



## **Office of Internal Audit**

### **Audit of Treasury Management**

**Report No. 19/20-04  
October 29, 2019**

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## **OBJECTIVES, SCOPE, AND METHODOLOGY**

Pursuant to the approved annual plan for the 2019-2020 fiscal year, we have completed an audit of the University's Treasury Management function for the period July 1, 2017, through December 31, 2018, and an assessment of the current practices through May 2019. The objectives of our audit were to determine whether the Office of the Treasurer's procedures and internal controls ensure that:

- (a) The monitoring and reporting of the Portfolio's performance is adequate;
- (b) Investment policies and procedures are in compliance with all applicable laws, rules, regulations, and best practices;
- (c) Controls for executing investment transactions are adequate and comport with best practices;
- (d) The University is in compliance with all indentures;
- (e) Procedures surrounding cash exhibit proper segregation of duties and are processed adequately; and
- (f) Processes for accessing new and ongoing relationships are proper.

The audit was conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing* promulgated by the *Institute of Internal Auditors*. The audit included tests of the accounting records and such other auditing procedures, as we considered necessary under the circumstances. Audit fieldwork was conducted from May 2019 through August 2019.

During the audit, we:

- Tested the adequacy of internal controls and processes for monitoring the Portfolio's performance;
- Reviewed the Portfolio's asset allocation for compliance with the University's Investment Policy;
- Observed the University's procedures for managing investments, debt compliance, and cash;
- Evaluated the adequacy of internal controls and processes for the periodic reconciliation of investment accounts;
- Tested selected investment transactions against University policies and procedures and Florida Statutes; and
- Evaluated existing vendor relationships to determine if proper.

Sample sizes and transactions selected for testing were determined on a judgmental basis applying a non-statistical sampling methodology.

As part of our audit, we reviewed our prior internal audit, Report No. 11/12-04, Audit of Controls over University Cash and Investment Accounts, issued December 15, 2011, to determine the status of any applicable prior recommendations related to the scope and objectives of this audit. Any repeat audit findings from the prior audit are indicated throughout this report. Additionally, the Florida Auditor General issued an Operational Audit Report (No. 2020-005) in July 2019 which identified two (2) findings related to investments. The University's responses to these findings were considered during our testing of investments (pages 8 and 11).

## **BACKGROUND**

The Florida International University Board of Trustees (“BOT”) and the four-member Investment Committee<sup>1</sup> (“Committee”) manages the assets of the University’s Portfolio in accordance with Florida Statutes, Section 218.415, *Local Government Investment Policies*, and Section 1011.42, *University Depositories*. The Investment Policy (Policy 1160.010) serves as the governing document, which sets forth the goals and objectives of the University’s operating funds investment Portfolio and establishes guidelines for the implementation of investment strategy.

The University’s Office of the Treasurer assists with functions related to:

- Monitoring the University’s liquidity position;
- Managing the investments of the Portfolio; and
- Administering the issuance of debt, annual disclosures, and compliance with post-issuance covenants.

### **Investments**

The Committee meets quarterly to review the results of the investment Portfolio, as well as to determine if the investment objectives set forth in the Investment Policy are being met. The Policy states that the Portfolio should be managed in accordance with the following three (3) objectives, in ranking order: (1) maintain the safety of the principal, (2) maintain the necessary liquidity to ensure funds are available to support operational needs, and (3) obtain a reasonable return for a prudent level of risk. The University’s Total Combined Pool Target consists of (subject to the approximate specified ranges):

Working Capital Pool	40%
Strategic Capital Pool	50%
Reserve Capital Pool	10%
<b>Total Combined Pool</b>	<b>100%</b>

The Committee utilizes a third-party investment consultant (Meketa Investment Group or “consultant”) for guidance and recommendations related to all Portfolio matters. The consultant is responsible for communicating with the investment managers (“managers”) and performing the attendant due diligence. Throughout the period tested, the University had assets managed by 21 managers. Such managers have full discretion in making all investment decisions for assets under their care, so long as assets are managed in a manner consistent with the established Investment Policy Statement.

Regions Bank serves as the University’s investment custodian (“custodian”). As part of this relationship, the custodian facilitates all transactions between the University and investment managers. Regions Bank initiates transactions upon written request (Direction Letter) from the Chief Financial Officer.

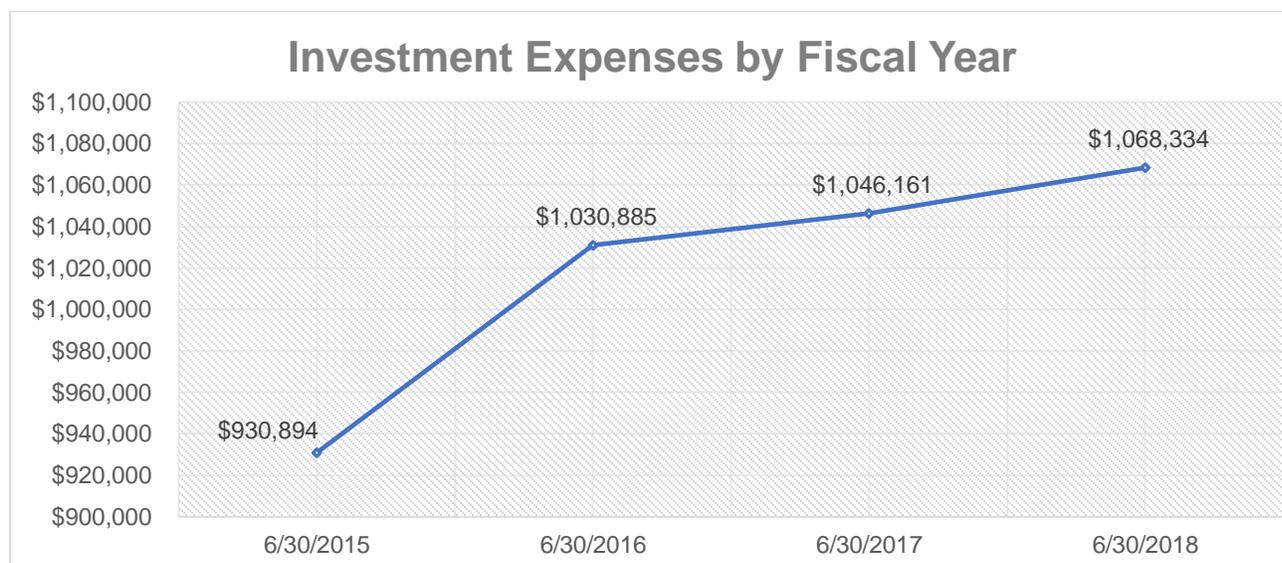
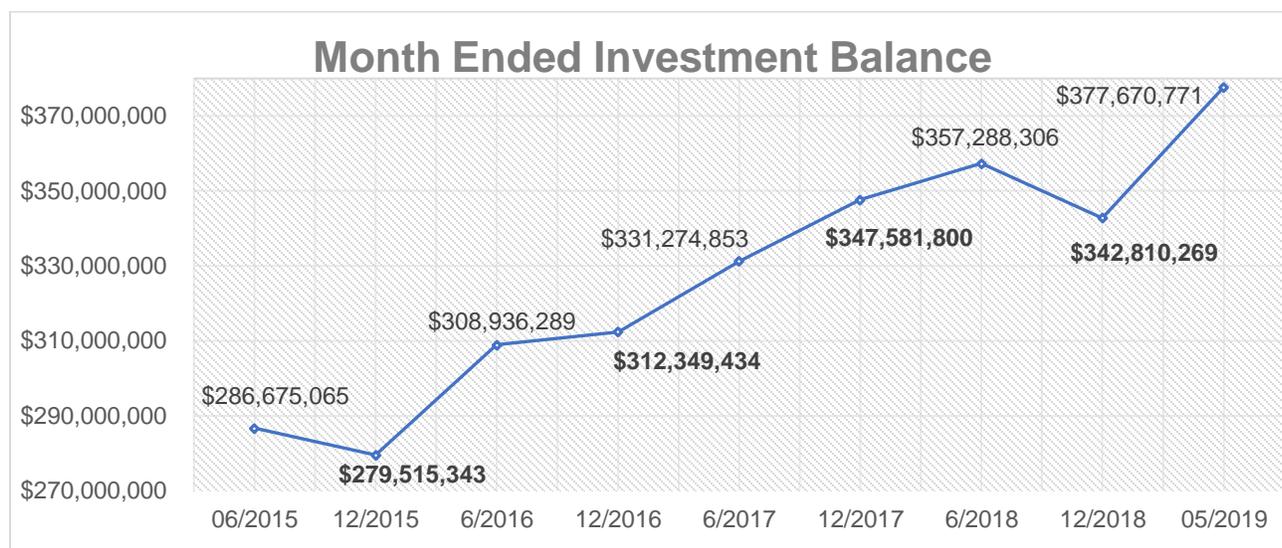
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<sup>1</sup> The Committee is composed of an individual designated by the BOT, the University’s Chief Financial Officer, the University’s Treasurer, and a representative from University academics.

On a quarterly basis, the University's Office of the Controller reconciles investment accounts utilizing corresponding bank and manager statements.

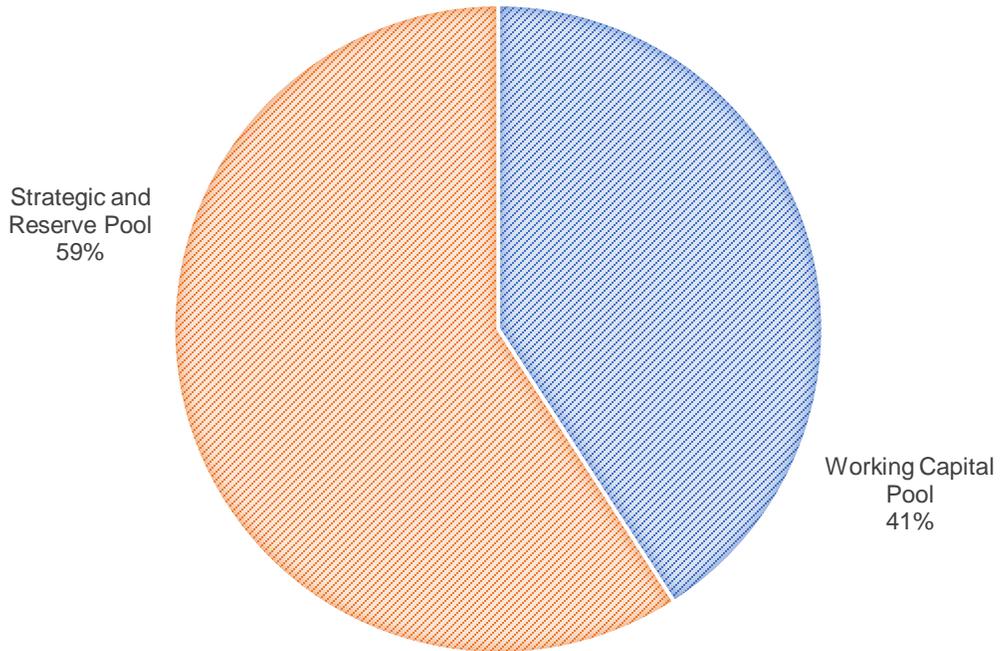
The University's investments totaled \$342,810,269 at December 31, 2018. We identified 21 activity numbers with investment purchases totaling \$177,475,415 and investment sales totaling \$187,332,300 between July 1, 2017, and December 31, 2018. Management stated that the decline in the investment balance at December 31, 2018 does not reflect investment results, but rather, the timing of cash flows.

For the same 18-month period, the University incurred \$1,303,036 in investment expenses, mostly composed of investment manager and custodian fees. (See Investment Manager Fees on page 15.)

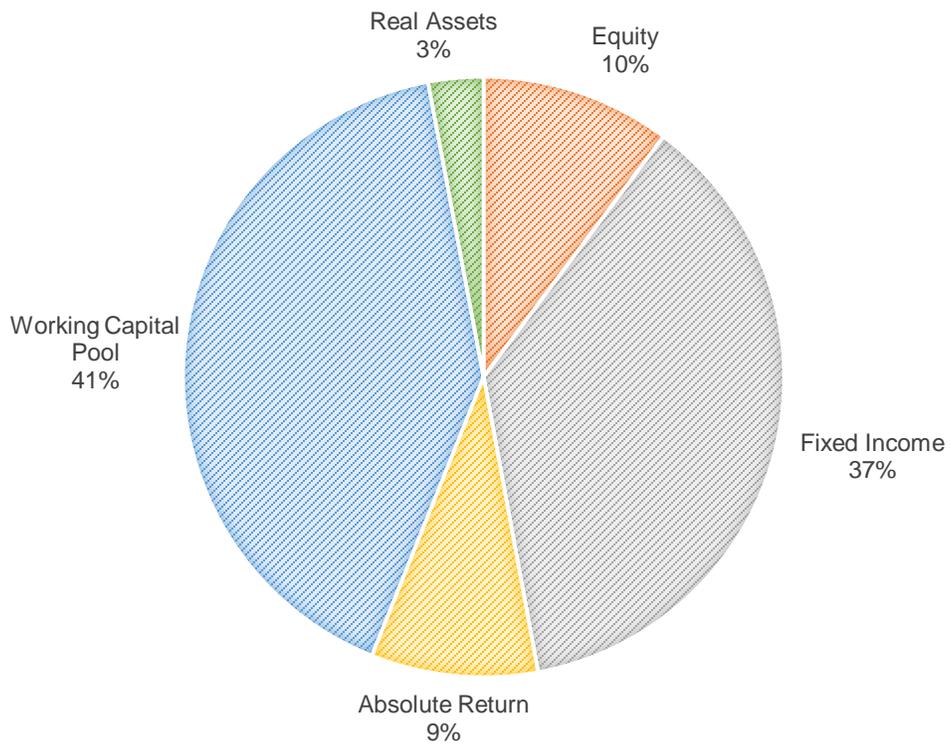


**Note:** 2019 Investment Expenses were not depicted above, as some investment managers had not yet billed Fiscal Year 2019 fees.

## Total Combined Pool at May 31, 2019



## Asset Allocation at May 31, 2019



## Debt

The Office of the Treasurer participates in the issuance of debt, assisting with annual disclosures, and complying with post-issuance covenants. A consultant (Digital Assurance Certification LLC) is engaged on retainer for post-issuance compliance. The Office of the Treasurer coordinates with the Division of Bond Finance and provides support for requests, as needed.

Throughout the years, the University has issued debt to finance capital improvements related to housing and parking projects. The following table lists such recent issues.

	<b>Series</b>	<b>Issue Date</b>	<b>Issue Amount</b>
<b>Housing</b>	2011A	December 21, 2011	\$22,210,000
	2012A	May 3, 2012	\$53,655,000
	2015A	July 21, 2015	\$29,105,000
<b>Parking</b>	2009B	December 17, 2009	\$28,915,000
	2013A	September 26, 2013	\$48,365,000

As of May 31, 2019, the University had \$142,752,056 outstanding Capital Improvement Debt. The University has pledged a portion of future housing rental revenues, traffic and parking fees, and an assessed transportation fee per student to repay the capital improvement revenue bonds issued by the Florida Board of Governors on behalf of the University. Repayment of bonds proceeds are solely from the aforementioned sources and are payable through 2043. The University has committed to appropriate each year's monies to cover the principal and interest requirements on the debt.

## Cash

The Office of the Treasurer monitors the University's liquidity position and evaluates whether funds are available to support the day-to-day operations. Liquidity matters and internal controls surrounding cash are governed by the University's Investment Policy and Cash Control Policy.

## **OBSERVATIONS AND RECOMMENDATIONS**

Our overall assessment of internal control is presented in the table below. In summary, we noted that the University’s investment portfolio is operated in accordance to the goals and objectives set forth by the Board of Trustees. However, opportunities for improvement exist as it relates to the documentation and approval of policies and procedures, as well as the timely completion of proper background screenings and Conflict of Interest disclosures. In addition, we noted certain inconsistencies in how investment manager fees are reported that could result in incomplete reporting. Our observations and recommendations pertaining to these identified areas are detailed on the following pages of this report. We have also included management’s responses to our observations and recommendations, along with their implementation dates.

<b>INTERNAL CONTROLS RATING</b>			
<b>CRITERIA</b>	<b>SATISFACTORY</b>	<b>FAIR</b>	<b>INADEQUATE</b>
<b>Process Controls</b>		<b>X</b>	
<b>Policy &amp; Procedures Compliance</b>	<b>X</b>		
<b>Effect</b>	<b>X</b>		
<b>Information Risk</b>	<b>X</b>		
<b>External Risk</b>	<b>X</b>		
<b>INTERNAL CONTROLS LEGEND</b>			
<b>CRITERIA</b>	<b>SATISFACTORY</b>	<b>FAIR</b>	<b>INADEQUATE</b>
<b>Process Controls</b>	Effective	Opportunities exist to improve effectiveness	Do not exist or are not reliable
<b>Policy &amp; Procedures Compliance</b>	Non-compliance issues are minor	Non-compliance Issues may be systemic	Non-compliance issues are pervasive, significant, or have severe consequences
<b>Effect</b>	Not likely to impact operations or program outcomes	Impact on outcomes contained	Negative impact on outcomes
<b>Information Risk</b>	Information systems are reliable	Data systems are mostly accurate but can be improved	Systems produce incomplete or inaccurate data which may cause inappropriate financial and operational decisions
<b>External Risk</b>	None or low	Potential for damage	Severe risk of damage

The areas tested during the audit and our observations and recommendations are detailed below.

## **Areas Within the Scope of the Audit Tested Without Exception:**

### **Portfolio Performance**

We performed tests to determine whether internal controls and processes for monitoring and reporting the portfolio's performance were adequate. Overall, our testing concluded that such controls and processes were adequate. We noted that:

1. The University's Board of Trustees and Investment Committee manage the assets of the portfolio in accordance with the Prudent Expert Rule, a higher standard than the Prudent Man Rule in the Florida Statutes, Section 218.415, *Local Government Investment Policies*, and Section 1011.42, *University Depositories*.
2. The quarterly Treasury Reports were timely presented to the Board of Trustees.
3. Reported figures reasonably agreed to the General Ledger and calculations appeared correct.
4. The Portfolio's underlying assets and composition are proper based on the University's Investment Policy and Florida Statute Section 218.415.

We also reviewed the overall process and assumptions for conducting forecasts and stress tests. We did not test or analyze the forecasts or the methodology used for stress tests. However, we validated that these activities were timely performed, the basis for assumptions (portfolio value) appeared reasonable, and the resulting numbers from these analyses were timely presented to the Committee.

### **Debt Compliance**

The Office of the Treasurer is involved with the issuance of debt and post-issuance compliance matters related to issuing annual disclosures and adhering to bond covenants. We ensured that there are clear guidelines outlining the authority to incur indebtedness and the reason for debt financing is clearly detailed and justified. We found that the University adheres to the State University System of Florida Board of Governors Debt Management Guidelines for pre-issuance requirements. Additionally, the University has established the Tax-Exempt Post-Issuance Compliance Policy, which outlines the post-issuance requirements for debt financing.

In addition, the University must comply with continuing disclosure and covenant requirements as stated in bond documents. The Office of the Treasurer is responsible for coordinating with the Division of Bond Finance to ensure compliance with any

special obligations. We reviewed outstanding bonds and concluded that post-issuance debt requirements are being timely adhered to.

### **Cash Policy Controls**

The Cash Control Policy is set forth to ensure uniformity University-wide in cash collection and handling, as well as, covering the controls for safeguarding the cash and mitigating the inherent risk of loss. We reviewed the Cash Control Policy to determine if it addressed proper segregation of duties for the collecting, depositing, recording, and monitoring of cash. We found that the Cash Control Policy in place requires separation of the cash handling and record-keeping functions.

### **Target Cash Balance**

The Investment Policy sets forth the goals and objectives of the University's operating funds investment portfolio and establishes guidelines for the implementation of the investment strategy. The focus of our testing was whether senior leadership had established a target cash balance. We found that the Committee does not have a target cash balance dollar amount, but rather a target cash percentage. The Policy has established the Working Capital Pool's target as 40 percent; however, due to the nature of this Pool (utilized for immediate normal operating requirements), the percentage may fluctuate. Nonetheless, it is our opinion that the target cash percentage complies with the Investment Policy.

### **Safeguarding of Data**

We determined if logical access to sensitive documentation and systems utilized in the Treasury process was restricted to the proper individuals and safeguards the University's financial assets. Our overall assessment was that the logical access granted is commensurate with job responsibilities. We also reviewed a sample of the University's bank accounts and determined that signers on the accounts were up-to-date and properly reflected the Board of Trustee's authorized signers.

### **Reconciliation of Investment Accounts (Follow-up)**

The State of Florida Auditor General's Operational Audit Report (No. 2020-005) issued in July 2019, noted that investment account reconciliations were not timely performed, with reconciliations conducted 87 to 309 days, or an average of 202 days, after the end of each quarter. The report stated that, "*good business practices require that investment accounts be periodically reconciled to accounting records and that the University establish procedures to reconcile investment accounts within 30 days after the end of each quarter*". Management noted several factors which occurred during the span of time audited, which resulted in unusual and unexpected delays in the investment reconciliation process. Moreover, management noted that some investment statements are not received for three or more months after a quarter's end. The University's response stated that 30-45 days was a reasonable time frame for quarterly reconciliations with up to 90 days for year-end reconciliations.

In order to determine if the timing of investment account reconciliations had improved, we reviewed the reconciliation performed by the Office of the Controller for the quarter ended March 31, 2019. Reconciliations for investment accounts were completed 45 days after quarter end. Therefore, we noted a significant improvement with the timing of completing the reconciliations. Amounts noted on the reconciliations agreed to the corresponding support (i.e., statements and trial balance) and the Office of the Controller exhibited proper segregation of duties between the preparer and the approver.

## **Training**

Per Florida Statutes Section 218.415, *Local Government Investment Policies*, local government officials responsible for making investment decisions or the Chief Financial Officer must annually complete eight (8) hours of continuing education in subjects of courses of study related to investment practices and products. We determined that the Chief Financial Officer, as well as the Treasurer, obtained more than the minimum number of annual continuing education hours required for 2017, 2018, and 2019.

## **Vendor Relations**

The University's treasury management function utilizes various vendors, including investment managers to assist with processes related to managing the University's investment portfolio. We evaluated these relationships to assess vendors' adherence to the University's competitive solicitation process and concluded that the University's bidding process is being adhered to for external service providers. We also evaluated vendor relationships for potential conflicts of interest and no potential conflicts with vendors or investment managers were identified. Also, please refer to Observation 3, Vendor Management on page 15 of this report.

## Areas Within the Scope of the Audit Tested With Exception:

### 1. Investments

We identified 21 activity numbers with investment purchases totaling \$177,475,415 and investment sales totaling \$187,332,300 from July 1, 2017, through December 31, 2018. The objective of our Investments testing was to determine if investment policies and procedures are in compliance with all applicable laws and regulations and whether internal controls for executing investment transactions are proper.

#### **Investment Policy**

The Investment Policy sets forth the goals and objectives of the University's operating funds investment portfolio and establishes guidelines for the implementation of the investment strategy. The Investment Policy was last revised on December 8, 2017, and is published in the University's Policies and Procedures Library. We reviewed Florida Statutes Section 218.415, *Local Government Investment Policies*, to ensure that the Investment Policy met all requirements as set out by the statute. We noted that the current Investment Policy does not address all required subsections of the statute. Specifically, we noted:

- Florida Statutes Section 218.415(10) states that, "*the investment policy shall provide appropriate arrangements for the holding of assets of the unit of local government.*" The Investment Policy does not address arrangements for the holding of assets by the third-party investment custodian (Region's Bank).
- Florida Statutes Section 218.415(13) states that, "*the investment policy shall provide for a system of internal controls and operational procedures. The unit of local government's officials responsible for making investment decisions or chief financial officer shall establish a system of internal controls which shall be in writing and made a part of the governmental entity's operational procedures. The investment policy shall provide for review of such controls by independent auditors as part of any financial audit periodically required of the unit of local government. The internal controls should be designed to prevent losses of funds which might arise from fraud, employee error, misrepresentation by third parties, or imprudent actions by employees of the unit of local government.*"

The Policy does not reference the operational procedures. Moreover, the existing operational procedures do not fully encompass key internal controls. During the planning phase of the audit, we noted that the Treasurer obtains a signed Direction Letter from the Chief Financial Officer prior to submitting transaction requests to the Investment Custodian (Regions Bank). However, this process, along with other internal operational processes (i.e., review of

investment manager fees) are not documented within the existing operational procedures. Documentation is necessary to foster transparency and support effective decision-making, and provides invaluable information if there were key personnel turnover in the future.

We noted that the remaining 14 subsections reviewed were properly addressed within the Investment Policy.

## **Investment Transactions**

We selected a sample of eight (8) purchases, totaling \$142,500,000 (80% of purchases) and 12 sales, totaling \$181,383,815 (96% of sales) to determine whether investment transactions were properly executed.

Our tests concluded that investment transactions were:

- Approved by an employee with proper authority;
- Reasonably within the established asset allocations; and
- Related to permissible asset classes.

However, we noted that Direction Letters may be approved for weeks, and sometimes months, ahead of the University's desired transaction execution date. Treasury Management informed us that each investment manager has different withdrawal requirements. As such, we reviewed the Direction Letters to determine whether management monitored changes during this extended notice period. We found there was no documentation which showed that market fluctuations between the two dates were monitored, prior to the transaction being executed. Per discussion with the Treasurer, he stated they are long-term investors and do not try to time the market. Moreover, they informed us that the transactions could have been canceled within a few days' notice should the need arise. Notwithstanding management's long-term strategy, we believe it would be prudent to monitor market fluctuations during extended lapses of time between transaction approval and execution dates. If a significant change were to occur that would cause the pool allocation to be materially out of balance, management could cancel the transaction in order to achieve the intended portfolio rebalancing goal.

## **Net Investment Income Allocations (Follow-up)**

The State of Florida Auditor General's Operational Audit Report (No. 2020-005) issued in July 2019, noted that they estimated the University over allocated more than \$8.2 million net investment income to the Auxiliary Enterprises Fund and under allocated the same amount to other funds, which increased the risk that income from restricted resources will not be used consistent with the restrictions governing those resources. The University's response stated that it will carefully review and, as appropriate, update the allocation methodology. As part of the review of the allocation methodology, FIU will make the necessary adjustments to restore the appropriate amount of allocations to the Educational and General (E&G), and other funds. The University stated that it will review the restricted investments to ensure that the use of

earnings is not inconsistent with restrictions governing those funds. As of the writing of this report, management is continuing its review of whether to update its allocation methodology and has yet to determine whether any adjustments are necessary to restore the appropriate amount of allocations to the E&G and other funds.

## **Recommendations**

Treasury Management should:	
1.1	Update the Investment Policy to fully comply with Florida Statutes Section 218.415.
1.2	Expand its investment procedures to encompass key processes.
1.3	Establish a formalized process for monitoring the market for significant fluctuations during lapses of time between transaction approval and execution dates.

## **Management Response/Action Plan**

- 1.1 We concur with this recommendation and expect to have the revised policy brought to the Board of Trustees, for approval, by the June 2020 Board Meeting.

**Implementation date:** June 2020

- 1.2 We concur with this recommendation and expect to have the expanded written procedures by December 2019.

**Implementation date:** December 31, 2019

- 1.3 The Investment committee does not attempt to time the markets but focuses on long term return performance and maintaining approved target weights by investment category. The committee will consider a policy change to monitor extreme market conditions and possibly canceling outstanding transactions, when appropriate.

**Implementation date:** December 31, 2019

## **2. Personnel**

The University's Office of the Treasurer is composed of two (2) employees, the University Treasurer and a Financial Analyst. The staff has the responsibility of administering and coordinating the implementation of decisions made by the Committee and the Board of Trustees. Therefore, our objective was to determine whether appropriate background screenings and Outside Activity Forms were timely completed by Treasury Staff and whether staff is obtaining sufficient hours of appropriate training as required per Florida Statutes Section 218.415, *Local Government Investment Policies* (please refer to the subsection titled Training on page 9 of this report for our observation on employee training).

### **Background Screenings**

University Policy No. 1710.257, *Background Check Requirements*, requires Level II<sup>2</sup> background screenings for the Treasurer and any position managing major investments. We reviewed both employees and noted that there was no evidence of a Level II screening for the Financial Analyst I on file with Human Resources. Subsequently, we were informed by Human Resources that the Financial Analyst I cleared the Level II screening on September 16, 2019.

As noted in University Policy No. 1710.257, if appropriate background screenings are not performed, the University may expose itself to "hiring individuals with a proven tendency to defraud or steal from their employers, who engage in workplace violence, or who would otherwise appear to be untrustworthy and unreliable."

### **Outside Activity/Conflict of Interest Disclosures**

According to Employee and Labor Relations procedures, the Outside Activity/Conflict of Interest reporting requirement must be completed by all FIU faculty and staff members on an annual basis, regardless of whether or not the employee has an activity to report.

We noted that neither of the Office of the Treasurer employees active at the 2017-2018 fiscal year end had completed an Outside Activity/Conflict of Interest disclosure for the year. By reporting outside activity, employees help to ensure that FIU's academic, research, and administrative affairs are conducted with the utmost integrity and in compliance with all legal requirements. Upon our notification both employees completed the Outside Activity/Conflict of Interest disclosure for the 2018-2019 fiscal year.

Failing to identify conflicts of interest may result in the University's primary objectives being influenced by secondary interests.

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<sup>2</sup> A Level I background screening consists of a search for any criminal information at the federal, state and county levels on an individual within the last seven (7) years. A Level II criminal background screening requires fingerprinting that searches the Florida Department of Law Enforcement and the Federal Bureau of Investigation database in addition to the Level I search.

## **Recommendation**

Treasury Management should:	
2.1	Ensure that all Office of the Treasurer personnel complete the Outside Activity/Conflict of Interest form annually.

## **Management Response/Action Plan:**

- 2.1 We concur with this recommendation. Office of the Treasurer personnel completed the FY 2020 conflict of interest form by October 14, 2019.

**Implementation date:** Immediately

### **3. Vendor Management**

The University's treasury management function utilizes various vendors, as well as investment managers to assist with processes related to managing the University's investment portfolio. We reviewed these relationships to determine the adequacy of assessed fees, evaluate adherence to the University's competitive solicitation process, and to identify any potential conflicts of interest with vendors. (Please refer to the subsection titled Vendor Relations on page 9 of this report for our observation on vendors' adherence to the University's competitive solicitation process and potential conflicts of interest).

#### **Investment Manager Fees**

We identified 21 activity numbers which incurred \$1,303,036 in investment expenses, mostly related to manager fees from July 1, 2017, through December 31, 2018, and we tested four transactions totaling \$193,108. We found that although the Investment Committee monitors and controls investment fees at the portfolio level, the Office of the Treasurer does not document its review of investment manager fees on each statement. Therefore, there is no evidence that fees are timely reviewed for accuracy by the Office of the Treasurer, prior to being submitted to the Office of the Controller for posting to PantherSoft. We recalculated \$121,263 of investment manager fees without exception.

However, for one of the four transactions tested, we found that a certain investment manager allocated the proportional share of net operating losses from investments (\$71,845), as permitted by the agreement, and this share along with the management fee were charged to *Investment Expenses*. However, other than the amount being charged on the statement, there was no evidence to support the amount. Management stated that said charges were minimal in comparison to the returns being received from this investment manager. Nonetheless, we believe that such charges should be properly supported and reviewed for accuracy or reasonableness. Subsequently, management obtained a breakdown of the net operating loss figure and recalculated the management fee without exception.

Furthermore, we noted that five investment managers do not reflect investment manager fees on their statements. The Treasurer explained that in the statements, investment manager fees are part of the investments' Net Asset Value (NAV). He stated that investment managers do not provide that level of detail on their statements and to do so would require them to change their reporting mechanism. However, we believe that the current reporting in the University's accounting records is incomplete and does not accurately reflect the true investment expense resulting from these investments. In order to provide the Committee with more accurate performance results and an accurate picture of manager fees paid, we believe that management should discuss with these investment managers opportunities to improve statement disclosures. The Treasurer estimated that the management fees for the five investment managers approximated \$553,500 for the year ended June 30, 2018.

## **Recommendations**

Treasury Management should:	
3.1	Ensure all investment manager fees' breakdown is provided, properly supported, and its review is documented prior to submitting to the Office of the Controller.
3.2	Discuss with the five investment managers the need for better disclosure to properly capture investment manager fees.

## **Management Response/Action Plan:**

- 3.1 We concur with this recommendation. Office of the Treasurer will document the monthly reconciliation of the investment manager fees.

**Implementation date:** December 31, 2019

- 3.2 We concur with this recommendation. The team will discuss detailed fee disclosure options with the 5 Investment Managers that charge the University net of returns (not directly).

**Implementation date:** December 31, 2019