GOVERNMENT OF THE DISTRICT OF COLUMBIA
OFFICE OF THE INSPECTOR GENERAL

AUDIT OF THE MANAGEMENT OF THE 401(a) DEFINED CONTRIBUTION PENSION PLAN

CHARLES C. MADDOX, ESQ.
Inspector General

OIG NO. 03-2-19AT **October 15, 2003**

GOVERNMENT OF THE DISTRICT OF COLUMBIA
Office of the Inspector General

Inspector General

October 15, 2003

Natwar M. Gandhi
Chief Financial Officer
Office of the Chief Financial Officer
John A. Wilson Building
1350 Pennsylvania Avenue, N.W., Room 203
Washington, D.C. 20004

Dear Dr. Gandhi:

Enclosed is the final audit report summarizing the results of the Office of the Inspector General's (OIG) *Audit of the Management of the 401(a) Defined Contribution Pension Plan* (OIG No. 03-2-19AT).

As a result of our audit, we directed three recommendations to the Chief Financial Officer of the District of Columbia (CFO) for necessary action to correct the noted deficiencies. The CFO took immediate action on all recommendations. The CFO advised that much of the recommended actions have been completed and also provided target dates (none later than December 31, 2003) to complete remaining efforts.

We commend the CFO and his staff for their extra efforts and cooperation during the audit and for their immediate corrective actions with regard to the $27.5 million of forfeitures formerly maintained in the 401(a) Defined Contribution Pension Plan.

If you have questions, please contact me or William J. DiVello, Assistant Inspector General for Audits, at the number below.

Sincerely,

Austin Andersen, Deputy IG

for Charles C. Maddox, Esq.
Inspector General

CCM/je

Enclosure

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**AUDIT OF THE MANAGEMENT OF THE
401(a) DEFINED CONTRIBUTION PENSION PLAN**

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EXECUTIVE DIGEST

OVERVIEW

This report summarizes the results of the Office of the Inspector General's (OIG) audit of the Management of the 401(a) Defined Contribution Pension Plan (Plan). Our audit objective was to determine whether forfeited funds were prudently managed and managed in accordance with law and regulation.

This report also contains a limited analysis of one fund's performance in the Plan in order to provide District management with information applicable to District government investment options, taking into consideration the legal limitations under which the District operates. This report should not be used as the basis for investment decisions by individual investors in regard to the options described in the Plan.

CONCLUSION AND CORRECTIVE ACTIONS

The report includes two findings. Finding 1 addresses the accumulation of $27.5 million of funds forfeited from the 401(a) Defined Contribution Pension Plan and the need to comply with District and federal regulations. Finding 2 discusses the investment of forfeitures in Plan options that are intended for long-term investors. Accordingly, we note that the forfeitures are at risk of greater loss than would otherwise exist if invested as authorized.

This report directed three recommendations to the District of Columbia Chief Financial Officer (CFO). First, we recommended offsetting contributions to the Defined Contribution Plan with forfeitures and applying saved budgeted funds to other purposes as authorized by District law. Second, we recommended discontinuing new District contributions to the Defined Contribution Plan in instances where forfeitures have accumulated. Finally, we recommended investing forfeited funds in safer investments to protect the principal.

The CFO provided a response to a draft of this report on October 2, 2003, which is included verbatim at Exhibit C, which supplements an earlier response at Exhibit B. The CFO took immediate action to return over $26 million to the District and, as an alternative to Recommendation 2, plans to return forfeitures to the District at least once each year. The CFO also directed ING to move forfeitures from the Janus fund to the ING fixed account, which should protect the principals. The CFO completed necessary actions or provided target dates to complete corrective action. Accordingly, all recommendations are resolved.

In addition, we were concerned that the Plan has not had a recent financial audit and note that the District might benefit from pursuing a change in federal regulations with regard to forfeitures. Both concerns are discussed further in the "Other Matters" section of this report.

INTRODUCTION

A former District employee suggested an audit of the District's 401(a) Plan forfeitures. We evaluated the suggestion and began preliminary research in mid April 2003 to determine whether the District's 401(a) Plan forfeitures warranted an audit and, if it did, when the audit should be conducted. The OIG began a performance audit in July 2003 because preliminary research indicated the need for the District to make immediate adjustments. We issued a Management Alert Report, MAR 03-A-05, on July 16, 2003, which contained what is now Finding 1 of this report. We received a response to the MAR from the Office of the Chief Financial Officer on August 26, 2003, which is summarized at the end of Finding 1 of this report and incorporated verbatim at Exhibit B and updated with Exhibit C.

BACKGROUND

According to the unaudited *Fiscal Year 2002 Annual Report for the 401(a) Defined Contribution Pension Plan* (Annual Report), for the year ended September 30, 2002, the total value of the 13 investment options was valued at $201 million. The ending balance a year earlier was $213 million, i.e., $12 million more. The Annual Report was silent on amounts forfeited from the Plan.

Information provided by the Office of Finance and Treasury (OFT) shows that forfeitures remain invested in the Plan and totaled $27,469,689, as of May 31, 2003. The forfeiture account fluctuates based on market value, new forfeitures, and administrative adjustments. Accordingly, the balance of forfeitures 19 months earlier, on September 30, 2001, was $27,923,840 and 7 months earlier, on September 30, 2002, the balance was $24,408,357.

The Annual Report provides that OFT "oversees the day-to-day administration of the 401(a) Plan," and it provides further:

> In June of 1999, Aetna Financial Services was selected as the provider of the District's 401(a) defined contribution Pension Plan, ushering in a series of enhancements to the Plan – particularly in the areas of administration, service, and investment selection.
>
> The year 2000 saw the acquisition of Aetna Financial Services and Aetna International by ING Groep N.V. [ING] a leading global integrated financial services organization, with outstanding positions in insurance banking and asset management. ING now has the organization in place to assume a position among the premier financial services companies in the United States and is sharing its vision of integrated financial services with others.

Under the Plan, the District contributes an amount equal to five percent of a District employee's base salary (5.5 percent for detention officers) annually. These contributions are

INTRODUCTION

made each pay period into an ING account (a default account or an account(s) selected by the employee). Contributions start after the employee has 1 year of service and vest after 5 years of creditable service. If an employee leaves District government employment before vesting, in most cases, the employee forfeits the account balance. The management of these forfeitures is the subject of this audit.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our audit objective was to determine whether forfeited funds were prudently managed and managed in accordance with laws and regulations.

To accomplish our objectives, we examined schedules, documents, contracts, financial records, and Plan brochures, and we interviewed cognizant District financial officials and reviewed various federal and District laws and regulations. We also contacted officials of other state and local government jurisdictions regarding their funding of audits of plans similar to the District's Plan.

Our audit was conducted in accordance with generally accepted auditing standards and included such tests as we considered necessary under the circumstances.

OTHER MATTERS

We have concerns about the timeliness of financial audits of the Plan. In addition, we believe that the District may benefit from an IRS waiver or change in federal law with regard to the direct use of forfeited funds to offset benefits.

Financial Audit. We determined that the Plan had not been subjected to an independent financial audit since calendar year 1999, i.e., nearly 5 years. However, District officials advised us that a draft Request for Proposal, which provides for an audit of the Plan, is under consideration. Although an audit is not required by federal regulations, prudent management should provide for periodic independent financial audits.

It is our understanding from discussions with District officials that the initial audit will be paid for with District local funds. Notwithstanding, our limited inquiries with other state and local government jurisdictions indicated that audits in three jurisdictions were paid for with Plan funds. In one of those jurisdictions, internal government auditors assisted the external auditors to lessen the costs to the Plan. In our opinion, District management may need the flexibility to use either District local funds or Plan funds, depending upon the circumstances, subject to the condition that management provides its justification and rational for selecting the funding source.

INTRODUCTION

Pursue Change in Federal Regulations. We note that 26 CFR § 1.401-7(a), as discussed in Finding 1, requires forfeited funds to be used to offset new contributions. However, we see no harm to federal tax receipts or controls should the District, and perhaps other local government entities, be permitted to pay forfeited funds directly to local government treasuries rather than be used to offset new contributions. Unlike private entities, the District has no tax liability or deductions with regard to contributions. With direct payment of forfeited funds to the local government treasuries, the budget process would not be impacted by forfeitures, which would simplify the budget, payroll, and accounting processes with regard to forfeitures. Accordingly, the Chief Financial Officer may want to consider whether to pursue a change in federal law or regulation.

FINDINGS AND RECOMMENDATIONS

FINDING 1: MANAGING DEFINED CONTRIBUTION PLAN FORFEITURES

SYNOPSIS

OFT incorrectly accumulated about $27.5 million in forfeitures from the Plan. We attribute the accumulation to OFT's misunderstanding of the complex Internal Revenue regulations that apply to defined contribution plans for government entities. Consequently, the Plan is not in compliance with federal regulations, and the District has unnecessarily requested appropriations to cover new contributions to the Plan by as much as $27.5 million. Remaining funding budgeted in FY 2003 for new contributions (as much as $4.2 million) may be immediately reallocated to other purposes, if otherwise permitted by District law. The balance of the $27.5 million in forfeitures and new forfeitures should offset contributions in FY 2004 and subsequent years.

We met with the Deputy Chief Financial Officer for OFT on June 13, 2003, and with the Deputy Chief Financial Officer for the Office of Financial Operations and Systems on June 17, 2003, to discuss the accumulation of forfeitures and corrective action. Their cooperation and assistance contributed to the formulation of recommendations for corrective action.

DISCUSSION

OFT has not used any of the funds forfeited from the Plan, except for correcting adjustments, and has the opportunity to attain immediate monetary benefits in FY 2003, totaling about $4.2 million. Forfeitures have been accumulating in recent months, due not only to new forfeitures but also to market gains, and totaled $27,469,689.83 as of May 31, 2003. This amount represents a gain of $3,061,332.02 since the close of FY 2002. Prior years have shown losses and gains to the overall forfeitures accumulated.

Funds Forfeited. The District's Plan must timely use funds forfeited from the Plan as required by 26 CFR § 1.401-7(a), which states:

> In the case of a trust forming a part of a qualified pension plan, the plan must expressly provide that forfeitures arising from severance of employment, death, or for any other reason, must not be applied to increase the benefits any employee would otherwise receive under the plan at any time prior to the termination of the plan or the complete discontinuance of employer contributions thereunder. **The amounts so forfeited must be used as soon as possible to reduce the employer's**

FINDINGS AND RECOMMENDATIONS

> **contributions under the plan. . . . Furthermore, a qualified plan will not be disqualified merely because a determination of the amount of forfeitures under the plan is made only once during each taxable year of the employer.** (Emphasis supplied.)

We infer from this section that a plan should generally offset employer contributions with forfeited funds within 1 year of forfeiture to minimize the risk of disqualification. Disqualification of the District's Plan would likely have tax implications for District employees. However, disqualification can be avoided because the Internal Revenue Service provides a correction program for sponsors of retirement plans such as the District's Plan. According to page 1054 of Internal Revenue Bulletin No. 2003-25 (June 23, 2003), Revenue Procedure 2003-44:

> updates the comprehensive system of correction programs for sponsors of retirement plans that are intended to satisfy the requirements of § 401(a), § 403(a), § 403(b), § 408(k), or § 408(p) of the Internal Revenue Code (the "Code"), but that have not met these requirements for a period of time. This system, the Employee Plans Compliance Resolution System ("EPCRS"), permits plan sponsors to correct these failures and thereby continue to provide their employees with retirement benefits on a tax-favored basis. The components of EPCRS are the Self-Correction Program ("SCP"), the Voluntary Correction Program ("VCP"), and the Audit Closing Agreement Program ("Audit CAP").

Monetary Benefits. Notwithstanding the need to come into compliance with federal regulations, OFT urgently needs to offset contributions to allow for immediate monetary benefits to the District for FY 2003. The FY 2003 budget provides for District contributions of five percent of each employee's base salary. The District's contributions to the Plan ranged from $740,000 to $845,000 in each of the first 19 pay periods of calendar year 2002. Accordingly, the District has the opportunity to use funds budgeted for contribution to the Plan in FY 2003 for other purposes during the remaining pay periods of FY 2003. We estimate the total remaining FY 2003 monetary benefits to range from $3.7 million to $4.2 million (5 paydays in August and September 2003).

RECOMMENDATIONS

We recommend that the District of Columbia Chief Financial Officer:

1. Offset contributions to the Defined Contribution Plan with forfeitures and use saved budgeted funds for other purposes as authorized by federal and District law.

FINDINGS AND RECOMMENDATIONS

2. Discontinue making new contributions to the Defined Contribution Plan in instances where forfeitures have accumulated.

CFO Response to Recommendations 1 and 2

The CFO concurred with the recommendations and, as of August 22, 2003, obtained $20.6 million from the forfeiture account. The CFO provided a target date of December 31, 2003, by which the forfeitures would be reduced to $1 million. The CFO also provided a target date of December 31, 2003, to update the 401(a) procedures manual to include processes and controls to ensure an annual offset of forfeitures. The CFO has applied the returned forfeitures to the D.C. Annuitants' Health and Life Insurance Employer Contribution Trust Fund. See Exhibits B and C for the verbatim responses.

OIG Comment to Recommendations 1 and 2

The recommendations are resolved and action is completed or specific target dates provided. We were also advised, on October 6, 2003, that the District had received almost $23.3 million, as follows:

- Funds in the amount $21,937,096 have been returned to the District, as of October 6, 2003, up from $16,178,585 reported in the CFO response (Exhibit B).

- The CFO notified the D.C. Water and Sewer Authority of the offsets, who should receive about $4,700 shortly. Likewise, D.C. Housing Authority received about $1,344,750, as of October 6, 2003, up from $983,487 reported in the CFO response (Exhibit B.)

The CFO proposed a satisfactory alternative to Recommendation 2 by proposing to return forfeitures at least once a year to the District.

The CFO may also want to consider whether amounts held for an employee who has left employment should be moved to the forfeiture account immediately rather than held in suspense for 1 year in accounts the employee requested. The funds due those employees should they return could still be identified. Historical trends related to the percent of employees returning or not returning to District employment, might indicate that sufficient funds are available in the suspense accounts to offset adjustments for those who do return. If otherwise permitted by law and regulation, the departed employee who returned would have his account reestablished in the ING fixed account until the employee directed otherwise and would have earned a return on the investment at the rate for the period in the ING fixed account. Accordingly, the forfeiture account has the potential for further reductions in amounts held over a year since the employee left.

FINDINGS AND RECOMMENDATIONS

FINDING 2: INVESTING DEFINED CONTRIBUTION PLAN FORFEITURES

SYNOPSIS

Forfeited funds have been invested in the Janus Aspen Series Balanced Portfolio (Janus), an investment option with the Plan. The forfeited funds were incorrectly accumulated as indicated in Finding 1, but remain in the Plan until used to offset new contributions. As a result of investment in Janus, the forfeitures (about $27.5 million) incur net annual expenses including investment advisory fees of .66 to .83 percent (about $178,200 at .66 percent). In addition, the Janus fund is riskier than alternative investments with regard to loss of principal for a short-term investment of District funds and contrary to the investment strategies contemplated by D.C. Code §§ 1-626.13(a) and 47-351.03(c). District management should remove the funds from Janus and invest the funds in a Plan option or other alternative more likely to preserve principal while District management acts to eliminate or significantly reduce the accumulated forfeitures.

DISCUSSION

Generally, when an employee separates from government service, the dollar value of the investment is forfeited back to the District government. These forfeitures, which include the District's former contributions to the Plan on behalf of an employee and any changes resulting from market fluctuation, remain invested in the manner previously designated by the employee for up to 1 year after an employee separates from District government service. The forfeited funds remain invested in that manner because, in accordance with District law, an employee may be reinstated within 1 year and regain the balance of the account. After the year has passed, managers move the forfeited funds into a single consolidated account titled "Mr. Forfeiture," which is invested in Janus (a variable fund subject to the risk of market fluctuation). Janus is an available investment option for District employees covered by the Plan, and is also the default investment option for the District's contributions on behalf of employees, if the employees choose not to designate one of the other available investment options.

The amount of forfeitures has increased to more than $27 million, as of May 31, 2003, and all of the forfeited funds have been invested in Janus. Although Janus may be appropriate for long-term investments of Plan participants, we believe that Janus is an inappropriate and risky investment of government funds for the short term. The Janus Prospectus, discussed subsequently, supports our opinion. In addition, D.C. Code §§ 47-351.03 and 1-626.13(a) provide for different investment strategies than those implemented. The forfeited funds are subject to management fees when invested in Janus, which lowers the amount of funds

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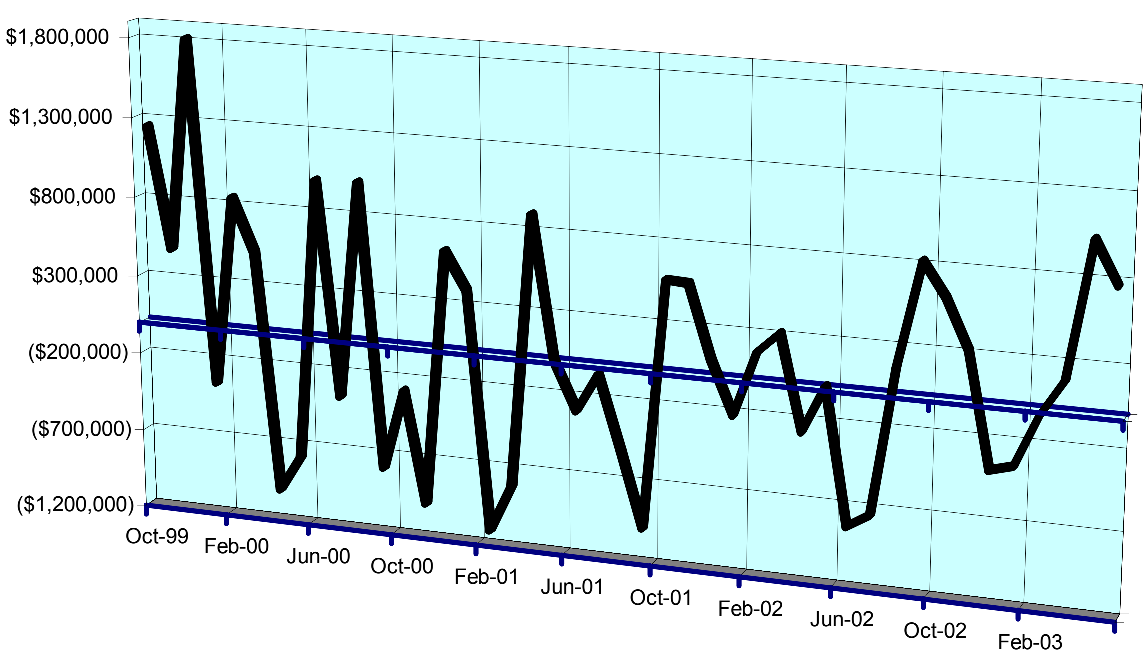
available to reduce the District's new contributions under the Plan. Furthermore, although the forfeitures may produce considerable gains while invested in Janus, the funds are also exposed to the risk of significant losses due to market volatility.

Janus Prospectus. The Janus Aspen Series Service Shares Prospectus provides that Janus "is **designed for long-term investors** who primarily seek growth of capital and who can tolerate the greater risks associated with common stock investments . . . [it] is not designed for investors who desire a consistent level of income." (Emphasis added.) The nature of forfeitures, as described in Finding 1, and the intent for management to use forfeitures timely to offset new contributions, as provided under federal law, make long-term investment inappropriate.

OFT provided a schedule of appreciation/depreciation for the forfeitures in Janus, which we recalculated and converted into Table A. Table A clearly demonstrates market fluctuation and the risk incurred by the District in the short term with regard to the forfeited funds. Over the 44-month period ended May 2003, Janus showed months with increases of as much as $1.8 million and decreases of as much as $1.1 million.

Table A
Increases/Decreases of Forfeiture Account
Resulting From Market Fluctuation
October 1999 through May 2003



FINDINGS AND RECOMMENDATIONS

During the same time frame and as shown in Table B, Janus demonstrated six periods with consecutive monthly losses for up to 4 straight months. During one of those periods, the value of the Mr. Forfeiture account dropped almost $2.1 million. Notwithstanding similar gains, these tables clearly demonstrate the risk assumed by the District with this investment option and cause us to question whether Janus is an appropriate investment for the District in the short term.

Table B-Consecutive Periods of Decrease

Periods With Consecutive Months of Decrease	Calendar Year	Month	Monthly Decrease	Total Decrease
1	2000	April	$ (1,011,210)	
	2000	May	(786,295)	$ (1,797,505)
2	2000	September	$ (789,916)	
	2000	October	(286,395)	
	2000	November	(989,509)	$ (2,065,820)
3	2001	February	$ (1,114,828)	
	2001	March	(819,872)	$ (1,934,700)
4	2001	June	$ (295,754)	
	2001	July	(57,543)	
	2001	August	(518,053)	
	2001	September	(990,076)	$ (1,861,426)
5	2002	June	$ (832,988)	
	2002	July	(748,734)	$ (1,581,722)
6	2002	December	$ (393,227)	
	2003	January	(356,427)	
	2003	February	(36,806)	$ (786,460)

Authorized Investment Strategies. The above discussion, tables, and figures demonstrate the financial risks of investing forfeitures in Janus. Furthermore, investing forfeiture funds in Janus conflicts with the intent of two sections of the D.C. Code, which provide investment strategies for District funds. First, D.C. Code § 1-626.13(a) states:

> A fiduciary shall discharge his duties with respect to the Trust [Section 401(a) Trust] solely in the interest of the participants and beneficiaries and:

FINDINGS AND RECOMMENDATIONS

(1) For the exclusive purpose of providing benefits to participants and beneficiaries;
(2) With the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent individual acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;
(3) By diversifying the investments of the Trust so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and
(4) In accordance with the provisions of law, documents, and instruments governing the retirement program to the extent that the documents and instruments are consistent with this chapter.

Therefore, District management should strive to protect the forfeited contributions by considering an investment approach that minimizes the risk of large losses. In addition, given that forfeitures are intended to offset new contributions that would otherwise be paid from the District's budget, the investment strategy used for forfeited funds could substantially impact the District's budget, especially if large decreases or increases materialize.

Although D.C. Code §47-351.03 does not specifically apply to investment of Plan forfeitures,[1] we believe this provision offers guidance that District management should consider when choosing investment options for the funds forfeited from the Plan. Specifically, D.C. Code § 47-351.03 provides:

> (a) Unless otherwise provided by law, the Mayor, or the CFO, pursuant to § 47-351.02(c), shall invest and deposit District funds in, and obtain financial services from, eligible financial institutions.
>
> (b) The Mayor, or the CFO pursuant to § 47-351.02(c), shall determine what amount of District funds are needed immediately and maintain deposit funds in amounts great enough to satisfy that need. The Mayor, or the CFO pursuant to § 47-351.02(c), shall invest all other funds.
>
> (c) The Mayor, or the CFO pursuant to § 47-351.02(c), shall invest District funds in:
>
> (1) Bonds, bills, notes, or other obligations issued by the United States government;

[1] For the purposes of this statute, District funds do "not include any assets of a pension, assets held by the District of Columbia Financial Responsibility and Management Assistance Authority, an employee deferred compensation program of the District, or an irrevocable trust established pursuant to § 1-626.11." D.C. Code § 47-351.01(8).

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(2) Federally insured negotiable certificates of deposit or other insured or uninsured evidences of deposit at a financial institution;

(3) Bonds, bills, notes, mortgage-backed or asset-backed securities, or other obligations of a quasi-governmental corporation;

(4) Prime banker acceptances that do not exceed 270 days maturity;

(5) Prime commercial paper that does not:

  (A) Have a maturity that exceeds 180 days; and

  (B) Exceed 10% of the outstanding commercial paper of the issuing corporation at the time of purchase;

(6) Investment grade obligations of the District or a state or local government;

(7) Repurchase agreements for the sale or purchase of securities by the District under the condition that, after a stated period of time, the original seller or purchaser will buy back or sell the securities at an agreed price that shall include interest;

(8) Investment grade asset-backed or mortgaged-backed securities; or

(9) Money market funds registered with the Securities and Exchange Commission and which meet the requirements of Rule 2(a)(7) of the Investment Company Act of 1940, approved August 22, 1940 (54 Stat. 789; 15 U.S.C. § 80a-1 et seq.).

These preceding sections of the D.C. Code contemplate investment strategies that reduce the risk that the principal will be lost. Furthermore, we believe OFT might be able to comply with the D.C. Code by moving the funds from Janus to other investment options available to Plan participants, provided those options are found to meet the requirements of D.C. Code § 626.13(a)(3). Those options include ING Fixed Account-046 and ING VP Money Market Portfolio–Class R-003. Alternatively, the Trust may need to be expanded to include additional financial institutions in order to protect District funds resulting from forfeitures.

In summary, District funds resulting from forfeitures from the Defined Contribution Plan are invested in riskier options those that contemplated by the D.C. Code for District funds and by prudent investors for the short term. OFT needs to act quickly to preserve the principal of the continuing flow of funds into the forfeiture account. By doing so, the District will be able to rely on the availability of the $27.5 million in forfeitures to fund contributions and lessen the risk of loss of principal and the resulting need to appropriate new funds for contributions.

FINDINGS AND RECOMMENDATIONS

RECOMMENDATION 3

We recommend that the District of Columbia Chief Financial Officer move forfeited funds from Janus to safer investments that are consistent with D.C. Codes §§ 1-626.13(a)(3) and 47-351.03(c).

CFO Response

The CFO directed ING to move the balance of the forfeitures from the Janus fund to the ING fixed account, which is currently paying interest at 4.7 percent.

OIG Comment

The CFO's actions indicate concurrence with the recommendation and action is complete.

EXHIBIT A: SUMMARY OF POTENTIAL BENEFITS RESULTING FROM AUDIT

Recommendation	Description of Benefit	Amount and/or Type of Monetary Benefit
1	Compliance, Economy and Efficiency. Uses accumulated forfeitures to offset new contributions to the Plan	$27.5 million
2	Compliance, Economy and Efficiency. Discontinues new contributions from budgeted funds until forfeitures are eliminated or reduced in accordance with federal law	See Above
3	Compliance, Program Results, and Economy and Efficiency—Reduces risk to forfeitures and District funds caused by market fluctuations	Unquantifiable

EXHIBIT B: RESPONSE FROM THE CHIEF FINANCIAL OFFICER TO THE MANAGEMENT ALERT REPORT (NOW FINDING 1)

Government of the District of Columbia
Office of the Chief Financial Officer

2003 ... 3: 49

Natwar M. Gandhi
Chief Financial Officer

AUG 21 2003

ENTERED 2099

Charles C. Maddox, Esq.
Inspector General
Office of the Inspector General
Government of the District of Columbia
717 14th Street, NW.
Washington, DC 20005

Dear Mr. Maddox:

This letter is in response to your Management Alert Report (MAR 03-A-05) and preliminary audit finding dated July 16, 2003 regarding the District's 401(a) Defined Contribution Pension Plan (the Plan).

The Office of the Chief Financial Officer appreciates your review of the Plan and related forfeitures. When we assumed responsibility for the financial administration of the Plan, it had already accumulated more than $20 million in forfeitures. Your preliminary audit finding is the first official guidance we have received regarding their disposition. We are gratified that it supports our preferred course of action, which the Office of Finance and Treasury (OFT) shared with your office during your review.

Your first recommendation is to offset contributions to the Plan with forfeitures and use saved budgeted funds for other purposes as authorized by District law. In keeping with your recommendation and Internal Revenue Service regulations, OFT has consulted with ING, the Plan's Service Provider, and received confirmation that all of the District's contributions to the Plan for fiscal year 2003 and first quarter fiscal year 2004 can be offset against the forfeitures. This course of action is expected to reduce the $27 million forfeiture balance by more than $26 million.

Two independent agencies, the D.C. Housing Authority and the D.C. Water and Sewer Authority, participate in the Plan. Fiscal year 2003 contributions through June 30, 2003 (i.e., pay period 13) were confirmed with ING, and are as follows:

Agency	Fiscal Year 2003 Contributions to June 30, 2003
District (UPPS & CAPPS)	$16,178,584.54
D.C. Housing Authority	$ 983,487.11
Water & Sewer Authority	$ 3,698.75
Total	$17,165,770.40

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EXHIBIT B: RESPONSE FROM THE CHIEF FINANCIAL OFFICER TO THE MANAGEMENT ALERT REPORT (NOW FINDING 1)

The Housing Authority and the Water & Sewer Authority have been notified of the offsets and will receive their funds shortly. Funds in the amount of $16,178,584.54 have been returned to the District and been invested in the DC Annuitants' Health and Life Insurance Employer Contribution Trust Fund (Trust Fund), which was established by DC Law 13-54. These funds represent a portion of the $23 million previously designated as "restricted funds" in anticipation of their investment in the Trust Fund.

Funds in the amount of the District's contributions from July through September 2003 will be returned to the District by ING on a biweekly basis. Offsets are expected to continue through the first quarter of FY 2004 in order to reduce the balance in the forfeitures account to a minimal amount. Thereafter, contributions will be offset against forfeitures at least once each year.

Your second recommendation is to discontinue making new contributions to the Plan in instances where forfeitures have accumulated. It is not feasible from a computer systems perspective to make this temporary change to the District's scheduled contributions. However, as discussed above, in instances where forfeitures have accumulated, the desired result will be achieved by having ING return funds equal to a specified amount of new District contributions. ING has agreed to do this.

Your preliminary audit finding suggests the possibility of realizing up to $4.2 million in "immediate monetary benefits" in FY 2003 by using Plan forfeitures to offset District contributions for the remaining pay periods of FY 2003. As noted above, the District has already booked $23 million in forfeiture-related funds for FY 2003. Any monetary benefits realized from offsets during the remainder of FY 2003 will be considered as restricted funds, along with the $16,178,584.54 already realized in FY 2003. These funds will not be available for expenditure, but will be invested in the Trust Fund until such time as they are appropriated to pay for District retiree health and life insurance benefits.

If you have questions or require additional information, please contact Tony Calhoun, Deputy Chief Financial Officer and Treasurer. Mr. Calhoun can be reached at 202-727-2469.

Sincerely,

Natwar M. Gandhi
Chief Financial Officer

cc: John A. Koskinen, City Administrator
N. Anthony Calhoun, Deputy Chief Financial Officer and Treasurer
Bert Molina, Deputy Chief Financial Officer for Budget and Planning
Anthony F. Pompa, Deputy Chief Financial Officer for Financial Operations and Systems
Ben Lorigo, Director, Office of Integrity and Oversight

EXHIBIT C: RESPONSE FROM THE CHIEF FINANCIAL OFFICER TO THE DRAFT REPORT

Government of the District of Columbia
Office of the Chief Financial Officer

Natwar M. Gandhi
Chief Financial Officer

OCT 2 2003

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Charles C. Maddox, Esq.
Inspector General
Office of the Inspector General
Government of the District of Columbia
717 14th Street, NW
Washington, DC 20005

Dear Mr. Maddox:

This letter is in response to your draft audit report summarizing the results of the Office of the Inspector General's Audit of the Management of the 401(a) Defined Contribution Pension Plan (OIG No. 03-2-19AT), dated September 15, 2003.

The Office of the Chief Financial Officer appreciates the opportunity to update you on our response to recommendations one and two and to respond to recommendation three.

Recommendation Number/ Description	*Action Taken or Planned*	*Target Dates for Completion*
#1 (Update) - Offset 401(a) contributions with forfeitures, and	As of August 22, 2003 (Pay Period 17), the District requested and received reimbursement of $20.6 million from the Forfeiture account held by ING. In addition, beginning with Pay Period 18, the District has instructed ING to use funds held in the Forfeiture account to offset current contributions to the 401(a) Plan until the balance in the said account has been reduced to approximately $1.0 million.	Forfeitures account balance is expected to be reduced to $1.0 million by the end of first quarter fiscal year 2004.

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EXHIBIT C: RESPONSE FROM THE CHIEF FINANCIAL OFFICER TO THE DRAFT REPORT

Charles C. Maddox, Esq.
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- Use unsaved budget funds for other purposes as authorized by federal and District law.	In fiscal year 2002, the District designated $22.4 million of the forfeited funds for the D. C. Annuitants' Health and Life Insurance Employer Contribution Trust Fund (Trust Fund). The savings from the use of additional forfeitures accumulated in fiscal year 2003, inclusive of accreted interest will also be designated for the Trust Fund.	Completed.
#2 (Update) - Discontinue making new contributions in instances where forfeitures have accumulated.	ING has been informed that the forfeitures will be used to offset future contributions on an annual basis.	Completed.
-Document management controls to ensure the annual offset of forfeitures and the return of funds to the District and the independent agencies.	The 401(a) procedures manual will be updated to include the process and controls to ensure the annual offset of forfeitures.	First quarter fiscal year 2004
#3 (New) - Move forfeited funds from Janus to safer investments that are consistent with D.C. Codes 1-626.13(a)(3) and 46-351.03(c).	OFT has instructed ING to move the balance of $4.6 million from the Janus fund to the ING fixed account which is currently paying interest at 4.7 percent.	Transfer of funds is scheduled for September 26, 2003.

In addition, I would like to clarify two statements made in your report:

1. In the Executive Digest, Conclusion and Corrective Actions, page 1, you mentioned that the Plan has never had a financial audit. The 401(a) Plan was audited by KPMG, Inc. in 1999. The Office of Finance and Treasury issued an RFP in August 2003 to audit the Plan. Audit proposals are currently being evaluated.
2. In the Executive Digest, Findings and Recommendations 1 and 2, second bullet, the amounts stated were interchanged between D.C. Housing Authority (DCHA) and the D.C. Water and Sewer Authority (WASA). It should read, "WASA has been notified of the offsets and will receive about $4,700 shortly. Likewise, DCHA should receive about $983,500."

EXHIBIT C: RESPONSE FROM THE CHIEF FINANCIAL OFFICER TO THE DRAFT REPORT

Charles C. Maddox, Esq.
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If you have questions or require additional information, please contact Tony Calhoun, Deputy Chief Financial Officer and Treasurer. Mr. Calhoun can be reached at 202-727-2469.

Sincerely,

Natwar M. Gandhi
Chief Financial Officer

Cc: Herbert R. Tillery, Deputy Mayor for Operations
N. Anthony Calhoun, Deputy Chief Financial Officer and Treasurer, OCFO
Ben Lorigo, Executive Director, Office of Integrity and Oversight, OCFO
Anthony Pompa, Deputy Chief Financial Officer, Office of Financial Operations and Systems, OCFO