



Office of City Auditor Memorandum

DATE: October 3, 2005

TO: Norman Ruggles, Executive Director, Seattle City Employees' Retirement System

FROM: Susan Cohen, City Auditor *Susan Cohen*

RE: Follow up on the Office of City Auditor's report *Review of the Seattle City Employees' Retirement System* and newsletter *Improvements! City Improving Controls Over Claims Warrants*.

The Office of City Auditor has completed its follow-up review of the report *Review of the Seattle City Employees' Retirement System*¹ and the newsletter *Improvements! City Improving Controls Over Claims Warrants*² to determine whether the proposed recommendations have been implemented. To perform this follow-up review, we interviewed Seattle City Employees' Retirement System (SCERS) personnel and reviewed pertinent documentation. SCERS management reviewed a draft of this report and concurred with our conclusions.

In performing this follow-up review, we followed Government Audit Standards, as prescribed by the Comptroller General of the United States, and the Institute of Internal Auditors' (IIA) International Standards for the Professional Practice of Internal Auditing. With respect to quality assurance reviews and training, the Seattle Office of City Auditor follows the IIA standards.

All but one of the recommendations made by the Office of City Auditor have either been fully or partially implemented by SCERS management. The matrix beginning on page three notes each recommendation and to what degree the Seattle City Employees' Retirement System has implemented it.

Please note that we added a suggestion to Recommendation 2 for consideration by SCERS management, and a suggestion to Recommendation 6 for consideration by SCERS management and the SCERS Board of Administration.

We would like to thank you and your staff for their assistance in completing this follow-up review.

cc: Councilmember Richard McIver, Chair, SCERS Board of Administration
Dwight Dively, SCERS Board of Administration
Norma McKinney, SCERS Board of Administration
Lou Walter, SCERS Board of Administration
Mary Norris, SCERS Board of Administration
Paul Berry, SCERS Board of Administration

¹ Published September 18, 2000.

² Published February 22, 2000.

Frank Mathews, SCERS Board of Administration
John Franklin, Mayor's Office
Rick Thorson, State Auditor's Office
Helen Welborn, Department of Finance
Mel Robertson, Assistant Executive Director, SCERS

Follow-up of the report: *Review of the Seattle City Employees' Retirement System*

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Recommendation	Current Status
<p>1. Develop System-Wide Accounting and Investment Management Standards, Policies and Procedures:</p> <p>SCERS should develop written accounting procedures for its cash receipts, accounts payable, and banking functions.</p>	<p>Pending: Seattle City Employees' Retirement System (SCERS) management assigned staff to develop these written procedures, and while the accounts payable section of this project has been completed, a comprehensive procedure document has not been compiled. The Executive Director said he will assist with the drafting process and will ensure that this project is coordinated and finalized.</p>
<p>2. Develop System-Wide Accounting and Investment Management Standards, Policies and Procedures:</p> <p>Adopt Government Finance Officers Association (GFOA) and Association for Investment Management and Research (AIMR) standards for disclosure and reporting, including those for directed brokerage commission rebates.</p>	<p>Completed: SCERS adheres to GFOA standards for the financial statement portion of its annual reports.</p> <p>SCERS management does not believe that all AIMR standards are suitable for a public sector retirement system. However, SCERS's Assistant Executive Director stated that SCERS calculates time-weighted rates of return for its investments, including cash and real estate investments. He also said that SCERS obtains the internal rate of return for venture placements. AIMR standards recommend that time-weighted rates of return be used for calculating investment returns, and that the internal rate of return be determined for venture placements.</p> <p>According to the SCERS Assistant Executive Director, SCERS has not published information in its annual reports about its directed brokerage commission rebates because the amount of money, about \$30,000, is relatively small.</p> <p><u>Matter for consideration by SCERS management:</u> SCERS should consider adding to its annual report the Overall Performance Goals found in Section II of its Statement of Investment Policy and Procedures, which is currently found in the Request for Proposal section of its website. We believe SCERS annual report readers would be interested in knowing SCERS's broad investment goals.</p>

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<p>3. The City's Treasury Office Should Perform Tasks Related to the Reconciliation of SCERS's Investment Statement:</p> <p>To provide sufficient segregation of duties, the City's Treasury Division should perform certain tasks related to the reconciliation of SCERS's investment statement. SCERS' Executive Director and Treasury officials should work together to determine the specifics of the reconciliation process.</p> <p>These reconciliation activities should be performed monthly or quarterly by a qualified, certified public accountant (CPA) who has no control over the movement of the funds. SCERS's Executive Director should instruct the Bank of New York and the investment firms to send copies of their statements directly to the Treasury official performing the reconciliation at the same time they are forwarding the statements to SCERS.</p>	<p>Partially completed: Treasury is not involved with the reconciliation of SCERS's investment statements, but SCERS management has assigned one of its accountants to reconcile SCERS's records with the information contained on the investment statements. SCERS management instructed the Bank of New York and the investments firms to send statements directly to this accountant. The accountant performs the reconciliation monthly, except when Summit year-end activities delay this activity.</p> <p>SCERS management stated that the reconciliation tasks did not require the expertise of a CPA, and that it would be difficult for SCERS to afford a CPA, given its current salary structure.</p>
<p>4. Formalize Internal Control Systems with the Bank of New York, Treasury, and Investment Managers:</p> <p>The SCERS Board of Administration should send a formal letter to the City's Treasury Division listing the investment managers hired by the City who can receive SCERS funds.</p> <p>In addition, the letter should state that no entity or account, with the exception of Treasury, may receive SCERS funds unless it is on the list.</p> <p>The list should be updated and signed by the Board's chair whenever an investment manager is added to or deleted from the list.</p> <p>In addition, the Bank of New York and the investment managers should be informed that transfers can only be accepted or issued through a wire transfer directed to the City Treasury.</p>	<p>Completed: In August 2000, SCERS's Executive Director and the City's Treasury Director established a repetitive wire agreement with the Bank of New York that directed the bank to have all wire transfers involving SCERS funds sent exclusively to a City-designated bank account. The repetitive wire form states that the City Treasury Director and the SCERS Executive Director must sign any changes to the repetitive wire arrangement.</p> <p>The Director of the City's Executive Services Department informed the Bank of New York in an August 2000 signed letter that the City authorized SCERS's Executive Director and Assistant Executive Director to give instructions to the Bank of New York relative to the purchase and sale of securities, and the transfer of securities between accounts, for all accounts held in custody by the Bank of New York on behalf of SCERS. This letter also authorized the two</p>

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	<p>SCERS officials to transfer cash to and from the Bank of New York for all accounts maintained by SCERS according to the instructions provided on the repetitive wire form.</p> <p>In October 2000, the SCERS Assistant Executive Director sent a letter to all of the investment firms used by SCERS informing them that the City's Treasury Director and SCERS's Executive Director wanted the firms to identify the wire instructions the City should use to wire funds to the firms to manage for SCERS. The letter also provided the firms with the wire instructions they should use whenever funds were to be withdrawn from their SCERS accounts and sent back to SCERS's bank account.³ The letter stated that the firms should accept changes in the City's wire instructions only if they received written, signed instructions from the City Treasury Director and SCERS's Executive Director. The letter also stated that any withdrawals must be sent via wire transfer only to the City bank account designated in writing on the letter signed by the City's Treasury Director and SCERS's Executive Director.</p> <p>According to SCERS Assistant Executive Director, the list of investment firms and wire transfer agreements is updated whenever a new firm is hired by SCERS.</p>
<p>5. Obtain Brokerage Commission Rebates through a Competitive Process:</p> <p>SCERS should issue a Request for Proposal (RFP) for a formal directed brokerage program. When it evaluates the proposals, SCERS should include the following two criteria: (1) the number of useful broker-dealers with which the prospective firm has contracts; and (2) the rebate percentage offered by the firm. SCERS' Acting Executive Director stated that SCERS planned to</p>	<p>Completed: SCERS issued an RFP for its directed brokerage program, and selected two firms in January 2001.</p>

³ According to the SCERS Assistant Executive Director, the funds that investment firms wire back to SCERS are withdrawn for a variety of reasons. These reasons include a need by SCERS to rebalance the fund; receive profits, capital or dividend payments from the investments; or reduce the firm's portfolio because of poor performance.

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<p>issue an RFP in the near future for the directed brokerage program.</p>	
<p>6. Require Investment Consultant to Give Up Its Role in Directed Brokerage Commission Rebate Process and Adhere to Investment Performance Reporting Standards:</p> <p>SCERS should ensure that its current investment consultant, Wurts & Associates, terminates its participation in the directed brokerage commission rebate program. The consultant should:</p> <ul style="list-style-type: none"> • Be independent and free from conflicts of interest; • Audit and report on dividend payments; • Report on investment performance using AIMR Performance Presentation Standards; • Analyze and report on the directed brokerage program; and • Provide a report and schedules for SCERS's comprehensive annual financial report. 	<p>Completed: SCERS terminated Wurts & Associates' participation in the directed brokerage program.</p> <p>Wurts & Associate's contract requires that it audit and report to SCERS on dividend payments.</p> <p>Wurts & Associates does not report to SCERS on the directed brokerage program. According to the SCERS Assistant Executive Director, SCERS management uses a SCERS accountant to analyze the program, and a summary of the analysis is provided to the SCERS Investment Committee and the SCERS Investment Advisory Committee.</p> <p>Wurts & Associates provides quarterly reports on investment rates of return to SCERS. According to the SCERS Assistant Executive Director, SCERS management uses some of this information for the SCERS annual report, which adheres to GFOA rather than AIMR presentation standards.</p> <p><u>Matter for consideration by SCERS management and the SCERS Board of Administration:</u> SCERS hired the Bank of New York to audit Wurts and Associates' performance reports for the fourth quarters of 2002 and 2003. According to the SCERS Assistant Executive Director, as of August 2005, the audit had not been finalized. SCERS management and the SCERS Board of Administration should carefully review the results of this audit. If the audit indicates that there are significant discrepancies, similar audits should be conducted frequently (e.g., quarterly) until any such gaps cease.</p>

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<p>7. Set Standards for the SCERS Investment Advisory Committee:</p> <p>The SCERS Board of Administration should develop a charter for the SCERS Investment Advisory Committee. The charter should include items such as the number of members, required qualifications for members, limits on a member's appointment term, job requirements and expectations (for example: meeting attendance, produce an annual report, etc.); and compensation (for example: lunch and \$100 per diem for each day of work).</p> <p>In addition, SCERS's responsibility to the committee should be defined in the charter. For example, the charter could specify that SCERS is responsible for formally debating and considering all issues listed in the Committee's Annual Report.</p>	<p>Completed: SCERS issued a charter in May 2001 for the SCERS Investment Advisory Committee. The charter specifies that the Investment Advisory Committee members will be invited to attend quarterly performance review meetings with the SCERS Investment Committee.</p>
<p>8. Commit More Resources to Compliance and Financial Audits:</p> <p>SCERS should commit more resources to independent compliance and financial audits.</p> <p>In addition, consultants hired to perform audits and evaluations of SCERS, as well as actuarial reviews, should be hired by, and report to, the Treasurer of the SCERS Board of Administration. The results of these audits and evaluations should be provided to each member of the SCERS Board of Administration.</p>	<p>Completed: In December 2002 the SCERS Board of Administration hired, through May 2007, the firm Deloitte & Touche LLP to audit the financial statements included in SCERS's annual reports. Deloitte & Touche audited the financial statements in the 2001, 2002, 2003 and 2004 SCERS annual reports.</p> <p>The SCERS's Board of Administration hired the Bank of New York to audit the fourth quarter 2002 and 2003 performance reports of its investment consultant, Wurts and Associates. According to the SCERS Assistant Executive Director, as of August 2005, the audit had not been finalized.</p>

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<p>9. Undergo Regular Actuarial Audits:</p> <p>SCERS should hire an independent actuarial firm to evaluate, on a regularly scheduled basis, the work of SCERS' actuarial consultant. The audit should evaluate the presentations and calculations in the actuarial valuation reports and actuarial assumptions. The results of the actuarial audit report should be included in SCERS's Annual Report.</p>	<p>Completed: On November 2, 2000, the actuarial firm Buck Consultants presented the results of its audit of SCERS's economic actuarial assumptions to the SCERS Board of Administration. This audit did not duplicate the actuarial valuations or review the actuarial reports prepared by SCERS actuary. SCERS management did not include information about the actuarial audit in its annual report. However, after the Board of Administration selected the actuarial firm Buck Consultants in June 2002 to replace Milliman USA, Buck performed a new actuarial valuation of SCERS.</p>

Follow-up of the newsletter: *Improvements! City Improving Controls Over Claims Warrants*

October 3, 2005

Recommendation	Current Status
<p>10. Controls Over Claims Warrant Need Strengthening:</p> <p>The SCERS employee who initiates a claims warrant (i.e., a check issued by the City to a vendor, employee, or other party) in the City's accounting system should not have the check returned to them to perform such duties as attaching remittance information. The routing of a check back to the department or employee that initiated it should be permitted only when a unique situation makes it necessary.</p>	<p>Partially completed: SCERS's Assistant Executive Director said that most checks issued by SCERS are sent directly to the payee. However, sometimes checks are returned to SCERS so that remittance materials can be attached to the check. SCERS rotates the duty of handling returned checks among three of its employees.</p>