

**Columbus City Schools
Office of Internal Audit**



**COLUMBUS
CITY SCHOOLS**

**Investment Management
Audit Report**

Report Date: September 26, 2019

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Executive Summary

The Columbus City Schools (District) Office of Internal Audit (OIA) completed an audit of the investment management function of the Treasurer’s Office. The District did not directly engage in transactional investing activities. The District contracted with a third-party custodian bank and three registered investment advisers (RIAs) to carry out the transactional duties and responsibilities of the investment management function. OIA’s audit focused on investment management business objectives and key performance indicators, governance, management monitoring, and compliance.

OIA reported nine (9) issues and 12 recommendations. OIA rated the risk associated with the nine (9) issues as follows:

High	Moderate	Low
2	7	0

OIA appreciates the cooperation and assistance provided by management and staff during the audit.

Risk Ratings, defined:

- 1 – High/unacceptable risk requiring immediate corrective action;**
- 2 – Moderate/undesirable risk requiring future corrective action;**
- 3 – Low/minor risk that management should assess for potential corrective action.**

Issues	Risk Rating		
	1	2	3
Objective 1: Determine whether management identified business objectives specific to the investment management function and identified key performance indicators or metrics to measure management’s success toward achieving the identified objectives.			
Issue No. 1 – Management identified business objectives did not include compliance with applicable statutes, policies, and contractual provisions and adequate safeguarding of securities as business objectives. Additionally, business objectives were not reduced to writing.		X	
Issue No. 2 – Management informally identified business risks			

Issues	Risk Rating		
	1	2	3
related to securities instruments only and no other areas of the investment management function. Informally identified business and fraud risks were assigned no measure of significance or likelihood.		X	
Objective 2: Determine whether sufficient relevant guidance exists to guide and direct management in carrying out the investment management function.			
Issue No. 3 – Formal written guidance such as memos, directives, and/or procedures manuals do not exist to carry out the investment management function.	X		
Issue No. 4 – BOE policy PO6144 omitted relevant Ohio Revised Code and best practice investment policy provisions; and included a provision which does not appear relevant to investment management.		X	
Issue No. 5 – The third-party custodian and RIA agreements are dated, ranging from 2004 to 2014. Some contain “standard” language which is neither relevant nor applicable to the arrangement or District circumstances.		X	
Issue No. 6 – OIA noted a number of conditions specific to the respective third-party custodian and RIA contracts which are reported in the Issues and Recommendations section.		X	
Objective 3: Determine whether management performs sufficient relevant monitoring of the investment management function.			
Issue No. 7 – Management has generally not implemented adequately designed internal controls to provide assurance management will meet its stated investment management objectives and reduce relevant significant risks to an acceptable level.	X		
Objective 4: Determine whether the district is in compliance with significant external and internal compliance requirements.			
Issue No. 8 – RIA and broker/dealer acknowledgements of, and agreement to comply with, the District’s investment policy were dated prior to the current policy adopted in August 2015.		X	

Issues	Risk Rating		
	1	2	3
Issue No. 9 – While management submitted the required commercial paper report for the most recent period to the Ohio Auditor of State at or prior to the required deadline, management did not submit the report to the District’s BOE and Superintendent of Public Instruction as required by Ohio statute and District policy.		X	

Audit Objectives

The objectives of the audit were:

- Determine whether management identified business objectives specific to the investment management function and identified key performance indicators or metrics to measure management’s success toward achieving the identified objectives;
- Determine whether sufficient relevant guidance exists to guide and direct management in carrying out the investment management function;
- Determine whether management performs sufficient relevant monitoring of the investment management function; and
- Determine whether the District is in compliance with significant external and internal compliance requirements.

Audit Scope

The period from which transactions and other periodic activities was generally March 1, 2018 through September 30, 2018.

Methodologies

OIA used inquiry, observation, and document/record examination to achieve the audit objectives.

Background

The District did not directly engage in investing activities. Instead, the District contracted with third-party RIAs to carry out many of the duties and responsibilities of the investment management function. The District employed three RIAs: Meeder Investments, RedTree, and United American Capital Corporation. The District contracted with Fifth Third Bank as a third-party custodian at which buy/sell transactions were settled and securities were recorded for safekeeping.

Results of the Investment Management Audit – Issues and Recommendations:

Issue No. 1 – Management identified business objectives did not include compliance with applicable statutes, policies, and contractual provisions and adequate safeguarding of securities as business objectives. Additionally, business objectives were not reduced to writing. (Moderate)

When identifying investment management business objectives management did not include compliance with applicable statutes, policies, and contractual provisions and adequate safeguarding of securities as business objectives. Additionally, management has not reduced relevant business objectives to writing.

Recommendations

1. We recommend management include compliance with applicable statutes, policies, and contractual provisions and adequate safeguarding of securities as relevant business objectives.
2. We recommend management reduce relevant business objectives to writing which include objective definitions and measurement standards.

Management Response: As part of the opportunities study within the Treasurer's Office, departmental business objectives is an expected outcome. Relevant business objectives will include recommendation 1 and will be reduced to writing.

Process Owner: Stan Bahorek, Treasurer

Implementation Date: June 30, 2020

Issue No. 2 – Management informally identified business risks related to securities instruments only and no other areas of the investment management function. Informally identified business and fraud risks were assigned no measure of significance or likelihood. (Moderate)

Management conducted no formal business or fraud risk identification and assessment activities related to investment management. Business risks informally identified included risks associated with securities only and no other areas of the function; and included no measure of significance and likelihood. Management informally identified several fraud risks but assigned no measure of significance or likelihood to the risks.

Recommendation

3. We recommend management conduct and document formal risk identification and assessment activities for the investment management function.

Management Response: A departmental risk assessment is planned for the upcoming fiscal year and will include this recommendation.

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Issue No. 3 – Formal written guidance such as memos, directives, and/or procedures manuals do not exist to carry out the investment management function. (High)

Management has not developed formal written guidance such as memos, directives, and/or procedures manuals used to carry out the investment management function.

Recommendation

4. We recommend management design, develop, and implement written operating procedures for the investment management function.

Management Response: As part of the risk assessment and internal controls development process, and in consultation with the advisor engaged in the opportunities study, appropriate procedures will be developed and committed to writing.

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Issue No. 4 – BOE policy PO6144 omitted relevant Ohio Revised Code and best practice investment policy provisions; and included a provision which does not appear relevant to investment management. (Moderate)

BOE policy PO6144 omitted the following relevant ORC provisions:

- 135.14(B)(4)(e) - Policy has paragraphs a-d; however, paragraph e is part of an “all apply” criteria;
- 135.14(G) - Provision sets prohibition on the use of interim moneys which seems relevant to specifically identify in policy;
- 135.14(K) - Provision sets expectation regarding safekeeping of securities; and
- 135.14(M)(2) - Provision sets expectation for delivery versus payment method of business.

Additionally, PO6144 does not incorporate the following provisions identified as best practice provisions for investment policies:

- A statement identifying the investment objectives;

- Standard of care language such as prudent person rule, due diligence, ethics and conflicts of interest, and knowledge and qualifications;
- Guidelines for identifying, selecting, and evaluating investment advisers;
- Statements on the government's approach to investment diversification and methods to create mix to achieve investment objectives;
- Statements on required safekeeping, custody and internal control; and
- Statements setting risks and performance measurements and standards.

Additionally, the following provision in PO6144 does not appear relevant to investment management:

- Provided the Board has no outstanding obligation(s) with respect to a loan received under the authority of R.C. 3313.483, the Treasurer of State and the Board issuing obligations under R.C. Chapter 133 that mature within one (1) year from the original date of issuance may enter into an agreement providing for:
 - the purchase of those obligations by the Treasurer of State on terms and subject to conditions set forth in the agreement; and
 - the payment by the Board to the Treasurer of State of a reasonable fee as consideration for the agreement of the Treasurer of State to purchase those obligations.

Recommendation

5. We recommend management evaluate and amend current BOE policy PO6144 for completeness, relevancy, and alignment with Ohio Revised Code guidance relative to investments and investment policy best practice provisions.

Management Response: Management will begin the process of evaluating and revising PO6144 to align with relevant Ohio Revised Code sections. Management does not believe that inclusion of relevant ORC sections verbatim in policy is necessary nor advisable. Management's intention is for policy to provide broad guidance for the investment of district funds with reference to relevant sections of the ORC as the ultimate control over investments. References to, rather than inclusion of, ORC language verbatim allows for policy to align with the ORC on an ongoing basis as changes occur in the ORC over time. Without this flexibility to, in essence, automatically align with changes in ORC, policy amendment(s) would be required to maintain alignment with the provisions of the ORC – an unnecessary step since ongoing alignment with the ORC is the desired state.

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Issue No. 5 – The third-party custodian and RIA agreements are dated, ranging from 2004 to 2014. Some contain “standard” language which is neither relevant nor applicable to the arrangement or District circumstances. (Moderate)

The third-party custodian and RIA agreements are dated, ranging from 2004 to 2014. Some contain “standard” language which is neither relevant nor applicable to the arrangement or District circumstances. Management has not periodically reviewed the custodian bank and RIA written agreement provisions since the agreements were initiated.

Recommendations

6. We recommend management reevaluate, update, and sign new agreements with the custodian bank and RIAs which reflect current circumstances and current relationships.
7. We recommend management periodically review the agreements to ensure provisions remain applicable and represent current circumstances and relationships.

Management Response: Agreements with RIAs and custodial agents will be reviewed by district management including legal counsel over the course of the fiscal year. Once completed, agreements will be scheduled for review on a triennial basis or in the event of a significant change in relevant law.

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Issue No. 6 – OIA noted a number of conditions specific to the respective third-party custodian and RIA contracts which are reported in the Issues and Recommendations section. (Moderate)

Review of third-party custodian and RIA contract agreements noted the following specific conditions to each agreement:

- Fifth Third Bank (Custodial Agreement)
 - Unclear basis and application/calculation of fees.
 - Lack of signed addendum to the agreement though required to be valid.
- Meeder Investment Management (RIA Agreement)
 - Unclear provisions regarding frequency management fee paid; period balance to which fee applied; and fee calculation.
 - Management does not have a separate agreement for investment activities related to the Short Term Liquidity Portfolio. This portfolio has different objectives and is assessed its own management fee.
- United American Capital Corporation (RIA Agreement)
 - Needed clarity to management fee provision to specify calculation of monthly billed management fee amount.

- Suggest use of provision prohibiting RIA from benefiting in any way from transactions executed for the District in all RIA agreements.
- RedTree (RIA Agreement)
 - No written agreement with current named RIA; management relied on assignment of account.
 - Paragraph 3 seems to allow the RIA to self-deal which could increase risk transactions are not in the interest of the District but instead the interest of the RIA.
 - Agreement includes reference to managing short term available monies for a fee; however, RIA does not provide such services for the District.
 - Paragraph 13 regarding mutual funds raises questions regarding permitted investments, relationships, and asset custody which management believes to not be applicable but concurred it should be removed if not applicable.
 - Agreement governed by the laws of Wisconsin rather than Ohio.
 - The agreement to manage sinking fund assets contains the same “standard” language of the RIAs agreement to manage available operating funds and thus has the same exceptions/observations noted. The management provided copy of the sinking fund agreement was signed only by the District.

Also, two of three RIA contracts lacked specific reference to delivery versus payment method of business which management identified as a significant control.

Additionally, management has not required the custodian bank, RIAs, and any brokers-dealers with which the RIAs conduct business to periodically agree/recertify to follow the District’s investment policy. Management asserted it provided the District’s investment policy only at the outset of the contractual agreement and required agreement to follow the policy only at the outset of the agreement.

Recommendations

8. When evaluating and updating custodian bank and RIA contracts, management should consider the conditions identified and seek modifications as needed to achieve objectives and promote consistency among all parties.
9. We also recommend management add and enforce a provision in the custodian bank and RIA contracts whereby the parties are required periodically to acknowledge and recertify a commitment to follow the District’s investment policy. The provision should also require RIAs assert they have provided brokers and dealers with which the RIAs conduct investment activities on behalf of the District a copy of the District’s investment policy and the brokers and dealers committed to complying with the policy. We recommend recertification be completed annually; but at a minimum no less frequently than every two years.

Management Response: Management will seek to include these recommendations in the work done as identified in responses to recommendations 5, 6, 7, and 11.

Process Owner: Stan Bahorek, Treasurer

Implementation Date: June 30, 2020

Issue No. 7 – Management has generally not implemented adequately designed internal controls to provide assurance management will meet its stated investment management objectives and reduce relevant significant risks to an acceptable level. (High)

Management has generally not implemented adequately designed internal controls to provide assurance management will meet its stated investment management objectives and reduce relevant significant risks to an acceptable level.

Recommendation

10. We recommend management implement internal controls designed to achieve its stated objectives and reduce applicable risks for the investment management function. For instance, as a control for monitoring RIAs, management could periodically present investment portfolio and performance data to the Finance and Appropriations Committee, a subcommittee of the Finance and Appropriations Committee, or a separately established investment committee.

Management Response: Design of internal controls will be included in the work identified in the response to recommendation 3. Management does not believe the establishment of another board committee is necessary and will, should the risk assessment determine additional reporting is needed, utilize the existing Finance and Appropriations Committee as appropriate.

Process Owner: Stan Bahorek, Treasurer

Implementation Date: June 30, 2020

Issue No. 8 – RIA and broker/dealer acknowledgements of, and agreement to comply with, the District's investment policy were dated prior to the current policy adopted in August 2015. (Moderate)

Scan of RIA and broker/dealer acknowledgements of, and agreement to comply with, the District's investment policy noted they were all prior to the current policy adopted in August 2015. All referenced a prior adopted policy no longer in effect.

Recommendation

11. We recommend RIAs and brokers/dealers doing investment business with or on behalf of the District sign receipt and acknowledgement of, and commitment to comply with, the District's current investment policy and management retain evidence of such to ensure accountability.

Management Response: A request was sent to all RIAs to sign the District's investment policy on June 25, 2019. Responses are expected within 60 days.

Process Owner: Stan Bahorek, Treasurer

Implementation Date: August 31, 2019

Issue No. 9 – While management submitted the required commercial paper report for the most recent period to the Ohio Auditor of State at or prior to the required deadline, management did not submit the report to the District's BOE and Superintendent of Public Instruction as required by Ohio statute and District policy. (Moderate)

Management was not in compliance with certain reporting provisions relative to investments in commercial paper. While management submitted the required report for the most recent period to the Ohio Auditor of State at or prior to the required deadline, management did not submit the report to the District's BOE and Superintendent of Public Instruction as required by Ohio statute and District policy.

Recommendation

12. We recommend management submit the required annual commercial paper investment activity report to the BOE and Superintendent of Public Instruction as required by statute and District policy.

Management Response: The annual commercial paper investment report was filed with the BOE and Superintendent of Public Instruction beginning with the August 2019 filing.

Process Owner: Stan Bahorek, Treasurer

Implementation Date: August 31, 2019