

IAD 11-00308

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INTEROFFICE MEMORANDUM

MEMORANDUM INTERIEUR

TO: Mr. Gurpur Kumar, Deputy Director  
A: Internal Audit Division, OIOS

DATE: 18 March 2011

REFERENCE:

FROM: Warren Sach, Assistant Secretary-General  
DE: Representative of the Secretary-General  
for the Investments of the UNJSPF

18/14/11

SUBJECT: IMD Response Assignment No. AS2010-801-05 - Audit  
OBJET: of UNJSPF Cash Management

I am pleased to respond to the draft report on the above-mentioned audit.

The IMD response to the OIOS recommendation specific to a "consolidated cash management approach" is in Annex 1 of this memorandum.

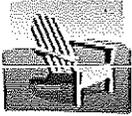
cc: Bernard Cochemé  
Suzanne Bishopric  
Sergio Arvizu  
Daniel Willey  
Amy Wong

CONFIDENTIAL - DRAFT AUDIT REPORT FOR COMMENTS

ANNEX 1

RESPONSE AND IMPLEMENTATION OF RECOMMENDATIONS  
Assignment No. ASS2010/801/02 – Audit of UNJSPF Cash Management

Para. no.	Recommendation	Risk category	Risk rating	Accepted (Yes/No)	Implementation date	Client Comments
21.	The UNJSPF should adopt a consolidated cash management approach whereby the currency/liquidity requirements of the Fund are met by the Fixed Income desk of IMD.	Operational	M	Yes	Immediately, as described in the adjacent comment.	IMD is ready to implement the recommendation immediately, to the extent possible within existing resources. IMD implementation would be dependent upon the full and timely cooperation of the Pension Fund Secretariat. Given the significant cost savings, as well as improvements to internal controls, IMD would begin by implementing the recommendation for three key currencies (Euro, CHF, GBP). The workload implications of properly managing all currency transactions, based on our review of the OIOS findings, will be supported by ongoing infrastructure enhancements such as SWIFT and Murex.
22.	The UNJSPF should implement bank arrangements that will sweep participant and member organizations' contributions, while maintaining a position for daily and weekly payroll, into IMD accounts so that the funds could be actively invested.	Operational	M			
23.	The UNJSPF Secretariat, while implementing the initiative to reduce the cost of benefit payments, should replace wire transfers with alternative low-cost means and address the root causes for wire repairs.	Operational	M			



Fw: Assignment No. AS2010/801/05-UNJSPF Cash Management  
Roy Lamazon to: Gurpur Kumar  
Cc: Ahsan Nabi, Qichun He

18/04/2011 10:03

FYI—Please see attached incoming document which has been logged for your reference.



11-00361 Assignment no. AS2010-801-05 - Audit of UNJSPF Cash Management.pdf

Regards,

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----- Forwarded by Roy Lamazon/NY/UNO on 18/04/2011 10:02 AM -----

From: Gedma Arndt/UNJSPF/NY/UNO@UNPENSION  
To: Gurpur Kumar/NY/UNO@UNHQ  
Cc: Roy Lamazon/NY/UNO@UNHQ, Dennis Liberatore/UNJSPF/NY/UNO@UNPENSION, Bernard G Cocheme/UNJSPF/NY/UNO@UNPENSION, Sergio Arvizu/UNJSPF/NY/UNO@UNPENSION, Jaana Sareva/UNJSPF/NY/UNO@UNPENSION  
Date: 14/04/2011 05:26 PM  
Subject: Assignment No. AS2010/801/05-UNJSPF Cash Management

*On behalf of Mr. Bernard Cochemé, Chief Executive Officer, UNJSPF*

Please find below the Fund's secretariat comments to the above-mentioned audit response.

With best regards,

Gedma Arndt  
United Nations Joint Staff Pension Fund (UNJSPF)  
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Tel: 212-963-4301  
arndt@un.org



Secretariats Comments on Cash Management Audit March 2011.pdf

*Comments attached  
(4 pages)*

Assignment Number AS2010/801/05  
Audit of UNJSPF Cash Management

1. The Fund secretariat would like to thank the OIOS for their continuing efforts on the Fund's behalf, particularly with regard to the above mentioned assignment. We recognize the important role that the OIOS performs in providing guidance for a more efficient operation of both the IMD and secretariat of the UNJSPF.

2. Before commenting on several paragraphs in the three page audit report and annexes and on the specific recommendations we must express our serious concern on how this audit was conducted. We must note that there was a lack of any discussion with secretariat management during the audit regarding possible effects of proposed recommendations and note with concern the lack of material supporting the recommendations. The secretariat was first made aware of preliminary findings when the Chief of FSS and Chief Cashier of the secretariat were invited to a preliminary closing meeting on 7 January 2011 with two members of the audit team. There was no IMD staff at this meeting.

3. After review of the schedules presented at this preliminary closing meeting, the secretariat noted a material error in one of the key schedules used to support the recommendation that the Fund adopt a consolidated cash approach. The schedule in question, table 3, presented five currency purchases with a total of some \$340,000 "potential savings" if IMD had purchased these currencies due to favorable exchange rates. However, the secretariat noted that the largest item of the savings was actually due to a more favorable rate received by the secretariat. This item represented \$290,000 of the "potential savings" of the total \$340,000. OIOS was advised of this error. This table was presented in the final report without any potential savings column and only the rate differential was indicated for five same day purchases of currencies.

4. After this 7 January 2011 meeting, and based on the nature of the recommendations, another meeting was requested by the CEO. This next meeting was held on 19 January. From OIOS, this meeting was attended by the Chief of Section and two members of the audit team. Representing the secretariat were the CEO, Deputy CEO, Chief of FSS and the Chief of the Cashier's Unit. At this meeting there was much concern expressed by the secretariat as to the basis, materiality, feasibility and implications for the Fund, of the proposed recommendations. The secretariat also presented cash management issues regarding disaster recovery and business continuity not raised by the audit report, but of great concern to the Fund secretariat's senior management.

5. It was also noted that the focus of the audit was rather narrow in that it only considered the return on the float of the operational account and did not review the investment and liquid portion of the Fund investment portfolio which generated moderate investment income on temporary investments in 2010 of \$16 million and negative income of \$41.1 million in 2009.

6. At the 19 January meeting, the secretariat noted that the presentation by OIOS at the Audit Entry Conference held on 19 October 2010 stated that one of the reasons the audit was being conducted was to cover cash management risks identified in the 2010 fixed income audit, such as the short-term liquidity management of IMD vs. secretariat and the retention of funds by the secretariat to ameliorate such risks. The entry conference presentation identified Business Continuity/ Emergency Procedures as a risk area. However, these topics were not addressed by

the audit, nor was the current arrangement evaluated which reflects implemented recommendations of the previous audit of cash management. In addition, the return on the investment of these short term funds transferred to IMD on a monthly basis has never been disclosed and IMD has been unable to communicate this return on any periodic or consistent manner.

7. The secretariat developed the current procedure for the transfer of excess funds between the secretariat and IMD following the recommendation of OIOS based on the assumption that this would generate additional returns for the Fund, without additional risk. The secretariat thinks that the procedures between the secretariat and IMD concerning the transfer of funds currently employed by the Fund is complex to administer and puts the payroll funding at a needless high risk for unsubstantiated investment return. The process also requires the secretariat to request funding from IMD for the month-end payroll. Funds are transferred to secretariat accounts a day before value date of the pensioner's payroll. Should there be any interruption with the transfer process, the payroll could be unfunded and the Fund would have some 60,000 pensioners' payments in jeopardy. We believe that this is a serious risk and should have been addressed, perhaps with a recommendation of the Fund maintaining some month's payroll funding in the secretariat's bank account.

8. On 20 January, the Deputy CEO sent an e-mail to the Chief of the Section OIOS requesting a possible postponement of the scheduled 21 January closing meeting. The purpose of the postponement was to allow the OIOS more time to review and possibly amend the audit report, based on the previous day's meeting.

9. A response was immediately received from the Chief of Section OIOS stating that *"the core issues noted in the audit had not changed significantly, considering the previous day's discussion and it was recommended that the exit conference proceed as scheduled on 21 January."* The exit conference meeting was held on 21 January.

10. In addition to the three audit recommendations to be addressed later in this note, specific concerns of the Fund secretariat regard the following items from the closing audit report sent to the CEO and RSG of the Fund dated 11 February 2011 are as follows:

- a) Paragraph 8 – *"interviews were conducted with management and key staff"* - The audit progress and findings were not discussed with the secretariat management during the audit. The only contact with the secretariat, during the audit, involved asking the Chief Cashier for schedules of member contributions, cash requirement, scheduled payment methods and F/X transaction records. The Chief of FSS was only asked to supply bank contracts and extensions.
- b) Paragraph 15 – Based on limited data on which OIOS based its analysis, the recommendation introduces additional risks to the operation following the same approach in 2007 where OIOS recommended "the transfer of float" to IMD. There is no evidence that this has added value to the Fund. *"OIOS analyzed the foreign currency transaction data...for the 11 months and noted instances, due to lack of coordination, where the secretariat and IMD entered into opposite currency transactions on the same day...the Fund as a whole incurred a net realized loss of \$19,068 on those transactions."* This "loss of \$19,086", is based on only three currency positions for the eleven-month period. It is not clear if these were the only items regarding "opposite currency transactions" for this period. Noting that the OIOS report states that *"the foreign exchange market is a fast*

*paced market, where two similar trades executed seconds apart could generate different bid-ask offers,"* we are of the opinion that these examples cannot support a change in the current secretariat F/X procedures. This paragraph further states that *"if the analysis is expanded to cover currency trades that were executed...one day apart, there would be potential losses of \$56,742."* The secretariat is also of the opinion that due to the noted volatility of the FX market, these four examples of one and two days difference from the secretariat purchases diminish the validity of this comparison. We are of the opinion that the several examples presented as "potential losses" are not conclusive. As the Fund disbursed some \$3.7 billion over the last biennium in the payment of benefits, we believe that any recommendations to change the funding mechanisms should be more carefully studied with the implication on both the IMD and secretariat carefully considered.

- c) Paragraph 18 – As noted in the OIOS report, the audit recommendation in the 2007 OIOS audit recommended that *"the secretariat should explore the possibility of using the services of IMD for foreign exchange transactions."* As noted by the OIOS, this recommendation was accepted in 2007. However, the practice of IMD performing F/X transactions for the secretariat's payroll would add, as previously commented to OIOS, another level of administrative complexity and additional risk to the payroll process. If IMD would perform the F/X, the secretariat would have to track the funding of secretariat accounts and attempt to manage the difficult practical implications of employing such a procedure. The secretariat would have to ensure that the various currency accounts around the world are funded timely, especially as IMD would be requesting sub-custodians to transfer funds through the custodians. This would seriously put at risk the payroll funding process. Further, we are of the opinion that this additional responsibility could interfere with investment activities of the Fund and additional risk of funding the payroll would shift from the secretariat to IMD, an unacceptable position for the Fund. Of further consideration, the OIOS report clearly states that the *"F/X market is a fast-paced market, where two similar trades executed seconds apart could generate different bid-ask offers"*.
- d) Paragraph 20 – The report recommends that balances other than USD should be *"automatically swept" into IMD bank accounts for timely investment*". The secretariat finds this recommendation to be particularly concerning. These balances are relatively immaterial, as these accounts do not include USD amounts that are already transferred to IMD for investment. To suggest an "automatic sweep" would be contrary to best industry practices and certainly demonstrates poor control of Fund cash. Sweep accounts are used by the banking industry to move funds from non-interest bearing accounts to interest bearing accounts on an overnight basis for the same client. To suggest that funds should be automatically swept from one bank to another bank for different clients (Secretariat and IMD) would be extremely risky, demonstrate a lack of internal controls and certainly put the transferred funds at risk of loss in the process.

11. We would now address the specific recommendations regarding this audit. Secretariat responses to audit recommendations – Assignment Number AS 2010/801/05 – Audit of UJSPF Cash Management.

- a. Paragraph 21 – Recommendation - UNJSPF adopt a consolidated cash management approach. This recommendation is not accepted. The secretariat is of the opinion that this "consolidation" would add additional risk and administrative burden to both the IMD and the secretariat for the funding of the

payroll process, while providing immaterial savings, if any, to the Fund as a whole. However, the secretariat is of the opinion that a better way to optimize the process would be for the secretariat to maintain the equivalent of two months payroll, with any excess being sent to IMD for investment. Regarding F/X transactions, the secretariat would propose that the funding of major additional operational accounts, namely British pounds, Euros and Swiss Francs be requested from IMD on a monthly basis. These currencies represent over 95 per cent of the foreign currencies needed by the secretariat.

- b. Paragraph 22 – Recommendation – Implement bank arrangements that will sweep contributions into IMD accounts so that funds could be actively invested. This recommendation is not accepted. As noted in the OIOS report, the secretariat presently transfers excess USD balances, the majority of contributions received, into IMD accounts. Sweep accounts are established within the banking industry to transfer excess funds, on an overnight basis, to an interest bearing account, and then be returned to the originating account the next day. To consider this process for Fund cash involving different accounts at different banks would be against industry best practices, and certainly put Fund cash at risk.
- c. Paragraph 29 – Recommendation – Replace wire transfers with alternative low-cost means and address the root causes for repair. This recommendation is not accepted. The Fund continuously seeks initiatives to lower bank fees and bank charges to pensioners as is the normal practice. It should be noted, however, wire transfers cannot presently be replaced by lower payment methods, as the wire transfers provide the payment method to fund beneficiaries outside the US, who request payment in USD. Due to banking payment regulations employed by government regulators around the world, it is not always possible to employ a seemingly less expensive payment method for particular payments. Regarding root causes for wire repairs, the Fund receives payment instructions directly from its beneficiaries. If these instructions are incorrect, i.e., wrong bank account number, there would be a charge for repair. The Fund maintains a practice of attempting to secure proper payment instructions from all beneficiaries. A more thorough review of the funding process would have revealed that the Fund employs the most economical process wherever possible.

12. Again, the Fund secretariat would like to thank the OIOS for their efforts and we look forward to future audits, open discussions and recommendations that assist the UNJSPF on an overall basis to follow the mandates of achieving investment objectives and payment of pensioners in an accurate and timely manner.