

Final Audit Follow-Up

As of December 31, 2013



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City Auditor

Non-Pension Investments (Report #1020 issued June 21, 2010)

Report #1412

February 11, 2014

Summary

Twenty-nine of the 30 action plan steps established to address the issues identified in our audit of the City's non-pension investments (report #1020) have been completed or otherwise resolved. Actions are underway to complete the one remaining step. Three of those 30 action plan steps were covered by this follow-up review.

In audit report #1020, we noted that as of June 30, 2009, the market value of all non-pension investments was approximately \$679 million. In that report we concluded that, overall, the Treasurer-Clerk's Office properly and adequately managed and invested available non-pension funds. As reported, no one sector/category lost capital and each sector/category performed reasonably well in relation to existing market conditions and policy benchmarks. The Treasurer-Clerk's Office took timely and appropriate actions to replace two external managers that were not performing well. We also found the Treasurer-Clerk's Office (1) established and implemented a sound and appropriate investment policy; (2) complied with that policy, as well as other legal requirements and industry practices; (3) established proper and adequate controls; (4) monitored activity and performance; and (5) prepared periodic reports showing performance and status of non-pension investments.

We identified several areas where we recommended enhancements and improvements to the non-pension investment processes and/or records. The most significant issue showed a need for the Treasurer-Clerk's Office to revise processes and controls pertaining to the allocation of investment earnings.

Thirty action plan steps were developed to address the identified issues and areas. Our three follow-up reviews showed the Treasurer-Clerk's Office has completed or resolved 29 of those 30 steps and has

initiated actions to complete the remaining step.

Issues addressed and/or resolved during this final follow-up reporting period included:

- Determining that retroactive calculations and adjustments were not appropriate or justified for investment earnings, relating to City funds that were invested through certain external entities (Galliard and Florida League of Cities) and internally by Treasurer-Clerk investment staff, which had previously been incorrectly allocated due to use of outdated (static) account balances. *(Note: As reported in our initial follow-up report [#1108], significant retroactive calculations and adjustments were, however, made for other investment earnings relating to City and BluePrint 2000 funds invested through a different external entity.) (step completed/resolved)*
- Obtaining updated arbitrage determinations for applicable bond proceeds. *(step initiated and turned over to management to ensure completion)*
- Updating the "Investment Internal Control Procedures" to reflect the current circumstances and processes. *(step completed)*

We appreciate the cooperation and assistance provided by Treasurer-Clerk staff during this audit follow-up.

Scope, Objectives, and Methodology

We conducted the original audit and this follow-up in accordance with the International Standards for the Professional Practice of Internal Auditing and Generally Accepted Government Auditing Standards. Those standards require we plan and perform the audit follow-up to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for

our findings and conclusions based on our audit objectives.

Report #1020

The scope of report #1020 included a review of activity and performance of the City's non-pension investments. The objectives were to determine whether:

- The City has a sound and proper non-pension investment policy;
- The City complied with its non-pension investment policy, legal requirements, and sound business practices;
- Contracts and agreements with third parties contain appropriate language and terms to protect the City's interest;
- Investment transactions are properly authorized, executed, documented, and otherwise in the best interest of the City;
- Monitoring and oversight of the non-pension investment function is appropriate;
- Adequate internal controls have been established in regard to the non-pension investment function; and
- Earnings performance has been successful in relation to established benchmarks.

Activity and performance over the three-year period ending June 30, 2009, was reviewed and analyzed, with an emphasis on activity during the one-year period ending June 30, 2009.

Report #1412

This is our third and final follow-up on action plan steps identified in audit report #1020. The purpose of this follow-up is to report on the progress and status of efforts to complete the three remaining action plan steps. Completion of those three steps was deferred until the transition of key staff within the Office of the Treasurer-Clerk was finalized. To determine the status of the action plan steps, we interviewed staff, made observations, and reviewed relevant documentation.

Background

The City's invested non-pension funds are primarily comprised of (1) operating cash that temporarily is not needed for disbursement, (2) bond proceeds not immediately disbursed for the projects or purposes for which the related bonds were issued, and (3) bond

reserves which must be held and invested pursuant to bond covenants. The Office of the Treasurer-Clerk is responsible for investing and managing the City's non-pension assets. City Commission Policy #234 governs investment of non-pension funds. That policy provides for non-pension assets to be invested prudently and in a manner that (1) preserves capital, (2) ensures liquidity to meet operating and capital needs, and (3) maximizes earnings within established risk levels.

At the time of our initial audit, City non-pension investments were categorized into two basic groups: (1) Core Portfolio and (2) Specialized Portfolios. As of June 30, 2009, the Office of the Treasurer-Clerk reported the market value of all non-pension investments was approximately \$679 million. Those funds were invested and managed internally by Treasurer-Clerk staff and through contracted external managers and available government investment pools.

The last half of the period included in the scope of our audit was during times of major financial market instability and upheaval. During those times we noted the Treasurer-Clerk's Office maintained a close vigil on the City's non-pension investments and acted prudently during that period to protect the City's invested assets.

Previous Conditions and Current Status

In report #1020, we noted that, overall, based on performance adjusted for several audit issues presented in the report, the Treasurer-Clerk's Office properly and adequately managed and invested available non-pension funds. Our review showed no one sector/category lost capital and each sector/category performed reasonably well in relation to existing market conditions and policy benchmarks. For two instances where external managers were not performing well, the Treasurer-Clerk's Office took timely and appropriate action to replace the managers and reinvest the applicable funds. We also found that, for the most part, the Treasurer-Clerk's Office:

- Established and implemented a sound and appropriate investment policy.
- Complied with the non-pension investment policy, other applicable legal requirements, and industry practices.
- Established proper and adequate controls and processes, consistent with industry standards.

- Monitored activity, including that of applicable third parties.
- Prepared periodic reports showing performance and status of non-pension investments.

However, one issue was identified that showed a need for the Treasurer-Clerk’s Office to revise processes and controls pertaining to the allocation of non-pension investment earnings. As noted in our initial follow-up report (#1108) for this audit, corrective actions because of this issue included the City’s recovery of \$2 million of investment earnings that had been incorrectly allocated to BluePrint 2000, an entity related to but separate from the City.

In addition to the issue relating to incorrect allocations of investment earnings, we identified several areas

where we recommended enhancements and improvements to the non-pension investment processes and/or records.

Thirty action plan steps were developed to address the identified issues. Twenty seven of those 30 steps were completed as of March 31, 2011, as reported in our previous follow-up report (report #1112, issued June 16, 2011). Because of significant staffing changes within the Office of the Treasurer-Clerk, completion of the three remaining steps was deferred by the City Treasurer-Clerk until staffing transitions were completed. As those staffing transitions have now been finalized and actions taken, we have determined and reported on the status of those three remaining steps, as shown below in Table 1.

Table 1
Action Plan Steps from Audit Report #1020
Due as of December 31, 2013, and Current Status

Action Plan Steps Due as of December 31, 2013	Current Status
Ensure equitable allocations of investment earnings	
<ul style="list-style-type: none"> • Updated (dynamic) account balances will be used to determine allocation percentages for each month’s allocation of non-pension investment earnings for the Core Portfolio. 	<ul style="list-style-type: none"> ✓ Completed in a prior period.
<ul style="list-style-type: none"> • The portion of the earnings allocation process performed manually will be automated. 	<ul style="list-style-type: none"> ✓ Completed in a prior period.
<ul style="list-style-type: none"> • Earning allocations for the Core Portfolio since the summer 2008 will be recalculated retroactively (i.e., through 2010) using appropriate proportions (i.e., monthly earnings will be allocated based on proportional balances determined for each month). Adjustments will be made to affected funds. 	<ul style="list-style-type: none"> ✓ In our report (#1108) for the initial follow up on Audit of Non-Pension Investments (#1020), we reported the Treasurer-Clerk’s Office retroactively recalculated investment earning allocations using updated and appropriate (dynamic) investment balances for the investment category involving both City and BluePrint 2000 funds. Those recalculations were for fiscal years 2008, 2009, and 2010. Appropriate adjustments were made based on those retroactive calculations. As reported, those adjustments resulted in a transfer of \$2 million from BluePrint 2000 to the City, as earnings had been incorrectly allocated to BluePrint 2000 when outdated (static) account balances were used as described in the initial audit report. <p>Furthermore, in our initial follow-up report, we reported no retroactive calculations or adjustments were made for other investment categories (i.e., categories not involving both the City and BluePrint 2000 funds) for which earnings had been allocated using outdated (static) account balances.</p>

Those categories included (1) internally managed investments, (2) investments through an external manager (Galliard), and (3) investments through the Florida League of Cities.

In our second follow-up review (report #1112), we found and reported the Treasurer-Clerk's Office was in the process of calculating and determining appropriate adjustments to make for those other investment categories. Those adjustments were being calculated and determined using updated (dynamic) account balances. However, subsequent to that second follow-up review, a key staff involved in that process resigned before the analysis was completed. Subsequent to the hiring of a new Treasury Analyst and new Deputy Treasurer-Clerk, the process was restarted and completed in spring and summer 2013.

For two of the three investment categories (Galliard and the Florida League of Cities), the results of that completed analysis showed further adjustments are not justified, as differences were such that there were no identified material under or over allocations within each major fund category (e.g., electric, gas, water, sewer, and General Fund). Accordingly, no adjustments were made for those two categories.

In regard to the third investment category (internally managed investments), current Treasurer-Clerk staff determined insufficient information was available to retroactively determine how various investment transactions (interest, gains, maturities, principal additions and withdrawals) occurring in fiscal years 2008, 2009, and 2010 should have been recorded and allocated among the different funds. Given the lack of data to indicate the prior allocations were not proper and equitable, the Treasurer-Clerk's Office concluded no adjustments were necessary. Therefore, no adjustments were proposed or made.

As stated in our previous follow-up reports (reports #1108 and #1112), corrective action was taken to ensure subsequent allocations are appropriately and equitably made based on updated balances determined on an ongoing basis (dynamic balances). That corrective action was accomplished through automation of the entire allocation process. Based on those actions and the efforts described above, this step is considered completed and resolved.

<ul style="list-style-type: none"> Adjustments will be made to correct the over and under-allocations of bond reserve earnings as identified in the initial audit report (page 23 of that report). 	<ul style="list-style-type: none"> ✓ Completed in a prior period.
<ul style="list-style-type: none"> Future allocations of earnings on bond reserves will be corrected for the worksheet error explained in the initial audit report (pages 22 and 23 of report #1020). 	<ul style="list-style-type: none"> ✓ Completed in a prior period.
<p>Ensure an adequate and proper policy</p>	
<ul style="list-style-type: none"> City Commission Policy #234 will be updated to make the corrections, clarifications, and enhancements as described on pages 23 through 26, 40, and 49 of the audit report. 	<ul style="list-style-type: none"> ✓ Completed in a prior period.
<p>Ensure compliance with policy requirements</p>	
<ul style="list-style-type: none"> Criteria will be developed for classification and reporting of bond proceeds investments as to portfolio type. 	<ul style="list-style-type: none"> ✓ Completed in a prior period.
<ul style="list-style-type: none"> The reporting and oversight process will be enhanced to identify all (even minor) violations of policy maturity duration requirements. 	<ul style="list-style-type: none"> ✓ Completed in a prior period.
<ul style="list-style-type: none"> Written approval will be sought from Ambac Assurance for investment of the Airport System Revenue Refunding Bonds (2004 series) in the State of Florida SPIA. 	<ul style="list-style-type: none"> ✓ Completed in a prior period.
<p>Comply with federal arbitrage requirements</p>	
<ul style="list-style-type: none"> Updated arbitrage determinations will be made. 	<ul style="list-style-type: none"> ❖ The City is required by the Internal Revenue Service (IRS) to determine if earnings on invested bond proceeds exceed the maximum allowed earnings rate pursuant to federal “arbitrage” regulations. If those earnings are found to exceed the maximum earnings rate, the City will be required to pay a “rebate” to the IRS on the excess earnings. In the initial audit we reported that timely arbitrage determinations had not been completed for all applicable bond issuances and recommended consideration be given to obtaining such updated determinations. <p>As reported in our second follow-up review (report #1112), the Treasurer-Clerk’s Office indicated the retroactive interest earning reallocations described above (see the third action plan step in this table) may impact the arbitrage determinations, as those reallocations likely would change the amount of recorded earnings on applicable invested bond proceeds. Accordingly, the Treasurer-Clerk’s Office made the prudent decision to wait until the interest reallocations for prior periods are calculated and finalized and correcting entries made before resuming the</p>

	<p>process of obtaining updated arbitrage determinations. As noted above (for the third action plan step in this table), the Treasurer-Clerk’s Office has subsequently determined no correcting entries will be made.</p> <p>Now that a determination has been made that no additional adjustments to previous interest allocations will be made, the Treasurer-Clerk’s Office has initiated actions to obtain current arbitrage determinations for applicable City bond issuances. Specifically, an arbitrage determination was completed in September 2013 for one of the City’s outstanding bonds. That determination showed no rebate was due as the investment earnings on that bond’s proceeds did not exceed amounts allowed by federal regulations. Additionally, the Treasurer-Clerk’s office entered into an agreement with an arbitrage company (Arbitrage Compliance Specialist) in September 2013 to complete required arbitrage determinations for the remaining City bonds.</p> <p>Because of those efforts, responsibility for ensuring the required arbitrage determinations are finalized and obtained for the remaining City bonds is turned over to management. (NOTE: Treasurer-Clerk management indicated because of past and current market conditions, they are confident the City did not earn any arbitrage [excess earnings] and will not be subject to any rebates or fines and penalties on the remaining bonds.)</p>
<p>Ensure accurate, informative, and complete performance and status reports</p>	
<ul style="list-style-type: none"> • Reports prepared by the Treasury Analyst will be reviewed by the Deputy Treasurer-Clerk for accuracy and completeness prior to distribution of those reports to management and the IAC. 	<p>✓ Completed in a prior period.</p>
<ul style="list-style-type: none"> • All non-pension investments will be addressed in the periodic reports, including GICs and the Securities Lending Portfolio. 	<p>✓ Completed in a prior period.</p>
<ul style="list-style-type: none"> • Investments will be classified on periodic reports in a manner that is consistent with classifications in an updated City Commission Policy #234. 	<p>✓ Completed in a prior period.</p>
<ul style="list-style-type: none"> • The periodic reports will be enhanced to report on additional policy requirements (e.g., duration) as addressed on pages 29 through 31 of the audit report. 	<p>✓ Completed in a prior period.</p>
<ul style="list-style-type: none"> • Graphical representations of non-pension investments will be prepared on the same basis or the bases will be disclosed in a legend to the graphs. 	<p>✓ Completed in a prior period.</p>

<ul style="list-style-type: none"> Weighted averages will be properly applied when disaggregating and reporting performance and maturity durations for applicable investment categories. 	✓ Completed in a prior period.
<ul style="list-style-type: none"> Policy benchmarks will be accurately and correctly determined. 	✓ Completed in a prior period.
Provide for adequate controls and processes	
<ul style="list-style-type: none"> Efforts will be made to recover the net overcharge of \$13,445 from the custodian. 	✓ Completed in a prior period.
<ul style="list-style-type: none"> The Deputy Treasurer-Clerk will ensure that fees billed by the custodian are accurate and reasonable. 	✓ Completed in a prior period.
<ul style="list-style-type: none"> Adequate documentation will be retained for future transactions to clearly demonstrate the evaluation of and justification for securities selected through competitive solicitation. 	✓ Completed in a prior period.
<ul style="list-style-type: none"> Adequate documentation will be retained for future transactions to clearly demonstrate that fair and reasonable prices (i.e., comparable to current market values) were received in connection with unsolicited sales of individual securities. 	✓ Completed in a prior period.
<ul style="list-style-type: none"> Requests for essential/critical background information on brokers/dealers will be enhanced to request disclosures/assertions as to recent or current litigation or regulatory violations. 	✓ Completed/resolved in a prior period.
<ul style="list-style-type: none"> Annual disclosures and assertions as to conflicts of interest will be required from key Treasurer-Clerk staff and IAC members. The investment policy will be revised to provide for those annual disclosures/assertions. 	✓ Completed in a prior period.
<ul style="list-style-type: none"> Efforts will be enhanced to ensure IAC meeting minutes are reviewed and approved by Treasurer-Clerk management and the IAC. 	✓ Completed in a prior period.
<ul style="list-style-type: none"> Treasurer-Clerk staff will work with Accounting Services staff to arrange for periodic account statements to be provided directly to, or accessed directly by, Accounting Services. 	✓ Completed in a prior period.
<ul style="list-style-type: none"> Treasurer-Clerk staff will reconcile the temporary clearing account, established for investment receipts, on a monthly basis. 	✓ Completed in a prior period.
<ul style="list-style-type: none"> Treasurer-Clerk staff will have applicable external managers certify they reconcile their activity to that reported by the custodian and will report any unresolved issues to the Treasurer-Clerk's Office. 	✓ Completed in a prior period.
<ul style="list-style-type: none"> The two system administrator permissions addressed in the audit report will be deleted. 	✓ Completed in a prior period.

<ul style="list-style-type: none"> • Treasurer-Clerk staff will ensure future agreements executed for non-negotiable CDs restrict the transfer of matured/redeemed funds to the City’s bank account. 	<ul style="list-style-type: none"> ✓ Completed/resolved in a prior period.
<ul style="list-style-type: none"> • The “Investment Internal Control Procedures” will be updated to reflect current circumstances and processes. 	<ul style="list-style-type: none"> ✓ Subsequent to the hiring of a new Deputy Treasurer-Clerk and Treasury Analyst, the Treasurer-Clerk’s Office updated the internal operating procedures to accurately reflect the current operating environment and conditions. Accordingly, this step is completed.

Table Legend:

- Issue to be addressed from the original audit.
- ✓ Issue addressed and resolved.
- ❖ Responsibility for ensuring completion of initiated action step turned over to management.

Conclusion

Table 1 above shows completion of 29 of the 30 action plan steps established to address the issues identified in our initial audit. Actions are underway to complete the one remaining step. Completion of the last few steps was delayed due to the turnover and transition of key Treasurer-Clerk staff.

Issues addressed and/or resolved during this final follow-up reporting period included:

- Determining that retroactive calculations and adjustments were not appropriate or justified for investment earnings, relating to City funds that were invested through certain external entities (Galliard and Florida League of Cities) and internally by Treasurer-Clerk investment staff, which were previously incorrectly allocated due to use of outdated (static) account balances (*step completed/resolved*).

- Obtaining updated arbitrage determinations for applicable bond proceeds (*step initiated and turned over to management to ensure completion*).
- Updating the “Investment Internal Control Procedures” to reflect the current circumstances and processes (*step completed*).

We appreciate the cooperation and assistance provided by Treasurer-Clerk staff during this audit follow-up.

Appointed Official’s Response

City Treasurer-Clerk:

I am pleased that 29 of the 30 action plan steps have been satisfactorily completed and that work is underway on the remaining step. I would like to thank the City Auditor for the professionalism exhibited throughout the audit process and for the contribution that his recommendations have made to the investment management process.

Copies of this audit final follow-up #1412 or audit report #1020 may be obtained from the City Auditor’s website (<http://talgov.com/auditing>) or via request by telephone (850 / 891-8397), by FAX (850 / 891-0912), by mail or in person (Office of the City Auditor, 300 S. Adams Street, Mail Box A-22, Tallahassee, FL 32301-1731), or by e-mail (auditors@talgov.com).

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