GOVERNMENT OF THE DISTRICT OF COLUMBIA
OFFICE OF THE CHIEF FINANCIAL OFFICER

AUDIT OF INTERNAL CONTROLS OVER
THE OFFICE OF FINANCE AND TREASURY'S
PENSION FUND OPERATIONS

OFFICE OF INTEGRITY AND OVERSIGHT

OIO No. 13-01-08-OFT

June 30, 2014
MEMORANDUM

TO: Jeffrey Barnette, Treasurer and Deputy Chief Financial Officer
    Office of Finance and Treasury

FROM: Mohamad K. Yusuff, Interim Executive Director
       Office of Integrity and Oversight

DATE: June 30, 2014

SUBJECT: Final Report: Audit of Internal Controls over the Office of Finance and
         Treasury’s (OFT) Pension Fund Operations (OIO No. 13-01-08 OFT)

The Office of Integrity and Oversight (OIO) conducted an audit of Internal Controls over
the Office of Finance and Treasury’s (OFT) Pension Fund Operations. This Audit was
included in OIO’s Audit and Integrity Plan for FY 2013. The attached report presents the
results of the audit.

The audit found deficiencies related to Monthly Asset Reconciliations, record retention
and updating OFT’s Pension Management Policies and Procedures. OIO provided five
recommendations to address the deficiencies identified. In response to OIO’s draft
report, dated June 24, 2014, OFT concurred with four of the recommendations, and
disagreed with one recommendation. With regards to the recommendation that OFT
disagreed with, OFT has since provided OIO with an updated Pension Management
Policies and Procedures Manual. Therefore, we consider this matter as closed.

Should you have questions on this report, please contact me at (202) 442-6433.

Attachment

cc: Kathy Crader, Chief Risk Officer, OCFO
    John Henry, Associate Treasurer, OFT
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AUDIT OF INTERNAL CONTROLS OVER
THE OFFICE OF FINANCE AND TREASURY'S (OFT)
PENSION FUND OPERATIONS

ACRONYMS

401(a) Defined Compensation Plan
AICPA American Institute of Certified Public Accountants
DCPLUS Deferred Compensation Plan
DOH Date of Hire
IRA Individual Retirement Account
IRS Internal Revenue Service
MRD Minimum Required Distribution
OFT Office of Finance and Treasury
CIO Office of Integrity and Oversight
CPRS Office of Pay and Retirement Services
PPD Pension Plan Director (PPD)
SSAE 16 Statement on Standards for Attestation Engagement No. 16
EXECUTIVE SUMMARY

OVERVIEW

The Office of Integrity and Oversight (OIO) has completed an audit of Internal Controls over the Office of Finance and Treasury’s Pension Fund Operations. We conducted this audit, which was included in OIO’s Audit and Integrity Plan for FY 2013, as part of OIO’s oversight responsibility over OCFO agencies.

The objectives of the audit were to:

• Determine OFT’s compliance with laws and regulations, policies and procedures governing the District’s pension plans; and

• Assess sufficiency of internal controls over OFT’s management of the pension plans.

CONCLUSIONS

Our audit revealed that overall, OFT has adequate controls over its management of the pension plans. However, we found that controls can be further strengthened by performing Monthly Asset Reconciliations in a timely manner, retaining records for plan participants until all payments are made and updating OFT’s Pension Management Policies and Procedures to incorporate changes in IRS regulations.

SUMMARY OF RECOMMENDATIONS

We directed 5 recommendations to OFT management for necessary action to correct the described deficiencies. The recommendations center on:

1. Ensuring that reconciliation of plan assets are completed on a monthly basis as required by OFT’s Pension Management Policies and Procedures;
2. Requiring that the Trustee retain records for plan participants until all payments are completed;
3. Updating the current Pension Management Policies to include record retention for plan documentation;
4. Conducting periodic reviews of the Trustee’s distribution process to assure compliance with regulatory rules and contract terms; and
5. Instituting a process that requires that the Pension Management Policies and Procedures are routinely updated to incorporate changes in IRS regulations.
EXECUTIVE SUMMARY

MANAGEMENT RESPONSE AND OIO COMMENTS

OIO received written responses from OFT on June 24, 2014. OFT concurred with four recommendations and provided target completion dates. OFT disagreed with one recommendation and stated that a process is in place to ensure that Internal Revenue Codes are reviewed during quarterly meetings. OFT has also provided OIO with a copy of the most recent update of the Pension Fund Management Policies and Procedures. We consider OFT corrective actions as responsive and deem the matter as closed. The full text of OFT’s response is included in this report as Appendix 1.
BACKGROUND

The District’s office of the Chief Financial officer (OCFO), Office of Finance and Treasury (OFT) is responsible for the administration of the District’s Pension Plans. The two plans offered by the District are:

- The 401 (a) Defined Contribution Pension Plan (401(a)); and
- The 457 Deferred Compensation Plan (DCPLUS).

OFT, in conjunction with the D.C. Department of Human Resources (DCHR), is responsible for adopting the plan’s administrative rules and regulations, investment policies and overseeing the duties of the Plan’s Program Manager (Trustee). The Trustee has custody of the Plan’s assets and is responsible for the plan’s marketing, enrollment, reporting and recordkeeping. The current Trustee, ING Life Assurance and Annuity Company (ING), was awarded a multi-year contract on July 31, 2008. The term of the contract was for a five (5) year base period with two (2) two-year options periods.

401(a) Defined Contribution Pension Plan (401(a))

The 401 (a) was established under D.C. Code 1-626.05(3) for all District employees hired on or after October 1, 1987. To be eligible for the plan, an employee has to be employed for a minimum of one year. The District contributes 5% of eligible employees’ base salary to the Plan, with the exception of detention officers who receive a 5.5% contribution of their base salary. Plan participants are not required to make any contributions to the Plan.

457 Deferred Compensation Plan (DCPLUS)

In addition to the 401(a) Defined Contribution Retirement Plan, the District also established a deferred compensation plan for eligible employees under the District’s Deferred Compensation Act of 1984, D. C. Law 5-118, and D. C. Code Section 47-30. The DCPLUS enables eligible employees to make tax deferred contributions towards their retirement. There is no age or length of service requirements to participate in the plan, and employees can start making contributions immediately when hired.

Plan Enrollment

401(a) Plan Enrollment Process

New employees are enrolled in the Plan nine months after Date of Hire (DOH). However, the contributions do not start until the employee completes one year of employment with the District. The enrollment process is as follows:
BACKGROUND

- DCHR enrolls participants in the Plan nine (9) months after their DOH;
- DCHR provides the Trustee with data on employees who qualify three months prior to the employees’ Plan eligibility date.
- The Trustee is responsible for loading enrolled participants onto its recordkeeping system; and
- OFT ensures that new employee files are sent to ING and are established on the ING recordkeeping system.

457 DCPLUS Enrollment Process:

DCHR is also responsible for enrolling employees in DCPLUS. Employees who elect to participate in the plan may enroll on their first day of employment. To enroll, employees are required to complete a Participation Agreement to authorize the Office of Pay and Retirement Services (OPRS) to deduct contributions from their paychecks. Employees may enroll in the plan at any time, as well as during the yearly open enrollment period.

Distribution to Plan Participants

401(a) Distribution Process:

Participants in the 401(a) plan can only receive a distribution or payout from their plan account when the following occur:
- Separation from service with the District;
- Death (payment to beneficiary);
- Permanent Disability; or
- Retirement.

In 2009, the period an employee could be vested in the plan was revised. The previous requirement that an employee had to have a total of 5 years of service to be vested was changed to the following vesting schedule currently used to determine the amount to be paid to the plan participant:

<table>
<thead>
<tr>
<th>Years of Service</th>
<th>Percentage of Payment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 2 years</td>
<td>0%</td>
</tr>
<tr>
<td>2 years</td>
<td>20%</td>
</tr>
<tr>
<td>3 years</td>
<td>40%</td>
</tr>
<tr>
<td>4 years</td>
<td>60%</td>
</tr>
<tr>
<td>5 years or more</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: Government of the District’s 401(a) Defined Contribution Plan Document, restated effective October 1, 2011
BACKGROUND

In order to initiate a distribution, the participant or their beneficiary is required to complete a Distribution Request Form, which is provided by the Trustee. The form is then forwarded to DCHR for approval to ensure the participant is vested. The forms are then returned to the Trustee for processing. DCHR submits a list of approved distributions for payment each week to the Trustee.

Payment Options

The following distribution options are available to plan participants in the 401(a) plan:

- cash payments (partial or lump sum);
- rollover to another eligible retirement plan or traditional Individual Retirement Account (IRA);
- installment payments;
- transfer to an annuity; or
- payments can be deferred to a specific future date, but prior to April 1 of the calendar year the employee attains age 70⅓.

DCPLUS Distribution Process

Distributions from the DCPLUS plan are only allowed upon separation from employment, death, attainment of age 70⅓, or the occurrence of an unforeseeable emergency. The plan also permits In-Service withdrawals, if certain conditions are met.

Payment Options

A participant that has separated from employment is entitled to receive benefits and has the right to elect both the timing and manner of benefit payments. The participant can select one of the following options:

- Postpone any decision on the payment of benefits to a future date that is no later than the April 1st following the calendar year in which he/she attains age 70⅓;
- Receive benefits immediately under one of the following distribution options:
  ➢ Lump sum payment
  ➢ Installment payments
  ➢ Annuity payments; or
- Rollover benefits into another employer-sponsored, eligible retirement plan or traditional IRA. All distributions are eligible for rollovers except for: unforeseeable emergency withdrawal; IRS minimum required distributions (MRD) payable on or after the participant attain age 70⅓ and periodic payments made over the participant’s life or a specified period of 10 years or more.
BACKGROUND

Monthly Asset Reconciliation:

The OFT pension analysts are responsible for reconciling the plan assets on a monthly basis. The analysts are required to reconcile fund activity from opening to closing balance. The reports from the Trustee and the payroll reports from OPRS are utilized in this process. Following is a summary of the steps followed in the reconciliation process:

- The Trustee provides OFT with a monthly asset reconciliation binder and a monthly management report for both plans;
- The analysts perform reconciliation of assets, contributions, and provides a list of rejected items to the Pension Plan Director (PPD) for approval;
- The analysts in conjunction with the Trustee resolve all the items that need adjustment and return the package to the PPD for final approval;
- The PPD reviews the reconciliation and informs the pension analyst if any issues need to be resolved before signing and dating the reconciliation package.

OBJECTIVES, SCOPE AND METHODOLOGY:

The objectives of the audit were to:

- Determine OFT's compliance with laws and regulations, policies and procedures governing the District's pension plans; and
- Assess sufficiency of internal controls over OFT's management of the pension plans.

In order to accomplish our objectives, we interviewed OFT officials responsible for managing the Pension Plans. We also reviewed plan documentation, policies and procedures, and other documents related to the two pension plans. In addition, we selected one non-statistical sample of 12 monthly asset reconciliations in FY 2013 and two statistical samples of plan participants who received distributions in FY 2012 and 2013 to test for accuracy. The audit covered the period FY 2012 to FY 2013.

We relied on computer processed data from the Trustees' database. We did not perform a reliability assessment of the computer processed data since we were provided with copies of the most recent Service Organization Control 1 Report, as required by the American Institute of Certified Public Accountants (AICPA) Statement on Standards for Attestation Engagement No. 16 (SSAE 16) which was performed by independent auditors on the Trustees systems for the period covered under our audit.
BACKGROUND

We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for the findings and conclusions based on our audit objectives.
FINDINGS AND RECOMMENDATIONS

FINDING 1: MONTHLY ASSET RECONCILIATION

SYNOPSIS

We found that OFT did not complete the monthly asset reconciliations in a timely manner. Specifically, we found that the six (6) reconciliations for the 401A Plan and six (6) for the 457 Plan that we selected for testing, all had taken at least 4 months to complete. OFT’s Pension Management Policies and Procedures require that asset reconciliations are conducted on a monthly basis and adjustments or corrections are completed each month. This delay could result in loss of earnings by plan participants.

DISCUSSION

We selected a non-statistical sample of 12 monthly asset reconciliations (6 for the 401 (a) and 6 for the DCPLUS) that had been completed in FY 2013. We found that OFT did not complete the asset reconciliations in a timely manner. Specifically, we found that all the 12 monthly asset reconciliations had taken at least 4 months from the end of each month to complete. According to OFT’s Pension Management Policies and Procedures, asset reconciliations for both plans should be completed on a monthly basis and should include making any adjustments or corrections. The OFT Program Director stated that they were aware of the delays which were due to a staffing shortage. Delay in completing the monthly asset reconciliations can lead to untimely correction of errors resulting in potential loss of earnings by plan participants.

RECOMMENDATIONS:

We recommend that the Deputy Chief Financial Officer/Treasurer, OFT:

1. Ensure that monthly asset reconciliations for the Pension Plans are completed in a timely manner in accordance with the agency’s established Policies and Procedures.

Management Comments (Recommendation 1):

OFT concurred with the recommendation and has recommended the addition of an analyst by January 2015 and plans to complete pending reconciliations by July 7. OFT disagreed that delay in reconciliation could lead to loss of earnings by plan participants.

OIO’s Comments:

OFT’s action is responsive and meets the intent of the recommendation.
FINDINGS AND RECOMMENDATIONS

FINDING 2: DOCUMENT RETENTION

SYNOPSIS

We found that the Trustee did not retain documentation for 12 plan participants’ payments. During our review of a statistically selected sample of 64 DCPLUS plan participants who received payments in FY 2013, we found that the Trustee did not have documentation supporting payments for 12 of the participants. The Internal Revenue Service (IRS) regulations require that documentation for pension plan participants be kept until all the payments are completed. This is to ensure that documentation is available should the plan be audited by the IRS. The lack of documentation can result in the plan being cited for non-compliance, and issues on participants’ contributions can become problematic.

DISCUSSION

We reviewed distributions made to plan participants in FY 2013 for both the 401(a) and the DCPLUS plans. For the 401(a) we selected a statistical sample of 64 out of a total of 2,568 payments, and for the 457 plan we selected a statistical sample of 64 out of a total of 4,202, for a total of 128 payments. We found that 12 out of 64 selected payments for the DCPLUS plan did not have supporting documentation. We noted that six (6) out of the 12 payments that did not have support were made to plan participants who signed up for long term installment payments, and the remaining six were termed as minimum required distribution (MRD). Both the 401(a) and the DCPLUS plans allow employees to receive their vested account balance in installments of equal amounts for a specific period not to exceed the life expectancy of the participant or beneficiary.

When we inquired about the missing supporting documentation, we were informed by the Trustee’s officials that six of the participants had signed up for installment payments more than 7 years prior, and the Trustee only retained documentation for 7 years. The remaining six (6) payments had been made to participants who had reached the age of 70½, as required by IRS regulations. The Trustee made the payments without documentation to avoid being penalized for non-compliance. We believe that support for all payments made to plan participants should be retained until payments are completed to ensure that the Pension Plans are in full compliance with IRS regulations.

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1 The statistical sample criteria for both samples were: Confidence level 95%, materiality level 10%, and auditor’s expectation of error 3%.
FINDINGS AND RECOMMENDATIONS

RECOMMENDATIONS:

We recommend that the Deputy Chief Financial Officer/Treasurer, OFT:

2. Require that the Trustee retain documentation for plan participants until all payments are completed.

3. Update the current Pension Management Policies to include record retention requirements for plan documentation;

4. Require that the Agency Pension Plan Director/COTR conduct periodic reviews of the Trustee’s distribution process to assure compliance with regulatory rules and contract terms.

Management Response (Recommendations 2, 3 and 4):

Recommendation 2:

OFT concurred with the recommendation and will ask the ING if they can retrieve the missing documentation from the prior Trustee. Since 2004 ING uses an imaging system and keeps plan documentation permanently.

OIO’s Comments:

OFT’s corrective action is responsive and meet the intent of the recommendation.

Recommendation 3:

OFT concurred with the recommendation and is working with the OCFO General Counsel’s office to update the 401(a) and 457 Plan Documents for applicable IRS updates, and they will also update the procedures to reflect changes.

OIO’s Comments:

OFT’s corrective action is responsive and meet the intent of the recommendation.
FINDINGS AND RECOMMENDATIONS

Recommendation 4:

OFT concurred with the recommendation and the OFT Pension Plan Director/COTR will implement quarterly reviews of the distribution process.

OIO’s Comments:

OFT’s corrective action is responsive and meet the intent of the recommendation.
FINDINGS AND RECOMMENDATIONS

FINDING 3: POLICIES AND PROCEDURES

SYNOPSIS

We found that OFT’s Policies and Procedures for managing the Pensions Plans were not updated to include recent changes in IRS regulations. Best business practices require the update of Policies and Procedures when new requirements and changes that impact processes are made. According to OFT, this was caused by a staffing shortage. The delay in updating Policies and Procedures could result in OFT officials making errors in the application of IRS laws and regulations.

DISCUSSION

During our review of OFT’s Pension Management Policies and Procedures, we found that the Policies and Procedures were not updated to include recent changes in IRS regulations. In particular, we found that the Policies that we were provided were issued in March 2012 and were citing 2010 IRS regulations which have since been changed. Although OFT officials informed us that this was due to a staffing shortage and an oversight on their part, more efforts need to be made to ensure that policies are reflecting the most current IRS rules and regulations. We believe that if Policies and Procedures are not updated as required, it can lead to non-compliance or inconsistencies in applying laws and regulations and result in the Plan being penalized by the IRS.

RECOMMENDATIONS

We recommend that the Deputy Chief Financial Officer/Treasurer, OFT:

5. Institute a process that requires that the Pension Management Policies and Procedures are routinely updated to incorporate changes in IRS regulations.

Management Response (Recommendation 5):

OFT did not concur with the recommendation and stated that they already have a process where Internal Revenue Code changes are reviewed at quarterly meetings and bi-monthly with the legal counsel to update plan documents.

OIO’s Comments:

OFT’s has provided OIO with updated Pension Management Policies and Procedures. We consider the recommendation closed.
EXHIBIT A: SUMMARY OF POTENTIAL BENEFITS RESULTING FROM AUDIT

<table>
<thead>
<tr>
<th>No.</th>
<th>Recommendations</th>
<th>Type of Benefit</th>
<th>Agency Reported Estimated Completion Date</th>
<th>Status²</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Ensure that monthly asset reconciliations for the Pension Plans are completed in a timely manner</td>
<td>Compliance/Internal control</td>
<td>July 2014 and January 2015</td>
<td>Open</td>
</tr>
<tr>
<td>2</td>
<td>Require that the Trustee retain documentation for plan participants until all payments are completed.</td>
<td>Compliance/Internal control</td>
<td>September 2014</td>
<td>Open</td>
</tr>
<tr>
<td>3</td>
<td>Update the current policies to include record retention for plan documentation</td>
<td>Compliance/Internal control</td>
<td>Completed June 2014</td>
<td>Closed</td>
</tr>
<tr>
<td>4</td>
<td>Require that the Agency Pension Plan Director/COTR conduct periodic reviews of the Trustee’s distribution process to assure compliance with regulatory rules and contract terms.</td>
<td>Compliance/Internal control</td>
<td>Completed June 2014 (ongoing)</td>
<td>Closed</td>
</tr>
<tr>
<td>5</td>
<td>Institute a process that requires that the Pension Management Policies and Procedures are routinely updated to incorporate changes in IRS regulations</td>
<td>Compliance/Internal control</td>
<td>Completed June 2014</td>
<td>Closed</td>
</tr>
</tbody>
</table>

² This column provides the status of a recommendation as of the report date. For final reports, “open” means management and the OIO are in agreement on the action to be taken, but is not complete. “Closed” means management has advised that action necessary to correct the deficiency is complete. If a completion date was not provided, the date of management’s response is used. “Unresolved” means that management has neither agreed to take the recommended action nor proposed a satisfactory alternative action to correct the condition.
GOVERNMENT OF THE DISTRICT OF COLUMBIA
Office of the Chief Financial Officer

Office of Finance and Treasury

MEMORANDUM

TO: Mohamed K. Yousif, Interim Executive Director
Office of Integrity and Oversight

FROM: Jeffrey Barnett, Deputy Chief Financial Officer and Treasurer
Office of Finance and Treasury

DATE: June 23, 2014

SUBJECT: Audit Response of Internal Controls over the Office of Finance and Treasury’s (OFT) Pension Fund Operations (OIO No. 13-08-OFT)

Attached is the response to the audit report for the Office of Finance and Treasury’s Pension Fund Operations.

If you have any questions, or require additional information, please contact John Henry at 727-0846.

Attachment

cc: John Henry, Associate Treasurer, OFT
MEMORANDUM

TO: Mohamad K. Yusuff, Interim Executive Director
   Office of Integrity and Oversight

FROM: Jeffrey Barnette, Deputy Chief Financial Officer and Treasurer
       Office of Finance and Treasury

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Attachment

cc: John Henry, Associate Treasurer, OFT
Office of Finance and Treasury
Audit of Internal Controls over Pension Fund Operations (OIO No. 13-01-08 OFT)

<table>
<thead>
<tr>
<th>Finding #</th>
<th>Finding/ Recommendation</th>
<th>Action Taken or Planned</th>
<th>Target Date for completion of Planned Actions</th>
<th>Official Responsible for Implementing the Actions</th>
</tr>
</thead>
</table>
| 1         | Monthly Asset Reconciliation  
Ensure that monthly asset reconciliations for the Pension Plans are completed in a timely manner. | We agree with the Finding. During this period, we were missing one of the two financial analysts. There was a vacancy for 9 months and another due to medical reasons was out for about four months. OFT has recommended the addition of a junior analyst to assist with the increasing demands of the pension plans, DC College Savings Plan and the Retiree’s Health Care Trust.  
We disagree with the point that “this delay could result in loss of earnings by plan participants.” Plan assets are always invested during the reconciliation process. Corrections or reversals have an inverse transactional relationship between a participant’s account and the forfeitures, which has a net zero effect on the assets. | Junior Analyst – January, 2015  
Certification for both plans through April 2014 will be completed by July 7, 2014. | John Henry  
Brenda Mathis |
<table>
<thead>
<tr>
<th></th>
<th>Document Retention require that the Trustee retain documentation for plan participants until all payments are completed.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>We agree with the Finding. The documentation in question were for participants who elected to have installment payments, e.g., monthly, quarterly, semi-annually or annually. The missing documents are for participants who have been receiving installment payments prior to ING becoming the recordkeeper. At the time of transfer, the supporting documents were not transferred from Nationwide, the prior recordkeeper, only the amount of the installment payment.</td>
</tr>
<tr>
<td></td>
<td>OFT will ask ING to reach out to Nationwide to determine if any of the information is still available to be transferred. Currently ING uses its imaging system which was installed in 2004 for all distribution requests, which are kept forever. In addition, the hard copies are kept for seven years.</td>
</tr>
<tr>
<td></td>
<td>In reference to the IRS regulation to force a participant payout when he/she reaches age 70 1/2, the recordkeeper, ING, sends out notification letters to all participants who will be eligible. The letters are sent in November of each year and the participants have until March 31st of the following year to take a minimum required distribution, per IRS guidelines. If an election is not made, ING sends the minimum required distribution to avoid them paying a 50% penalty. This is standard</td>
</tr>
<tr>
<td></td>
<td>September 1, 2014.</td>
</tr>
<tr>
<td></td>
<td>Brenda Mathis</td>
</tr>
<tr>
<td></td>
<td>Policies and Procedures</td>
</tr>
<tr>
<td>---</td>
<td>-------------------------</td>
</tr>
<tr>
<td>3</td>
<td>Policies and Procedures</td>
</tr>
<tr>
<td>4</td>
<td>Require that the Agency Pension Plan Director/ COTR conduct periodic reviews of the Trustee’s distribution process to assure compliance with regulatory rules and contract terms.</td>
</tr>
<tr>
<td>5</td>
<td>Institute a process that requires that the Pension Management Policies and Procedures are routinely updated to</td>
</tr>
<tr>
<td>incorporate changes in IRS regulations.</td>
<td>provisions and/or elective provisions the plan adopts. Changes are incorporated into the policies and procedures, if necessary.</td>
</tr>
</tbody>
</table>