



Federated City Employees' Retirement System

Police and Fire Department Retirement Plan

Investment Wires and Internal Transfers Audit

Table of Contents

Executive Summary	1
Background	3
Audit Objectives	4
Audit Scope.....	5
Audit Methodology	5
Audit Results.....	6
Appendix A	11

Executive Summary

As part of the FY 2018-2019 plan, we audited the investment wire and internal transfer process with the objective of assessing the controls over the investment cash outflow process and determine if transactions are authorized, approved, and documented properly. The overall process, if done poorly, can lead to significant operational and financial risk to ORS. Examples may include the following: late processing of wires and internal transfers which can lead to penalties imposed by investment managers, transmission errors, incorrect wired amounts, unauthorized and unsupported transactions, and cash overdrafts.

In performing the audit, we reviewed the processes on documentation and authorization, review and approval, and protection of assets (cash). 100% of the transactions within the covered period (May 20, 2019 to August 20, 2019) were tested.

Police and Fire Department Retirement Plan – 36 samples with \$362 million total value
Federated City Employees' Retirement System – 28 sample with \$243 million total value

Based on the audit procedures performed, internal controls over wire and internal transfer process were adequate. Control strengths were identified and are as follows:

- Only the staff in the authorization list can initiate and approve the processing of wires and transfers.
- There is a proper segregation of duties within the Investment Division in processing transactions.
- There is a thorough review in place. A minimum of two persons will review the initiated wire or internal transfer. An additional layer of review is required if amount is greater than \$10 million.
- No one can edit or change any information once approved. Only the final approver can stop or cancel the payment.
- Cash projection is being done daily to ensure there is enough cash to fund the investments and avoid overdrafts.
- There is a back-up process in place if in any way, eCFM, the cash management system, is not working. The secondary process is done through fax or secure email.

However, the following issues were identified that should be addressed to further strengthen internal controls over the investment cash outflow process.

- a. Investment Division owns the investment wires and internal transfers process from initiation, processing, review, and approval. Although it was noted that investment staff cannot process the wire or internal transfer request alone, it was determined that all the staff involved in process are all from Investment Division. Segregation of duties is only implemented on the functions (set-up, initiate, and review) within the process but not on the overall process itself. This can lead to an internal control failure due to possible staff collusion.
- b. There were two capital call wires that were processed late for the Police and Fire plan. The first wire was because of a missed email notification while the second one was due to an incorrect duplicate template used in eCFM with a “no custody movement” set-up.
- c. Documentation supporting the reason for funding request and calculation of the amount for trades instructed by Investment Officers are not included as an attachment in eCFM.

- d. There is no procedure in place in making sure investment managers receive the funds wired or transferred.
- e. Wire and Internal transfer directives are not stored and maintained separately from the eCFM system.

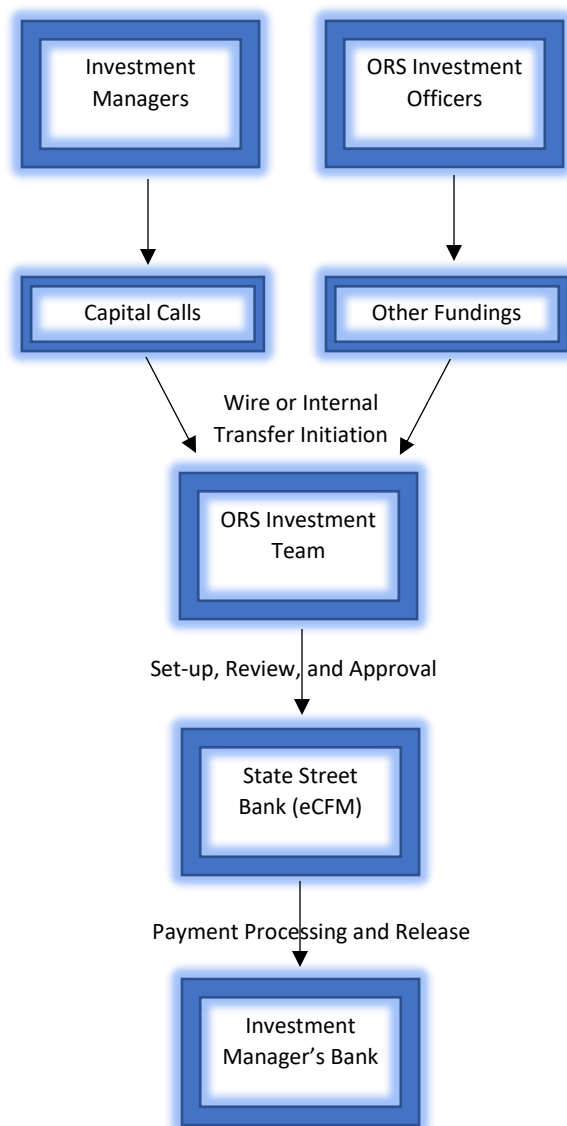
Audit recommendations based on the findings have been made in order to improve internal controls. Details of the recommendations are addressed in the Audit Results section of this report.

Background

The Investment Division of the Office of Retirement Services (ORS) is responsible for managing the plans' funds and invest them per the asset allocation stated in the Investment Policy. One of the functions of the Investment Team is to oversee the cash outflows and ensure all movements are authorized, processed, and supported with proper documentation.

To help fulfill this responsibility, the Plans maintain an external custodian (State Street Bank) to process and track investment activities. The Investment Group is responsible for initiating investment wires and transfers transactions to State Street for investment manager funding and capital calls. State Street does not have the authority to make investment decisions or initiate transactions.

The flowchart below illustrates the process flows and parties involved when administering electronic wires and internal transfers.



For the purpose of this audit, we differentiated a wire from internal transfer. A wire is a transaction to move funds to the external investment manager's bank or any financial institution. Internal transfer on the hand is to move funds between State Street accounts. This is applicable for separately managed investment accounts held by the Plans under State Street's custody. The overall process covers both wires and internal transfers.

Wires and internal transfers are usually initiated in two ways.

1. Capital calls – This request is usually from private investment managers with a draw down structure. When the plans invest into a private fund, they make an agreement to commit to a fixed amount of capital. The funds from the capital commitment should be available when the investment manager requests them. This process is done through a capital call notice. Capital calls are usually issued when an investment deal has been reached and is nearing close. The plans have a predetermined amount of time, usually ranges from five days to three weeks, to provide the funds.
2. ORS Investment Officer's instruction – In carrying out the responsibility of managing the Plan's assets per the investment strategy, the investment team will direct wires and internal transfers to fund certain investments periodically. The decision is based on the analysis of weekly exposures and periodic review of asset allocation. This is done in order to rebalance the funds according to policy.

Once a capital call or instruction from an investment officer is received, the Investment Operations team will review the documentation to make sure all the necessary information is accurate and substantiated. Payment will then be set-up in eCFM (electronic cash flow module) which is State Street's online portal for cash management. All necessary documents related to the wire or internal transfer will be included as an attachment in the system. Examples are capital call notice, subscription document and trade directives.

After submission of the payment, reviewers will then be notified that a wire or internal transfer has been initiated. The level of review depends on the amount of the payment. Reviewers can reject the payment request if any information is incorrect or missing. The system will send the request back to the initiator for amendments. Once change has been done, initiator is required to resend it to the approvers for review. Once all the necessary approvals are met, State Street will process and release the wire or internal transfer on the appropriate date.

Audit Objectives

The objectives were to assess controls over ORS's investment cash outflow process to determine whether outgoing wires and internal cash transfers are authorized, approved, documented, and processed properly. Specifically, we reviewed the following:

- a. Documentation and Authorization
- b. Review, Approval, and Processing
- c. Security of Assets

Audit Scope

The audit was performed for the period from May 20, 2019 to August 20, 2019. 100% of the transactions within the covered period were tested.

Audit Methodology

To perform the audit, the following procedures were performed:

General Procedures

1. Discussion with Investment Team about the processes for investment wires and internal transfers.
2. Reviewed policies and procedures utilized by staff to process wires and internal transfers.
3. Analysis of outgoing wires and transfers records.
4. Transactions testing to determine whether adequate controls are in place.
5. Reviewed controls and safeguards related to handling investment funding requests.

Specific Procedures

- A. Documentation and Authorization of Wires and Internal Transfers
 1. Sampled 100% of transactions within the covered period.
36 samples – Police and Fire Department Retirement Plan
28 samples – Federated City Employees' Retirement System
 2. Reviewed proper documentation for wires and internal transfers requests.
 3. Validated if the investment manager has an actual contract with the plans. This was done to ensure requests were coming from an authorized person or entity.
- B. Review, Approval and Processing of Wires and Internal Transfers
 1. Tested 100% of the transactions within the covered period.
\$362 million total for Police and Fire Department Retirement Plan
\$243 million total for Federated City Employees' Retirement System
 2. Observed proper controls regarding the processing, review, approval, and recording of investment cash outflows.
 3. Verified if all payments were processed timely.
 4. Traced the wire and internal transfer amounts to the documentation for accuracy.
 5. Confirmed receipt of cash from investment managers.
- C. Security of Assets
 1. Compared authorization list for eCFM with the current ORS staff. This control test was done to ensure that only authorized users can access the system.
 2. Observed proper segregation of duties between staff.
 3. Determined if there are procedures in place to ensure cash is sufficient to make the necessary payments and avoid overdrafts.
 4. Reviewed procedures in keeping wire information updated to ensure payments are going to the correct recipients.

Audit Results

Based on the audit procedures performed, control strengths were identified, as well issues that should be addressed in order to improve the current process. Overall, Internal Audit observed good practices with ORS's administration of wires and internal transfers requests for investment funding.

Control Strengths Identified

- a. **eCFM Authorization**
Only the staff in the authorization list can initiate and approve the processing of wires and transfers.
- b. **Segregation of Duties**
Each person on the list has limited access depending on the role. Staff cannot set-up and approve a wire or internal transfer request at the same time.

State Street Bank, the plans' custodian, maintains segregation of duties regarding cash transfer recording, cash processing and release, and wire request review.
- c. **Level of Review**
There is a thorough review process in place. Currently, two sets of approvers are needed if the amount is less than or equal to ten million. If greater than ten million, a third approver is required.

Investment Division also periodically review wire instruction details to ensure funds are going to the correct recipients.
- d. **Processing**
Any information on the request cannot be changed by any staff once approved. Only final approver has the ability to cancel or stop the payment if deemed necessary.
- e. **Cash Tracking**
Investment Division performs daily cash projection work to ensure there is enough cash to fund the investments and avoid overdrafts.
- f. **Back-up Process**
In any case eCFM is not working, a back-up process is in place. All other steps will still be the same but instead of entering the instruction in eCFM, it will be through paper and will be sent via fax or secure email.

Below are the issues identified that should be addressed to further strengthen internal controls over the investment cash outflow process. Management was already made aware and a summary of their response on findings and recommendations will be documented separately.

Priority Rating Process

To assist management in its evaluation, the findings have been assigned a qualitative assessment of the need for corrective action. Each item is assessed as high, moderate, or low as follows:

1. High – Finding that requires immediate action by management.
2. Moderate – Finding that requires timely action by management.
3. Low – Finding that requires action by management at the earliest convenience.

Finding #1: Investment Division owns the investment wires and internal transfers process from initiation, processing, review, and approval. Proper segregation of duties may be an issue.

Although it was noted that investment staff cannot process the wire or internal transfer request alone, it was determined that all the staff involved in process are all from Investment Division. Segregation of duties is only implemented on the functions (set-up, initiate, and review) within the process but not on the overall process itself. This can lead to an internal control failure due to possible staff collusion.

Furthermore, based on the perusal of the review process, it was determined that the Investment Officer preparing the funding request was also performing the 1st review/approval. There is a risk that an issue would not be identified if the preparer and reviewer is the same person.

Priority Rating: High

Recommendation #1.1: Internal Audit recommends sharing the investment wires and transfers process with Accounting Division.

The initiation and set-up process shall be maintained and administered by the Investment Division. The review and approval process can be divided between Investments and Accounting. The final approval will come from Accounting Division. See below comparison for current and proposed process.

<u>Current Process</u>		<u>Proposed Process</u>	
Initiate:	Investment Division	Initiate:	Investment Division
Set-up:	Investment Division	Set-up:	Investment Division
1st Review:	Investment Division	1st Review:	Investment Division
2nd Review/Approval:	Investment Division	2nd Review/Approval:	Accounting Division

Recommendation #1.2: To reduce the risk of not appropriately evaluating the work regarding wire and internal transfer request, it is recommended that another authorized staff, separate from the person who requested the funding, should perform the review step in the process.

Finding #2: There were two capital call wires that were processed late for the Police and Fire plan.

Investment Division gets capital call notifications through email. The email will either have the capital call document as an attachment or it will have the link to a secure website where investment staff can download the file.

The first wire that was processed late was due on Friday, June 7th but the email notification was missed. The wire was then immediately sent to the investment manager on the next business day which is June 10th.

The second wire which is an international wire (EUR) was supposed to go out on 6/6/2019. The payment set-up including the review and approval was completed before the due date. On 6/6/2019, as soon as staff found out about the wire issue, they communicated it immediately to both the custodian and investment manager. It was discovered that the cash flow template used in eCFM to wire the funds to the investment manager was an incorrect duplicate. The duplicate template has a “no custody movement” set-up which renders an invalid flow so cash didn’t go out.

After checking the issue, State Street initiated the wire for 6/13/2019 which is the soonest valid value date. State Street also deleted the duplicate template and confirmed there were no other payments set up with “No Custody Movement” in eCFM for all four entities.

Priority Rating: High

Recommendation #2.1: Capital calls are generally issued when an investment deal is about to close. In case investors default on the capital calls, investment managers may penalize the investors (the benefit plans in this case) due to liquidity and investment opportunity risks that they may face. Depending on the agreements, penalties may include interest charges, fund interest forfeiture, call of full capital commitment, cancellation of voting rights, sale of fund’s interest, withholding of future interest distributions, etc.

To prevent any penalties from occurring, it is crucial to always send the funds within the set deadline. Internal audit recommends to strengthen the process of monitoring capital calls. Since the communication channel is through email, it is not uncommon to miss a capital call notice. Therefore, there should always be more than one person checking emails daily to ensure nothing is being missed. Periodically, a designated staff should research the email inbox to see if there is any unseen capital call. Since notices are sent several days or weeks before the deadline, weekly research should be sufficient. The designated staff should also oversee and verify if all capital calls notices are processed in eCFM.

Recommendation #2.2: Investment Operations team, a sub group of the Investment Division, maintains a cash flow worksheet where a summary of the investment fundings, redemptions, capital calls and distributions is kept. Data includes fund name, fund code, amount, eCFM payment initiation date, trade date, settlement date, and cash transfer date. This worksheet can be utilized to follow up wires that are not processed timely.

As noted in the findings about the second wire that was processed late, investment team followed up timely with the custodian and communicated the issue to the investment manager. By continuing to check cash movements and update the information on the cash flow worksheet daily, a timelier inquiry and resolution can be made to address any issue with wires and internal transfers.

Recommendation #2.3: For international wires, it is recommended to send the funds at least a day before the due date. Unlike domestic wires that are processed through the Fedwire system, meaning funds are directly going to one domestic bank to another domestic bank, international wires are processed a little bit differently.

International wires are generally done on the SWIFT network. Transfer instructions get sent from the sender’s bank to the recipient’s bank but not always directly. Most of the time, it has to go through an intermediary bank first. The intermediary bank will have another set of review to make sure there are no issues (e.g., check if funds are going to the ultimate beneficiary). Thus, processing international wires takes

a little longer than domestic wires. By sending the funds at least a day before the deadline, ORS will have a buffer to resolve any issue that may come along the way and still be able to send the money on time.

Finding #3: Documentation supporting the reason for funding request and calculation of the amount for trades instructed by Investment Officers are not included as an attachment in eCFM.

Only trade tickets and trade directive forms are included in setting up the payment in eCFM. The trade ticket is a standard template created by the Investment Team for funding and redemption requests. The template includes fund code, fund name, trade date, settlement date, cash transfer date, and notes. Trade directive form varies per investment manager but its purpose is to summarize the details for trade execution.

Priority Rating: Moderate

Recommendation #3: Include all supporting files and back-up calculation in setting up funding requests in eCFM.

Knowing the rationale behind a wire or internal transfer request will assist the reviewers not only in checking the accuracy of amounts but it will also help them in ensuring funding requests are substantiated. It is always a good business practice to include proper and complete documentation.

Finding #4: There is no procedure in place in making sure investment managers receive the funds wired or transferred.

Currently, the only way to confirm receipt of funds is by relying on the capital statements provided by investment managers monthly or quarterly. Time is of the essence when executing trades but producing these reports takes a considerable amount of time. Some investment managers provide transaction confirmation but only a few delivers this type of report and this isn't a real time affirmation as well. For capital calls, investment managers usually do follow up actions to remind that a payment is due but this is not always the case.

Priority Rating: Moderate

Recommendation #4: Develop a uniform process that will enable the Investment Team to confirm if the investment managers receive payments timely. Document the process in the written policies and procedures.

A simple procedure requiring each investment manager to confirm receipt of cash through email as soon as they get it will be sufficient. Being proactive will help staff be aware of possible issues and resolve them in a timely manner.

Finding #5: Wire and Internal transfer directives are not stored and maintained separately from the eCFM system.

Priority Rating: Low

Recommendation #5: Update the current procedure in place to include a step to store and maintain the completed eCFM wire directive separately from the custodian's system.

Once a funding request is reviewed and approved, an electronic copy of the directive should be extracted from eCFM and maintained separately in a designated folder in the department's database.

External auditors usually request for these wire and internal transfer directives as part of their audit procedures to corroborate evidence based on management's assertions regarding the financial statements. Following the procedure will make the year-end financial audit more efficient for all parties since documents are already readily available.

Appendix A - Control Risk Reassessment

Control Risk Scoring Scale

1 Strong	2 Reasonably Strong	3 Adequate	4 Marginally Adequate	5 Weak or Nonexistent
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Initial Assessment – Control risk for investment cash outflow process was rated 3 in the planning phase of the audit based on the assumption that internal control design is present but there's not enough evidence to conclude its effectiveness and proper implementation.

Reassessment – After performing test of controls in the audit execution, it was determined that controls are adequate. If recommendations will be implemented, internal controls will be categorized under strong (1) or reasonably strong (2) classification.

Division	Audit Activity	Control Risk Score (Initial Assessment)	Control Risk Score (Reassessment after Audit Testing)	Control Risk Score (If recommendations will be implemented)
Investments	Investment Cash Outflows (Wires and Internal Transfers)	3	3	1