



Memorandum

TO: Federated City Employees' Retirement System and
Police and Fire Department Retirement Plan
Audit Committee

FROM: Ron Kumar

SUBJECT: Response to Internal Audit

DATE: October 8, 2019

Approved

Date

10/10/19

Background

As part of the fiscal year 2019-20, an internal audit was performed on the investment wire and internal cash transfer process. Following are the responses to the findings and recommendations by the Internal Auditor.

Analysis

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.

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

Response: The current process for wire and internal transfers involve at least three members of staff. Transfers of over \$10mm require approval by either the CEO, CIO, or the Deputy Director. It should also be noted that investment staff cannot make changes to the wire instructions which is hardcoded in the eCFM system by State Street, the plans'

custodian. The approvers review the wire instruction details at all levels prior to approving a transaction to ensure funds are sent to the correct recipients.

Investment staff evaluate market conditions daily and react when necessary. There may be a need to transfer funds the next day and decision to do so may occur late in the day. Investment staff make themselves available afterhours when there is a need to approve transactions. Including a separate division may hinder in timely transaction approvals. Failure to transfer funds in a timely manner could result in millions of dollars in loss to the retirement funds.

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.

Response: Will evaluate the process.

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

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.

Response: This process has always been in place. Due to staff turnover in investment operations group, this wire was missed. The process was reviewed following the incident and now requires an investment officer to also notify the Investment Operations Supervisor of the capital call request.

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.

Response: Will evaluate the process.

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.

Response: State Street's deadline to send international wires is 10:00 am Eastern Time on the day it is due which has been confirmed with State Street. Wire instructions are provided to State Street (either via eCFM or fax) at least a day prior to the deadline. Releasing international wires a day early, which could be in the millions of dollars, would lead to the plans' loss of interest and as a fiduciary it would be imprudent. Staff is not aware of any manager requests to send the funds prior to the due date. Managers generally plan for situations where fund transfers could be delayed due to SWIFT process.

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.

Response: Data for transfers are stored in the department's server and available to the approver for review. eCFM is State Street's web portal for fund transfers. Including data related to investments, especially alternative investments, could lead to inadvertent release of undisclosed information.

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.

Response: Will evaluate the process.

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.

Response: Will evaluate the process.

Conclusion

Investment staff will evaluate the recommendations above and implements procedures as practical.


 Ron Kumar
 Investment Operations Supervisor