OCTA

October 28, 2015

To: Finance and Administration Committee

From: Darrell Johnson, Chief Executive Officer

Janet Sutter, Executive Director
Internal Audit Department

Subject: Investigation and Limited Scope Review of Administration of the Deferred Compensation Plan and Revenue Reimbursement Account

Overview

The Internal Audit Department of the Orange County Transportation Authority has completed an investigation and limited scope review of the administration of the Orange County Transportation Authority's Deferred Compensation Plan and related Revenue Reimbursement Account, funded through plan participant investment fees. As a result of the review, the Internal Audit Department is making recommendations to improve transparency; enhance and formalize the governance structure; implement controls to safeguard funds maintained in the account; obtain reimbursement of $15,000 in duplicated charges from Nationwide Retirement Solutions; monitor and enforce terms of the contract with the investment consultant; and monitor the Deferred Compensation Plan fee structure consistent with fiduciary requirements.

Recommendation

Direct staff to implement recommendations provided in the Investigation and Limited Scope Review of Administration of the Deferred Compensation Plan and Revenue Reimbursement Account.

Background

The investigation stemmed from an anonymous inquiry about deposits made to employee Deferred Compensation Plan (Plan) accounts at the end of fiscal year (FY) 2014-15.

In August 2010, the Orange County Transportation Authority (OCTA) contracted with Nationwide Retirement Solutions (NRS) to provide Plan recordkeeping services. Under the Plan, participant accounts are assessed costs through the expense structure of investment options. Each investment option in the Plan has an expense ratio associated with it to compensate investment managers and to provide for costs of recordkeeping and administration of the Plan. Under the agreement, NRS requires revenue of 25 basis points, overall, from investment managers participating in the Plan. Any excess revenue earned over 25 basis points is deposited into a Revenue Reimbursement Account (Account) held by NRS for OCTA. Under this model, which is common in the industry, Plan participants fund the costs of both recordkeeping and administration of the Plan. Excess funds are held in the Account and are available to pay Plan-related expenses and/or be redistributed back to participants, which occurred for the first time at the end of FY 2014-15.

<u>The Investment Policy Statement, Deferred Compensation Committee, and Investment Consultant</u>

An Investment Policy (IP) Statement establishes the policies and objectives for the Plan. It outlines and prescribes a prudent and acceptable investment philosophy and sets out the investment management procedures designed to assist the plan sponsor in the discharge of its fiduciary duties.

A Deferred Compensation Plan Committee (Committee) acts as OCTA's investment fiduciary and is responsible for evaluation of investment options and Plan performance, and monitoring of Plan fees.

OCTA contracts with an investment consultant, Benefit Funding Services Group (BFSG), to provide advice to the Committee, to assist in the selection of investment managers, and to provide performance analysis and monitoring services.

As of September 30, 2015, the value of Plan accounts totaled approximately $100 million.

Discussion

The Plan IP Statement, which has not been formally approved by OCTA, states that OCTA will appoint a committee to discharge the fiduciary duties imposed by California law; however, it does not outline how the appointments will be made or describe the composition of the Committee. There have been no communications to Plan participants notifying them of the existence of the

Account, the IP Statement, or the Committee. Between 2010 and 2015, excess revenues accumulated in the Account and, at the end of FY 2014-15, $137,582 was redistributed to 1,784 Plan participant accounts. Participants were not provided with an explanation of the credit or how it was applied among Plan accounts. Internal Audit recommended that management formalize and document the Plan governance structure, formally approve policies and make information on Plan governance available to participants, review the composition of the Committee, and require members to be formally appointed. Management agreed and proposed actions to formally approve and make available Plan policies and documents. Also, management agreed to reconsider the composition of the Committee.

The Account has not been reconciled by OCTA staff. In addition, the OCTA employee that receives Account statements also authorizes distributions from the Account. Through review of Account activity, Internal Audit discovered that NRS had overcharged $15,000 to the Account for BFSG invoices. In addition, NRS issued a $2,220 check to the former OCTA Benefits Section Manager (SM) in response to a request for travel advance for attendance at a professional conference. The check was deposited into the Benefits SM’s personal account. Contact with the conference sponsor confirmed that the Benefits SM and a subordinate employee attended the conference and paid registration fees totaling $1,100; however, neither OCTA nor NRS had any receipts or travel authorizations on file, and the balance of the amount disbursed could not be substantiated. Neither the IP Statement nor the Account Policy outline the types of expenditures that may be made from the Account. Internal Audit recommended management obtain reimbursement from NRS, improve controls to ensure adequate segregation of duties, amend policies to identify the types of eligible Account expenditures, require proper approval for Account expenditures, and implement procedures for account reconciliation. Management responded that reimbursement from NRS was obtained in August 2015. Management proposed actions to improve disbursement controls, expand procedures for eligible Account expenditures, and provide for reconciliation of the Account.

Consistent with fiduciary duties, the Committee is responsible for monitoring the Plan fee structure and for attempting to negotiate with the Plan service provider if the fees are found to be above-average or not deemed reasonable. To accomplish this, the agreement with BFSG requires the consultant to provide a fee structure report, a fee comparison report, and a Plan review report to OCTA on an annual basis. However, none of the required annual reports have been provided, and there is no evidence of review or comparison of the Plan fee structure in the minutes of Committee meetings. Despite this, BFSG has been paid in full each year. In addition, BFSG invoices are not in compliance with the agreement; specifically, invoices are issued quarterly rather than semi-annually, are not accompanied by required progress reports, do not specify task numbers, and do not include required certification language. These invoices are forwarded directly to NRS for payment and are not scrutinized by OCTA accounts payable staff. Further, since the departure of both the HR Manager and the Benefits SM in 2014, the invoices have not evidenced a signature for approval. Despite this, the invoices have been paid by Nationwide. Internal Audit recommended that Committee members be provided training and be required to annually review and reaffirm the IP Statement outlining their fiduciary duties. In addition, management should exercise oversight of BFSG to ensure all deliverables are provided and invoices are in compliance with the agreement. Management agreed to provide training and require annual review of the IP Statement by Committee members. In addition, management agreed to implement annual review of the Plan fee structure. Management also agreed to implement invoice review controls and enforce contract terms.

Summary

Internal Audit has completed an investigation and limited scope review of the administration and oversight of the Deferred Compensation Plan and Revenue Reimbursement Account.

Attachment

A. Investigation and Limited Scope Review of Administration of the Deferred Compensation Plan and Revenue Reimbursement Account

Prepared by:

Janet Sutter
Executive Director, Internal Audit
714-560-5591

ATTACHMENT A

ORANGE COUNTY TRANSPORTATION AUTHORITY
INTERNAL AUDIT DEPARTMENT

Investigation and Limited Scope Review of Administration of the Deferred Compensation Plan and Revenue Reimbursement Account

October 15, 2015

Performed by: Serena Ng, CPA, Principal Internal Auditor
Janet Sutter, CIA, Executive Director

Distributed to: Kenneth Phipps, Acting Executive Director, Human Resources & Organizational Development
Andrew Oftelie, Executive Director, Finance and Administration

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Conclusion

The Internal Audit Department (Internal Audit) of the Orange County Transportation Authority (OCTA) has completed an investigation and limited scope review of the administration of OCTA's Deferred Compensation Plan (Plan) and related Revenue Reimbursement Account (Account), funded through Plan participant investment fees. As a result of the review, Internal Audit is making recommendations to improve transparency, enhance and formalize the governance structure of the Plan, implement controls to safeguard funds maintained in the Plan Account; obtain reimbursement of $15,000 in duplicated charges from Nationwide Retirement Solutions (NRS); monitor and enforce terms of the contract with OCTA's Plan consultant; and monitor the Plan fee structure consistent with fiduciary requirements.

Background

The investigation stemmed from an anonymous inquiry about deposits made to employee deferred compensation accounts at the end of fiscal year (FY) 2014-15. A notice on the NRS website advised that participants "…may see a credit" to their accounts but provided no explanation as to the source of funds or the distribution methodology. Internal Audit discovered that the deposits were related to a redistribution of excess revenues that began accruing to the Account in 2010.

As of September 30, 2015, the value of Plan accounts totaled approximately $100 million. Responsibility for the Plan is assigned to the Benefits Section of the Human Resources (HR) Department within the Human Resources and Organizational Development (HROD) Division. The Benefits Section Manager (SM) terminated employment in June 2014, and since that time a Benefits Analyst has acted as the OCTA contact for the Plan and the Account.

<u>Revenue Reimbursement Account</u>

In August 2010, OCTA executed Agreement No. C-9-0872 with NRS to provide Plan recordkeeping services. Under the Plan, participant accounts are assessed costs through the expense structure of investment options. Each investment option in the Plan has an expense ratio associated with it to compensate investment managers and to provide for costs of recordkeeping and administration of the Plan. Under the agreement, NRS requires revenue of 25 basis points, overall, from investment managers participating in the Plan. Any excess revenue earned over 25 basis points is deposited in an Account held by NRS for the OCTA Plan. Under this model, which is common in the industry, Plan participants fund the costs of both recordkeeping and administration of the Plan. Excess funds are held in the Account and are available to pay Plan-related expenses and/or they may be periodically redistributed back to participants, which occurred for the first time, at the end of FY 2014-15.

<u>The Investment Policy Statement, Deferred Compensation Committee, and Investment Consultant</u>

The Investment Policy (IP) Statement establishes the policies and objectives for the Plan. It outlines and prescribes a prudent and acceptable investment philosophy and sets out the investment management procedures designed to assist the plan sponsor in the discharge of its fiduciary duties.

A Deferred Compensation Plan Committee (Committee) acts as OCTA's investment fiduciary and is responsible for evaluation of investment options and Plan performance, and monitoring of Plan fees.

OCTA contracts with an investment consultant, Benefit Funding Services Group (BFSG), to provide advice to the Committee, to assist in the selection of investment managers, and to provide performance analysis and monitoring services.

Objectives, Scope, and Methodology

The <u>objective</u> of the investigation and limited review was to assess controls related to the OCTA Plan and Account, to determine whether distributions from the Account were valid and allowable, and to assess the adequacy of governance and administration of the Plan and related Account. The <u>scope</u> was limited to OCTA's Plan and related Account.

In conducting the investigation and limited scope review, Internal Audit employed the following <u>methodology</u>:

- Interview with applicable managers, staff in HR, and Committee members;
- Review of the IP Statement, the Account Policy, the Plan document, Agreement No. C-9-0872 with NRS, and Agreement No. C-1-2464 with BFSG;
- Review of supporting documentation for all Account transactions from inception through July 2015;
- Consultation with legal counsel; and
- Review of all Committee meeting minutes.

This report is the result of an investigation into an anonymous inquiry received by Internal Audit and does not represent an audit conducted in accordance with Generally Accepted Government Auditing Standards.

Observations, Recommendations, and Management Responses

<u>Plan Governance, Administration, and Transparency</u>

Under California law, duties are imposed on fiduciaries of governmental deferred compensation plans. These duties require that the fiduciary, OCTA, administer the plan, act for the exclusive purpose of providing benefits to participants and their beneficiaries, and engage in a prudent process for making all decisions related to the operation of the plan. To meet these responsibilities, fiduciaries typically adopt an investment policy and create a committee to oversee and administer the plan.

The OCTA Plan with NRS began in 2010, a Committee was first convened in 2011, and a governing IP Statement was first developed in 2012. The IP Statement, drafted by BFSG, states that OCTA will appoint a committee to discharge the fiduciary duties imposed by California law; however, it does not outline how the appointments will be made or describe the composition of the committee. While a group of three employees, two from HROD and one from the Finance and Administration (F&A) Division, held meetings beginning in 2011, there is no record of official appointment of these individuals to act as the Committee, nor is there a record of adoption of the IP Statement by OCTA. An Account Policy was adopted by the Committee in February 2015 that outlines the intended use of funds in the Account, sets a reserve amount for the Account, and describes the method to be used for redistribution of excess funds to the participants; however, this policy lacks an effective date and approval by the executive office.

There have been no communications to Plan participants notifying them of the existence of the Account, the IP Statement, or the Committee. The Plan and related governance structure is not outlined in the Personnel and Salary Resolution or on the intranet. All of the policy documents, Committee meeting minutes, and Account statements are maintained by the Benefits section of HR.

Between 2010 and 2015, revenue from Plan participants in excess of 25 basis points accumulated in the Account and, at the end of FY 2014-15, the Committee chose to proportionally redistribute $137,582 to 1,784 Plan participant accounts. The only notice provided to participants was on the NRS website. The notice stated that employees “may see a credit to your OCTA account”; however, there was no explanation as to where the credit came from or how it was distributed among accounts. During the course of this review, another more detailed communication was provided via an internally-distributed online newsletter.

Recommendation 1:

Internal Audit recommends management formalize and document the Plan governance structure and Committee structure. Committee configuration should be reviewed and consideration given to appointing a member to represent employee groups participating in the Plan. Committee members should be appointed and policies should be approved by OCTA.

Management should improve transparency by informing participants of the existence of the Account, the Committee, and related policies and procedures.

Management Response:

Management concurs with Internal Audit recommendation to improve transparency. The IP Statement will be formally approved by the executive office and made available to participants electronically. Management will also post the quarterly meeting minutes, the quarterly reports, and the Account Policy. The Committee composition will be included in the IP Statement, with consideration given to expanding the Committee to include a member to represent employees that participate in the Plan. These tasks will be completed by the end of calendar year 2015.

Account Oversight, Reconciliation, and Disbursement Controls

There is no evidence that Account activity has ever been reconciled by OCTA staff. In addition, the OCTA employee that receives the Account statements also authorizes NRS to pay invoices and make distributions from the Account. While this arrangement meets NRS' requirements, it does not provide for adequate segregation of duties.

As part of the review, Internal Audit requested a detailed accounting of all activity since Account inception and traced the activity to supporting documentation. Through this process, Internal Audit discovered that NRS had double-charged the Account for BFSG invoices processed in late 2012 and early 2013. The amount overcharged was $15,000.

In addition, NRS issued a $2,220 check to the former OCTA Benefits SM in September 2012, in response to a request for travel advance. The letter requesting the check was signed by a former HR Representative (Rep) that reported to the former Benefits SM. The letter stated that the advance was to pay for the HR Rep and the Benefits SM to attend a National Association of Government Defined Contribution Administrators (NAGDCA) conference. The check was deposited into the Benefits SM's personal account.

OCTA's approved Travel Policy does not allow advances for travel expenses by non-union employees. The Travel Policy also requires preapproval of all overnight travel and original receipts for reimbursements of expenses. Contact with NAGDCA during this investigation confirmed that the two employees attended the conference and paid registration fees totaling $1,100; however, neither OCTA nor NRS had any receipts or travel authorizations on file.

Neither the IP Statement nor the Account Policy outline the types of expenditures that may be made from the Account.

Recommendation 2:

Internal Audit recommends that management take the following actions:

1. Obtain reimbursement from NRS for $15,000 in overcharges.
2. To improve controls, notify NRS that distributions from the Account may only be authorized by two designated OCTA employees. Then, provide NRS with the names and sample signatures of the authorized individuals and ensure timely update of the list, as needed.
3. Amend policies to include definition of eligible expenditures, ensure that travel-related disbursements comply with OCTA policy, and require review and approval of any distributions from the Account by the Committee.
4. Require routine account reconciliations to be performed and documented.
5. Assign responsibility for reconciling this Account to an appropriate individual that does not also direct disbursements from the Account.

Management Response:

1. NRS reimbursed the Account $15,000 in overcharges plus lost earnings effective August 31, 2015.
2. OCTA will notify NRS that distributions from the Account may only be authorized by two designated OCTA employees. A signature card including the names and sample signatures of the authorized OCTA employees will be provided to NRS. This signature card will be updated to reflect changes in staff as needed.
3. Management will expand the Account Policy to include some examples of common qualified expenses and a reference to the Internal Revenue Service section that governs qualified expenses. Management will also require that any and all future travel related to the Plan be governed by the OCTA Travel Policy and be pre-approved on an OCTA Travel Authorization form. Receipts will be required for reimbursement as stipulated within the OCTA Travel Policy. Finally, the Committee will review any distributions from the Account in their quarterly meetings and document such distributions in the meeting minutes. The expanded Account Policy will also include

the requirement to have two approved signatures before qualified expenditures are submitted to NRS for payment.

4. Account reconciliations will be performed and documented on a quarterly basis.
5. Account reconciliation will be performed by a staff member within the F&A Division who does not also direct disbursements from the Account.

Enforcement of Agreement Provisions and Invoice Payment Controls

Per guidance from the Department of Labor and the IP Statement adopted by the Committee, the Committee is responsible for monitoring fees charged to the Plan and its participants and for attempting to negotiate with the Plan service provider if the fees are found to be above-average or not deemed reasonable. To accomplish this, the agreement with BFSG requires the consultant to provide a fee structure report, a fee comparison report, and a Plan review report to OCTA on an annual basis.

None of the required annual reports have been provided and Internal Audit found no reference to review or comparison of the Plan fee structure in the minutes of the Committee meetings. Despite this, BFSG has been paid in full for services rendered each year.

In addition, the agreement requires BFSG to invoice OCTA bi-annually and to provide a progress report. Each invoice is required to specify the task numbers for which payment is being requested and must include a certification signed by the consultant that the invoice is a "…true, complete, and correct statement of reimbursable costs and progress, etc…" Invoices, however, are remitted quarterly without referencing tasks completed; they do not include required certification language and are not accompanied by required progress reports. Since these invoices are forwarded by HR staff directly to NRS for payment from the Account, they are not scrutinized by Accounts Payable staff that may have identified the omissions.

Typically, the invoices reflected authorization by the Benefits SM or the HR Manager; however, since those positions became vacant in 2014, invoices have not reflected any signature for approval but continue to be paid by NRS.

Recommendation 3:

Internal Audit recommends management take the following actions:

1. Ensure Committee members annually review and reaffirm the IP Statement outlining their fiduciary duties and responsibilities.

2. Provide training and require Committee members to monitor fees charged to the Plan and its participants and, when applicable, attempt to negotiate fees to a reasonable level.
3. Exercise oversight of BFSG to ensure all deliverables required by the agreement are provided.
4. Review invoices for compliance with the agreement terms and obtain proper approval before submitting to NRS for payment.

Management Response:

1. Management concurs. The IP Statement will be annually reviewed and reaffirmed by the Committee.
2. Management concurs. BFSG will provide training to Committee members on an annual basis once the IP Statement has been reaffirmed. Committee members will review annual reports provided by BFSG and will work with the Contracts Administration and Materials Management Department to attempt to negotiate fees if they are deemed unreasonable through the annual review.
3. Management will ensure that OCTA receives all deliverables specified in the contract. Management believes that BFSG has provided outstanding service as it relates to the required quarterly reports and attendance at committee meetings. Management will ensure that required annual fee reports are provided by BFSG.
4. Management concurs. BFSG will be required to include the appropriate certification language on all future invoices. All future BFSG invoices will be properly reviewed for compliance with the agreement terms and two authorized parties will approve the invoices before submitting to NRS for payment.