# Department of Personnel Administration:

## Improved Controls Would Reduce Risk in Long-Term Savings Plans

April 1997
96125

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April 17, 1997 96125

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

## *Summary*

In a recent investigation, we reported that a state employee at the Department of Personnel Administration (department) stole over $400,000 held by the State in long-term savings plans between 1984 and 1986.[1] These plans are designed to supplement retirement income of state employees. The thefts occurred because the department lacked an adequate system of internal controls. Although these thefts occurred more than ten years ago and the department has made improvements to help prevent future thefts from its savings plans, we conducted this follow-up audit to assess the adequacy of the existing system.

Under state law, the department is required to establish and maintain an adequate system of internal controls to prevent errors, irregularities, or illegal acts. The maintenance of a strong system of internal control is critical when large amounts of money are involved, as is the case with these savings plans.

Despite improvements made over the last ten years and as the result of our investigation, several significant weaknesses still exist in the department's internal controls over the State's long-term savings plans. Specifically, we noted the following conditions:

- The department has a number of dormant accounts in the savings plan for permanent employees. It also has an inordinate number of dormant accounts in the savings plans for temporary employees. The existence of these dormant

[1] We reported this employee's thefts in October 1996 and March 1997.

accounts increases the department's risk of theft and noncompliance with Internal Revenue Service (IRS) regulations.

- The department has not adequately separated duties among employees to ensure that no one employee has the opportunity to commit and conceal theft.

- The department's requirements for establishing the identity of participants when they request payments or changes to accounts are minimal and lack the rigors to ensure an appropriate distribution from an account.

- The department needs to improve security over participants' records.

## *Background*

The department administers the Savings Plus Program (program), a long-term savings program for state employees. Two savings plans are designed to supplement the retirement income of permanent state employees. A third savings plan is a retirement plan for certain state employees who are excluded from the Public Employees' Retirement System.

**SAVINGS PLUS PROGRAM AT A GLANCE**

- **Who administers it:** The State Department of Personnel Administration in Sacramento. The program administration for the 457 and the 401(k) plans is completely funded by fees assessed on participant accounts.

- **What it is:** A long-term savings program administered by the State as a significant benefit to its employees. Two savings plans are designed to supplement state employees' retirement income and a third is a retirement plan. All funds placed into the program, along with investment earnings, are tax-deferred. The State makes no contributions to the program.

- The **457 plan** is a deferred compensation plan. State employees have the option to participate. As of December 1996, it had assets with a market value of approximately $2.7 billion and 72,511 participants.

- The **401(k) plan,** a thrift plan, is also voluntary. As of December 1996, it had a market value of approximately $362 million and 30,164 participants.

- The **Part-Time, Seasonal, and Temporary** employees retirement plan (PST plan) is mandatory for certain state employees who are excluded from the Public Employees' Retirement System. As of December 1996, it had a market value of approximately $48 million and 99,506 participants.

### *The Savings Plans Authorized Under Sections 401(k) and 457 of the Internal Revenue Code*

Within the program, there is a deferred compensation plan authorized under the Internal Revenue Code, Section 457 (457 plan). In addition, there is a thrift plan authorized under the Internal Revenue Code, Section 401(k) (401(k) plan). State employees have the option to participate in either or both of these savings plans.

Employees of the State of California who participate in these savings plans have pre-tax deductions taken directly from their paychecks and deposited into their choice of investment options. Employees in the 457 plan may request a routine withdrawal immediately upon separation or retirement from state service regardless of age. Employees in the 401(k) plan may request a routine withdrawal when they are 55 and retired from state service or are 59½, even if they have not retired. In either plan, employees can choose to receive their funds as a lump-sum payment, an annuity, or a combination of these choices. Employees in the 401(k) plan may also have their funds rollover into another 401(k) plan or an Individual Retirement Account.

Under program policy for the 457 plan, when employees separate from state service, they have 60 days to elect a commencement date for the distribution of their funds. If an employee does not choose a commencement date, the program's policy is to issue the employee a lump-sum distribution. However, according to the program manager, the program invoked this policy only twice. Instead, the program relies upon state employees to notify the department that they have separated from state service. Also, through its normal course of business, the program discovers that some employees have separated from state service. Therefore, when employees fail to notify the program that they have separated from state service or the program does not discover them, the funds remain in the plan.

According to the program manager, the policy has rarely been invoked because he believes that a potential liability to the State exists. Specifically, the program is concerned that some participants may be incapable of understanding payment election requirements and that some participants with joint bank accounts may be taken advantage of by unscrupulous joint account holders if the program makes these lump-sum distributions. The program plans to retain private tax counsel to determine the best legal approach to ensure the State does not incur any liability for issuing these payments.

The Internal Revenue Code permits early distribution of moneys held in these plans, but only for unforeseen emergencies or financial hardship. Approval for an emergency or hardship withdrawal is not automatic. However, if approved by the program, an employee may receive an amount equal to the demonstrated need, up to the full amount of the account balance.

Upon the death of a participant, the Internal Revenue Code requires the program to pay all moneys to the participant's designated beneficiary. If the participant does not designate a beneficiary, the moneys are paid to the participant's estate or an established trust.

The program contracts with a bank to provide record keeping and trust services for these plans. To accomplish these services, the bank provides the program access to its computer system that reflects current account balances for each participant. Program staff enter initial participant data, such as names, social security numbers, and addresses, into this system and update the information as needed. In addition, certain staff have access to the system to authorize payments to participants. After the program authorizes a payment, the bank sends a check to the participant.

### *Retirement Plan for Part-Time, Seasonal, and Temporary Employees*

The Federal Omnibus Budget Reconciliation Act of 1990 requires that part-time, seasonal, or temporary public employees who are not members of a retirement system, be covered by either a qualified retirement plan or Social Security. The State has elected to use the deferred compensation plan, authorized under Section 457 of the Internal Revenue Code, as the qualified retirement plan for this purpose. This plan, also administered by the department, is referred to as the Part-Time, Seasonal, and Temporary employees retirement plan (PST plan).

Participation in the PST plan is mandatory for part-time employees who work less than half-time, seasonal employees, and temporary employees who work less than six months in a fiscal year. Examples of these employees include seasonal tax workers, seasonal fair employees, and part-time professors. For employees covered by the PST plan, the State automatically deducts 7.5 percent of their gross pay for investment in this program. Upon permanent separation from state service, employees may choose to leave the funds in the PST plan until they reach 70½, or receive a distribution of the funds. The program allows participants in the PST plan to wait up to one

year after separation before deciding what to do with their funds. Employees are eligible to receive these moneys one year after separating from state service.

## *Scope and Methodology*

The purpose of our audit was to determine if the conditions and internal control weaknesses that allowed the previous thefts to occur still exist. Thus, we focused our review on payments from the plans because payments represent the greatest risk of theft.

The existence of dormant accounts was one of the conditions that allowed the previous thefts to occur because staff and participants failed to regularly scrutinize them. Therefore, we reviewed safeguards over dormant accounts.

To determine if the payment procedures of the program are reasonable, we evaluated whether these procedures contained the internal controls needed to prevent theft. Specifically, we reviewed various plan documents and manuals to gain an understanding of how the program makes payments to participants. We also interviewed staff who authorize payments. We then determined whether the payment procedures contained standard internal controls, such as proper segregation of duties or security over sensitive files.

In addition, we contacted administrators of governmental entities that operate similar savings plans or hold assets in trust. These entities include two state departments, two counties, and a utility district. We asked them about their key internal controls and processes over payments to participants. We then compared the procedures used by the program to the procedures used by these similar entities.

Finally, we reviewed federal and state laws and regulations relevant to these savings plans. Where appropriate, we reviewed the department's compliance with these laws and regulations.

## *Examples of How Theft Occurred as Reported in Our Previous Investigation*

In October 1996, the Bureau of State Audits issued its investigation titled *"Theft of Funds From a Long-Term Savings Plan by a State Employee."* In this investigation, we reported that a state employee working in the program was able to steal funds from three participants during 1985 and 1986. In

March 1997, we reported the same employee had stolen funds from a fourth plan participant in 1984 as well. In one of the four thefts, the individual stole from a former state employee by forging the victim's signature on documents to convince the program that it was paying the funds to the participant. In two other thefts, the individual notified the program that a state employee was deceased and, using an alias, had herself named as the victim's beneficiary. Finally, in the fourth theft, the individual had her mother declared as the deceased victim's beneficiary and submitted documents for the program to pay the victim's funds to her mother. Because these participants or their beneficiaries failed to monitor their accounts, this individual was able to commit these thefts without the knowledge of the participants. Moreover, the program's internal controls failed to detect the thefts. These thefts came to light after the IRS contacted our office.

These thefts totaled over $400,000, but the State's potential liability to the victims, including accrued interest and investment earnings, totaled over $691,000 as of December 31, 1996. In December 1996, the employee pleaded guilty to one count of grand theft and, in January 1997, was sentenced to three years in prison. These thefts have created a temporary out-of-balance condition in the 457 plan. An out-of-balance condition exists when the balances of participant accounts are greater than the assets in the plan. The department acknowledges that the State is liable for funding the thefts and is in the process of arranging permanent funding to restore the affected accounts. Consequently, until permanent funding is arranged, if the participants whose funds were stolen request their funds, the department would temporarily need to use funds belonging to other participants to pay them. However, the department believes that this would be an issue only if all participants requested a lump-sum distribution of their accounts at the same time.

Our investigation of the thefts and our subsequent system review reveals that the program has improved some of the internal controls over certain functions. In particular, it has significantly improved controls over payments to beneficiaries of deceased participants.

### *Dormant Accounts in the Savings Plans for Permanent Employees Increase the Risk of Theft and Noncompliance with Internal Revenue Service Regulations*

One common factor in these thefts was that the accounts were dormant. We consider an account dormant when the program has lost contact with the participant or the participant is not actively monitoring the account. Because the victims or the victims' beneficiaries were not actively monitoring their funds, the employee was able to steal the funds and go undetected. When an individual places funds in a savings plan, a critical assumption is that the individual will actively monitor his or her funds. Although the participants' primary objective probably is ensuring they are meeting their investment goals, this periodic review should identify whether any errors or unauthorized withdrawals have occurred. The program facilitates monitoring by providing participants with periodic statements that show their contributions, investment earnings, and distributions. Participants in the 457 and 401(k) plans receive these statements quarterly, while participants in the PST plan receive them annually. However, if participants are not actively reviewing their accounts or are not receiving their quarterly statements, there is a greater risk that they will not detect errors or unauthorized withdrawals. Further, if a potential thief is aware of participants that are not monitoring their accounts, then those accounts are especially susceptible to theft.

During our review of the program, we identified 180 potentially dormant 457 and 401(k) plan accounts. Although this number is small in comparison to the total number of accounts, the total value is significant, and some individual balances are very large. Specifically, the total value is about $7.5 million, and one dormant account we reviewed had a balance of more than $485,000. (Refer to the chart on page 2 for the total number of participants and market values of these plans.)

We considered some accounts dormant if the program could not locate a correct address to deliver the participant's September 30, 1996, quarterly statement. Fifty-nine accounts with balances totaling $1.0 million fell into this category. We also classified another 121 accounts totaling $6.5 million as potentially dormant because the participants have left state service but have not chosen a date to receive their funds, or they have chosen a date but have failed to submit all of the necessary documents to begin the payment process and, the

program's attempts to contact or distribute funds to these participants have been unsuccessful. These dormant accounts are susceptible to theft because participants may not be actively monitoring them.

**DORMANT ACCOUNTS**

- **We identified** 180 accounts totaling $7.5 million.

- **59 of the 180 accounts** total $1.0 million and were considered dormant because the participants could not be located.

- **The remaining 121 of the 180 accounts** total $6.5 million and are potentially dormant because the participants have not decided when to receive their funds, or the participants have separated or retired but have not completed the paperwork needed to receive their funds. Additionally, the program's attempts to contact or distribute funds to these participants have been unsuccessful.

In addition, because of the dormant accounts, the program also increases the risk that it will not comply with IRS regulations regarding 457 plan distributions. IRS regulations allow participants to decide when to receive their funds. If participants chose to receive their funds before January 1997, they could not change their minds later; their decision was "irrevocable."

Under IRS regulations, a participant must begin receiving his or her funds before the later of 60 days after the close of the plan year in which the participant reaches 70½, or 60 days after the close of the plan year in which the participant separates from state service. We reviewed the 121 accounts in which the department's attempts to contact or distribute funds to its participants have been unsuccessful. We found that IRS regulations were violated for 5 accounts. Specifically, for 2 accounts, the funds had not been distributed within 60 days after the plan year that the participants reached age 70½ and, for 3 other accounts, the program had allowed the participants to change the "irrevocable" election.

The program's current procedures are not effective in preventing, detecting, and eliminating dormant accounts. For example, the program does not adequately prevent dormant accounts caused by outdated addresses. The State Controller's Office (SCO) maintains the State's payroll system that contains addresses for most current state employees. Rather than acquiring addresses from the SCO for current state employees, the program acquires addresses only for state

employees currently contributing to the 457 or 401(k) plans. Current state employees not contributing to a savings plan are required to submit address changes directly to the program. Thus, the program cannot ensure that it is informed of the addresses of current state employees who are no longer contributing to the plans. Similar entities we contacted accept address changes for current employees only from their payroll systems, thereby reducing the potential for someone to divert funds to another address.

In addition, the program does not adequately prevent dormant accounts caused by state employees who leave state service without making a fund distribution decision. Specifically, the program does not actively request that the appropriate documentation be included in employee separation and retirement packages distributed by state personnel offices, nor does it obtain reports from the SCO to help identify separated employees. As a result, the program cannot ensure that it is properly notified when a participant leaves state service, nor does it use all avenues to require participants to elect a date to receive their funds.

The program has no procedures for detecting dormant accounts. Specifically, the program does not identify or maintain a log of accounts with incorrect addresses, accounts in which the participant has failed to elect a commencement date for distribution, or accounts in which the participant has failed to submit all of the necessary documents for distribution. Moreover, the program's record keeping system does not produce reports to help identify accounts that may have become dormant. Consequently, the program cannot determine the total number of dormant accounts.

Finally, the program has not taken sufficient steps to eliminate dormant accounts. For example, other than checking the records of the SCO, the program does not use other sources to locate owners of dormant accounts. The other entities with similar programs we contacted use the Franchise Tax Board, Department of Motor Vehicles, Social Security Administration, or private search companies to help locate participants. Furthermore, the program has rarely issued lump-sum payments to 457 plan participants who have left state service but failed to elect a commencement date for their distribution, as required by its own internal policy. Also, because IRS regulations do not require it, the program has not established a similar policy for the 401(k) plan. As a result, these accounts remain dormant until a participant comes forth to claim his or her funds, leaving the accounts vulnerable to theft.

### *An Excessive Number of Dormant Accounts in the Retirement Plan for Temporary Employees Increases the Risk of Theft*

In addition to the dormant accounts noted in the 457 and 401(k) plans, an excessive number of dormant accounts exist in the PST plan. Participants in the PST plan tend to change jobs frequently and may work only a short time for the State. As of December 1996, there were 99,506 accounts in the PST plan with the total market value of $48 million or an average of $485 per account. Based on the volume of returned annual statements, program staff estimate that between 20 to 30 percent of total PST plan accounts are dormant. Using this estimate, we calculate that the PST plan may hold between 19,900 and 29,900 dormant accounts with a combined market value of between $9.6 million and $14.5 million. The program manager believes that most of the dormant accounts relate to participants with balances smaller than the average account balance and that the market value of the dormant accounts is less than this range. However, the program manager has no quantifiable estimate of the market value of the dormant PST plan accounts.

The high number of dormant accounts provides ample opportunity for theft from the PST plan. As noted previously, participant review of account activity is an essential control over these savings plans. The program facilitates this review by providing annual statements to PST plan participants. Although the likelihood of address changes for PST plan participants is high, the program does not have an effective process for obtaining correct addresses, so the accounts become dormant. Thus, many participants may not review their accounts because they do not receive annual account statements. Without this essential control, these accounts are at risk.

Like the 457 and 401(k) plans, the PST plan's current procedures are not effective in preventing, detecting, and eliminating dormant accounts. As mentioned previously, the program does not attempt to identify dormant accounts, does not attempt to get information from state agencies on employees who have separated from the State, and does not take sufficient steps to locate the owners of dormant accounts. In addition, two weaknesses unique to the PST plan magnify its dormant account problem: the length of time the program allows participants to choose how to receive their funds and the lack of a provision to make mandatory payments to participants if they do not choose within this time period.

When employees resign or retire, the program requires participants in the 457 and PST plans to elect a date for the distribution of funds. The program gives 457 plan participants 60 days to make this choice. In contrast, the program gives PST plan participants one year to choose. The extended election period allows more time for former employees to move without informing the program, increasing the likelihood of PST plan accounts becoming dormant. The similar entities we surveyed required their PST plan participants to choose within 60 days of separation. Thus, the one-year election period provided by the program appears excessive.

The program also has no provisions for distributing funds when participants in the PST plan fail to elect a payment date. For example, the program's policy for the 457 plan requires distribution of funds to begin 90 days after employees separate or retire, if they do not make a choice themselves. The similar entities we surveyed distribute PST plan funds within one to three months of an employee's permanent separation or retirement. The State's PST plan, however, lacks such a provision. Without this type of requirement, the program has no basis for making mandatory payments. As a result, the program cannot eliminate what may be a sizable portion of the accounts belonging to former employees.

### *Other Weaknesses in Internal Controls Increase the Risk of Theft*

In addition to the significant weaknesses caused by the inordinate number of dormant accounts that exist in the plans, we found other areas that present internal control weaknesses relating to the three savings plans. These weaknesses lie in separation of duties, establishing the identity of participants when distributing funds or making changes to accounts, and security of office files.

Taken individually, these weaknesses would not significantly increase the risk of theft. However, in combination with the existing dormant accounts, these weaknesses could allow for unscrupulous program staff to steal funds from the savings plans.

### *Inadequate Segregation of Duties in Some Functions*

A key element in a system of internal controls is the segregation of incompatible duties. Incompatible duties are segregated to ensure that various individuals perform different functions so that no one person can commit and conceal errors or thefts. For example, an employee should not be able to change participants' addresses or beneficiaries and be able to authorize payments to participants. In addition, an employee should not be able to authorize participants' payments and input those payments to the bank's computer system to initiate the checks. However, we noted several situations in which these types of duties are not adequately segregated. Though we did not identify any instances of inappropriate activities, a poor separation of duties provides an environment that could allow thefts to occur.

For instance, though the program has assigned one employee the responsibility to make most address changes, eight additional staff have the ability to change addresses on the computer system. All nine of these employees also have the ability to input payments into the computer system. Thus, any of these nine employees could authorize a fraudulent payment to an improper address without the assistance of other employees. In addition, though another employee is primarily responsible for changing account beneficiaries on the system, ten staff have this ability. Five of these ten staff also have the ability to authorize payments, enabling them to change a beneficiary and authorize a payment without involving someone else. As reported in our previous investigation, the ability to change addresses and beneficiaries were methods used to steal participant funds.

According to the program manager, these staff have been allowed this level of access to handle backlogs. Despite catching up on its backlog, at the time of this audit, the program had not yet changed staff access to the computer system to match current responsibilities. Even without backlogs, the program manager believes that three staff need the ability to perform all functions on the computer system so that they can train or assist other staff.

For certain types of payments, the program has assigned all duties related to making these payments to a single employee. For example, only one employee is assigned to process and make payments to participants requesting a hardship withdrawal of their funds in the 401(k) plan. This employee receives the requests, authorizes payment, and then initiates payment. In addition, until recently, a single employee processed and made

payments to participants of the PST plan. This employee was responsible for receiving, authorizing, and inputting payment requests for the PST plan, with the occasional assistance of other employees. The same employee also received the undelivered annual statements of the PST plan. The program reassigned these responsibilities to other employees in mid-March 1997. When individual employees have too many responsibilities in processing payments, they could perpetrate and conceal errors or thefts.

### *Weak Procedures for Identifying Participants Requesting Payments or Making Changes to Accounts*

Once participants elect a method to receive their funds, they note their choice on a standard form that they sign and submit to the program. The same is true when participants change beneficiaries. Also, certain participants can change addresses by sending a letter to the program. In each instance, the participant's signature is the only evidence that the program uses to establish identity. Since anyone could sign and submit these forms, this procedure provides little assurance of the participant's identity. The other governmental entities we contacted generally require some additional evidence of the participant's identity. For example, one entity requires participants to provide a copy of their picture identification, such as a driver's license, along with their payment request. Another method requires participants to submit a statement from a notary that affirms their identity. Without an adequate method to establish identity, the program places the funds it manages at a higher risk of theft.

### *Insufficient Security Over Sensitive Participant Files*

The program does not adequately secure or control access to sensitive participant files. All employees working in the program have access to the files contained in the office and its file room. For example, the program stores all incoming and pending participant requests for payment on an open shelf in the office. The undelivered quarterly statements, some of which relate to dormant accounts, are also freely accessible. With these documents unsecured, a dishonest employee could find dormant accounts and initiate unauthorized payment requests.

Also, all program staff are allowed access to the office file room where sensitive documents, such as approved payment requests, are stored. Thus, any employee could enter the file room to alter or destroy documents to conceal an unauthorized payment.

### *Conclusions*

The department has improved some internal controls in the Savings Plus Program. However, certain internal control weaknesses still exist. In particular, an inordinate number of dormant participant accounts exist. These dormant accounts are susceptible to theft in part, because participants may not be actively monitoring these funds. In addition, duties among program staff are not adequately separated, procedures for establishing the identity of participants are weak, and security over office files needs improvement. These internal control weaknesses, when combined with the existence of dormant accounts, provide an environment that could allow theft to occur. Moreover, though the thefts occurred in the past, our review revealed that it could happen again, given the weaknesses in internal controls.

## *Recommendations*

To prevent, detect, and eliminate dormant accounts in the 457, 401(k), and PST plans, the department should take the following steps:

- Identify all long-outstanding dormant accounts. Methods may include reviewing undelivered quarterly statements and files of participants who have either separated or retired from state service but have not elected a date to receive their funds. Accounts for which participants failed to submit all the necessary documentation to begin the payment process should also be reviewed. In addition, performing automated searches of computer records may help. Finally, the department should track dormant accounts.

- Use the SCO's records to update the addresses of all current state employees, not just those state employees who are currently contributing to a long-term savings plan.

- Inform participants when they separate or retire that they must choose a payment method. This action may include requesting that state personnel offices provide employees with payment request forms upon separation or retirement.

- Regularly request from the SCO a listing of state employees who have separated from state service and use this list to identify state employees who should elect a commencement date for their distribution. The program should then ensure that these employees make this election within a reasonable period.

- Contact other organizations (such as the Franchise Tax Board, Department of Motor Vehicles, California Public Employees' Retirement System) or a search company to locate participant addresses when the SCO cannot obtain the correct address.

- Contact participants in the 457 plan who have separated or retired from state service but have not elected a commencement date. If a participant chooses not to make an election, then, with the concurrence of legal counsel, issue a lump-sum payment as outlined in the program's internal 457 plan policy.

- Contact participants in the 401(k) plan who have separated or retired from state service but have not chosen a method of payment and obtain their election.

- Add provisions to make lump-sum payments to participants in the 401(k) plan who choose not to make a distribution election after they separate or retire.

- Shorten the PST plan election period from one year to a more reasonable length.

- Add provisions allowing for mandatory payment of PST plan accounts within a short time after permanent separation from state service.

To improve internal controls within the Savings Plus Program, the department should take the following actions:

- Separate incompatible duties, such as changing addresses or beneficiaries, and authorizing payments, among program staff.

- Strengthen procedures for identifying participants requesting payments or making important account changes such as to addresses or beneficiaries.

- Improve security over sensitive documents, such as payment requests and undelivered quarterly statements, and restrict staff access to the office file room.

We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope of this report.

Respectfully submitted,

KURT R. SJOBERG
State Auditor

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STATE OF CALIFORNIA PETE WILSON, *Governor*

**DEPARTMENT OF PERSONNEL ADMINISTRATION**
OFFICE OF THE DIRECTOR
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April 11, 1997

Mr. Kurt R. Sjoberg
State Auditor
Bureau of State Audits
660 "J" Street, Suite 300
Sacramento, CA 95814

Dear Mr. Sjoberg:

This letter is in response to the draft report prepared by your office entitled "Department of Personnel Administration: Improved Controls Would Reduce Risk in Long-Term Savings Plans." Thank you for the opportunity to review the report in draft form and to make comments that will be included in the final report. Your staff was extremely helpful in this process. Per your letter dated April 4, 1997, we are submitting our response in writing and have copied it onto the enclosed diskette in a PC-compatible text file.

As an overall comment, we appreciate the extensive analysis of the Savings Plus Program (SPP) and of the causes which allowed the thefts to occur over ten years ago. We agree with the summary conclusions that additional internal control changes will provide increased security in the program. Attached are our specific responses to each recommendation.

As you know, during the ten years since the thefts occurred, many controls have been implemented to improve the security of the program. We outlined many of those improvements in a letter to you dated August 30, 1996. Since sending you that letter, we have continued to make changes to the program, many of which are described in the "Response to Recommendations" attachment.

As your report correctly points out, there is still room for improvement. However, because the administration of SPP is 100 percent funded by its participants through their monthly fees, the costs of some of the proposed additional internal controls must be analyzed to make sure that these can be added at the lowest costs to our participants. We will do this over the next few months. Additionally, we are hopeful that the business practice review currently being conducted to both streamline the operations and reduce the costs of the program will assist us in implementing the changes you have recommended.

Again, thank you for the extensive and valuable audit of this important program and for the opportunity to respond to the draft report prior to your issuance of the final report. If you have any questions, please feel free to call me at 322-5193, fax at 322-8376, or by e-mail at dtirapelle@smtp.dpa.ca.gov.

Sincerely,

David J. Tirapelle
Director

Attachment

## *Response to Recommendations*

***<u>Steps to prevent, detect, and eliminate dormant accounts in the 457, 401(k), and Part-Time, Seasonal, and Temporary retirement plans</u>***

***First Bullet***
In early 1996, the Savings Plus Program (SPP) implemented the following practices to reduce the number of undelivered quarterly statements: 1) the statement addresses are compared to the State Controller's (SCO) payroll system addresses and updated as needed; 2) when plan participants change their beneficiary designation (approximately 1,000 per month), we compare the address on the beneficiary change form to the address on record. If there is a difference, we verify with the plan participant and update address changes; and 3) the Public Employees' Retirement System (CalPERS) retiree address records are used to update addresses. In a 12-month period, these practices have reduced the number of undelivered statements by 50 percent. We will continue these practices which should further reduce the total number of dormant accounts.

The established process to notify participants who failed to submit all necessary benefit distribution documentation is to contact them via registered letters. Although these practices are labor intensive, SPP feels they have proven to be quite effective. The Department is currently exploring an automated process through its record keeper and the various State payroll systems to identify and track dormant accounts. Further, in order to identify new retirees, the Department is currently pursuing notification from CalPERS and SCO of retirement benefit applicants to SPP.

***Second Bullet***
The Department will pursue this recommendation. Successful implementation will depend on the interface capabilities of SCO and the record-keeping systems.

***Third Bullet***
As stated in the first bullet the Department is currently pursuing notification from CalPERS of retirement benefit applicants to SPP. The Department will also explore the recommendation to request that State personnel offices provide employees with payment request forms upon separation.

***Fourth Bullet***
The Department will request information from SCO to assist in identifying State employees who should elect a commencement date for their distribution.

***Fifth Bullet***
The Department intends to contact other organizations to locate participants' addresses.

***Sixth Bullet***
The Department will get advice of outside legal counsel to pursue your recommendations to issue a lump sum payment to participants who have not elected a commencement date.

***Seventh & Eighth Bullets***
The 401(k) IRS regulations do not require participants to elect a distribution commencement date. Further, because of the tax implications to the participant, the Department will seek advice of outside tax counsel before making any change to its policy.

***Ninth Bullet***
Effective April 1, 1997, the Department changed its policy for the Part-Time, Seasonal, and Temporary Retirement (PST) payout from one year to 90 days.

***Tenth Bullet***
The Department will seek advice of outside tax counsel before a determination is made to make mandatory payment of PST plan accounts after permanent separation from State service.

***Improve internal controls within the Savings Plus Program***

***Eleventh Bullet***
The Department is currently in the process of adjusting duties and system access for all staff to comply with this recommendation. In addition, the program is working with the record keeper on generating a disbursement transaction report. This will be audited by the program manager to ensure the approved authorization process is followed.

***Twelfth Bullet***
The Department will add participant identification procedures for allowing important account changes.

***Thirteenth Bullet***
The Department is currently in the process of securing all sensitive documents by storing them in locked cabinets. Further, access to the office file room will be restricted to staff in pairs.

cc: Members of the Legislature
Office of the Lieutenant Governor
Attorney General
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps