

General Government Non-Pension Investments Review

November 16, 2020

Report No. 2020-08



GAINESVILLE CITY COMMISSION

Lauren Poe, Mayor *
David Arreola, Mayor-Commissioner Pro Tem *
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Gail Johnson
Reina Saco
Gigi Simmons
Harvey Ward

***Audit & Finance Committee Member**

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INTRODUCTION

The General Government Non-Pension Investments Review was included in the City Auditor's 2020 Fiscal Year Audit Plan, Resolution #190633, approved on December 5, 2019.

The General Government Pension & Investments Division of the Budget and Finance Department manages two non-pension investment portfolios valued at \$157,059,491 as of September 30, 2020. Investment in these two accounts are held for various reasons that include operational needs, capital projects, and funds held in trust for the exclusive use for the care and maintenance of the cemetery grounds.

In June 2020, the City Commission approved a policy to allow the City Manager to implement a Fuel Hedging Program and engage in fuel futures and options as price risk management strategies related to unleaded and diesel fuel within the City's approved fuel hedging policy. The value of these funds were \$410,558 as of September 30, 2020.

AUDIT OBJECTIVE

The City Auditor's Office conducted a review of General Government Non-Pension Investment processes and related internal controls. The objective of the engagement was to examine the internal control environment and governance of two designated non-pension investments portfolios (surplus operating funds and cemetery trust fund) and internal controls over a recently implemented Fuel Hedging Program, at management's request.

AUDIT SCOPE AND METHODOLOGY

The scope of this review included assessing the design and operating effectiveness of the controls related to the non-pension investments processes and fuel hedging program during the period October 1, 2019 through September 30, 2020. (Note: the first deposit into the Fuel Hedging Fund was July 22, 2020). Specifically, we performed the following:

Governance

- Reviewed adequacy and completeness of policies and procedures related to investments and assessed compliance with State laws and City policies and procedures to ensure the controls are sufficient to mitigate risk of fraud, waste, and abuse.
- Assessed adequacy of management oversight and monitoring controls related to non-pension investments, portfolio management, and performance and monitoring of economic and market analyses.

Investment Activities

- Interviewed key staff and reviewed source documentation including applicable laws, policies, procedures, and Pension and Investments Committee minutes.
- Reviewed transactions on a sample basis to test control effectiveness around non-pension investment deposits and withdrawals, and changes to investment accounts.
- Assessed City processes and internal controls around selection of investment banks and brokers/dealers, including Information Technology (IT) general controls such as access controls to investment accounts and related third parties.
- Reviewed investment data and schedules based on Budget and Finance internal reports.

RESULTS AND CONCLUSION

During this review we noted transactions to and from investment accounts were routine in nature, though we have noted three areas where improvements in the control environment around non-pension investment processes are recommended: 1) Pension and Investments Division of the Budget & Finance Department should establish an Investments-Related User Access Management Program (High Risk); 2) The approved broker/dealer list is not maintained in compliance with the non-pension investments policy (Moderate Risk); 3) Non-pension investment-related policies and procedures need strengthening (Moderate Risk).

- **High Risk:** Key controls do not exist or are not effective, resulting in an impaired control environment. High Risk control weaknesses require immediate corrective action detailed in the management action plan.
- **Moderate Risk:** Adequate control environment exists for most processes. Moderate risk control weaknesses require corrective action detailed in the management action plan.
- **Low Risk:** Satisfactory overall control environment; small number of low risk control improvement opportunities do not require corrective action or a management action plan.

The details of these audit issues, recommendations, and management action plans are included within the *Audit Issues and Management Action Plans* section beginning on page 11.

We would like to thank General Government Budget and Finance staff for their professionalism and cooperation during this engagement.

BACKGROUND

Investments Roles and Responsibilities

City investments policies require that investments programs be managed in a manner responsive to public trust and consistent with all federal, state and local laws. The primary objectives of the City's investment activities, in priority order, shall be:

- Safety
- Liquidity
- Return

The Finance Director is responsible for establishing and maintaining internal controls and operational procedures designed to ensure that the assets of the City are protected from loss, theft, or misuse. The controls and procedures shall be designed to prevent the loss of public funds arising from fraud, employee error, and misrepresentation by third parties, or imprudent actions by employees and officers of the City. The controls shall also ensure that functional duties are adequately segregated for separation of duties between investment and accounting operations. The City has a dedicated Investments Officer and an internally staffed Pensions and Investments (P&I) Committee.

The Investments Officer is responsible for daily activity that includes monitoring cash flows and cash balances, determining optimal investment activity required to align P&I Committee investments strategies, performing any required security trading to maintain most effective levels and types of investments portfolios, and reporting to and documenting P&I Committee actions. Pension & Investments staff are responsible for processing and recording investment activities, verifying investment activity receipts, payments and income, and coordinating all investment transactions with Billing & Collections and Accounting staff. Segregation of key duties is not always possible or cost-effective in the City's Pension & Investments Division of the Budget and Finance Department, increasing financial risks that require monitoring and periodic assessment by senior leadership.

Investments Fund Types

Below are descriptions of the two non-pension investments fund types in scope for this review:

1) Operating Surplus Funds:

In accordance with FL Statute §218.415, the City established an Investments Policy that applies to the investment of operating and capital funds under the control of the City that are in excess of those required to meet current expenses. This policy excludes pension or retirement funds, Other Post-Employment Benefit (OPEB) funds, certain special use funds, or funds related to the issuance of debt where there are other existing policies or indentures in effect for such funds. The investment goal is to maximize investments earnings and increase efficiencies with regard to investment pricing, safekeeping, and administration. Investments income is allocated to the various funds based on their respective participation and in accordance with generally accepted accounting principles. Funds are invested in The Florida State Board of Administration (SBA) Prime Account. **See Figures 1 & 2.**

2) Evergreen Cemetery Trust Fund:

In February of 1856, the ground now known as Evergreen Cemetery received its first burial from the newly named community of Gainesville, Florida. The Evergreen Cemetery Association sold the Cemetery in 1944 for \$1.00 to the City, which has managed it since. The City established a perpetual care trust fund known as "Evergreen Cemetery Trust Fund". City of Gainesville Ordinance Sec. 7-11 states:

- a) There is hereby established a perpetual care trust fund known as "Evergreen Cemetery Trust Fund." All moneys received from owners of lots who are changing from annual to perpetual care, together with a portion of the moneys received from the sale of spaces specified by the city commission shall be paid to the city manager or designee, who shall deposit the moneys in the trust fund in any depository for deposit of city funds or as otherwise authorized by the city commission. The city commission when setting prices for spaces shall designate what portion of moneys received shall be paid into the trust fund.
- b) The income from the trust fund shall be used exclusively for the care and maintenance of the lots and spaces covered thereby and for the care and maintenance of the cemetery grounds.
- c) The city commission shall invest such funds as they deem advisable. **See Figures 3 & 4.**

Fuel Hedging Program

The City Manager established a Fuel Hedging Program that was approved by the City Commission on June 18, 2020 via Resolution #200052. The resolution includes approval of the City Manager's selection of Linwood Capital, LLS to act as the Futures Commission merchant. Linwood Capital, LLC uses RJ O'Brien Associates, LLC as the clearing broker.

The Fuel Hedging Program requires the use of futures and options contracts that are managed by a third party Commodity Trading Advisor (CTA) and traded through a futures trading account established in the City's name. The program was established to seek to:

- Decrease volatility of petroleum fuel costs
- Increase likelihood that actual net petroleum fuel cost will remain below budgeted cost
- Increase the certainty of future petroleum fuel costs
- Attain a lower overall cost of petroleum fuel in the long-term

The Investments Officer monitors the fuel hedging trading activity and provides monthly statements to accounting staff and the Finance Director. The fuel hedging program is not considered an investment. **See Figure 5.**

User Access Management and Segregation of Duties

User access management is the set of procedures that includes segregation of duties, least privileged access, and uniquely identifiable IDs to manage the digital identities of users and systems. Adequate user access management controls allow users with a genuine "need to know" to view or change information and help prevent unauthorized access, potential loss and fraud.

Where possible, key duties around non-pension investments processes should be performed by different staff. Where segregation of duties is not possible, periodic and documented management monitoring of investment-related activity and transactions, performed by senior staff who do not have investment-

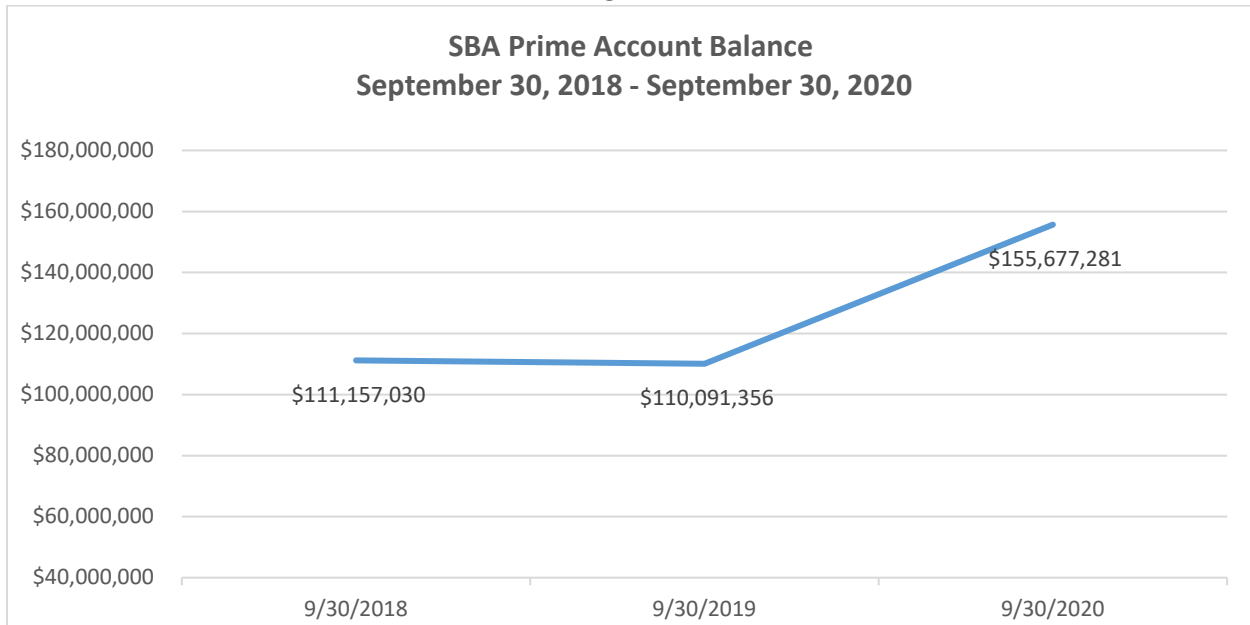
related transactional or reconciliation responsibilities, is a best practice. Segregation of duties includes consideration of investment-related systems access and third party risk management activities to ensure that one person is not responsible for both:

- Investments-related administrative and governance duties, or
- Investments-related transactional/reconciliation processes and monitoring processes.

RELATED FACTS AND FIGURES

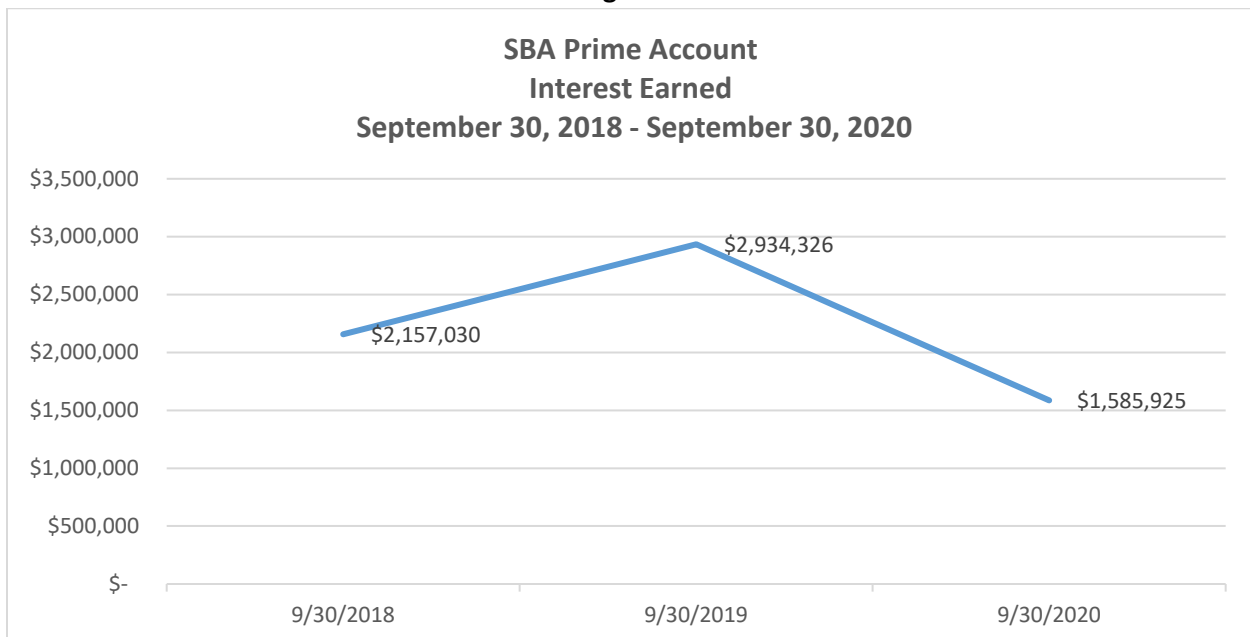
The following information on comparative year-end balances, earnings, or other related data for the SBA Prime Account Investments, Evergreen Cemetery Trust Fund, and Fuel Hedging Program are provided in **Figures 1 – 5**.

Figure 1



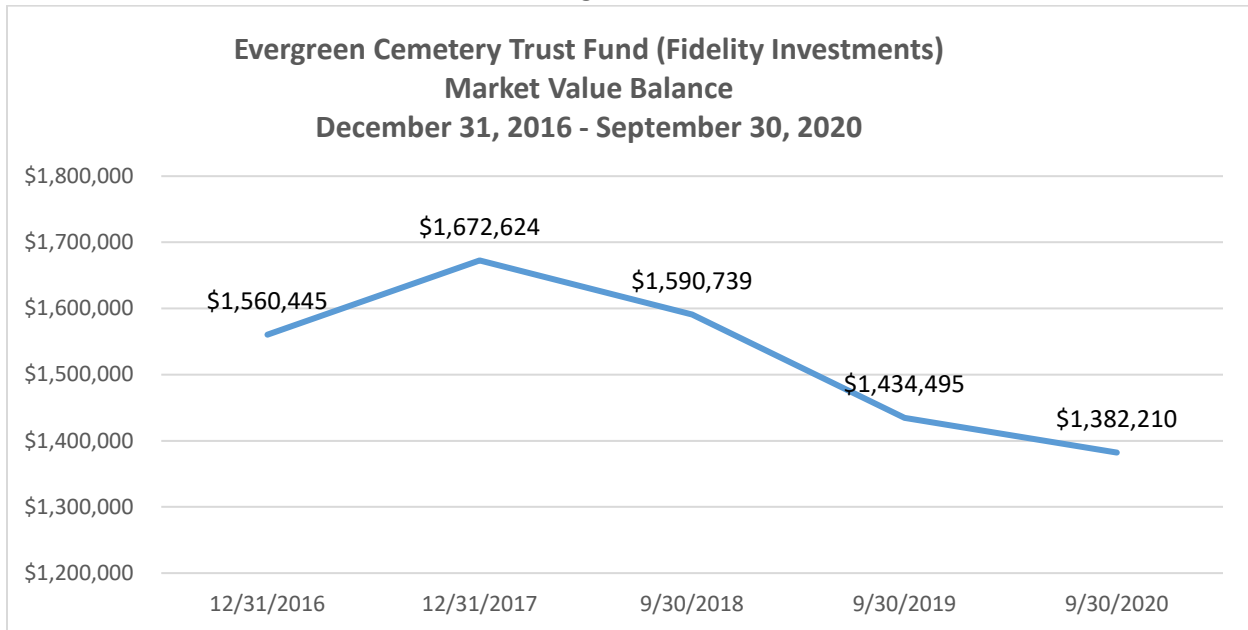
Source: SBA Prime Fund Account Interest & Yield Report provided by the City Investments Officer

Figure 2



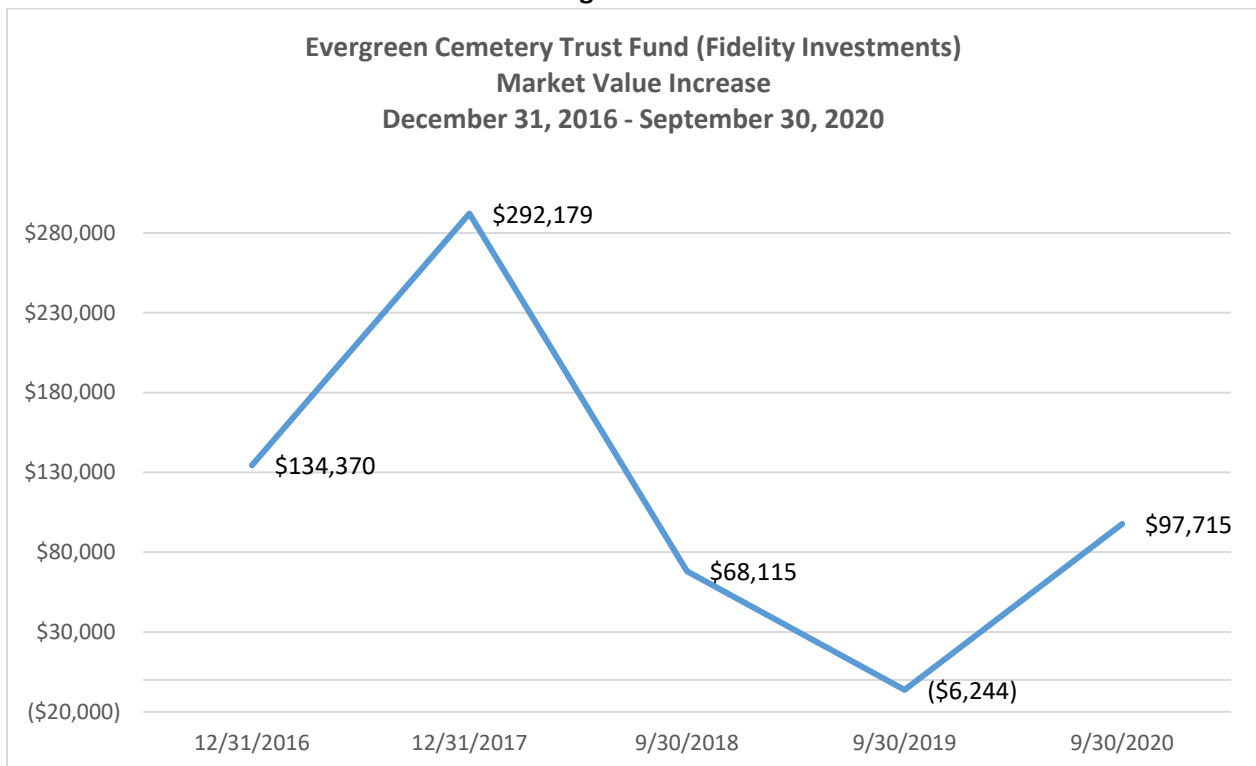
Source: SBA Prime Fund Account Interest & Yield Report provided by the City Investments Officer

Figure 3



Source: Evergreen Annual Investments Report provided by the City Investments Officer

Figure 4



Source: Evergreen Annual Investments Report provided by the City Investments Officer

Figure 5

Fuel Hedging Program Activity	
Initial Deposit (7/22/20) thru Fiscal Year End (9/30/20)	
Total Deposits	\$ 430,696
Realized Gain/(Loss)	(9,715)
Transaction Fees	(1,106)
	<hr/>
Ending Account Balance	\$ 419,876
Unrealized Gain/(Loss)	(9,317)
	<hr/>
Account Value at September 30, 2020	<u>\$ 410,558</u>
Note: Additional expense not reflected in above fund:	<u>\$ (8,250)</u>
Advisory Fees Paid to Linwood Capital	
Contracted @ \$2,750/mo.	

Source: Linwood Monthly Account Report provided by the City Investments Officer

GOVERNMENT AUDITING STANDARDS COMPLIANCE

We conducted this performance audit engagement in accordance with *Generally Accepted Government Auditing Standards*, the *International Standards for the Professional Practice of Internal Auditing*, and *ISACA IS Audit and Assurance Standards*. These standards require that we plan and perform the engagement to obtain sufficient, appropriate 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 observations and conclusions based on our audit objectives.

INTERNAL AUDIT TEAM

Ginger Bigbie, CPA, CFE, City Auditor

Eileen Marzak, CPA, CFE, Interim Assistant City Auditor*

Gregory Robeson, CPA, CIA, CFE, Senior Internal Auditor (Lead Auditor for this engagement)*

Vincent Iovino, CISA, CRISC, IT Audit Manager*

Brecka Anderson, CIA, CFE, Internal Audit Manager

Patrick Keegan, CISA, Senior IT Auditor*

**Denotes primary auditors on this engagement*

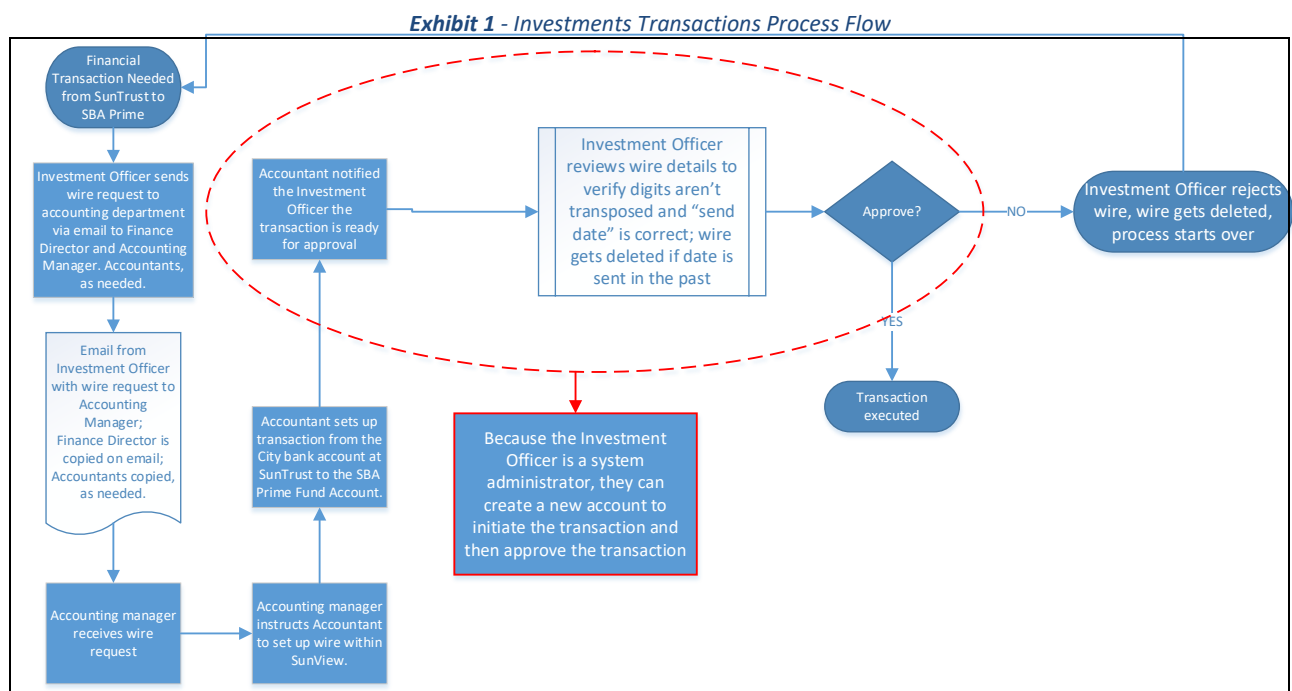
AUDIT ISSUES AND MANAGEMENT ACTION PLANS

ISSUE #1 Pension and Investments Division of the Budget & Finance Department should establish an Investments-Related User Access Management Program

Risk rating: **High**

Observation:

The Pension and Investments Division of the Budget & Finance Department should establish an investments-related User Access Management Program. Exhibit 1 outlines the current investment process.



While our audit did not identify any irregular or inappropriate investment activity, two of four investment related information systems had user accounts with the ability to bypass segregation of duties controls. For the remaining two accounts, a user access management program governing access to the financial institutions' websites should be adopted to ensure user privileges align with adequate segregation of duties best practices, least privilege access and uniquely identifiable user accounts.

Where limited resources do not allow for segregation of all key duties, formal senior staff oversight and monitoring activities should be implemented as an effective compensating control.

Criteria:

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) defines internal controls and includes control activities (such as segregation of duties) and monitoring activities as key components of a control environment.

Florida Statute 218.415 Subsection (13) requires an investment policy to be in writing and provide for a system of internal controls and operational procedures. The internal controls should be designed to prevent losses of funds, which might arise from fraud, employee error, misrepresentation, by third parties, or imprudent actions by employee.

COBIT 2019 (Control Objectives for Information Technologies) recommends the following as best practice for segregation of duties and least privileged access: 1) allocate roles for sensitive activities so there is a clear segregation of duties; 2) allocate access rights and privileges based on the minimum that is required to perform job duties and to remove or revise access rights immediately if the job role changes or a staff member leaves the business process area. COBIT 2019 recommends the following as best practice for uniquely identifiable user accounts: 1) ensure all users are uniquely identifiable; 2) perform regular management review of all accounts and related privileges.

Cause:

The Pension and Investments Division of the Budget and Finance Department is a small team where segregation of all key duties is not cost-effective, resulting in some employees having both administrator access to information systems as well as the ability to enter and/or approve transactions. Management has enabled activity email alert settings but alerts on their own cannot be relied upon as the only compensating control due to the possibility of emails being lost or email alert settings being changed. Compensating controls including senior staff oversight of all user access changes has not been formalized.

Risk:

Lack of a formal investment-related User Access Management Program increases the risk of error, fraud, and potential financial loss around non-pension investment activities. The American Institute of Certified Public Accountants (AICPA) defines segregation of duties as a basic building block of internal controls. Without separation of in key processes, fraud and error risks are far less manageable.

Recommendation:

The City Auditor recommends and agrees with management on the following management action plan.

Management Action Plan

Management will adopt a User Access Management Program that includes periodic access reviews to ensure access is uniquely identifiable, minimum necessary to perform their job duties, and cannot bypass segregation of duties controls. Management will establish formal senior staff oversight roles and responsibilities where segregation of key duties (such as transactions and approvals), and to monitor all non-pension investment activities.

Due date: May 31, 2021

Responsible Parties: William Johnston, Pension & Investments Officer
Cintya Ramos, General Government Finance Director

ISSUE #2 The current approved broker/dealer list is not maintained in compliance with the non-pension investments policy

Risk rating: Moderate

Observation:

The current approved broker/dealer list is not maintained in compliance with the current non-pension investments policy. Proof of state registration for three of five brokers on the list was not on file and none of the listed brokers has provided certification of having read and understood the City's Investments Policy.

Criteria:

City of Gainesville Investment Policy (190924A), Section VIII, Subsection 1.B details requirements for brokers/dealers to become qualified for investments transactions with the City. The Pension & Investments Division of the Budget and Finance Department is required to maintain a list of approved security brokers/dealers that is selected by conducting a process of due diligence. Evaluation criteria includes a firm's prior experience, financial stability, and broker's qualification. According to current policy, each approved institution must provide the City with a copy of the following:

- Audited financial statements demonstrating compliance with state and federal capital adequacy guidelines
- Proof of all FINRA and SEC registrations and certifications
- Proof of state registration
- Broker background, qualifications and experience
- Certification of having read and understood, and agreeing to comply with the City's investments policy.

Section VIII, Subsection 1.B also requires a periodic review by the Investments Officer of the financial condition and registration of all authorized financial institutions.

City of Gainesville Investments Procedures Manual, Section H, Subsection 2 states that the Investments Officer shall maintain an approved list of securities brokers/dealers with whom the City may conduct security transactions. Though the procedure states that the approved list has no minimum or maximum number of brokers/dealers, only those brokers/dealers on the approved list are entitled to submit quotations and transact business with the City and that the City will purchase securities only from those institutions included on the City's approved list of brokers/dealers and banks.

Cause:

Due to the infrequency of non-pension investments transactions, the list of brokers/dealers has not been actively maintained in compliance with current policy for soliciting bids for new investments.

Risk:

The risk of error or fraud resulting in financial loss is greater when a broker/dealer is not in full compliance with the City's non-pension investments policy requirements. In addition, without a current approved broker/dealer list, the City may not be sufficiently agile to capture specific market changes in revenues or growth of securities. When management explores investment opportunities, delays in transitioning to a new broker/dealer, obtaining required documentation to validate broker/dealers, and evaluating and selecting qualified bids may cause delays and place the City at risk for missing investment opportunities.

Recommendation:

The City Auditor recommends and agrees with management on the following management action plan:

Management Action Plan

Management will update non-pension investments policies or procedures to update broker/dealer selection criteria and specify the method and timing of periodic updates of the approved broker/dealer list. Procedures will include frequency and documentation requirements for management's periodic review of the broker/dealer list and follow GFOA Best Practice Recommendations.

Due date:

May 31, 2021

Responsible Parties:

William Johnston, Pension & Investments Officer
Cintya Ramos, General Government Finance Director

ISSUE #3 Non-pension Investment-related Policies and Procedures Need Strengthening

Risk rating: Moderate

Observation:

Policies and procedures need strengthening in the following areas:

- The key internal controls of segregation of duties and management oversight are not clearly defined in the current policy and procedure, although they were observed in relation to the transfer of funds to/from investment accounts.
- Current policy and procedure related to the management of the Fuel Hedging Program (non-investments) do not provide sufficient details on expected performance margins or trigger points that would result in exiting from hedging program. In addition, while procedures do require quarterly investments activity reporting to the Audit and Finance Committee (A&FC), procedures have not been updated to include fuel hedging activity in the quarterly reporting.
- The current policy and procedure do not require documentation of key information reviewed or actions taken during the Pension & Investments Committee meetings. Procedures should be updated to require minutes that reflect discussions of investment activities and executive oversight activities. Reports utilized in the process should be retained in the format presented along with the minutes.

Criteria:

According to the Government Financial Officers Association Investments Policy best practices, the investments policy (and procedures) should be reviewed and updated annually and should include statements on:

- Roles, responsibilities, and standards of care: Identify the roles of all persons involved in the investments program by title and responsibility. Standards of care should include language on prudence (i.e., the prudent person rule), due diligence, ethics and conflicts of interest, delegation and authority, and knowledge and qualifications.
- Safekeeping, custody, and internal controls: Develop guidelines to enhance the separation of duties and reduce the risk of fraud.
- Authorized financial institutions, depositories, and broker/dealers: Establish a process for creating a list of financial institutions, depositories, and broker/dealers that will provide the primary services necessary for executing the investments program.

In addition, Florida Statute 218.415 requires Investments activity to be consistent with a written investments plan adopted by the governing body or respective principal officer. A unit of local

government is required to have an investments policy, or must meet the alternative investments guidelines contained in subsection (17).

Subsection (15) required the investments policy to provide for appropriate annual or more frequent reporting activities with periodic reports prepared by officials responsible for making investment decisions or the chief financial officer. The reports are to be submitted to the legislative and governing and include securities in the portfolio by class or type, book value, income earned, and market value as of the report date. The reports are to be made available to the public.

Cause:

Neither the current policy nor procedures require formalized meeting minutes, attendance records or reporting requirements to the AF&C.

Risk:

Procedures that do not include some key controls, such as segregation of duties and reporting requirements for all investment-related activities, may lead to staff doing their own thing due to unclear guidance, increasing overall risk of error or financial loss. Identifying and clearly detailing key internal control processes and procedures that must be observed and followed by staff members provides for the continuation of investment-related operations during personnel turnover and reduces the risk of fraud, error and possible financial loss.

Recommendation:

The City Auditor recommends and agrees with management on the following management action plan.

Management Action Plan

Management will review non-pension investments procedures and update as needed to ensure segregation of duties, roles and responsibilities. Additionally, during the next review cycle of the Investments Policy, Management will update to include the fuel hedging program.

Management will formalize the Pension and Investments Committee during FY 2021 including updating procedures as they relate to documentation of Committee meetings, including discussion and actions taken by attendees of Investments Committee meetings, and retention of any reports prepared and delivered.

The Pensions & Investments Committee was established for the purpose of reviewing market and economic data, formulating investment strategies, performance monitoring, and reviewing procedural compliance. The committee meets quarterly and members include: Finance Director, Assistant Finance Director, Investment Officer, and Pension & Investment Analyst. All reports discussed during these meetings are available for review and the current policy does not require formalized meeting minutes, attendance records nor reporting requirements to the A&FC.

Further, the Finance Director and Investment Officer review investment activity on an ongoing basis to evaluate performance and adherence to policy and procedures. Investment activity and performance is reviewed quarterly by the Pensions & Investments Committee, and investment performance reports are submitted annually to the City Manager and City Commission. During the past two fiscal years, staff has been directed by the A&FC to submit annual versus quarterly updates.

Review of compliance with investment policy and related procedures is a part of the annual audit process performed by external independent auditors. Testing of the investment practices and controls (including proper execution and completion of required documentation) is performed by the external auditors during the annual audit process. To date, the external independent auditors have not found deficiencies with current policies and procedures.

The City implemented its new Fuel Hedging Program in July 2020. This program is a price risk management tool not a Fund or an Investment and should not be treated as such. Management of the Fuel Hedging Program is outlined in the City's Investment Manual (Section III – Investment Guidelines and Operating Procedures, Item G – Fuel Hedging Program). Per the City's Investment Policy, a quarterly report has been drafted for the first quarter the program has been active, ended September 30, 2020, and will be presented at the November 16, 2020 A&FC meeting.

Due date:

May 31, 2021

Responsible Parties:

William Johnston, Pension & Investments Officer
Cintya Ramos, General Government Finance
Director