

Improving Your Retirement System's Financial Controls

MACRS

James Tivnan

Deputy Chief Auditor

Public Employee Retirement Administration Commission



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A review of emerging trends in risk management and staff oversight and a discussion of best practices in risk management with a focus on relevant revisions in the PERAC Audit Process

Theoretical Concepts (1)

- Maintaining an effective system of internal controls is a basic responsibility for all Board members
- Segregating duties may be impractical in a single administrator system
- Computerized software adds to the high risk environment
- How can we better meet this challenge?

Theoretical Concepts (2)

- Transaction is **authorized**: by Board, by Manager, by Administrator
- **Record** the transaction: on the books
- **Reconcile** to the information that confirms the transaction is complete: bank statement
- Maintain **custody** of the asset or property exchanged

Segregating Duties

Risks

- A single employee controls more than 2 elements of a transaction
- Compensating controls may be inadequate
- Segregating duties and compensating controls are overridden, compromised

Now is the time to re-evaluate your system's
existing financial and internal controls

WHY?

WHY NOW?

WHY NOT?

Remember the Old Days?

- People joined or ran for a Board to help people get the benefits they deserved
- The retirement administrator will take care of things if we just let her/him alone
- There is no cash to access in the system, so there's no way anybody can steal from us
- We all know each other, we'd know if there was anything wrong!

Risks

Pre 2012:

- We were reasonably confident that irregular financial activity would not occur: *It's never been worth the risk.*
- Trading losses were our primary focus. Limited degree of probability for loss from malfeasance.
- Confidence in those we held responsible: *System assets couldn't be at risk?*
- Limited opportunity to take any risk or expose the system to impairment or loss

Controls Were Compromised

We thought we had:

- *A coordinated system of controls:*
 - *Board supervision of the administrator*
 - *Board was responsible for the system of controls?*
 - *Controls can be compromised or overridden*
 - *Any control step just complicates the normal routine*
 - *Don't most of these tasks contradict the way we administer the plan?*

Did You Ever Think To Ask?

- What is the optimal cash balance?
- Why is our current bank balance different?
- What obligations do we need to fund:
 - Today?
 - This week?
 - Next week?
 - This month?
 - Next month?
- What funds can we access to meet these?

Questions That Weren't Asked?

- Why did we need to wire money in from PRIM to fund the retiree payroll?
- Why are we holding such a large balance in the local bank account?
- Why haven't we added to our invested portfolio in so many months?
- Why is check number 2507 the next one when the previous warrant ended with 2499? Where do we keep the blank checks? Who is tracking that inventory?

Answers That Weren't Given!

- I need your permission to wire money in from PRIM to fund the retiree payroll. Our contributions don't match our obligations by \$50K every month!
- We should be keeping only a minimal balance in the local bank account; interest rates are LOW!
- How are we going to invest the Appropriation from the town? Get a recommendation from the consultant!
- The last check number on the previous warrant was #2499. This warrant begins with #2500.

Cash/Bank Account Activity

- Blank check inventory controlled by 1 person
- Checks printed in retirement office for retiree payroll, vendors, transfers, etc.
- Authorized to transfer funds by wire
- Bank statement delivered directly to same person
- Access to facsimile signature to attach to checks

“The Perfect Storm”

- Laptop docking station so the Administrator could “work from home”
- One bank account for all purposes, no file provided to bank
- Warrant did not include actual checks printed, they were done later after approval
- He limited access to actual bank account activity

The Aftermath

- Printed checks payable to a Board Administrator on Quickbooks program at home
- Printed signature of an Assistant Treasurer on same checks
- Deposited checks to a personal bank account
- Reconciled the single bank statement & waited for postman to deliver it!

Undiscovered Theft

- Scheme went undiscovered for nearly 3 years
- Underreported receipts and disbursements on general ledger to cover cash imbalance
- Maintained large cash balance uninvested to cover malfeasance
- “Everybody liked him”, a gregarious, friendly guy

What Went Wrong? Everything!

- Nobody ever
 - inspected cancelled checks
 - reconciled bank account to actual records of retirement system
 - questioned check order sequence
- Bank had no reason to question his deposits
- Board delegated duty to employee with minimal oversight, very common practice

And, There's More

- Transfer of funds by wire never required any justification
- No policy on limits to signature authority, who was authorized?
- No policy on optimal cash balances
- Did not connect with invested cash position
- All deposits were prepared by the Board Administrator, delivered to bank, not recorded in any form of record

Controls Should Have Worked

- Town Treasurer should reconcile bank statement activity with retirement general ledger
- Town accountant should control check inventory, maintain log record
- Duplicate record of bank deposits kept
- Someone other than staff person who prepares the warrant should prepare and print the checks
- Uninvested cash available should have been explained

What Didn't Happen?

- Board delegated most functions to the Administrator
- Considerable discretion to perform tasks
- No regular reporting format or agenda
- Budget was an afterthought
- Informal cash position calculation, if any
- Minimal interaction with Investment Manager
- Wire transfers never reported or questioned

What We Can Do Now

- Insist on treasury reconciliation to prove cash, include all reconciling items, no variances or unidentified differences carried over
- Review all cash receipts, disbursements & adjusting journal entries every month
- Match payments to checks, wires, transfers
- Calculate cash position, cover current requirements, determine excess available to invest
- No longer accept the excuse “don’t know anything about financial stuff”

Corresponding Controls

- Periodic self-assessment by staff of risk elements
- Rotate functions in high risk areas
- Design management reports that confirm activities
- A different individual updates/confirms wire and/or cash/funds transfers
- Include wire transfers on the warrant

Monthly Financial Reporting

A significant internal financial control device is the distribution of relevant financial information to the members of the Retirement Board for their review and approval.

- Especially significant for a local retirement system with a single administrator.
- Discretion afforded a single person in the administration of the system funds must be supervised by the Retirement Board.
- Financial information provided to the Board was limited.

Financial Reporting Package

- current bank account reconciliations
- general ledger (GL) trial balances
- monthly cash receipts and cash disbursements journals
- adjusting journal entries, to be authorized
- periodic budget to actual analysis, all significant variances should be explained
- monthly forecast of cash available to be invested

Build A Better Budget

- Forecast cash position 12 months in advance
- Compare actual results to the budget by month, year-to-date and 12 months rolling
- Use %'s and positive/negative variances to provide a more visual evaluation
- Insist on a narrative explanation for every variance

Cash Budgeting Controls

- Priorities are set in written policy manual
- Match disbursements for benefits and operational expenses with receipts from contributions, buy-backs, and appropriations
- Prioritize asset liquidity
- Identify capital calls
- Compare budget to actual expenditures

Don't Ignore Payroll Data

- Many systems include a Housing Authority, RVTHS, RTS, other units
- Contributions can be diverted due to irregular schedule for payments
- Few employees unlikely to match contributions to deductions on W-2
- Many don't confirm with Annual Statement of Contributions

Business Continuity Risks

- No disaster recovery plan
- Disaster recovery plan is inadequate
- Plan is not tested, reviewed, or updated
- Key external service providers do not have a plan

Business Continuity Controls

- Develop a plan
- Identify critical processes and assign priorities for recovery within 24, 36, 72 hours
- Develop checklists, procedures, and expected results
- Establish schedule to review and update the plan
- Coordinate with external service providers
- Conduct an actual test

Strategic Planning Risks

- Inadequate planning and documentation
- Inefficient or inappropriate allocation of staff resources
- Failure to complete major projects in a timely fashion

Strategic Planning Controls

- Develop a mission statement, strategic plan, and short and long-term objectives with time frames
- Conduct annual risk assessment and performance review
- Prioritize major projects
- Document existing procedures
- Monitor the plan for compliance

The Day of Reckoning

- Pled guilty on Friday in front of Judge Tuttmann. Count 1 – Larceny Over 250; Count 2 – Uttering; Count 3 – Forgery. Tuttmann gave him the following:
 - **Count 1** – 2 years in the house of correction, suspended for 7 years with conditions
 - **Count 2** – 2 years in the house of correction, suspended for 7 years with conditions
 - **Count 3** – probation for 7 years with conditions
 - Probation conditions are: 1) home confinement for 6 months; 2) must undergo individual counseling; 3) no employment in the financial services/accounting industry; 4) random drug screens and drug treatment as deemed necessary by the probation department; 5) restitution with a minimum payment of \$200/mo.; 6) must attend either AA or NA.

CRIME DOES PAY!

Summary

- Develop a strategic plan
- Develop a plan for business continuity and disaster recovery
- Put all procedures in writing and analyze all functions for vulnerability to fraud and manipulation
- Look for efficiencies without compromising security
- Coordinate budgeting, forecasting, and system funding
- Ensure your system tools work for you and not vice versa
- Provide quality service to all members, retirees, and others
- Keep your investment advisor accountable
- **Identify Risks, Implement Controls**