



AUDITOR GENERAL

WILLIAM O. MONROE, CPA



DEPARTMENT OF FINANCIAL SERVICES

DEFERRED COMPENSATION PROGRAM

Operational Audit

SUMMARY

The State of Florida, pursuant to Section 112.215, Florida Statutes, has provided State employees a deferred compensation program to supplement the State of Florida's defined benefit and defined contribution retirement plans. The Deferred Compensation Office within the Department of Financial Services, Division of State Treasury, administers the deferred compensation program.

The Department has contracted with four insurance companies, a mutual fund company, and a self-directed brokerage company to provide various investment options for State employees. Additionally, the Department has contracted with a records administration company to maintain participant account records. Department records indicate that as of June 30, 2004, Program participants totaled 70,248.

Our audit, covering the period May 15, 2002, through February 29, 2004, and selected actions taken through July 9, 2004, focused on issues relating to the Department's selection and monitoring of the Deferred Compensation Program's records administrator and investment product providers. Also, as indicated in Finding No. 12, we found that, although it was exempt under the authorizing laws, the Department had paid certain communications taxes that had been assessed by cellular telephone service providers.

Finding No. 1: On May 15, 2002, the Department issued a request for proposal (RFP) seeking responses from firms interested in providing third-party administrator and records administrator services. Our audit disclosed that the RFP contained restrictive provisions that may have eliminated many potential providers and that the Department could have taken additional actions to ensure that more potential providers were made aware of the RFP.

Finding No. 2: The Department received two responses to its May 15, 2002, RFP. One of the two

responses was disqualified, leaving only one response deemed by the Department to be responsive to the RFP, that being the response from Florida Records Administrator, Inc., (FRA). FRA was subsequently selected and awarded the records administrator contract. Our audit disclosed:

- For some of the more significant RFP requirements, the Department evaluated the information relating to a proposed subcontractor rather than information pertaining to FRA. The RFP made no provision for the substitution of a subcontractor's qualifications for that of the respondent.
- Section 1.7 of the RFP states, "The firm selected to provide TPA [third-party administrator services] for the DCP [Deferred Compensation Plan] may not be an approved investment provider, or be affiliated with one." We found the award of the contract to FRA to be in conflict with the apparent intent of this provision of the RFP, in that while FRA may not have been directly or indirectly owned by an investment provider, FRA was established primarily for the purpose of facilitating the subcontracting of the records administration work to National Deferred Compensation, Inc., a subsidiary of an investment provider.
- Contrary to the Department's *Request for Proposal (RFP) Guide, Composition of Selection Team Section, Conflict of Interest section*, the members of the records administrator selection committee did not sign a statement indicating that there were no conflicts of interest.
- The contract, effective January 1, 2003, between the Department and the FRA, was signed by the Chief Financial Officer (CFO) and the FRA's president. However, contrary to law, a related subcontract was signed by the Chief of the

Bureau of Deferred Compensation and not the CFO.

The CFO has taken actions to change the contract's expiration date from June 30, 2007, to March 31, 2005, so that the services can be resolicited.

Finding No. 3: A monthly plan audit is a monthly report prepared by the Records Administrator that identifies for each participant any discrepancies between investment provider records and Records Administrator records. The Department has not established and implemented procedures designed to verify that the Records Administrator has properly prepared the monthly plan audits and that appropriate corrective actions have been taken to correct all discrepancies.

Finding No. 4: Investment providers are required to pay a 5 cent-per-month per-participant marketing and education fee. The fee is to be paid to the Records Administrator, for the benefit of the Deferred Compensation Program, and the Records Administrator is to deposit and maintain in a separate account the amounts received. At May 28, 2004, the account had a balance of \$241,449. The Department was not receiving bank statements for the account and had not implemented procedures requiring a periodic verification of the marketing and education fee account's activity. We also noted that transactions and balances relating to the bank account had not been recorded in the State's general ledger accounting records.

Finding No. 5: The Records Administrator contract requires that each June 30 and December 31, the Records Administrator obtain from each investment provider an amount representing the present value of participant annuity accounts. Department procedures had not been established to reasonably ensure the accuracy and completeness of the amounts reported for the participant annuity accounts.

Finding No. 6: The Department paid the Multi-Vendor Enhanced Enrollment System (MVEES) project contractor a total of \$299,054. Our audit disclosed that, contrary to law, competitive means were not used to select the MVEES contractor.

Finding No. 7: Section 287.058(2), Florida Statutes, and the Department's purchasing procedures, require that a written agreement be signed by the agency head and the contractor prior to the rendering of any contractual service the value of which is in excess of \$25,000. Likewise, prior to the authorization of contractor services, purchase requisitions and purchase orders should be approved. Our review disclosed that an agency employee, rather than the agency head, had signed the MVEES project agreement and that contractual services were provided prior to purchase

requisition approval, the signing of the agreement, and purchase order issuance.

Finding No. 8: The MVEES contract does not contain provisions addressing the ownership of the source code and any other tangible or intangible assets.

Finding No. 9: The Department on June 24, 2002, issued an RFP requesting proposals from companies interested in providing investment products and services for the Deferred Compensation Program. Our audit disclosed that, as with the Records Administrator RFP, the investment provider RFP contained restrictive provisions that may have eliminated potential providers and the Department could have taken additional actions to ensure that more potential providers were made aware of the RFP.

Finding No. 10: A total of 11 investment provider proposals were received by the Department. Subsequent to the evaluation of the responses, a total of six companies were engaged by the Department to provide investment products and services. Our audit of the Department's award of the contracts disclosed:

- Contrary to the *Request for Proposal (RFP) Guide, Composition of Selection Team Section, Conflict of Interest* section, the members of the selection committee did not sign a statement indicating that there were no conflicts of interest.
- Section 3.3.1 of the RFP requires of proposers the management of at least one plan with a minimum of \$1.6 billion under investment management and 20,000 participants. It was not clear from the documentation provided whether several of the selected investment providers met this requirement.

Finding No. 11: The Department, following the completion of an investigation, suspended without pay for a period of 31 days the Chief of the Bureau of Deferred Compensation. The notice of suspension stated that the basis for the suspension was the lack of professional judgment in accepting and not reporting gifts.

Finding No. 12: Although with respect to Department cellular phone services, the Department was exempt from paying certain communications service taxes, the Department paid to one vendor such taxes approximating \$60,000 during the audit period.

BACKGROUND

The State of Florida, pursuant to Section 112.215, Florida Statutes, has provided State employees a deferred

compensation program¹ to supplement the State of Florida’s defined benefit and defined contribution retirement plans. The Deferred Compensation Office within the Department of Financial Services, Division of State Treasury, administers the deferred compensation program.

State employees who elect to take advantage of the deferred compensation program may defer a portion of their salary and that portion is to be invested based upon the employee’s direction. Maximum deferral amounts are set by Section 457 of the Internal Revenue Code, and pursuant to the Code, the employee does not pay income taxes on the deferred salary until the employee receives distribution of the salary and accrued earnings.

The Department has contracted with four insurance companies, a mutual fund company, and a self-directed brokerage company to provide various investment options for State employees. Additionally, the Department has contracted with a records administration company to maintain participant account records. Department records indicate that as of June 30, 2004, Program participants totaled 70,248.

To offset the cost of administering the deferred compensation program, and for providing certain marketing services of the program to State employees, the investment providers were contractually required to pay the State \$1.00 for each of their respective participant accounts. To cover the cost of records administration services, the investment providers were also required to pay the records administrator \$1.00 for each of the provider’s participant accounts. Furthermore, for marketing services, investment providers were required to pay the records administrator five cents for each of the provider’s participant accounts. Effective July 2003, the amount paid to the State for administration was reduced to 75 cents, and the amount paid to the records administrator for marketing was increased to 30 cents.

FINDINGS AND RECOMMENDATIONS

As more fully described in the following findings and recommendations, our audit disclosed issues relating to the Department’s selection and monitoring of the Deferred Compensation Program’s records administrator and

investment product providers. Also, as indicated in Finding No. 12, in a matter unrelated to the primary scope of this audit, we found that, although it was exempt under the authorizing laws, the Department had paid certain communications service taxes that had been assessed by cellular telephone service providers.

Records Administrator

On May 15, 2002, the Department issued a request for proposal (RFP) seeking responses from firms interested in providing third-party administrator and records administrator services. The RFP required that respondents quote proposed fees for functioning as the Program’s third-party administrator, and alternatively, as a records administrator. The Department received two responses, one from CitiStreet, LLC, and one from Florida Records Administrator, Inc. (FRA). CitiStreet’s response was disqualified because it provided proposed fees for third-party administrator services only. The contract, effective January 1, 2003, was awarded to FRA. Under the contract, for the provision of records administrator services, the FRA has been paid compensation approximating \$1.2 million as of June 30, 2004.

The contract, in addition to requiring the provision of Plan records and reports, required the records administrator to conduct monthly plan audits and to administer a bank account in which moneys for Plan marketing and education were to be maintained.

Finding No. 1: Request for Proposal Terms and Advertisement

Our audit, which included an evaluation of the Department’s records administrator selection process, disclosed that the RFP contained restrictive provisions that may have eliminated many potential providers and that the Department could have taken additional actions to ensure that more potential providers were made aware of the RFP. More specifically:

- Section 1.5 of the RFP, which contains the provisions for minimum qualifications for the records administrator provides, “As of December 2001, the Proposer must have been providing record keeping and administrative services for clients for a minimum of ten (10) years for IRC 457 Plans. The size of one plan must be \$1.6 billion in assets and eighty thousand (80,000) participant accounts or

¹ The State’s tax deferred employee contribution investment program is established pursuant to the provisions of Section 457 of the Internal Revenue Code.

larger.” It is likely that the specifications relating to administered plan size severely limited the number of potential respondents. As shown by Exhibit A, the 2001 Survey of 457 Plans, published by National Association of Defined Contribution Administrators, Inc., indicates that there were, as of December 31, 2001, few companies administering IRC 457 plans of the size specified.

The size of the plans administered can provide a measure of the capabilities of a respondent, and such information should be obtained from respondents and used as one of several measures of respondent capabilities. However, since other factors, such as information technology infrastructure, staff capabilities, and client satisfaction are also relevant to evaluating respondent potential, it was not clear that RFP provisions limiting potential respondents to only those already administering extremely large plans were necessary.

- Section 1.7 of the RFP provides that the firm selected to provide third-party administrator services may not be an approved investment provider, or be affiliated with one. The inclusion of this specification may have unnecessarily restricted the number of potential providers. Through the use of firewalls, the risk that an investment provider or its affiliate would access and misuse participant data to create an unfair advantage can be reduced to a tolerable level. Rather than eliminating investment providers and their affiliates from consideration, the RFP should have required such potential providers to describe proposed firewall provisions.
- Pursuant to information provided by Department staff, the Department advertised its request for proposal for the records administrator contract on the Department of Management Services’ Vendor Bid System (a Web-based application that allows vendors to view bid advertisements of State agencies). No other media or methods were used to solicit RFP responses. Due to the specialized nature of these services, the Department should have considered taking steps beyond those required by standard procedure and advertised the request for proposal in an appropriate trade journal or newspaper utilized by companies providing records administrator services. Additionally, the process may have benefited from a search for such records administrator companies and the provision of notice concerning the request for proposal.

Recommendation: To better realize the benefits of a competitive selection process, we recommend:

- The Department consider the size of plans administered as but one factor used in

evaluation of respondent capabilities, rather than a factor leading to disqualification.

- The Department reconsider the need for the RFP provisions that in effect eliminate investment providers and their affiliates from consideration as the records administrator. The RFP should instead require of such entities a description of firewall provisions.
- The Department take steps to identify potential providers and inform them of the RFP.
- The Department advertise the RFP in relevant industry publications.

Finding No. 2: Records Administrator Selection

As indicated above, under the heading **Records Administrator**, the Department received two responses to its May 15, 2002, RFP. One of the two responses was disqualified, leaving only one response deemed by the Department to be responsive to the RFP. The Department’s six-member selection team consisted of one employee of the State Board of Administration, a Deferred Compensation Advisory Council member, and four Department employees, including the Department’s Chief of the Bureau of Deferred Compensation, the Chief of the Bureau of Funds Management; a Senior Management Analyst I, and a Management Analyst II. Florida Records Administrator, Inc., (FRA) was selected and awarded the records administrator contract.

Our analysis of the records provided relative to the Department’s selection of FRA as the records administrator and our reading of the related contract and subcontract disclosed:

- For some of the more significant RFP requirements, the Department evaluated the information relating to a proposed subcontractor rather than information pertaining to FRA. For example:
 - Section 1.5 of the RFP requires that, as of December 2001, the Proposer must have been providing for IRC 457 Plans record keeping and administrative services for a minimum of ten (10) years. The Department selected and contracted with Florida Records Administrator, Inc., (FRA) which had been in existence for less than 5 years. In response to our inquiries, the Department indicated that the FRA had designated in its response a specific subcontractor, National Deferred

Compensation, Inc., (NDC) and the subcontractor did satisfy the RFP specification.

- Section 4.1(3) of the RFP requires that the respondent supply audited financial statements for the most recently closed fiscal year. The financial statements were to be used to evaluate the financial strength of respondents. FRA in its response to the Department provided a copy of the December 31, 2000, audited financial statements for the proposed subcontractor, NDC. There were no audited or unaudited financial statements for FRA in the RFP file.

The RFP made no provision for the substitution of a subcontractor's qualifications for that of the respondent. To allow FRA to do so, and not provide through the RFP the same opportunity to all other potential respondents, would seem to have provided an unfair advantage to FRA.

- Section 1.7 of the RFP states, "The firm selected to provide TPA [third-party administrator services] for the DCP [Deferred Compensation Plan] may not be an approved investment provider, or be affiliated with one." The RFP's definition of affiliated is "a party in a relationship whereby one party directly or indirectly owns a controlling ownership interest in [the other party, or] each of the parties is held directly or indirectly by a third party." We found the award of the contract to FRA to be in conflict with the apparent intent of this provision of the RFP, in that while FRA may not have been directly or indirectly owned by an investment provider, FRA was established primarily for the purpose of facilitating the subcontracting of the records administration work to NDC, a subsidiary of an investment provider. In July 1998 correspondence addressed to the Department's Program Administrator (now Chief of the Bureau of Deferred Compensation), one of the future organizers of FRA described the plans for the establishment of a company, such as FRA, which could, under the Department's definition of affiliate, qualify as an unaffiliated company and then subcontract the work to NDC, a company at that time owned by the future organizers of FRA. According to the correspondence, NDC, which was also at that time the Program's records administrator, was to be sold to Nationwide Financial Services, Inc., a Program investment provider.
- Contrary to the Department's *Request for Proposal (RFP) Guide, Composition of Selection Team Section, Conflict of Interest* section, the members of the records administrator selection committee did not sign a statement indicating that there were no conflicts of interest. A conflict of interest statement should have been signed by each member of the selection team

to document that each selection team member was free of conflicts of interest that may, in fact or in appearance, interfere with the impartial selection of a records administrator.

- Pursuant to Section 287.058(2), Florida Statutes, and the Department's purchasing procedures, a written agreement shall be signed by the agency head and the contractor prior to the rendering of any contractual service the value of which is in excess of \$25,000. The contract, effective January 1, 2003, between the Department and the FRA, was signed by the Chief Financial Officer (CFO) and the FRA's president. However, the subcontract was signed by the Chief of the Bureau of Deferred Compensation and not the CFO. The authority to sign such contracts had not been delegated by the CFO to the Chief.

In response to the CFO's concerns regarding the nature of the relationship between FRA, NDC, and Nationwide Financial Services, Inc., the CFO has taken actions to change the contract's expiration date from June 30, 2007, to March 31, 2005, so that the services can be resolicited.

Recommendation: In the evaluation of future responses, we recommend that the RFP specifications be strictly applied and that contracts be awarded only to firms clearly qualified under the terms of the RFP. We also recommend that, in accordance with the Department's established procedure, conflict of interest statements be executed by each member of the Department's contractor selection teams.

Finding No. 3: Monthly Plan Audit Report

Article III(i) of the Records Administrator contract indicates that investment providers are to furnish a monthly file of participant accounts to the Records Administrator to be utilized in preparing monthly plan audits. A monthly plan audit is a monthly report prepared by the Records Administrator that identifies for each participant any discrepancies between investment provider records and Records Administrator records.

Any discrepancy between the Records Administrator's records and the investment provider's records of participant account activity were to be communicated by the Records Administrator to the investment providers and the Department, along with the course of action required for correction.

The Department has not established and implemented procedures designed to verify that the Records Administrator has properly prepared the monthly plan audits and that appropriate corrective actions have been taken to address all discrepancies. Absent the implementation of such procedures, errors in the records of the investment providers and the Records Administrator may not be subject to timely detection and correction.

Recommendation: We recommend that the Department establish and implement procedures that will facilitate a periodic verification that all monthly plan audits have been timely prepared and that all discrepancies disclosed by the audits have been timely corrected.

Finding No. 4: Marketing and Education Fee

Investment providers are required by contract to pay a 5 cent-per-month per-participant marketing and education fee.² The fee is to be paid to the Records Administrator, and the Records Administrator is to deposit and maintain in a separate account the amounts received. The amounts received may be disbursed by the Records Administrator only upon authorization of the Department. At the 5 cent-per-participant-per-month rate, deposits to the account should total approximately \$40,000 per year. A July 2003 fee increase to 30 cents should lead to deposits in excess of \$230,000 per year. At May 28, 2004, the account had a balance of \$241,449.

The marketing and education fees were held in a noninterest-bearing account in the name of NDC, the Records Administrator’s subcontractor, and the authorized signors for the account were employees of NDC. Under such circumstances, the Department should have in place procedures requiring a periodic certification that all amounts due and collected have been deposited in the bank account and that all amounts disbursed from the account have been authorized by the Department to pay marketing and educational expenses of the Deferred Compensation Program. Such procedures may include obtaining for the account monthly bank statements and comparing the deposit amounts and disbursement amounts to corroborating information.

² Effective July 2003, the Department’s administrative fee and the marketing and education fee were changed to 75 and 30 cents, respectively.

For deposits, such corroborating information might include calculated estimates of the amounts due (number of participants for the month multiplied by the fee amount). For disbursements, the corroborating information would consist of Department records authorizing the disbursements for the month.

Our audit disclosed that the Department was not receiving bank statements for the account and had not implemented procedures requiring a periodic verification of the marketing and education fee account’s activity. We also noted that transactions and balances relating to the bank account had not been recorded in the State’s general ledger accounting records.

Absent verification procedures, the Department has reduced assurance that all amounts received have been deposited and that all amounts disbursed were authorized. The recording of the transactions and balances facilitates the use of State budgetary and financial reporting systems to account for and control these State resources.

Recommendation: We recommend that the Department obtain directly from the bank a copy of the monthly bank statement and that someone, other than those Department employees who authorize disbursements, be made responsible for documenting a periodic reconciliation of the amounts that should have been deposited to the amounts shown by the bank statements and the amounts authorized for disbursement to the amounts shown by the bank statements. We also recommend that the transactions and balances relating to the bank account be recorded in the State’s general ledger accounting records. Moreover, we recommend that consideration be given to the use of an interest-bearing bank account should earnings be expected to exceed any related bank fees.

Finding No. 5: Participant Annuity Accounts

The Records Administrator contract requires that each June 30 and December 31, the Records Administrator obtain from each investment provider an amount representing the present value of participant annuity accounts. These amounts are then to be reported to the Department.

Our review of Department procedures relating to these participant account types disclosed that procedures had not been established to reasonably ensure the accuracy and completeness of the amounts reported. Such assurance might be obtained by requiring that the annual independent random

audit of participant accounts include in its scope participant annuity accounts. The Records Administrator contract required the conduct of an annual independent random audit of participant accounts. However, the contract did not require the inclusion of participant annuity accounts.

Absent the establishment of appropriate procedures, errors or omissions in the amounts reported and recorded in the Department's accounting records may escape timely detection. Our audit tests disclosed that the value of participant annuity accounts with one investment provider was not recorded and reported by the Department. The present value of these annuity accounts was estimated to be approximately \$12 million at June 30, 2003.

Recommendation: We recommend that the Department establish procedures designed to reasonably ensure the accuracy and completeness of participant annuity accounts.

Multi-Vendor Enhanced Enrollment System

As part of our audit, we reviewed additional services that the Department had purchased from the FRA. We found that the Department had purchased a multi-vendor enhanced enrollment system (MVEES) from the FRA at a cost of \$299,054. With respect to the MVEES, a January 23, 2003, *Letter of Intent* provided that the FRA was to develop and produce:

- A Web site that State of Florida employees and participants can use to:
 - Learn about the Plan.
 - Obtain information about approved investment providers.
 - View a record showing the balances for all of their accounts.
 - Link to investment provider Web sites to enroll.
- A Web site that the CFO can use to view plan level account summary information.
- An electronic *Participant Action Form* application that will:
 - Reduce paper flow by creating an electronic alternative to the *Participant Action Form*.
 - Allow investment providers to maintain the same administrative processes they have today.

On February 3, 2003, a purchase requisition for the project was approved, and on March 5, 2003, the Chief of the Bureau of Deferred Compensation, acting for the CFO, signed an Addendum to Agreement with FRA. On April 2, 2003, a purchase order was issued.

Finding No. 6: Competitive Awarding of MVEES Contract

Section 287.057, Florida Statutes, provides that unless otherwise authorized by law, all contracts for the purchase of commodities or contractual services in excess of \$25,000 shall be awarded by competitive means (sealed bids, proposals, or replies).

As indicated above, the Department paid the MVEES project contractor a total of \$299,054. Our audit disclosed that, contrary to the requirements of Section 287.057, Florida Statutes, competitive means were not used to select the MVEES contractor. The contractor, FRA, was selected because it was the contracted records administrator. No other information was provided to explain why competitive means were not used to select an MVEES contractor. It does appear that other vendors were available and could have provided the service.

Absent the Department competitively selecting vendors for projects such as the MVEES, the Department cannot demonstrate that the contract is awarded to the most responsible and responsive vendor whose proposal is determined in writing to be the most advantageous to the State, taking into consideration price and other criteria.

Recommendation: We recommend that the Department competitively select vendors for projects such as the programming for the MVEES.

Finding No. 7: MVEES Contract Addendum

Section 287.058(2), Florida Statutes, and the Department's purchasing procedures, require that a written agreement be signed by the agency head and the contractor prior to the rendering of any contractual service the value of which is in excess of \$25,000. Likewise, prior to the authorization of contractor services, purchase requisitions and purchase orders should be approved. Our review disclosed:

- The agency head (the CFO) did not sign the addendum to agreement. The addendum to

agreement was signed by the Chief of the Bureau of Deferred Compensation. We were advised that the authority to contract had not been delegated by the CFO to the Chief of the Bureau of Deferred Compensation. The Chief of the Bureau of Deferred Compensation advised us that she believed that she had the authority to bind the Department by contract.

- Contractual services were provided prior to purchase requisition approval, the signing of the agreement, and purchase order issuance. Various tasks required by the agreement were completed by January 31, 2003. As indicated above, purchase requisition approval, the signing of the addendum, and purchase order approval occurred on February 3, 2003, March 5, 2003, and April 2, 2003, respectively.

By allowing contractors to provide services prior to the approval of requisitions and contracts, the Department increases the risks that unauthorized goods and services may be provided and that sufficient moneys may not be available to pay any related invoices. We noted that moneys were not available to pay from Program appropriations the MVEES invoices. Those invoices were ultimately charged to the Information Technology budget entity and paid from the Insurance Regulatory Trust Fund. Program costs are normally appropriated from moneys derived from the administrative fees paid by investment providers.

Recommendation: We recommend that the Department take immediate action to ensure that all levels of management are fully cognizant of the appropriate procedures to be followed with respect to the requisition and authorization of contractual services.

Finding No. 8: Source Code

Although the MVEES contract does state that the Department retains ownership of the registration, content, data, and file layouts of the Web address, the agreement does not contain provisions addressing the ownership of the source code and any other tangible or intangible assets.

Absent provisions that provide for the ownership of source code and other tangible and intangible assets, it is not clear who owns the source code and any other tangible or intangible assets related to the MVEES project.

Recommendation: We recommend that the Department ensure that all contracts or agreements for programming and software-related services include

provisions addressing the ownership of tangible and intangible assets, including source code.

Investment Providers

The Department on June 24, 2002, issued an RFP requesting proposals from companies interested in providing investment products and services to Program participants. A total of 12 proposals were received by the Department. Subsequent to the evaluation of the responses, a total of six companies were engaged by the Department to provide investment products and services.

The performance of Program providers and products is to be periodically monitored by the Department. Those providers or products not performing up to expectations may be terminated.

Finding No. 9: Request for Proposal Terms and Advertisement

As described below, our audit of the Department's investment provider selection process disclosed that, as with the Records Administrator RFP, the investment provider RFP contained restrictive provisions that may have eliminated potential providers and the Department could have taken additional actions to ensure that more potential providers were made aware of the RFP:

- Section 3.3.1 of the RFP, which contains the provisions for minimum qualifications for an investment provider states, "As of December 2001, the Respondent must have been providing investment and administrative services to clients of an IRC 457 Plan for a minimum of ten (10) years. The size of one plan must be at least \$1.6 billion in assets and have at least twenty thousand (20,000) participant accounts or larger." It is likely that the specifications relating to administered plan size restricted the number of potential responders. A review of the 2001 Survey of 457 Plans published by the National Association of Defined Contribution Administrators, Inc., indicated that as of December 31, 2001, there were only 7 IRC 457 plans with assets greater than \$1.6 billion.

The size of the plans served does provide a measure of the capabilities of a respondent, and such information should be obtained from respondents and used as one of several measures of respondent capabilities. However, since other factors, such as the performance of the proposed funds and the provider's administrative capabilities are also relevant

to evaluating respondent potential, it is not clear that RFP provisions limiting potential respondents to only those already providing investment services to extremely large plans were necessary.

- Pursuant to information provided by Department staff, the Department advertised its request for proposal for the investment providers on the Department of Management Services' Vendor Bid System. Due to the specialized nature of these services, the Department should have considered taking steps beyond those required by standard procedures and advertised the request for proposal in an appropriate trade journal or newspaper utilized by companies providing investment provider services. Additionally, the process may have benefited from a search for such investment provider companies and the provision of notice concerning the request for proposal.

Recommendation: We recommend that in future investment provider RFPs, the Department consider the size of plans administered as but one factor used in evaluation of respondent capabilities, rather than a factor leading to disqualification, and that the Department take steps to broaden the advertisement of its investment provider RFP.

Finding No. 10: Investment Provider Selection

The Department received nine investment provider responses and three self-directed brokerage window responses to its June 24, 2002, RFP. The Department's six-member selection team consisted of one employee of the State Board of Administration and five employees of the Department.

Our audit of the Department's award of the investment provider contracts and the self-directed brokerage window contract disclosed:

- Contrary to the *Request for Proposal (RFP) Guide, Composition of Selection Team Section, Conflict of Interest* section, the members of the selection committee did not sign a statement indicating that there were no conflicts of interest. A conflict of interest statement should have been signed by each member of the selection team to document that each selection team member was free of conflicts of interest that may, in fact or in appearance, interfere with the impartial selection of a records administrator.
- As indicated in Finding No. 9, Section 3.3.1 of the RFP requires of proposers a minimum of \$1.6 billion under investment management and 20,000 participants. It was not clear from the documentation provided whether several of the

selected investment providers met this requirement. For example, although one investment provider reported over 2 million participant accounts under management, Department RFP records did not contain evidence of a single provider plan having \$1.6 billion under management and 20,000 participants. Additionally, although another investment provider reported having \$17.4 billion in assets under management, Department RFP records did not contain evidence of a single provider plan having \$1.6 billion under management and 20,000 participants.

Recommendation: We recommend that the Department ensure that conflict of interest statements are completed and that RFP response evaluation files document a determination that selected providers have met all specified minimum qualifications.

Standards of Conduct

Finding No. 11: Employee Suspension

The Department, following the completion of an investigation, suspended without pay for a period of 31 days the Chief of the Bureau of Deferred Compensation. The notice of suspension stated that the basis for the suspension was the lack of professional judgment in accepting and not reporting gifts.

The notice further provided that, in accepting and not reporting gifts, the Chief had violated the Department's conflicts of interest policy and Section 112.313, Florida Statutes, which addresses standards of conduct for public officers and employees. The gifts referred to in the Department's investigation were provided by Records Administrator and investment provider representatives and consisted of such items as, for example, meals and wedding gifts. The suspension was effective January 2, 2004, through February 2, 2004.

OTHER MATTERS

Finding No. 12: Communications Taxes

Although with respect to Department cellular phone services, the Department was exempt from paying the Federal Communications Tax, the State Communications Service Tax, the State Gross Receipts Tax, and local communications service taxes, the Department paid to one vendor such taxes approximating \$60,000 during the audit period.

With respect to the Department’s pre-audit of cellular telephone service invoices, our audit disclosed that the Department did not have in place written policies and procedures addressing the preaudit of invoices for evidence of the assessment of communications taxes.

Recommendation: We recommend that as part of the preaudit of cellular telephone service invoices, the Department address the existence of incorrectly assessed taxes. Additionally, we recommend that the Department pursue the refund of the taxes assessed and paid.

OBJECTIVES, SCOPE, AND METHODOLOGY

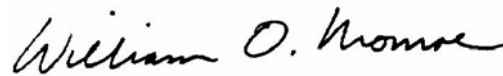
This operational audit focused on an examination of the Department of Financial Services’ internal controls and operations applicable to the Deferred Compensation Program. Audit objectives were:

- To determine the extent to which the Program’s internal controls promoted and encouraged the achievement of management’s objectives relative to investment provider selection, investment provider monitoring, records administrator selection, and records administrator monitoring.
- To evaluate Department management’s performance in achieving compliance with controlling laws, administrative rules, and other guidelines; the economic, efficient, and effective operation of State government; the reliability of records and reports; and the safeguarding of assets.

In conducting our audit, we obtained an understanding of governing laws, rules, and other guidelines; evaluated relevant internal controls; interviewed selected Department management and staff; and examined selected contracts and participant accounts. Our audit included an examination of various transactions (as well as events and conditions) occurring during the period May 15, 2002, through February 29, 2004, and selected actions taken through July 9, 2004.

AUTHORITY

Pursuant to the provisions of Section 11.45, Florida Statutes, I have directed that this report be prepared to present the results of our operational audit.



William O. Monroe, CPA
Auditor General

AUDITEE RESPONSE

In a letter dated September 29, 2004, the Chief Financial Officer provided responses to our preliminary and tentative findings. The letter is included in its entirety at the end of this report.

To promote accountability in government and improvement in government operations, the Auditor General makes operational audits of selected programs, activities, and functions of State agencies. This operational audit was made in accordance with applicable Government Auditing Standards issued by the Comptroller General of the United States. This audit was conducted by Yueh-Lin Sullivan, CPA, and supervised by Allen G. Weiner, CPA. Please address inquiries regarding this report to Don Hancock, CPA, Audit Manager, via e-mail at donhancock@state.fl.us or by telephone at (850) 487-9037.

This report and other audit reports prepared by the Auditor General can be obtained on our Web site (<http://www.state.fl.us/audgen>); by telephone (850 487-9024); or by mail (G74 Claude Pepper Building, 111 West Madison Street, Tallahassee, Florida 32399-1450).

EXHIBIT A
DEFERRED COMPENSATION PLANS
WITH ASSETS IN EXCESS OF \$1 BILLION

City or State	Total Plan Assets	Number of Participants	Records Administration
State of New York	\$5,143,612,783	119,086	CitiStreet
City of New York	\$4,423,306,000	108,703	Great West
State of Ohio	\$4,334,386,611	121,825	State of Ohio
State of California	\$3,472,422,265	44,897	Nationwide Retirement Solutions
State of Minnesota	\$2,168,355,603	58,703	Great West
State of Michigan	\$2,088,904,973	18,115	(No survey response reported)
State of Illinois	\$1,791,720,172	45,000	T. Rowe Price
City of Chicago	\$1,573,344,476	30,513	Nationwide Retirement Solutions
City of Los Angeles	\$1,508,545,448	24,089	Great West
State of Washington	\$1,431,800,000	30,183	CitiStreet
State of Florida	\$1,318,570,000	51,591	Florida Records Administrator
State of Wisconsin	\$1,122,521,994	29,963	Nationwide Retirement Solutions
State of New Jersey	\$1,100,751,617	24,501	State of New Jersey
State of Maryland	\$1,001,937,897	45,154	Nationwide Retirement Solutions

Source: 2001 Survey of 457 Plans, Defined Contribution Administrators, Inc.
(The survey included responses from 37 State governments and 44 local governments.)



CHIEF FINANCIAL OFFICER
STATE OF FLORIDA

TOM GALLAGHER

September 29, 2004

Mr. William O. Monroe
Auditor General
State of Florida
Claude Pepper Building
111 West Madison Street
Tallahassee, Florida 32399-1450

Dear Mr. Monroe:

Pursuant to Section 11.45(4)(d), Florida Statutes, the enclosed responses are provided for the preliminary and tentative findings and recommendations included in the report of the Audit of Department of Financial Services and the Deferred Compensation Program, 2004.

If you have any questions or would like to discuss the matter further, please contact David Harlan, Inspector General at (850) 413-4960.

Sincerely,

A handwritten signature in black ink, appearing to read "Tom Gallagher".

Tom Gallagher

TG:Hc

Enclosure

Florida Department of Financial Services
Audit Response
Audit of the Department of Financial Services and
The Deferred Compensation Program
Preliminary and Tentative Findings and Recommendations

Finding No. 1: On May 15, 2002, the Department issued a request for proposal (RFP) seeking responses from firms interested in providing third-party administrator and records administrator services. Our audit disclosed that the RFP contained restrictive provisions that may have eliminated many potential providers and that the Department could have taken additional actions to ensure that more potential providers were made aware of the RFP.

Recommendation: To better realize the benefits of a competitive selection process, we recommend:

- The Department consider the size of plans administered as but one factor used in evaluation of respondent capabilities, rather than a factor leading to disqualification.
- The Department reconsider the need for the RFP provisions that in effect eliminate investment providers and their affiliates from consideration as the records administrator. The RFP should instead require of such entities a description of firewall provisions.
- The Department take steps to identify potential providers and inform them of the RFP.
- The Department advertise the RFP in relevant industry publications.

Response: The Department manages a large multi-vendor deferred compensation program with personnel inputs from thirteen different sources. The restrictive provisions in the requests for proposal were designed to ensure that potential contractors had the experience and capacity to perform required services. The Department believes that it is important to separate the records administration function from the investment provider function and is taking steps to achieve that end. The possibility of conflict of interest will thus be removed. Nevertheless, the Department will promote competition among vendors providing records administration services as recommended by The Auditor General.

Finding No. 2: The Department received two responses to its May 15, 2002, RFP. One of the two responses was disqualified, leaving only one response deemed by the Department to be responsive to the RFP, that being the response from Florida Records Administrator, Inc., (FRA). FRA was subsequently selected and awarded the records administrator contract.

Recommendation: In the evaluation of future responses, we recommend that the RFP specifications be strictly applied and that contracts be awarded only to firms clearly qualified under the terms of the RFP. We also recommend that, in accordance with the Department's established procedure, conflict of interest statements be executed by each member of the Department's contractor selection teams.

Response: The Department concurs with this finding and will comply with the recommendations. The Department has already taken action to replace the records administrator.

Finding No. 3: A monthly plan audit is a report prepared by the Records Administrator that identifies for each participant any discrepancies between Investment Provider records and

Records Administrator records. The Department has not established and implemented procedures designed to verify that the Records Administrator has properly prepared the monthly plan audits and that appropriate corrective actions have been taken to correct all discrepancies.

Recommendation: We recommend that the Department establish and implement procedures that will facilitate a periodic verification that all monthly plan audits have been timely prepared and that all discrepancies disclosed by the audits have been timely corrected.

Response: The Department has written and implemented procedures that reconcile the company totals to the records administrator totals each month. These procedures have been in effect since July 30, 2004. The Auditor General has been provided these monthly audit procedures.

Finding No. 4: Investment providers are required to pay a 5 cent-per-month per-participant marketing and education fee. The fee is to be paid to the Records Administrator, for the benefit of the Deferred Compensation Program, and the Records Administrator is to deposit and maintain in a separate account the amounts received. At May 28, 2004, the account had a balance totaling \$241,449. The Department was not receiving bank statements for the account and had not implemented procedures requiring a periodic verification of the marketing and education fee account's activity. We also noted that transactions and balances relating to the bank account had not been recorded in the State's general ledger accounting records.

Recommendation: We recommend that the Department obtain directly from the bank a copy of the monthly bank statement and that someone, other than those Department employees who authorize disbursements, be made responsible for documenting a periodic reconciliation of the amounts that should have been deposited to the amounts shown by the bank statements and the amounts authorized for disbursement to the amounts shown by the bank statements. We also recommend that the transactions and balances relating to the bank account be recorded in the State's general ledger accounting records. Moreover, we recommend that consideration be given to the use of an interest-bearing bank account should earnings be expected to exceed any related bank fees.

Response: The recommended procedures have been established and implemented as of July 30, 2004. The Deferred Compensation Office has received and reconciled all bank transactions since January 2000. In addition, the current records administrator has been instructed to only pay items approved in writing by both the Bureau Chief of Deferred Compensation and the Director of the Treasury. The balance of this account will be included in the Treasurer's monthly report and will be included in totals reported in the Comprehensive Annual Financial Report. This account will be restructured under the new records administrator and the recommended procedures will be adopted.

Finding No. 5: The Records Administrator contract requires that each June 30 and December 31, the Records Administrator obtain from each investment provider an amount representing the present value of participant annuity accounts. Department procedures had not been established to reasonably ensure the accuracy and completeness of the amounts reported for the participant account values.

Recommendation: We recommend that the Department establish procedures designed to reasonably ensure the accuracy and completeness of participant annuity accounts.

Response: The recommended procedures have been established and implemented as of September 1, 2004, to ensure the accuracy and completeness of participant annuity accounts.

Finding No. 6: The Department paid the Multi-Vendor Enhanced Enrollment System (MVEES) project contractor a total of \$299,054. Our audit disclosed that, contrary to law, competitive means were not used to select the MVEES contractor.

Recommendation: We recommend that the Department competitively select vendors for projects such as the programming for the MVEES.

Response: We agree that where the nature or scope of additional required services materially exceeds the scope of services originally contemplated, the Division should competitively select contractors providing the additional services. In this instance the Division believed that the MVEES was a reasonable addition to the duties of the records administrator as the files that populate the website were maintained by the records administrator. However, the Division will implement a procedure whereby legal staff of the Department will determine whether a competitive selection process should be used to secure additional services.

Finding No. 7: Section 287.058(2), Florida Statutes, and the Department's purchasing procedures, require that a written agreement be signed by the agency head and the contractor prior to the rendering of any contractual service the value of which is in excess of \$25,000. Likewise, prior to the authorization of contractor services, purchase requisitions and purchase orders should be approved. Our review disclosed that an agency employee, rather than the agency head, had signed the MVEES project agreement and that contractual services were provided prior to purchase requisition approval, the signing of the agreement, and purchase order issuance.

Recommendation: We recommend that the Department take immediate action to ensure that all levels of management are fully cognizant of the appropriate procedures to be followed with respect to the requisition and authorization of contractual services.

Response: The Department has taken action to ensure that all levels of management are fully cognizant of the appropriate procedures to be followed with respect to the requisition and authorization of contractual services effective December 1, 2003.

Finding No. 8: The MVEES contract does not contain provisions addressing the ownership of the source code and any other tangible or intangible assets.

Recommendation: We recommend that the Department ensure that all contracts or agreements for programming and software-related services include provisions addressing the ownership of tangible and intangible assets, including source code.

Response: The Department will ensure that all contracts or agreements for programming and software related services include provisions addressing the ownership of tangible and intangible assets, including source code.

Finding No. 9: The Department on June 24, 2002, issued an RFP requesting proposals from companies interested in providing investment products and services for the Deferred Compensation Program. Our audit disclosed that, as with the Records Administrator RFP, the investment provider RFP contained restrictive provisions that may have eliminated potential providers and the Department could have taken additional actions to ensure that more potential providers were made aware of the RFP.

Recommendation: We recommend that in future investment provider RFPs, the Department consider the size of plans administered as but one factor used in evaluation of respondent capabilities, rather than a factor leading to disqualification, and that the Department take steps to broaden the advertisement of its investment provider RFP.

Response: The Bureau of Deferred Compensation will design future purchasing documents to comply with the recommendations made by The Auditor General.

Finding No. 10: A total of 11 investment provider proposals were received by the Department in response to its June 24, 2002 RFP. Subsequent to the evaluation of the responses, a total of six companies were engaged by the Department to provide investment products and services.

Recommendation: We recommend the Department ensure that conflict of interest statements are completed by selection committee members, and that RFP response evaluation files document a determination that selected providers have met all specified minimum qualifications.

Response: The Department concurs with this finding and will comply with the recommendation.

Finding No. 11: The Department, following the completion of an investigation, suspended without pay for a period of 31 days the Chief of the Bureau of Deferred Compensation. The notice of suspension stated that the basis for the suspension was the lack of professional judgment in accepting and not reporting gifts.

Recommendation: No recommendation was made.

Response: The Department of Financial Services reviewed this case and took appropriate action on its own. Effective August 2003, the Division of Treasury adopted a policy prohibiting the acceptance of vendor meals. The Bureau Chief reimbursed the four wedding gifts accepted in June 1998 to the givers on November 17, 2003. The total value of the gifts was \$225.

Finding No. 12: Although with respect to Department cellular phone services, the Department was exempt from paying certain communications service taxes, the Department paid one vendor such taxes approximating \$60,000 during the audit period.

Recommendation: We recommend that as part of the preaudit of cellular telephone service invoices, the Department address the existence of incorrectly assessed taxes. Additionally, we recommend that the Department pursue the refund of the taxes assessed and paid.

Response: The Department concurs with the substance of the finding and we have implemented appropriate preaudit procedures. We have researched all invoices for cellular service and determined the overpayment amount to be approximately \$44,000. We are currently working with the vendor to obtain a refund of the overpayment.