



“Investment Reconciliations”

Report #0211

January 24, 2002

Introduction

This Assistance and Guidance Report was completed in response to a request from the Department of Management and Administration for assistance in performing successful reconciliations of the City’s investment accounts.

Background

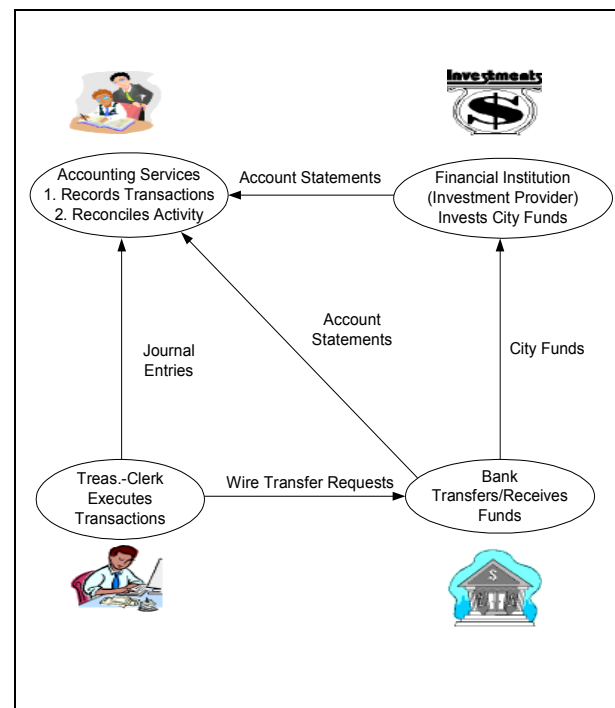
As of September 30, 2001, the value of City investments exceeded \$1.3 billion. Those investments include both pension and non-pension funds and are managed primarily through five external parties (providers). Investment transactions (purchases, sales, etc.) are executed by the Treasurer-Clerk’s (TC) office. Those transactions are based on determinations of available funds by TC staff and notifications from the payroll office of amounts that should be invested with the providers managing the City’s pension funds. Periodically (e.g., monthly or quarterly) the providers send statements to the City reflecting activity (e.g., purchases, sales, maturities, interest, and dividends) in and values of the City’s accounts.

Because of the amount and volume of City investments, it is essential that activity per the providers’ periodic account statements be reconciled to investment activity recorded in the City’s general ledger and/or applicable source records (e.g., wire transfer requests executed by the TC office and authorizations for pension transactions from the retirement office). Furthermore, staff other than the TC office that

executes the transactions should perform such reconciliations. If done properly, the independent reconciliations will detect (1) errors by TC or Accounting Services (AS) staff in recording transactions, (2) errors by the investment providers in recording transactions and activity in the City’s account or otherwise safeguarding City funds, and (3) fraudulent activity by either City staff or investment providers.

The AS office is assigned responsibility for conducting independent reconciliations of the City’s investment accounts maintained with the five providers. The following figure shows what the TC and AS functions should include.

CITY INVESTMENTS



Identified Issues

In conjunction with TC and AS staff and the City's external auditors, we identified several issues that have limited the effectiveness of the reconciliation activity conducted by AS staff. These issues include the following:

- In regard to City's defined contribution and deferred compensation (pension) plans, there have not been independent verifications by AS staff that funds wire transferred for deposit into employee pension accounts were actually transferred to and received by the provider.
- Either of two individuals within the TC office have the capability to independently change the bank or account to which defined contribution and deferred compensation funds are wire transferred.
- The City maintains an account (DEFRA account) at Prudential (a provider) for purposes of funding additional pension benefits payable to eligible retiring employees. Independent reconciliations of the account by AS had not been done prior to August 2001. At that time AS staff started reconciling Prudential's quarterly statements to activity based on City records, including wire transfers executed by the TC office and authorizations from the retirement office for the DEFRA payments to eligible retiring employees.
- Adequate detailed activity relative to the defined contribution plan has not been recorded into the general ledger. That information is needed to properly record plan activity on the City's financial statements. In order to record the appropriate activity into the general ledger, AS staff must obtain an understanding of the activity currently presented on the provider's statements.
- Some investment accounts were not being reconciled prior to April 2001 because AS staff was not aware that some new investment accounts had been established by

the TC office. Because these accounts had not been reconciled for an extended period of time, there were numerous reconciling differences that had to be researched and resolved/explained during the initial reconciliations.

- Contrary to recommended internal control practices, provider statements were sent directly to the TC office and not directly to AS. Good internal controls provide that the statements be delivered unopened directly to the reconciler in order to avoid tampering by parties executing transactions. As a result of our preliminary meeting with AS and TC staff, several of the providers were notified by the TC to send their statements directly to AS.
- There are no written procedures providing AS staff instruction and guidance in performing the reconciliations. This may have contributed to errors in recent reconciliations as identified by the City's external auditors. For example, it was noted in one reconciliation where AS staff incorrectly included interest receivable amounts from the provider statement as part of the investment balance to be reconciled to the general ledger.
- Information on some provider statements was not sufficient and/or explained in a manner to allow for a complete and adequate reconciliation. One provider only provided market values in the periodic statements. For another provider, the activity statements did not contain sufficient detail or explanations to allow AS staff to reconcile contributions recorded in the general ledger to contributions shown on the statements.

The above issues limit the effectiveness of reconciliations completed by AS staff. Also, and as a result, the external auditors have indicated the need to conduct additional audit work in order to obtain sufficient evidence as to the fair presentation of investments on the City's financial statements. That additional work increases the City's audit fees.

Recommendations

Actions that should be taken to address the noted issues include the following:

- AS staff should reconcile contributions shown on the Prudential statements for the defined contribution and deferred compensation plans to the contributions wire transferred as recorded in the general ledger based on transactions initiated by the payroll office and executed by the TC office.
- The TC office should revise current procedures to require documented approval of two TC staff in order to establish or change the bank or account to which repetitive wire transfers are sent.
- AS should continue their recently initiated reconciliations of activity for the City's DEFRA account. Any unexplained reconciling items should be timely pursued and resolved.
- AS staff should record complete and current activity of the defined contribution plan in the general ledger. That information should then be used to report pension fund activities on the financial statements and in related disclosures. To do this, AS staff needs to obtain a sufficient understanding of the activity recorded on the periodic Prudential statements and, if needed, request Prudential to submit additional information with the periodic statements.
- The TC office should request the remaining two providers to send their periodic statements directly to AS. For those providers that have already been requested

by the TC office to submit their statements directly to AS, TC and AS staff should follow up to ensure that those providers comply with that request.

- The AS office should establish and distribute to staff written procedures for completing independent reconciliations of the City's investment accounts. Those procedures should be established to ensure proper, accurate, and consistent reconciliations.
- Applicable providers should be requested to submit sufficient information and explanations to enable useful and meaningful reconciliations.

In addition to strengthening existing controls, implementation of the above recommendations should address the need for external auditors to perform similar additional work in subsequent years.

Conclusion

City investments represent a material amount of the City's assets. Independent reconciliations of investment activity serve to ensure the proper accountability and safeguarding of those assets.

We would like to acknowledge that Accounting Services and Treasurer-Clerk staffs recognize the need to have proper segregation of duties and adequate internal controls. Consistent with this objective, both offices have assisted in identifying weaknesses that exist and in proposing solutions that will result in timely, accurate, and complete reconciliations and full reporting of investment activity.

Copies of this Assistance and Guidance Report #0211 (project #0207) may be obtained from the City Auditor's web site (<http://talgov.com/citytlh/auditing/index.html>), or via request by telephone (850 / 891-8397), by FAX (850 / 891-0912), by mail or in person (City Auditor, 300 S. Adams Street, Mail Box A-22, Tallahassee, FL 32301-1731), or by e-mail (dooleym@talgov.com).

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