

**DEPARTMENT OF REVENUE AND FINANCE  
GENERAL EMPLOYEES PENSION FUND  
AUDIT 09-12  
JUNE 15, 2010**



# CITY OF TAMPA

Pam Iorio, Mayor

Internal Audit Department

Roger Strout, Internal Audit Director

June 15, 2010

Honorable Pam Iorio  
Mayor, City of Tampa  
1 City Hall Plaza  
Tampa, Florida

RE: General Employees Pension Fund, Audit 09-12

Dear Mayor Iorio:

Attached is the Internal Audit Department's report on the General Employees Pension Fund.

Pension Administration has already taken positive actions in response to our recommendations. We thank the management and staff of Pension Administration and Accounting for their cooperation and assistance during this audit.

Sincerely,

/s/ Roger Strout

Roger Strout  
Internal Audit Director

cc: Darrell Smith, Chief of Staff  
Bonnie Wise, Chief Financial Officer  
Lee Huffstutler, Chief Accountant  
Bill Spinelli, Accounting Operations Manager  
Marlene Herrera, Accounting Operations Manager

**DEPARTMENT OF REVENUE AND FINANCE  
GENERAL EMPLOYEES PENSION FUND  
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*/s/ Thomas Sanchez*

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Auditor

*/s/ Roger Strout*

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Audit Director

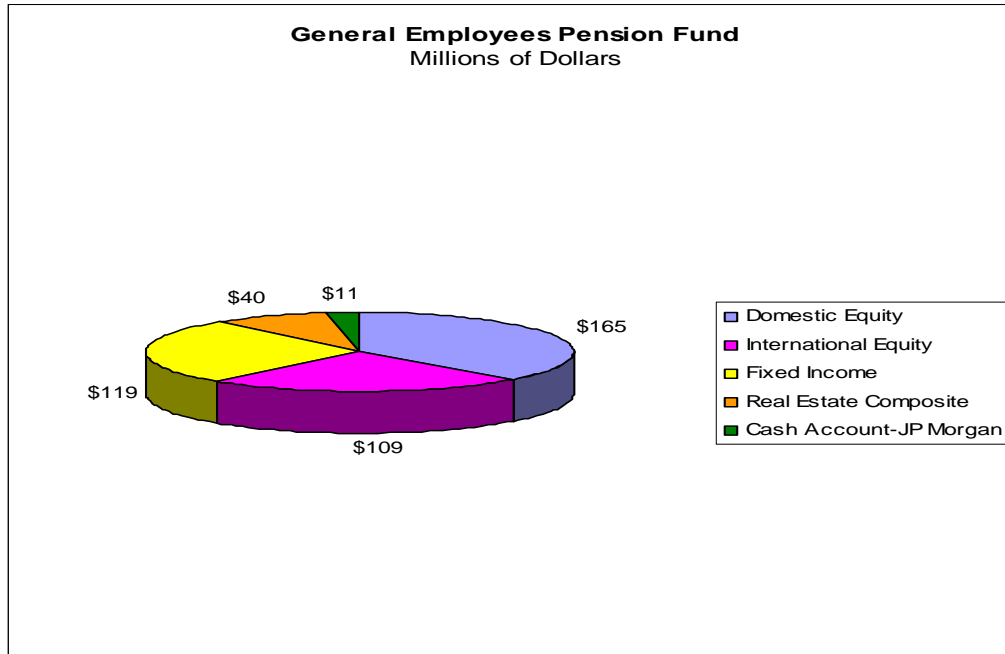
**REVENUE & FINANCE  
GENERAL EMPLOYEES PENSION FUND  
ACCOUNTING  
AUDIT 09-12**

**BACKGROUND**

The General Employees' Pension Fund provides benefits for full time and part time City employees and their survivors if specified requirements are met. This audit evaluated support for the manner in which pension benefit entitlement is determined and the amount calculated, and controls in place to ensure benefits are terminated or converted to survivor benefits in the event of death. It also reviewed support for determining disability retirements. The plan was established by a special act of the Florida Legislature in 1945. Thirty-seven amendments to the plan have been proposed to and enacted by the Legislature. This audit reviewed administration of policies and procedures adopted in accordance with the legislation.

Plan assets totaled \$443.7<sup>1</sup> million as of June 30, 2009, and are managed by 14 Investment Managers. Investments include equities (stock), both domestic and foreign, debt instruments (bonds), and real estate instruments. Most assets are held by a third-party custodian under contract with the City. The actual breakdown of funds and managers is attached as Appendix I, the chart below provides an overview of the types of investments the fund holds.

A consultant measures performance of each of the managers by comparing to appropriate indices. The overall plan goal is to achieve a long-term investment return of at least 5% above inflation.



<sup>1</sup> Includes \$10.8 million held in cash equivalents by the Custodian.

## **STATEMENT OF OBJECTIVES**

This audit was conducted in accordance with the Internal Audit Department's FY09 Audit Agenda. The objectives of this audit were to ensure that:

1. Reasonable controls were in place to provide security of investments.
2. Investment guidelines were adhered to.
3. Reimbursement for Hartline and Library Employees remaining in the City pension plan were reasonable.
4. Plan administration and funding were managed properly.

## **STATEMENT OF SCOPE**

This audit includes the period from October 1, 2008 through June 30, 2009. Testing included periods before and after the stated time frame, when deemed appropriate, to trace events for which the duration extends beyond these dates.

This audit does NOT include:

- The Fire and Police Pension
- The Deferred Retirement Option Plan (DROP)
- Other Post Employment Benefits

## **STATEMENT OF METHODOLOGY**

Based on the work performed during the preliminary survey and the assessment of risk, this audit covered the operations and administration of the General Employees Pension Fund.

External reports were obtained from:

- Each of the Investment Managers
- The City's Custodian (JP Morgan)
- Internal Control Reports for the Investment Managers and the Custodian (SAS 70 reports)
- The Pension Consultant (Mercer)
- External Auditor Work Papers
- Actuarial report dated July 6, 2009 as of January 1, 2009 (AON Consulting)

Judgmental samples were taken to determine reasonableness of transactions compared with available market data. Fees assessed by various service providers were recalculated and procedures for plan administration were reviewed for reasonableness.

## **STATEMENT OF AUDITING STANDARDS**

We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit 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 findings and conclusions based on our audit objectives.

## **AUDIT CONCLUSIONS**

Based upon the test work performed and the audit findings noted below, we conclude that:

1. Investment Policy, although usually followed, is not always adhered to with respect to the requirement that all fund assets, including securities, must be held by the Plan custodian.
2. It is unclear if securities lending<sup>2</sup> is appropriate for the Pension Fund. The board has determined not to engage in direct securities lending at this time, although there is indirect securities lending through one of the funds.
3. Monitoring for compliance with specific investment policies has not always been performed.
4. Reimbursements from Hartline for retired employees do not appear to be supported. Also, Hillsborough County is not being billed for one remaining active Library employee in the City pension plan.
5. We identified several issues with respect to fees and reconciling financial statements from service providers:
  - a. Custodial fees for compliance monitoring were inappropriately billed and paid.
  - b. Custodial fees for several investment accounts were based upon improper classification of accounts, resulting in overpayment.
  - c. Fees for five of the funds were being directly charged to the account rather than billed with supporting details. Additionally, they were not always reconciled.
  - d. One of the funds, SSgA, generates credits for "securities lending". The City is not provided with the basis for calculating the credit, and as a result the credit cannot be verified.

We relied upon benefits testing performed by the City's external auditors. No exceptions were noted.

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<sup>2</sup> Securities lending is a sophisticated investment practice in which securities owned by SSgA are loaned or "rented" to other investors to meet certain compliance requirements of those investors. SSgA is compensated for lending, and the securities are returned in accordance with the lending agreement. The Pension Plan receives a share of the compensation, which is shown as a credit on the quarterly statement.

While the findings discussed below may not, individually or in the aggregate, significantly impair the operations of the General Employee Pension Fund, they do present risks that can be more effectively controlled. Before we completed our audit, Revenue & Finance personnel implemented some of the Internal Audit Department's recommendations.

## INVESTMENT POLICY-COMMINGLED FUNDS

### AUDIT ISSUE

The Investment Policy requires that all assets be held by the plan custodian, JP Morgan (JPM). However, not all assets are currently being held by JPM.

### OBSERVATIONS

The City's Custodian, JPM, does not hold securities for the seven commingled funds:

- SSgA
- Mercator
- Aberdeen
- UBS Trumbull
- Fidelity funds I, II, and III

The JPM statements for the first three funds listed above indicate that they are *commingled* funds. However, there is no indication on the JPM statements for the remaining four funds (UBS and the Fidelity funds) to indicate that they are commingled funds. We were advised that they were commingled funds during discussion with JPM.

Commingled funds are a commonly used investment tool similar to mutual funds. Each fund has its own custodian-who reports to the Investment Manager. The Pension Plan owns units of the fund; it does not own individual securities. The nature of commingled funds may require separate custodians since the funds are pooled accounts with multiple investors. However, the Investment Policy does not provide for such custodians.

The custodian for SSgA would not confirm the Plan's holdings directly with us. However, the custodians for Mercator and Aberdeen, State Street Bank and Northern Trust, respectively, did forward statements for the City's accounts to us. The statements we received were prepared by the fund managers, not their custodians. JPM asserts verbally no responsibility for custody or reporting of these funds beyond information it receives from the Investment Managers or their custodians. We found no contractual relationship between JPM and these managers or their custodians with respect to the City's accounts.

It is unclear if securities lending, as described in the footnote on page 3, is appropriate for the Pension Fund. During a January, 2010 Board meeting, securities lending was considered. Two of the board members, including the City's Finance Director, felt strongly that the plan should not engage in this type of investment. This would have allowed direct lending of Fund assets by Investment Managers. This differs from the existing commingled investment with SSgA, which is managed by its fund manager on behalf of all subscribers to the fund. However, the underlying issue is still securities lending, whether it is actively conducted with Fund investments or through a commingled fund.

Section II of the GE Investment policy states:

*The City of Tampa shall contract on behalf of the Board with a third party custodian which shall have a level of experience and expertise in providing custodial services to plans and funds similar to those of the Plan. The Custodian shall act as a fiduciary in the administration of the Plan's accounts utilizing appropriate internal controls to insure the safety of the Plan's assets from such things as fraud, collusion, loss, diversion, etc. The custodian has been delegated the following responsibilities:*

- *Handle all income, cash transactions, clipping of coupons, interest received, and other necessary activities;*
- *Hold all securities on behalf of the Plan and only deliver securities upon proper instruction from those authorized to provide such instruction or direction;*
- *Perform, participate in and exercise such rights, privileges, duties and responsibilities possessed by any other owner or holder of bonds or other evidence of indebtedness and common and preferred stock, except for the voting of proxies, which shall be delegated to investment managers;*
- *Safekeep all assets including securities, cash and cash equivalents.*

The City's external auditors did not test any of the commingled funds for FY08. During our discussions with them at the conclusion of this audit, the external auditors indicated they would address this concern. We will continue to follow-up.

#### CRITERIA

Protection of City assets. Control is weakened when a custodian reports directly to the Investment Manager rather than to the Plan.

While the commingled funds are audited by their respective outside auditors, the audit encompasses the commingled fund as a whole, not the separate interest of each investor.

#### RISK DESCRIPTION

Over \$130 million of City assets are invested in these commingled funds. While the likelihood of impropriety may be minimal, the impact could be significant.

### RECOMMENDATION 1

Management should always comply with the Investment policy and purchase funds which can be delivered to the City's custodian, or should change the Investment Policy. If the policy is changed, we recommend that alternative controls be implemented to protect the City's interests.

Additionally, the board should determine if securities lending is appropriate for the fund.

### MANAGEMENT'S RESPONSE

Policies and practices surrounding the Board's investments comply with statutes and regulations. Pension Office staff will work with the Pension Board to clarify the Investment Policy as it relates to the Funds' custodians, the various investment types used to achieve targeted investment returns and oversight of the same. The Pension Board investigated securities lending and determined not to utilize it with custodian JPMorgan, and the Board is divesting itself of some SSgA investments using securities lending; however, securities lending may be employed by the Board in the future.

## COMPLIANCE MONITORING- INVESTMENT POLICY

### AUDIT ISSUE

Compliance with the Investment Policy related to Investment Manager asset restrictions is not documented.

### OBSERVATIONS

The Plan's Investment Policy provides that the Board is responsible for monitoring policy guidelines and objectives to ensure that they are being adhered to. The Policy further provides that the Board is authorized to delegate these responsibilities to qualified agents. These agents include the Investment Consultant (Mercer). The agreement with Mercer includes a requirement that its quarterly reports provide, among other things:

*An indication of whether the manager is meeting the Board's goals and adhering to investment guidelines and legal requirements.<sup>3</sup>*

In our review of compliance with the Investment Policy we noted the following:

- While Mercer prepares and discusses the performance of the investment managers, it does not specifically review the investments held by each manager to ensure that the fund is not holding assets which are restricted per the investment policy. Mercer has represented that it performs compliance monitoring on an "informal" basis. Mercer states that it works closely with the Managers and that compliance with the guidelines is not a problem.
- Currently there is no documentation supporting that a review is performed to verify that this portion of the policy is adhered to. However, it has been represented by the Investment Consultant that audits of various Fund Managers are received and reviewed by the Consultant.

### CRITERIA

Compliance with the Investment Policy and the agreement with Mercer. Ultimately the Board has a fiduciary duty to ensure that all parties comply with the Investment Policy.

### RISK DESCRIPTION

Investment Managers could invest in holdings that are restricted or limited per the policy and result in the Plan having a higher risk tolerance than the risk level set by the Board and its policy.

### RECOMMENDATION 2

We recommend that the Board develop a procedure to ensure compliance with the investment policy on an ongoing basis. The Board may choose to delegate this to a specific individual or agent. This designee should report results of reviews back to the board on a regular basis. A schedule should be maintained by the City Pension Office, and follow-up action taken if necessary.

Written documentation of this process should be maintained by the Plan Administration.

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<sup>3</sup>Agreement with Mercer Investment Consulting, Article II, Section A 2) g) as of April 1, 2009

### MANAGEMENT'S RESPONSE

The Board's investment managers, who meet with the Board annually, operate under clearly defined parameters. The Board also employs a performance monitor who meets with the Board monthly and reports on manager performance. The Board has determined that these steps are sufficient for investment oversight. Pension Office staff will work with the Board's performance monitor and money managers to develop and implement procedures for reviewing money manager compliance with investment guidelines.

**CONTINUING PROFESSIONAL EDUCATION (CPE) REQUIREMENT NOT ALWAYS MET**

**AUDIT ISSUE**

Most of the trustees have attended the required CPE, however, one did not. No individual has been tasked with tracking compliance with this requirement.

**OBSERVATIONS**

The Plan's Investment Policy provides that each Trustee is required to attend not less than one educational and training seminar or conference each fiscal year on matters relating to investments and the board's responsibilities.

In our review of compliance with the Investment Policy, we noted that no specific individual is verifying that CPE requirements are being met each year. Additionally, there is no form for reporting the trustees' attendance.

In our testing, one trustee did not attend any classes during 2008.

**CRITERIA**

Controls should be set up to document adherence to the Investment Policy CPE requirement.

**RISK DESCRIPTION**

The trustee may not have enough training to make well informed decisions.

**RECOMMENDATION 3**

We recommend that a standard reporting form be developed to be filled out and submitted by each trustee to document CPE attendance. The trustee should sign this form annually and submit to a designated person. That individual should develop a report summarizing the attendance for file documentation of compliance with the Investment Policy.

**MANAGEMENT'S RESPONSE**

We will take the steps as outlined.

## **INCORRECT HARTLINE AND LIBRARY BILLINGS**

### **AUDIT ISSUE**

Reimbursements from Hartline for retired employees do not appear to be supported. Hillsborough County should be billed for one active (working) "Plan B" Employee.

### **OBSERVATIONS - HARTLINE**

Until March, 1980, the City's bus system, then know as Tampa Transit Lines, operated as a Department of the City of Tampa. Personnel working for the system were City employees, entitled to all employee benefits, including participation in the GE Pension Plan.

Part of the agreement with the new Hillsborough Transit Authority (HTA) provided that employees of the system could retain participation in the City's Pension Plan if they so desired and many did. The agreement specified that HTA would pay to the City, for remittance to the trustee of the Pension Plan, all amounts necessary to fully fund the pension benefits of those employees remaining in the plan. These shall be paid contemporaneously with the accrual of the relevant employee pension liabilities under the Pension Plan.

None of the employees who transitioned to the HTA are still working. Approximately 22 are drawing pensions, including 15 spouses drawing survivor benefits. At some time in the past, a formula was drawn up to bill HTA (now Hillsborough Area Regional Transit, or Hartline) a portion of the pension payments. Hartline is being billed quarterly for about \$30,000.

- If the pensions were in fact funded by Hartline during the working years of the employee, the benefits should have been "paid up" upon retirement. It would not seem appropriate for Hartline to continue to fund their pensions.
- The origin of the reimbursement formula is not clear or documented. Some appear to be a pro-ration based upon the years worked at Hartline as a percentage of total creditable years, but others do not.

#### OBSERVATIONS - LIBRARY

An executed copy of the agreement transferring the Library to the County could not be located. An unexecuted copy provided that the County would pay the employer's share for employees who chose to remain in the City plan. Several memos from the Chief Accountant were in the file which provided that no payment would be due with respect to Plan B employees as a result of an actuarial determination for that year. Recent actuarial reports do not mention the Library, but if the same rate as the City was due for its employees, payments should have been collected.

The Library's two active (working) "Plan A" employees are being billed to the Library for both employer and employee shares.

However, the billing continues to state that no payment is due for the one remaining "Plan B" employee.

#### CRITERIA

Correct reimbursements should be collected for costs incurred for other entities' employees participating in the City's Pension Fund.

#### RISK DESCRIPTION

Inaccurate pension cost reimbursement.

#### RECOMMENDATION 4

Terminate billings for retired Hartline employees unless support can be found.  
Bill Hillsborough County for the Library "Plan B" employee.

#### MANAGEMENT'S RESPONSE

We will review the current procedures with both agencies, HART and Hillsborough County, and will take the steps as outlined, unless in our further investigation we find support for the contrary.

## **CUSTODIAN FEES ARE NOT BEING RECONCILED**

### **AUDIT ISSUE**

- Custodial fees have not been reconciled for some funds.
- We found overcharges resulting from the misclassification of funds, and resulting from charges for services not rendered.
- Fees for some funds were netted against income rather than recognized as an expense.

### **OBSERVATIONS**

Custodial Fees are charged per manager and are fairly complex. Variables include:

- Basic account fee (per manager).
- Account structure of the fund: domestic equity, domestic fixed income, commingled, global, or cash.
- Percentage of asset value in the account, expressed in basis points.
- Transactions (purchases and sales).

We could not find any evidence that prior payments for custodial services had been reconciled.

We found overcharges of approximately \$6,500 per year due to misclassification of the account structure of the funds.

Aberdeen and Wellington were classified as Global funds, which carry annual fees of \$5,000 per fund. Aberdeen should be classified as a commingled (annual fee \$1,000), a savings of \$4,000 per year. Wellington should be classified as a domestic equity fund (annual fee \$2,500). The Pension office is now working out the details. Changing these two fund classifications will save \$6,500 per year. Pension Administration has been proactive and upon learning of this discrepancy, has advised us that the fund will receive a \$6,000 credit on the next statement.

Also, as a result of our audit inquiries, Pension Administration queried JPM and found that the Pension Fund was overcharged \$14,000 from January 2008 through September 2009. This was the net savings of eliminating fees for compliance reporting, which was not performed, and correcting undercharges due to incorrect percentages applied to asset values. Pension Administration has advised us that the Pension Fund has received a credit of \$13,837 on the last statement. Estimated recurring savings will be \$8,000 per year.

JPM is the custodian for most of the assets held in the Investment Managers' accounts. As previously discussed, the commingled funds have their own custodians.

Custodial Fees average about \$40,000 - \$60,000 per quarter. The agreement caps fees at \$350,000 per year.

CRITERIA

Invoices for custodial services should be reconciled and approved prior to payment.

RISK DESCRIPTION

Loss of possible savings if fees have been in excess of contractual amounts.

RECOMMENDATION 5

Assign responsibility to reconcile the quarterly fees prior to payment. Pension Administration has already been proactive and has begun obtaining and reconciling quarterly billings from the custodian.

MANAGEMENT'S RESPONSE

We will take the steps as outlined.

## **CUSTODIAN TRANSACTIONS STATEMENTS NOT RECONCILED**

### **AUDIT ISSUE**

Transaction reports from the Custodian are used to record the balances and bring FAMIS into balance with the Custodian. However, testing of transactions for reasonableness of price was not done.

### **OBSERVATIONS**

JPM, the GE Pension plan's custodian, sends monthly statements for each of the 16 active funds (from 14 different Investment Managers) in the plan, plus the custodian's cash equivalent account. The City's General Accounting makes a journal entry to record changes in balances, income, expenditures, and transfers. Realized and unrealized gains and losses on investments are posted to FAMIS in this manner. There is no actual reconciliation. Individual transactions are not posted (there could be hundreds in a given month). Price testing of purchases and sales is not conducted to assure reasonableness.

The JPM report for Fidelity I is indicating an unrealized loss of \$4.3 million for an investment that cost \$4.5 million. Mercer, the Pension Fund's consultant, however, shows this investment as profitable. We researched this apparent discrepancy and found that payments over the years consisted of both principal and interest, much like a mortgage. The custodial statements have overstated income and understated return of principal, leaving the principal balance overstated. When compared to current market value, a loss is shown. The custodian may not have been given the breakdown between principal and interest and recorded most or all receipts as income.

Similarly, there is a discrepancy in reporting for Fidelity II. Both of these Fidelity Funds are "commingled" funds, which means JPM does not actually hold the security, which could have contributed to the inaccuracies.

In each of these instances, the errors would have offset each other, but it still resulted in incorrect reporting of investment income and in unrealized gains and losses.

These discrepancies may predate JPM's tenure as custodian.

### **CRITERIA**

Accurate reporting of Pension Fund assets and Revenue.

### **RISK DESCRIPTION**

Losses and gains reported by the custodian could be in error, leading to misstatement of City's financial records.

#### RECOMMENDATION 6

On a test basis, trace individual transactions to the summary totals and compare historical prices on the same day with the amount reported. If the prices do not fall within the highs and lows for the day, determine why there is a difference. On the occasion where a security pricing is not available, determine valuation method for reasonableness and document.

Determine the proper allocation of income and return of principal on any securities that pay out both and record accordingly.

#### MANAGEMENT'S RESPONSE

Pension Office staff will record the redemption of securities or other investment types in accordance with accounting rules and other conventions and on a test basis will check individual transactions for reasonableness of price.

## **MANAGERS' FEES FOR COMMINGLED FUNDS NOT RECONCILED**

### **AUDIT ISSUE**

Fees for most of the commingled funds are being charged directly to the account balance rather than billed. As a result, fees are not being reconciled, in part because no action is necessary to pay the fees. This creates two concerns:

- Fees may be incorrect
- Fees are not recognized or budgeted as an expense.

### **OBSERVATIONS**

Fees for most of the commingled funds<sup>4</sup> are being charged directly to the account by the Investment Manager, rather than billed. The fees are not being reconciled, and they are recorded as an offset to income rather than an expense by the Investment Manager.

As described earlier in this report, SSgA fees are being offset by a lending credit generated by loans of securities to other investors by the fund. Pension Administration did not have the formula to verify the credit, and could not reconcile it. As a result of inquiries made during this audit, Pension Administration obtained the formula and is now verifying calculation of the credit.

### **CRITERIA**

Control over expenses. Management fees should be budgeted and recognized in order to properly account for income and expense. Credits should be reconciled as well as expenses.

### **RISK DESCRIPTION**

Possible excessive fees.

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<sup>4</sup> Mercator, UBS, SSgA, Fidelity I, II, and III

RECOMMENDATION 7

All managers should be instructed to bill fees directly to Pension Administration. They should be processed for payment as a budgeted expense and not deducted from income.

The lending credit needs to be reconciled with the quarterly statements.

MANAGEMENT'S RESPONSE

We concur with this recommendation and will notify the various managers of the same.

Audit Note

Pension Administration has been reorganized in recent months. We found personnel to be responsive and proactive with regard to our recommendations. Current operational procedures are being reviewed and we expect continued improvements in plan administration will be forthcoming.