to be significant deficiencies.

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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Magistrates Retirement Fund of Georgia's Response to Findings

The Fund's response to the findings identified in our audit are described in the accompanying *Schedule of Findings and Questioned Costs*. 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.

Respectfully submitted,

Greg S. Griffin

Greg S. Griffin
State Auditor

May 31, 2017

SECTION III – SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FS-991-16-01 Improve Documentation and Performance of Controls

Internal Control Impact: Significant Deficiency
Compliance Impact: Nonmaterial Noncompliance

The Magistrates Retirement Fund of Georgia (MRF) should comply with the statewide guidance for documenting its internal control framework and improve performance of its change management and logical access controls.

Background Information:
The State of Georgia has adopted the standards presented in the U.S. Government Accountability Office's (GAO) Green Book that provide an overall framework for establishing and maintaining an effective system of internal control. The State Accounting Office (SAO) has issued guidance to state organizations for implementing the Green Book framework.

During our fiscal year 2015 audit, we noted that MRF has an informal internal control framework in place over financial reporting and compliance processes. The MRF personnel could generally describe control policies and procedures; however, controls were not consistently documented, and they were not designed based on a thorough analysis of business objectives and risks related to operational, financial reporting, and compliance requirements. During our fiscal year 2016 audit, we followed up on MRF's efforts to update, document, and monitor its system of internal control.

Criteria:
The MRF management is responsible for establishing and maintaining a system of internal control over financial reporting and compliance processes, including relevant information systems, that provides reasonable assurance of accurate financial reporting and compliance with applicable laws and regulations as well as statewide policies and procedures. The statewide internal control guidance issued by SAO required MRF to update and document the Control Environment component of its internal control framework and to submit that documentation to SAO.

Condition:
The MRF did not comply with SAO's established timeline for updating and documenting the Control Environment component of its internal control framework and submitting that documentation to SAO. The Control Environment documentation was due on April 15, 2016; the MRF submitted its documentation to SAO on May 12, 2017.

We also noted MRF has not yet updated and documented the Risk Assessment and Control Activities components of its internal control framework. The guidance SAO issued for these components included reporting and recording templates, which are intended to provide documentation of the organization's internal control system in accordance with the statewide guidance. Documentation for the reporting template was due to SAO by October 31, 2016, and the recording template was due by February 28, 2017.

In addition, we noted inconsistent compliance with existing controls related to change management and logical access related to MRF's information systems.

Cause:
The MRF has a small staff and did not assign sufficient resources to fully follow SAO's guidance and timeline for implementing the Green Book's internal control framework standards. In addition, the MRF has not allocated sufficient resources to monitor compliance with existing information system controls.

Effect or Potential Effect:
Without adequately documenting and implementing each component of an internal control system in accordance with the statewide guidance, management cannot ensure MRF's internal control framework will comply with the Green Book standards or that a material misstatement of the MRF's financial information would be prevented or detected and corrected in a timely manner. This may also impede management's ability to gain reasonable assurance that MRF will achieve its operational, financial reporting, and compliance objectives.

Recommendation:
The MRF should review the resources available within its existing staff to determine whether additional internal resources could be assigned to implementing the Green Book's internal control framework standards and monitoring performance of the existing information system controls. If sufficient internal resources are not available, the MRF should consider obtaining additional resources on either a permanent or temporary basis.

When implementing its comprehensive internal control structure, an organization such as MRF should:

- Establish appropriate Tone at the Top; have clear, documented policies and procedures outlining those charged with governance and authority; and set responsibility and expectations for a system of internal control throughout the organization.
- Conduct risk assessments to determine risks that would prohibit the organization from achieving its operational, reporting, and compliance objectives. The risk assessment framework should:
    - Establish objectives related to operational, reporting, and compliance requirements across the organization.
    - Assess the suitability of the objectives and analyze risks (including fraud) to achieving each objective.
    - Consider possible changes from internal and external environments and their impact.
- Define control activities to manage the objectives and mitigate risks identified during the risk assessment process. Control activities should be:
    - Linked to each objective and risk.
    - Established through documented policies and procedures.
    - Performed at every level of the organization and applied at the appropriate stages within the business process and IT environment.
    - Assessed periodically to determine their overall effectiveness in mitigating risks to achieving objectives.
- Identify information needed to assess the internal control environment. This information should be collected and communicated both internally and externally to support the effectiveness of internal controls.

- Put on-going monitoring and evaluation processes in place to determine whether components of internal control are present and functioning effectively.

A robust system of internal control over financial reporting and compliance processes, including relevant information systems, is critical to gain assurance in meeting operational, reporting, and compliance requirements. It also serves as a way to enhance control activities, have safeguards in place to prevent or detect fraud and abuse, and gain efficiencies in operations.

Views of Responsible Officials:
Management concurs with the finding.

Corrective Action Plan:
Management has started to review the U.S. Government Accountability Office's Green Book as well as reviewing the guidance issued by SAO. Management is presently working on the Risk Assessment and Control Activities templates from SAO. Management is in the process of formalizing policies and procedures for better internal control.

Management is concurrently developing and revising policies and procedures as it relates to the internal control matters for relevant information systems as it relates to change management and logical access. Management is developing logical access policies to ensure proper documentation is in place, to ensure parameters are appropriately set and updated, and to ensure proper deprovisioning documentation. Management is reviewing change management policies to ensure workflow changes are authorized, tested, and approved.

Estimated Completion Date: December 30, 2017

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FS-991-16-02 Improve Controls over Income Tax Withholdings

Internal Control Impact: Significant Deficiency
Compliance Impact: Nonmaterial Noncompliance

The Magistrates Retirement Fund of Georgia (MRF) should improve internal controls over Federal and State income taxes withheld from members' benefit payments.

Background Information:
Each month, the MRF makes payments to eligible members for pension benefits. As directed by each individual member, the MRF withholds amounts from these benefit payments for Federal and State income taxes. The MRF made its first benefit payments in fiscal year 2014.

Criteria:
The MRF is responsible for establishing and maintaining a system of internal control designed to provide reasonable assurance of compliance with applicable laws and regulations, including those that govern income tax withholdings. The Internal Revenue Service (IRS) of the United States Department of the Treasury issues instructions for depositing and reporting Federal tax withholdings. These instructions require the MRF to make monthly deposits of Federal tax withholdings and to file an annual report (Form 945). Form 945 is generally due by January 31 for the previous calendar year.

Similarly, the Georgia Department of Revenue (GDOR) issues instructions for depositing and reporting State tax withholdings. These instructions require the MRF to make quarterly deposits and to file annual (Form G-1003) and quarterly (Form G-7) reports. Form G-1003 is due by January 31 for the previous calendar year, while Form G-7 is due by the end of the month following the end of each quarter.

Condition:
The MRF withheld Federal and State income taxes from members' monthly benefit payments. These withholdings were recorded correctly in MRF's accounting system. However, the MRF's system of internal control did not ensure that the amounts of Federal and State income taxes withheld from members' monthly benefit payments were deposited in a timely manner and did not detect that the deposits were not made for calendar years 2015 and 2016. At June 30, 2016, there were \$9,311 in Federal tax withholdings and \$4,455 in State tax withholdings that were overdue. The FY 2015 portion of these amounts withheld applicable to calendar year 2015 was deposited with the proper agencies in April 2017, and the FY 2016 portion of these amounts was deposited in February 2017 after we brought this matter to management's attention.

The MRF's system of internal control also did not ensure that the required tax withholding reports were filed with the IRS and the GDOR, and did not detect that the reports had not been filed. The IRS Form 945 for calendar year 2015 was due on January 31, 2016, but was filed in April 2017, after we brought this matter to management's attention. The GDOR Form G-1003 for calendar year 2015 was due on January 31, 2016, but was filed in April 2017. Form G-3 reports due to GDOR for each quarter in fiscal year 2016 were all filed in February 2017.

Cause:
The MRF had a change of accounting personnel during fiscal year 2015. At that time, the MRF had not established strong internal controls over the relatively new process of making benefit payments to members, withholding taxes from those payments, and depositing and reporting those withholdings. The deposit and reporting requirements related to income tax withholdings were overlooked because of the lack of strong internal controls combined with the change in accounting personnel.

Effect or Potential Effect:
Noncompliance with Federal and State withholding deposit and reporting requirements can result in the imposition of penalties by the applicable tax agency. For example, IRS penalties for not making timely withholding tax deposits range from 2 to 15%, while GDOR penalties for not making timely withholding tax deposits are 5% per month. While not considered likely, the IRS or GDOR could also assess penalties *personally* against the individuals responsible for depositing income tax withholdings. As a fiduciary, management of MRF is responsible for operating the fund in the best interest of the beneficiaries, which includes avoiding unnecessary costs such as tax penalties.

Recommendation:
The MRF should improve its internal control over depositing tax withholdings and reporting those withholdings as required by the applicable tax agencies. The strengthened controls should include additional oversight by management of these processes and review of the applicable tax reports.

The MRF should also document its policies and procedures for depositing and reporting income tax withholdings and its process for monitoring and evaluating controls. This will further reinforce that internal controls over income tax withholdings are designed, implemented, and operating effectively, in addition to retaining organizational knowledge.

A strong system of internal control will help ensure MRF complies with Federal and State requirements for depositing and reporting income tax withholdings.

Views of Responsible Officials:
Management concurs with the finding.

Corrective Action Plan:
MRF has filed applicable forms and remitted payments to the Internal Revenue Service and State of Georgia. MRF is currently using a third-party vendor to assist with paying retirement benefits and remitting withholdings to the Internal Revenue Service and the State of Georgia. MRF is monitoring the third-party vendor to ensure applicable deadlines are being met.

Estimated Completion Date: July 2018

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