



September 20, 2023

Investment Management Process Audit

City of Milwaukee Employees' Retirement System

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Background

At the request and direction of the Administration and Operations (A&O) Committee, an audit of the Investment Management Process for the City of Milwaukee Employees' Retirement System (CMERS) was performed during the period from June 1, 2023, through August 17, 2023.

The audit was requested to review and evaluate, the organization's Investment Management process and controls against leading practices and test those controls to determine whether control deficiencies existed within the internal control environment or whether there were identified control design or operating deficiencies. This audit cannot be relied upon to disclose errors, fraud, or noncompliance with laws and regulations.



Internal Control Assessment Objectives and Scope

The objective of the Investment Management Process Audit was to review and evaluate processes and controls currently in place against leading practices. The focus of the assessment was to address the following risks:

1. Assess the suitability of the design for process and controls over Investment Management Process, including the inherent risks of inaccurate payment, and the non-compliance with state and federal reporting compliance.
2. Assess the governance and accountability over in scope process and controls, including the inherent risks from misappropriation, fraud, and abuse.
3. Compare current state internal controls versus leading practices.
4. Propose future state changes that mitigate risk or enhance CMERS' internal control structure and outcomes.

The following processes and sub-processes were in-scope, as well as segregation of duties in each area:

The objective of the Investment Management Process Audit included the review of processes and controls related to the design and operating effectiveness of the processes and controls, including:

1. Service Provider Selection and Termination
 - a. Due Diligence and Analysis
 - b. Contract Review
 - c. Management / Board of Directors (BOD) Approval
2. Contract Management
 - a. Performance Analysis and Reconciliation of Investment Accounts
 - b. Provider Due Diligence and Review
 - c. Calculation, approval, and payment of investment manager and other third-party fees
3. Investment Manager Fees
 - a. Invoice Review and Reconciliation
 - b. Payment Approval Process
4. Investment Policy Compliance
5. Management and BOD Reporting
6. System Access Restrictions
 - a. User System Access Review and Approval
 - b. Segregation of Duties
7. Organizational Resilience
 - a. Cross Training Procedures



Procedures Performed

The Investment Management Process Audit was performed in collaboration with members of CMERS.

As part of the audit, various techniques were used to audit and assess the effectiveness of the internal controls, including:

1. Interviewed members of CMERS
 - David Silber, Chief Investment Officer
 - Erich Sauer, Deputy Chief Investment Officer
 - Terry Siddiqui, IT Consultant
2. Gathered supporting documents describing current state processes (e.g., policies, procedures, screenshots, flowcharts, reconciliations, analyses, etc.)
3. Reviewed, tested and evaluated CMERS processes and controls for the following functions;
 - Service Provider Selection and Termination
 - Contract Administration
 - Investment Policy Compliance
 - Investment Activity Reporting
 - System Access Restrictions
 - Organizational Resilience
4. Ranked current-state processes against five levels of maturity definition (1. Initial; 2. Repeatable; 3. Defined; 4. Managed; and 5. Optimized)

We would like to acknowledge and thank management with whom we interacted. The time, effort, and discussions they provided were instrumental in our understanding and provided the necessary information to complete our project. During the course of our assessment, management and personnel provided all of the materials requested and answered all of our questions promptly. Below is the assessment executive summary.



Audit and Assessment Results – Executive Summary

All processes assessed during the audit were rated as Defined Maturity*: Management has established policies, processes and controls that are regularly updated. This level of maturity is considered suitable for these control environments by management and internal audit.

Processes	Control Description	Control Finding?	Process Maturity Level
Service Provider Selection and Termination	<p>Vendors used by the Investment Management Team are selected according to City of Milwaukee Purchasing Guidelines. As part of the selection process, each vendor is evaluated based on defined criteria. Once a vendor is selected, a standard contract is prepared with specific contract provisions. Each Investment Manager contract requires the appropriate review and approval by the City Attorney’s Department, CMERS management, and the CMERS BOD.</p> <p>Once approved, the vendor is set-up by the City of Milwaukee Procurement Department in their Vendor Management System. Any subsequent changes to the Vendor information are requested and approved by CMERS management, prior to being changed by the City of Milwaukee Procurement Department. Vendor terminations follow those provisions defined in the vendor contract.</p>	No	Defined
Contract Management	<p>The Investment Management Team will review and reconcile their Investment Managers accounts on a quarterly basis. As, part of the review, the Investment Management Team will recalculate manager returns, benchmark results to index returns, and reconcile the amounts managed by the Investment Managers to those amounts reported by the custodian, Northern Trust, and their investment advisor, Callan.</p> <p>As Private Equity and Real Estate Holding values are not traded on public exchanges, valuation and reconciliation of these holdings will be performed once or twice a year when holding statements are received at CMERS.</p>	No	Defined
	<p>Investment Management Team will regularly perform detailed on-site Due Diligence at each of their Investment Managers to evaluate the Investment Manager’s operations and capabilities.</p>	No	Defined
Investment Manager Fees	<p>Investment Manager Fee Invoices are reviewed and reconciled to the balances recorded by Northern Trust by the Investment Management Team. As part of the review, each fee is recalculated in accordance with the terms defined in the Investment Manager Contracts.</p>	No	Defined



	After the fee invoices have been reconciled, they are reviewed and approved by the appropriate members of management before they are submitted to the City of Milwaukee payment.		
Investment Policy Compliance	CMERS Investment Policies are reviewed annually by its management and its BOD. Any changes to these policies are approved by the CMERS BOD.	No	Defined
	CMERS requires that those Investment Managers who manage publicly traded securities certify that they are following CMERS Investment Policy on an annual basis	No	Defined
Management and BOD Reporting	The Investment Management Team regularly prepares a variety of financial reporting packages for presentation to CMERS BOD. Each reporting package is validated against the Investment Balances recorded by Northern Trust and supported with the appropriate information. When complete, each reporting package is reviewed by Management before it is presented to the BOD for review and approval.	No	Defined
System Access Controls	Employee access to CMERS systems is reviewed by management twice a year to ensure that ERS's employees and business partners have the appropriate system access and that no Segregation of Duties conflicts exist.	No	Defined
Organization Resilience	Management regularly cross trains and evaluates department personnel as to their ability to competently perform duties outside of the employee's current role and responsibilities.	No	Defined
*DEFINED MATURITY	Policies and processes are established and are reviewed and updated as needed (e.g., annually) to reflect changing business needs; preventive and detective controls are employed but are primarily reliant on manual activities; performance monitoring is performed using a mix of manual and automated processes. <i>See Appendix for all Maturity Definitions.</i>		

Following the conclusion of our testing of CMERS Internal Control Environment, we identified No Internal Control Design or Operating Deficiencies.



Observations, Recommendations, and Management Responses

None.



Closing

We wish to extend our appreciation to management and staff for their timely cooperation and assistance during the project.

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CliftonLarsonAllen LLP

August 31, 2023



Appendix

Maturity Definitions

Capability Level	Capability Description	Capabilities Attribute
5. Optimized	Policies and processes are continuously reviewed and improved within a highly automated control environment.	<ul style="list-style-type: none"> Processes and controls are continuously reviewed and improved Preventive and detective controls are highly automated to reduce human error and cost of operation. Comprehensive, defined performance metrics exist, with extensive automated performance monitoring. Extensive use of best practices, benchmarking, and/or self-assessment to continuously improve process.
4. Managed	Policies and processes are documented, standardized, regularly updated and controls increasingly use automation.	<ul style="list-style-type: none"> Procedures and controls are well documented and kept current. Preventive and detective controls are employed, with greater use of automation to reduce human error. Many metrics are used with a blend of automated and manual performance monitoring. Best practices and/or benchmarking are used to improve process
3. Defined	Policies and processes are established, are reviewed, and updated as needed (e.g., annually) to reflect changing business needs; preventive and detective controls are employed but are primarily reliant on manual activities; performance monitoring is performed using a mix of manual and automated processes.	<ul style="list-style-type: none"> Procedures are well documented, but not kept current to reflect changing business needs. Preventive and detective controls are employed, still reliant on manual activities. Some metrics are used, but performance monitoring is still manual and/or infrequent. Generally occurs during periodic (e.g., annual) policy and procedure renewal.
2. Repeatable	Some standard processes are defined, and success depends largely on "tribal knowledge" and detective controls.	<ul style="list-style-type: none"> Some standard procedures exist, relies on "tribal knowledge." Mostly detective are in place, minimal preventive controls, and highly manual. Few performance metrics exist, thus performance monitoring is inconsistent or informal. Most likely in reaction to audits or service disruptions.
1. Initial	Few processes are defined and success depends on individual effort and heroics.	<ul style="list-style-type: none"> No formal procedures exist. Controls are non-existent or primarily in reaction to a "surprise." There are no metrics or performance monitoring.

