



Employee Benefits Security Administration

Performance Audit of the Thrift Savings Plan Lifecycle Funds Process

June 14, 2019

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EXECUTIVE SUMMARY

Members of the Federal Retirement Thrift Investment Board
Washington, D.C.

Michael Auerbach
Acting Chief Accountant
U.S. Department of Labor, Employee Benefit Security Administration
Washington, D.C.

As part of the U.S. Department of Labor Employee Benefits Security Administration (EBSA) Fiduciary Oversight Program, we conducted a performance audit of the Thrift Savings Plan (TSP) Lifecycle Funds (L Funds) process. We performed our fieldwork from December 3, 2018 through April 5, 2019, primarily at the Federal Retirement Thrift Investment Board's Staff's (Agency) headquarters in Washington, D.C. Our scope period for testing was January 1, 2018 through December 31, 2018.

We conducted this performance audit in accordance with the performance audit standards contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and the American Institute of Certified Public Accountants *Standards for Consulting Services*. *Government Auditing Standards* require that we plan and perform the audit to obtain sufficient, appropriate audit 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 our findings and conclusions based on our objectives. Criteria used for this audit is defined in the EBSA's *Thrift Savings Plan Fiduciary Oversight Program*, which includes the Code of Federal Regulation (CFR) Title 5, Part 1601.40.

The objectives of our audit over the TSP L Funds process were to:

- Determine if the Agency implemented certain procedures to (1) rebalance the L Funds on a daily basis to reflect the fund’s target allocation for the current quarter; (2) adjust the asset allocations of the L Funds each quarter based on each fund’s prescribed time horizon; (3) review the assumptions of the L Funds at least annually to determine whether any changes to the allocations are warranted; (4) conduct the most current assumptions review in accordance with the terms of the contract between the Agency and the vendor; (5) accurately calculate the published ratio of administrative expenses per \$1,000 of account balance in the L Funds; and (6) verify that the published asset allocations for each L Fund agree to the actual asset allocation;
- Determine if the assumptions used to develop the L Funds’ allocations, as identified in the vendor’s annual review as of September 2018, were consistent with industry benchmarks¹;
- Test compliance of the TSP L Funds process with 5 CFR 1601.40; and
- Determine the status of the prior EBSA TSP open recommendation reported in *Performance Audit of the Thrift Savings Plan Lifecycle Funds Process*, dated April 14, 2017.

We present one recommendation related to the TSP L Funds process, which addresses other controls. Fundamental control recommendations address significant² procedures or processes that have been designed and operate to reduce the risk that material intentional or unintentional processing errors could occur without timely detection or that assets are inadequately safeguarded against loss. Other control recommendations address procedures or processes that are less significant than fundamental controls. All recommendations are intended to strengthen the TSP L Funds process. The Agency should review and consider this recommendation for timely implementation. Section III.C presents the details that support the current year finding and recommendation.

¹ Assumptions were compared to industrial standard sources such as [REDACTED]
[REDACTED]
[REDACTED] All sources are standard resources frequently used in business and asset valuation analysis.

² *Government Auditing Standards* section 6.04 defines significance in the context of a performance audit.

Based upon the performance audit procedures conducted and the results obtained, we have met our audit objectives. We conclude that for the period January 1, 2018 through December 31, 2018, the Agency implemented certain procedures to (1) rebalance the L Funds on a daily basis to reflect the fund's target allocation for the current quarter; (2) adjust the asset allocations of the L Funds each quarter based on each fund's prescribed time horizon; (3) review the assumptions of the L Funds at least annually to determine whether any changes to the allocations are warranted; (4) conduct the most current assumptions review in accordance with the terms of the contract between the Agency and the vendor; (5) accurately calculate the published ratio of administrative expenses per \$1,000 of account balance in the L Funds; and (6) verify that the published asset allocations for each L Fund agree to the actual asset allocation. In addition, as a result of our audit procedures, we determined that the current assumptions used to develop the L Funds' allocations, as identified in the vendor's annual review as of September 2018, were consistent with industry benchmarks¹. As a result of our compliance testing, we did not identify any instances of noncompliance with 5 CFR 1601.40. However, as indicated above, we noted an internal control weakness that could adversely affect the TSP L Funds process.

We also reviewed five prior EBSA recommendations related to the TSP L Funds process to determine their current status. Section III.B documents the status of these prior recommendations. In summary, two recommendations have been implemented and closed, and three recommendations have been partially implemented and closed.

The Agency's response to the recommendation, including the Executive Director's formal reply, is included as an appendix within the report (Appendix A). The Agency concurred with the recommendation.

This performance audit did not constitute an audit of the TSP's financial statements in accordance with *Government Auditing Standards*. KPMG was not engaged to, and did not render an opinion on the Agency's internal controls over financial reporting or over financial management systems. KPMG cautions that projecting the results of this audit to future periods is subject to the risks that controls may become inadequate because of changes in conditions or because compliance with controls may deteriorate.

While we understand that this report may be used to make the results of our performance audit available to the public in accordance with *Government Auditing Standards*, this report is intended for the information and use of the U.S. Department of Labor Employee Benefit Security Administration, Members of the Federal Retirement Thrift Investment Board, and Agency

management. The report is not intended to be, and should not be, used by anyone other than these specified parties.

KPMG LLP

June 14, 2019

I. BACKGROUND OF THE TSP AND LIFECYCLE FUNDS PROCESS

A. The Thrift Savings Plan

Public Law 99-335, the Federal Employees' Retirement System Act of 1986 (FERSA), as amended, established the Thrift Savings Plan (TSP). The TSP is the basic component of the Federal Employees' Retirement System (FERS) and provides a Federal (and, in certain cases, State) income tax deferral on employee contributions and related earnings. The TSP is available to Federal and Postal employees, members of the uniformed services, and members of Congress and certain Congressional employees. The TSP began accepting contributions on April 1, 1987, and as of December 31, 2018, had approximately \$536 billion in assets and approximately 5.5 million participants³.

The FERSA established the Federal Retirement Thrift Investment Board (the Board) and the position of Executive Director. The Executive Director manages the TSP for its participants and beneficiaries. The Board's Staff (Agency) is responsible for administering TSP operations.

For civilian participants enrolled in the TSP on or after September 5, 2015, all contributions received by the TSP are deposited into an age-appropriate Lifecycle Fund (L Fund), unless another investment option is selected.

B. Overview of the Lifecycle Funds⁴

Prior to 2005, participants could only elect to distribute their balances among the five primary TSP investment funds. These funds include the Government Securities Investment Fund (G Fund), Fixed Income Index Investment Fund (F Fund), Common Stock Index Investment Fund (C Fund), Small Capitalization Stock Index Fund (S Fund), and International Stock Index Investment Fund (I Fund). In August 2005, the Agency implemented the L Funds, which provided TSP participants an additional investment option. The five L Funds diversify participant accounts among the G, F, C, S, and I Funds, using professionally determined investment mixes (allocations) that are tailored to five different time horizons, as follows:

³ Source: Minutes of the January 28, 2019, Federal Retirement Thrift Investment Board meeting, posted on www.frtib.gov.

⁴ Sources: Summary of the Thrift Savings Plan, Investing in the TSP, dated March 2019, and [REDACTED]

- L 2050 – For participants who will begin to withdraw their money after 2044.
- L 2040 – For participants who will withdraw their money beginning in 2035 through 2044.
- L 2030 – For participants who will withdraw their money beginning in 2025 through 2034.
- L 2020 – For participants who will withdraw their money beginning in 2015 through 2024.
- L Income – For participants who are currently withdrawing their account in monthly payments.

The objective of the L Funds is to achieve the highest rate of return relative to the level of risk taken. No restrictions on investing in the L Funds are in place, as participants may invest any part of their TSP account in any L Fund, and even invest in more than one L Fund. Participants who select L Funds do not need to reallocate their account assets in order to maintain a target allocation that is designed to be consistent with an expected time horizon (retirement); the lifecycle investment model automatically rebalances and reallocates participants' exposure to the five underlying funds.

The asset allocations of these funds adjust quarterly, moving to a more conservative mix, gradually approaching those of the L Income Fund. These quarterly adjustments are pre-determined based on the fund design and are reviewed for reasonableness at least annually by both the Office of Investments and external consultants to determine if any changes are necessary. Between quarterly adjustments, the asset allocations of each fund are maintained through daily rebalancing to that fund's target allocation.

The L Income Fund's asset allocation represents the ending point for all of the other funds as they gradually move toward a less risky mix of investments. When an L Fund reaches its horizon, it will roll into the L Income Fund, and a new fund will be added with a more distant horizon. For example, the L 2010 Fund was rolled into the L Income Fund in December 2010, and the L 2050 Fund was created on January 31, 2011. The L Income Fund is designed to produce current income for participants who are already receiving money from their accounts through monthly payments or who will begin withdrawing money in the near-term. The asset allocation of the L Income Fund does not change over time; it is maintained through daily rebalancing.

The Agency initially contracted with [REDACTED] to design the original quarterly asset allocations for the L Funds based on assumptions regarding future investment returns, inflation, economic growth, and interest rates. [REDACTED] also performed annual reviews of the L Funds' assumptions to determine whether any changes to the asset allocations currently in place for the five L Funds were warranted. During the scope period, the Agency contracted with a new consultant, [REDACTED] to perform the annual review of the L Funds'

assumptions. To review the appropriateness of the current quarterly asset allocations, [REDACTED] performed two separate analyses: an efficient frontier analysis and a glide path⁵ analysis.

[REDACTED]

[REDACTED]

[REDACTED] recommended a set of quarterly asset allocations for the L Funds for the Agency's consideration.

As a result of the annual assumptions review of the L Funds conducted by [REDACTED] in September 2018, [REDACTED] recommended changes to the existing asset allocations. As a result, the Agency implemented a new set of asset allocations in January 2019.

The administrative expenses associated with the L Funds are those of the underlying G, F, C, S, and I Funds, calculated by the Office of the Chief Financial Officer in proportion to their allocations in each L Fund. The L Funds do not have any additional charges. While [REDACTED] charges a fee for its annual assumption review, the fees are not significantly relative to total administrative expenses and are shared proportionately among all of the TSP funds.

Exhibit I-1 presents a summary of the L Fund investments held in L Income, L 2020, L 2030, L 2040, and L 2050 Funds as of December 31, 2017.

⁵ [REDACTED]

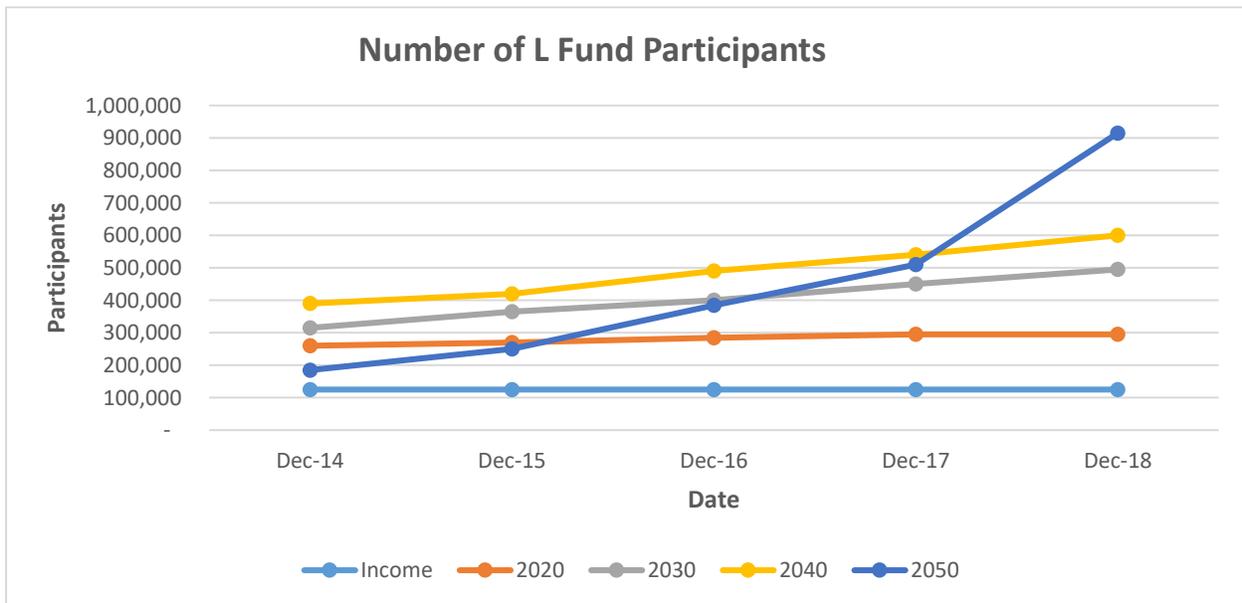
Exhibit I-1 (unaudited)

L Fund	L Fund Balances December 31, 2017	% of Total L Fund Balances	% of Total TSP Fund Balances
L Income	\$8.491 billion	8%	1%
L 2020	\$27.507 billion	25%	5%
L 2030	\$33.731 billion	31%	6%
L 2040	\$26.549 billion	25%	5%
L 2050	\$11.900 billion	11%	2%
Total	\$108.178 billion	100%	19%

Source: Thrift Savings Fund Financial Statements for the years ended December 31, 2017 and December 31, 2016.

Exhibit I-2 presents the number of L Fund participants from December 31, 2014 through December 31, 2018.

Exhibit I-2 (unaudited)



Source: Underlying data used from the minutes of the January 28, 2019 Federal Retirement Thrift Investment Board meeting, December 2018 Performance Review – G, F, C, S, I and L Funds, posted on www.frtib.gov.

II. OBJECTIVE, SCOPE AND METHODOLOGY

A. Objectives

The U.S. Department of Labor Employee Benefits Security Administration (EBSA) engaged KPMG LLP (KPMG) to conduct a performance audit of the Thrift Savings Plan (TSP) Lifecycle Funds (L Funds) process.

The objectives of this performance audit were to:

- Determine if the Federal Retirement Thrift Investment Board's Staff (Agency) implemented certain procedures to (1) rebalance the L Funds on a daily basis to reflect the fund's target allocation for the current quarter; (2) adjust the asset allocations of the L Funds each quarter based on each fund's prescribed time horizon; (3) review the assumptions of the L Funds at least annually to determine whether any changes to the allocations are warranted; (4) conduct the most current assumptions review in accordance with the terms of the contract between the Agency and the vendor; (5) accurately calculate the published ratio of administrative expenses per \$1,000 of account balance in the L Funds; and (6) verify that the published asset allocations for each L Fund agree to the actual asset allocation;
- Determine if the assumptions used to develop the L Funds' allocations, as identified in the vendor's annual review as of September 2018, were consistent with industry benchmarks¹;
- Test compliance of the TSP L Funds process with Code of Federal Regulations (CFR) Title 5, Part 1601.40; and
- Determine the status of the prior EBSA TSP open recommendation reported in *Performance Audit of the Thrift Savings Plan Lifecycle Funds Process*, dated April 14, 2017.

B. Scope and Methodology

We conducted this performance audit in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and the American Institute of Certified Public Accountants' *Standards for Consulting Services*, using EBSA's *Thrift Savings Plan Fiduciary Oversight Program*. Our scope period for testing was January 1, 2018 through December 31, 2018. We performed the audit in four phases: (1) planning, (2) arranging for the engagement with the Agency, (3) testing and interviewing, and (4) report writing.

During the planning phase, team members developed a collective understanding of the activities and controls associated with the applications, processes, and personnel involved with the TSP L Funds process. Arranging the engagement included contacting the Agency and agreeing on the timing of detailed testing procedures.

During the testing and interviewing phase, we performed the following procedures to achieve our audit objectives:

- Conducted interviews, collected and inspected auditee-provided documentation and evidence, and participated in process walk-throughs;
- [REDACTED]
- [REDACTED]
- [REDACTED]

- [REDACTED]
[REDACTED]
[REDACTED]
- [REDACTED]
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- [REDACTED]
[REDACTED] [REDACTED]
[REDACTED]
[REDACTED] data, were designed to achieve their intended control objectives and implemented.

We conducted these test procedures primarily at the Agency’s headquarters in Washington, DC. Appendix B lists the key Agency documentation and reports we reviewed during our performance audit. [REDACTED]
[REDACTED]

The report writing phase entailed drafting a preliminary report, conducting an exit conference, providing a formal draft report to the Agency for comment, and preparing and issuing the final report.

⁶ [REDACTED]

III. FINDINGS AND RECOMMENDATIONS

A. Introduction

We performed procedures related to the Thrift Savings Plan (TSP) Lifecycle Funds (L Funds) process while conducting a performance audit at the Federal Retirement Thrift Investment Board's Staff (Agency) headquarters. Our scope period for testing was January 1, 2018 through December 31, 2018. This performance audit consisted of reviewing applicable policies and procedures and testing manual and automated processes and controls, which included interviewing key personnel, reviewing key reports and documentation (Appendix B), and observing selected procedures.

Based upon the performance audit procedures conducted and the results obtained, we have met our audit objectives. We conclude that for the period January 1, 2018 through December 31, 2018, the Agency implemented certain procedures to (1) rebalance the L Funds on a daily basis to reflect the fund's target allocation for the current quarter; (2) adjust the asset allocations of the L Funds each quarter based on each fund's prescribed time horizon; (3) review the assumptions of the L Funds at least annually to determine whether any changes to the allocations are warranted; (4) conduct the most current assumptions review in accordance with the terms of the contract between the Agency and the vendor; (5) accurately calculate the published ratio of administrative expenses per \$1,000 of account balance in the L Funds; and (6) verify that the published asset allocations for each L Fund agree to the actual asset allocation. In addition, as a result of our audit procedures, we determined that the assumptions used to develop the L Funds' allocations, as identified in the vendor's annual review as of September 2018, were consistent with industry benchmarks¹. As a result of our compliance testing, we did not identify any instances of noncompliance with 5 Code of Federal Regulations Part 1601.40. However, we noted an internal control weakness that could adversely affect the TSP L Funds process.

We present one new recommendation, presented in Section III.C, related to the TSP L Funds process which addresses other controls. Fundamental control recommendations address significant procedures or processes that have been designed and operate to reduce the risk that material intentional or unintentional processing errors could occur without timely detection or that assets are inadequately safeguarded against loss. Other control recommendations address procedures or processes that are less significant than fundamental controls. This recommendation is intended to strengthen TSP L Funds operations. The Agency should review and consider this recommendation for timely implementation. The Agency's response to this recommendation is included as an appendix within this report (Appendix A).

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2016 Lifecycle Funds Recommendation No. 4:

Title: Contract Requirements Not Fully Satisfied

Original Recommendation: The Agency should enhance monitoring procedures for its L Funds vendor to ensure that all deliverables are received timely.

Reason for Recommendation: During our 2016 test procedures, we noted that the Agency contracted with [REDACTED] to review the assumptions of the L Funds, to determine whether any changes to asset allocations were warranted. Section C, part 2.0, item 5 of the contract between the Agency and [REDACTED] indicated that "...the contractor will also provide a peer comparison including asset allocations to international equity; asset allocations to mid/small stocks; expense ratios; and notes regarding asset classes commonly used by peers but not included in the TSP lifecycle funds." However, the information that would satisfy the requirement to provide the peer comparisons of asset allocations to mid/small stocks and expense ratios were not received during the applicable option period of March 8, 2015 through March 8, 2016. Therefore, this information was not reviewed by Agency management as part of their review of the conclusions in the September 2015 [REDACTED] report. Management indicated that this information, which was not deemed critical to management's review, was not obtained because of an oversight in assessing if the contract terms had been met.

[REDACTED]

[REDACTED]

[REDACTED]

Failure to follow standard naming conventions for service accounts prevents the Agency from distinguishing service accounts from group and shared accounts, which reduces the Agency's ability to enforce access requirements for such accounts.

D. Summary of Open Recommendations

2019 RECOMMENDATIONS

RECOMMENDATIONS TO ADDRESS OTHER CONTROLS

[REDACTED]

AGENCY'S RESPONSE



FEDERAL RETIREMENT THRIFT INVESTMENT BOARD
77K Street, NE Washington, DC 20002

June 14, 2019

Mr. Michael Auerbach
Chief Accountant
Employee Benefits Security Administration
United States Department of Labor
Suite 400
122 C Street, N.W.
Washington, D.C. 20001-2109

Dear Michael:

This is in response to KPMG's email dated May 24, 2019, transmitting the KPMG LLP report entitled Employee Benefits Security Administration Performance Audit of the Thrift Savings Plan Lifecycle Funds Process dated June 2019. My comments with respect to this report are enclosed.

Thank you once again for the constructive approach that the Department of Labor and its contractors are taking in conducting the various audits of the TSP. The information and recommendations that are developed as a result of your reviews are useful to the continued improvement of the Thrift Savings Plan.

Very truly yours,

A handwritten signature in blue ink that reads "Ravindra Deo".

Ravindra Deo

Enclosure

AGENCY'S RESPONSE

Executive Director's Staff Draft Comments on the
Employee Benefits Security Administration Performance Audit of the Thrift Savings Plan
Lifecycle Funds Process

FUNDAMENTAL CONTROL FINDINGS AND RECOMMENDATIONS

[REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]

[REDACTED]

[REDACTED] [REDACTED]
[REDACTED]

KEY DOCUMENTATION AND REPORTS REVIEWED

[REDACTED]

- [REDACTED]
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