



MIAMIBEACH

BUDGET AND PERFORMANCE IMPROVEMENT
Internal Audit Division

INTERNAL AUDIT REPORT

TO: Kathie G. Brooks, Interim City Manager

FROM: James J. Sutter, Internal Auditor

DATE: December 20, 2012

AUDIT: City Non-Pension Investment Revenue Audit

PERIOD: October 1, 2010 through August 31, 2012

This report is the result of a regularly scheduled audit of the City's non-pension investment revenue between October 1, 2010 and August 31, 2012 as managed, monitored and recorded by the Finance Department's Treasury Management Section. Additionally, the Finance Department's General Ledger Section independent reviews of these investments as part of their reconciliation of the City's pooled cash SunTrust bank accounts were also analyzed.

INTRODUCTION

The City Commission through the passage of resolutions (the most recent was Resolution No. 2012-27816) has established policies relating to the investment of excess funds or monies not required to meet short term expenditures of the City in accordance with Chapter 218.415 of the Florida Statutes. These excess funds are placed into two general categories of investments.

The first category is "cash management investments" which can be defined as investments whose terms are less than one year and include all daily operating funds, debt service funds and various deposits. Short term expenditures are defined as all daily operating expenditures excluding payroll and debt service which are invested based on their payment cycle. For these short term expenditures, the City maintains a continuous investment program called a Municipal NOW account, collateralized by the full faith and credit instruments of the United States Government and its Agencies, held by the State of Florida with the City designated as collateral beneficiary.

The City is to comply with Chapter 280 of the Florida Statutes called the "Florida Security for Public Deposits Act" which among other items insures against investment principal loss on certificates of deposits and demand deposits in excess of \$250,000 per institution. In addition, the Federal Deposit Insurance Corporation (FDIC) covers demand deposits up to \$250,000 per institution. The City is to utilize only financial institutions qualified under Chapter 280 in a quarterly listing received and is required to file designated reports annually with the State.

The second category is "long term city investments" whose maturities are longer than one year. The City's investment objectives prioritized by their level of importance are safety of capital, liquidity of capital and return on capital so that safety and liquidity in that order take precedence over the return.

The City Commission through the passage of Resolution No. 2009-27066 authorized the administration to begin negotiations for investment advisory services with MBIA Municipal Investors Service Corporation, now known as Cutwater Asset Management. Although a new

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agreement has not been reached to date, Cutwater Asset Management continues to operate on a month-to-month basis under the terms of its prior agreement. Once the City's Treasury Manager determines the availability of excess funds, Cutwater Asset Management is contacted to perform its due diligence in selecting the most appropriate investment given the parameters outlined through the following formal bidding process:

- Maintain a bid list of approximately five major financial institutions qualified under Chapter 280 and two major brokerage firms which is adjusted periodically. The brokerage houses must maintain an office in Miami-Dade County and are selected based on the amount of equity in the firm, number of years the firm has been in operation and reputation.
- Place telephone calls requesting a bid from each institution on the bid list either on the day of the transaction or the afternoon immediately preceding the transaction date.
- Receive and note all bids on a standard form designated for this purpose and retain on file for each transaction.
- Recommend the highest winning bid to the City's Treasury Manager.
- If approved by the Treasury Manager, the funds are to be transferred in exchange for evidentiary receipt from the winning bidder.

The City's investment policy and procedure identifies a list of authorized types of investments accompanied by their maximum duration, maximum percentage of portfolio and the maximum number that can be purchased per issuer. For example, certificates of deposits can be purchased with a maximum duration of one (1) to three (3) years, they can comprise up to 100% of the portfolio and 25% is the maximum per issuer; rated or unrated bonds, notes or instruments backed by the full faith and government of Israel can have a maximum duration of seven (7) years, they can comprise up to 5% of the portfolio and 5% is the maximum per user; etc.

Meanwhile, section E of the City's investment policy and procedure specifically prohibits the purchase of such investments as common stock, options/futures, limited partnerships, commodities, short selling securities, etc. Also, no funds are to be invested in any scrutinized companies with active business operations in Sudan or Iran as listed by the State Board of Administration on a quarterly basis.

All City investments, except for swap agreements, must be held in an independent custodial account within the trust department of a major financial institution with a branch located in Miami-Dade County (Fiduciary Trust International). All investments must be registered in the City's name in book entry form evidenced by transaction tickets maintained by the custodian with a copy provided to the City.

The Finance Department's Treasury Management Section is to maintain the following types of information and reports on these investments:

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- Investment Transaction Report is a recording/approval form for each investment transaction regarding both active and matured investments and it also indicated all bids obtained.
- Investment Bid Sheets for each investment.
- Investment Monthly Statement which lists in chronological maturity order, pertinent information on each investment.
- Investment Monthly Statement is to be reconciled with the City's general ledger.
- Annual summary of average investment returns which is subjected to external audit for reasonableness of average stated yield for the fiscal year.

The Treasury Manager through the monthly creation of journal entry #027 records the City's investments and any interest earned. Meanwhile, the investments held by Fiduciary Trust International are to be reconciled monthly to the City's general ledger by the Finance Department's General Ledger Section, which is independent of the Treasury Management Section, as part of their review of the pooled cash SunTrust Bank accounts.

The City carries the investments at cost but maintains a record of the portfolio's market value each month. These investments' balances are adjusted to equal fair value in the annual financial statements except for those with remaining maturities of one year or less at the time of purchase, which are recorded at amortized cost as disclosed in the notes section of the City's Comprehensive Annual Financial Report (CAFR) and in accordance with GASB Statement #31. The following table shows the values of the tested City investments managed by the Finance Department's Treasury Manager, separated by revenue source, as of the designated dates:

Revenue Source	September 30, 2011 *	August 31, 2012 **
G.O. Bonds Series 2003	\$40,200,840	\$40,360,055
Parking Revenue Bonds Series 2010	\$17,181,418	\$12,112,912
RDA City Center Historic Village	\$25,102,949	\$50,321,164
RDA South Pointe	\$9,379,006	\$9,403,337
Storm Water Revenue Bonds Series 2011	\$0	\$45,750,711
Water & Sewer Bonds Series 2000	\$11,368,244	\$10,370,133
Water & Sewer Bonds Series 2006	\$10,735,197	\$9,969,844
Water & Sewer Bonds Series 2009	\$28,247,350	\$21,890,363
Pooled Cash	\$353,324,835	\$382,832,745
Israeli Bonds	\$0	\$2,000,000
Total	\$495,539,839	\$585,011,264

* The September 30, 2011 column's figures are reported at either fair value or amortized cost based on the corresponding investments' maturity dates in accordance with the City's CAFR and GASB Statement #31.

** The August 31, 2012 column's figures are all reported at cost since any investments with maturities in excess of one year would not be adjusted to fair value until September 30, 2012.

All of these tested investments above were purchased by Cutwater Asset Management and held by Fiduciary Trust International upon the Treasury Manager's authorization except for the Israeli Bonds. Instead, these bonds were purchased at the direction of the City Commission

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through Computershare (a sole source provider) and are held by the State of Israel until their June 1, 2014 maturity date.

Finally, the City's average yield for its investments excluding fiduciary trust funds according to its CAFRs for the past four fiscal years is as follows:

Fiscal Year Ending	Investments Excluding Fiduciary Trust Funds
09/30/08	3.83%
09/30/09	2.51%
09/30/10	1.49%
09/30/11	1.15%

OVERALL OPINION

The Finance Department's Treasury Management Section was found to be functioning in compliance with the City's Investment Policy and Procedure as well as applicable state and local regulations. The implementation of and adherence to strong internal controls has reduced the City's risk exposure concerning investments. Furthermore, reporting and accounting for these investments was noted to be complete, consistent and timely. Despite these positives, the following shortcomings were noted during testing and are in need of corrective action:

- The City's investment adviser, Cutwater Asset Management (formerly known as MBIA Municipal Investors Service Corporation), has been operating on a month-to-month basis since its previous non-discretionary agreement ended on January 31, 2009.
- The investment advisory fees paid to Cutwater Asset Management recorded in the City's Financial System resulted in an equal understatement of expenses and revenues by a total of \$480,334.79 during the audit period but net income (basically revenues – expenses) was not affected.
- Although the accompanying cover letter was signed, two (2) of the 171 trade tickets reviewed during the audit period or 1.17% were not signed by the City's Treasury Manager. As a result of this oversight, Fiduciary Trust International inadvertently did not receive proper purchase authorization for these two transactions totaling \$10,000,000 but they still acted as instructed.
- Twelve of the twenty-two month's pooled cash SunTrust Bank account reconciliations completed during the audit period or 54.54% were not prepared timely. Calculations show that the late reconciliations were completed an average of 9.33 days (including weekends and holidays) after the due date listed in the Finance Department's policies and procedures.

PURPOSE

The purpose of this audit was to determine whether updated City Commission approved investment policy and procedure existed that were known and followed by staff; whether sufficient documentation and internal controls were implemented to help determine the completeness and correctness of tested transactions; and whether these tested transactions were accurately recorded into the City's Financial System.

SCOPE

1. Confirm that the Finance Department's Treasury Management, investment advisor and designated fiduciary are following the City Commission approved operating policy and procedure to best achieve their mission of investing excess funds in investments that will ensure in order of importance: safety of capital, liquidity of capital and return on capital. Also, confirm that the Finance Department's staff followed the departmental policy and procedure approved by the City Administration.
2. Confirm that proper segregation of duties and internal controls are followed to provide reasonable assurance that all tested City investments are accounted for.
3. Confirm that tested files and records are adequately secured, neatly organized and properly maintained.
4. Confirm by examination of the records that tested investments were correctly deposited into the designated City accounts.
5. Confirm that tested investments and any corresponding interest payments received have been accurately recorded in the City's Financial System.
6. Confirm that an Investment Adviser has been selected, is performing the duties described in the signed valid agreement and is being properly compensated.

FINDINGS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

1. Finding – *The City's Investment Adviser (Cutwater Asset Management) has been Operating on a Month-to-Month Basis since its Previous Non-Discretionary Agreement Ended on January 31, 2007*
The City Commission adopted Resolution No. 2004-25456 which included a signed Investment Advisory Non-Discretionary Agreement reached with MBIA Municipal Investors Service Corporation (now known as Cutwater Asset Management). This three page agreement was in effect through January 31, 2007 but could be extended for two one-year periods upon written mutual agreement. However, no documentation was

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provided showing that both parties elected to extend the agreement's terms through January 31, 2009.

The City Commission approved item number C2B from the Consent Agenda's Competitive Bid Reports Section on December 10, 2008 which authorizing the issuance of a request for proposals for investment advisory services and to extend the existing agreement in a month to month basis with MBIA Investors Service Corporation. Resolution No. 2009-27066 was subsequently ratified by the City Commission on May 13, 2009 authorizing the Administration to enter into negotiations with the top ranked investment advisory services proposer, MBIA Municipal Investors Service Corporation, based on their response to Request For Proposals (RFP) No. 11-08/09. Furthermore, it stated that negotiations should begin with the second ranked proposer if they were unsuccessful with the top ranked proposer. To date, no documentation has been provided showing that an agreement has been reached with any firm to provide investment advisory services.

Instead, MBIA Municipal Investors Service Corporation/Cutwater Asset Management has continued to provide these investment advisory services under the terms of the non-discretionary agreement approved in Resolution No. 2004-25456. One drawback noted was that their winning response to RFP No. 11-08/09 offered to decrease its investment advisory fees by 1% for the City's first \$175,000,000 invested which would result in a monthly savings of \$1,458.33. Consequently, the absence of a new agreement has resulted in the City not realizing \$56,875 in savings between June 2009 and August 2012 with this amount increasing by \$1,458 for each passing month.

Finally, inquiries with the Procurement Division and review of the City Clerk's Pending Items Report found that the Finance Department would not have been notified of the need to reach an agreement with MBIA Municipal Investors Service Corporation/Cutwater Asset Management after the passage of Resolution No. 2009-27066. There was no procedure in place by which departments/divisions were continually notified of expired agreements at this time.

Recommendation(s):

The City Administration should issue a new RFP for investment advisory services due to the amount of time that has elapsed since Resolution No. 2009-27066 was approved. Meanwhile, the City's Finance Department should consider reducing Cutwater Asset Management's monthly fee to equal the terms stipulated in RFP No. 11-08/09. Also, a legal opinion should be requested from the City Attorney's Office on whether collection of the \$56,875 (\$1,458.33 x 39 months) paid between June 2009 and August 2012 should be pursued.

Finally, the City's Procurement Division should maintain an accurate and updated list of all agreements which have expired and that have not been replaced to date. This listing should be distributed monthly to all City Department/Division Heads so that their status can be continually monitored to help ensure that the appropriate actions are being taken.

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Management Response:

Since there is no signed contract with the current Investment Advisor, the Finance Department will issue an RFP for Investment Advisors as soon as possible.

2. Finding – *The Finance Department Did Not Properly Record the Investment Advisory Fees Paid to Cutwater Asset Management During the Audit Period Resulting in an Equal Understatement of Expenses and Revenues by \$480,334.79*

Cutwater Asset Management billed the City monthly for its investment advisory fees and was timely paid by City check or wire transfer during the 23 month audit period. However, review of the affected general ledger accounts in the City's Financial System found that the transactions were not recorded in the most transparent manner. The Finance Department opted to debit or decrease interest revenue rather than debiting the appropriate expense account instead by the amount of the monthly fee payment. As a result, the City's revenues and expenses were equally understated by \$480,334.79 during the audit period (excludes August 2012's investment advisory fee payment which was not made prior to the conclusion of this audit) but net income (basically revenues – expenses) was not affected.

Recommendation(s):

Going forward, the Finance Department should debit the appropriate expense general ledger account when recording the monthly Cutwater Asset Management investment advisory fee payment so that the corresponding expense and revenue accounts are accurately stated.

Management Response:

Ever since the City hired an Investment Advisor to assist with the City's investments, it was agreed that their fees would be paid from the interest earnings as it was stated in the Resolutions that authorized the hiring of the Investment Advisor. Thus, that is the reason why the payment of their fees is posted as a reduction to interest revenue in the general ledger.

3. Finding – *Two (2) of the 171 Trade Tickets Reviewed or 1.17% were Not Signed by the City's Treasury Manager Giving Approval to Fiduciary Trust International to Purchase the Designated Investments*

Once the City's Treasury Manager determines the availability of excess funds, Cutwater Asset Management is contacted to perform its due diligence in selecting the most appropriate investment given the parameters outlined. Upon the completion of their analysis, the Treasury Manager receives a trade ticket which contains the required Investment Transaction Report (a recording/approval form for each investment transaction regarding both active and matured investments and it also indicated all bids obtained) and the Investment Bid Sheets (lists the other possible investments received that were not recommended to be purchased).

The received trade ticket is to be reviewed and signed only if approved before being forwarded to the City's custodian (Fiduciary Trust International) authorizing the purchase

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of the corresponding investment. If the trade ticket is not signed, no action is to be taken and the investment is not to be purchased.

Testing found that two (2) of the 171 trade tickets reviewed or 1.17% were inadvertently not signed by the City's Treasury Manager before being forwarded to Fiduciary Trust International but the listed investments totaling \$10,000,000 were purchased. In fairness to Fiduciary Trust International the attached cover letter was signed and the documents were emailed from the City's Treasury Manager, however; the cover letter specifically states "Please accept my signature on the attached Transaction Reports {trade tickets} as purchase authorization for the investments."

Recommendation(s):

The City's Treasury Manager or his designee should ensure that all trade tickets are signed before they are submitted to Fiduciary Trust International for processing. Similarly, Fiduciary Trust International should also confirm that the trade tickets are signed before making any purchases and immediately notify the City of any missing signatures.

Management Response:

The Treasury Manager will make every effort possible to assure that all trade tickets are signed by him before submitting them to Fiduciary Trust International (FTI) for trading. This oversight did not affect the security of the transaction due to the fact that the Treasury Manager prepares a signed cover sheet which authorizes FTI to honor the trade tickets that are attached to said cover sheet, and in addition, the cover sheet and trade tickets are scanned and emailed (by the Treasury Manager) to FTI. This adds two layers of security in addition to the signed trade tickets. Even if a trade ticket was not authorized by the Treasury Manager and FTI purchased/sold any investment, the Treasury Manager would have found out this discrepancy on the 1st of the following month when FTI faxes the Treasury Manager the activity in the account for the prior month.

In addition, the Treasury Manager will contact FTI and remind them not to honor any trade tickets that are not signed by the Treasury Manager, and to immediately call the Treasury Manager, the Assistant Finance Director or the Chief Financial Officer.

4. Finding – *Tested Pooled Cash Bank Reconciliations were Not Completed Timely for Twelve of the Twenty-Two Months Sampled or 54.54%*

The Finance Department's policy and procedure states "A reconciliation of each bank account held by the City of Miami Beach must be completed and approved on a monthly basis. The pooled cash bank reconciliation should be completed 45 days from the end of the month being reconciled." Consequently, October's pooled cash bank reconciliation should be completed by December 15th and so on. However, their target measure on the City's performance measurement software is 50 days which is 5 days more than stated in the department's policy and procedure. Reconciliations are a valuable internal control feature when individuals, independent from those performing

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the work, complete them timely as they enable others to be reasonably assured that all monies are accounted for and that the checking account balances are correct.

Testing found that twelve of the twenty-two pooled cash bank reconciliations completed during the audit period or 54.54% were finished after the due date specified in the department's policy and procedure. The number of days late ranged from a low of 2 days for April 2011 to a high of 27 days for June 2012 and were an average of 9.33 days late per month (includes weekends and holidays).

Using the more lenient 50 day due date detailed in the City's performance measurement software, the number of months not prepared timely decreased to nine of the twenty-two pooled cash months bank reconciliations sampled or 40.91%. The number of days late ranged from a low of 1 day for November 2010 to a high of 22 days for June 2012, averaging 6.11 days for all months late (including weekends and holidays).

Recommendation(s):

The Finance Department should amend either their policy and procedure or their performance measurement software goals so that they are in agreement. Once the targeted due date is finalized, Finance Department personnel should complete all bank reconciliations timely in adherence to sound internal controls.

Management Response:

The Finance Department has 50 days to complete the pooled cash and investment bank reconciliation as noted in the City's performance measurement software and the department's operating policy and procedure will be changed accordingly. All other investment reconciliations were also completed within 50 days.

EXIT CONFERENCE

An exit conference was held on November 7, 2012 to discuss the audit report in the Finance Department's Conference Room. Attendees were Assistant Finance Director Georgina Echert, Treasury Manager Juan Rodriguez, Internal Auditor James Sutter and Senior Auditor Mark Coolidge. Management responses were solicited and were received shortly thereafter. All were in agreement with the contents of this report.

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(audit performed by Senior Auditor Mark Coolidge)

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cc: Patricia Walker, Chief Financial Officer
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