



City of Phoenix

**Mission Statement**

To improve the quality of life in Phoenix through efficient delivery of outstanding public services.

**Consultant Team**

**REDW**

Caitlin Gutierrez  
*Sr. Manager*

Ali Wagner  
*Sr. Auditor*

**Project Team**

Aaron Cook  
*City Auditor*

Ryan Richelson  
*Sr. Internal Auditor*

**Project Number**

1240034

This report can be made available in alternate format upon request.

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**Finance Department  
Investment and Cash Management Analysis**

**May 8, 2024**

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***Report Highlights***

**Overall Assessment**

*Overall, the Finance Department appropriately followed its Investment Policy Statement, followed protocols for transactions, and kept the Investment Committee informed with appropriate reporting.*

**Reconciliations**

*Minor improvements could be made to the monthly reconciliation process.*

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*City Auditor Department  
140 N 3<sup>rd</sup> Avenue Phoenix, AZ 85003  
602-262-6641 (TTY use 7-1-1)*

## **Executive Summary**

### **Purpose**

The City Auditor Department contracted with REDW Advisors & CPAs (Consultant), an external audit firm, to assess the Finance Department's (Finance) investment and cash management processes to ensure compliance with applicable state statutes and internal policies, as well as ensuring the adequacy of internal controls over investment transactions.

### **Background**

Finance manages approximately \$4.5 billion in cash and short-term investments which are governed by the City of Phoenix Investment Policy Statement (IPS). The Finance Treasury and Debt Management Division ("Treasury Division") serves as the custodian of all City funds. The Treasury Division is responsible for monitoring compliance with the IPS strategies and objectives to ensure investments are managed within approved risk tolerances. In addition, the Finance Financial Accounting and Reporting Division (FAR) is responsible for daily balancing/monitoring of the City's pooled cash account, reconciling the City's investments, allocating interest earnings to all City funds, and preparing and filing monthly financial statements.

This audit focused on evaluating the processes and internal controls over Investment Policy Statement (IPS) compliance, investment transactions and approvals, user access management, investment performance reporting, daily and monthly investment activity reconciliations, document retention, and reconciliation of the investment system to the City's financial system, SAP. In addition, the Consultant tested to determine if back-up and recovery processes were in place over key investment software.

### **Results in Brief**

The full Consultant report can be found at **Attachment A**.

#### **Overall, Finance appropriately followed the IPS and followed policies for managing investments and conducting transactions.**

The Consultant found appropriate controls, with no exceptions, in the following areas:

- Compliance with the Investment Policy Statement – investment activity, reporting, and performance aligned with IPS requirements.
- Investment Transactions and Approvals – purchases and sales tested from 2023 were performed in accordance with department procedures.
- Authorized Listings and Terminated Employees – all authorized traders were active investment personnel. Trading privileges were appropriately removed upon termination.

- Incident Response and Data Recovery – plans were in place with both the custody bank and applicable City departments to restore investment functionality in the event of system failure, outage, or catastrophic loss.
- Daily Investments Reporting – daily reports tested from 2023 contained required information.
- Monthly Performance Reporting – monthly performance reports tested from 2023 contained required information.
- Investment Committee – Finance provided the committee relevant reports, made investment presentations, and documented decisions.
- Reconciliation to the Financial Accounting System (SAP) – all journal entries from 2023 were accurate and posted timely by appropriate personnel.

**Minor improvements can be made to the monthly reconciliation process. The Consultant marked these as low risks.**

The Consultant concluded that the monthly investment reconciliation process could be improved. The Consultant found that procedures did not specify a timeline for completing reconciliations. Typically, those would be completed by the last business day of the subsequent month. The Consultant found that 5 of the 12 reconciliations from 2023 were completed from 14 to 145 days past that timeframe. The Consultant also found that twice the same person prepared and reviewed the reconciliation, which was described to be the result of training a new preparer.

## **Recommendations**

1. Update the Financial Accounting & Reporting Division reconciliation procedures to include defined timelines regarding when reconciliations must be completed by.
2. For monthly reconciliations, identify a back-up preparer and a back-up reviewer and train them on proper procedures if the division experiences turnover or in the case that employees go on extended leave to ensure the reconciliation process does not lapse.

## **Standards**

This audit was conducted by REDW. REDW was contractually obligated to conduct this performance audit in accordance with generally accepted government auditing standards. Those standards require that REDW plan and perform the performance audit to obtain sufficient, appropriate evidence to provide a reasonable basis for its findings and conclusions based on its audit objectives.

## Department Responses to Recommendations

<b>Rec. #1:</b> Update the Financial Accounting & Reporting Division reconciliation procedures to include defined timelines regarding when reconciliations must be completed by.	
<b>Response:</b> Finance will update the Financial Accounting & Reporting Division reconciliation procedures to include defined timelines regarding when reconciliations must be completed by.	<b><u>Target Date:</u></b> 6/14/24
<b>Rec. 2:</b> For monthly reconciliations, identify a back-up preparer and a back-up reviewer and train them on proper procedures if the division experiences turnover or in the case that employees go on extended leave to ensure the reconciliation process does not lapse.	
<b>Response:</b> Finance will, for monthly reconciliations, identify a back-up preparer and a back-up reviewer and train them on proper procedures if the division experiences turnover or in the case that employees go on extended leave to ensure the reconciliation process does not lapse.	<b><u>Target Date:</u></b> 6/14/24

**Attachment A – Consultant Report**

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# City of Phoenix

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*Investment and Cash Management  
Internal Audit*

*February 2024*

**redw**  
Advisors & CPAs

**City of Phoenix  
Internal Audit  
Investment and Cash Management**

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**City of Phoenix  
Internal Audit  
Investment and Cash Management  
Report**

**Introduction**

We performed the internal audit services described below to assist the City of Phoenix in assessing investment and cash management processes to ensure compliance with applicable state statutes and internal policies as well as ensuring the adequacy of internal controls over investment transactions.

Our services were conducted in accordance with the Consulting Standards issued by the American Institute of Certified Public Accountants, relevant portions of the Generally Accepted Government Auditing Standards and the terms of our contract for internal audit services. Since our procedures were applied to samples of processes, it is possible that significant issues related to the areas tested may not have been identified. Although we have included management's responses in our report, we do not take responsibility for the sufficiency of these responses or the effective implementation of any corrective action.

**Purpose and Objectives**

The City of Phoenix manages approximately \$4.5 billion in cash and short-term investments which are governed by the City of Phoenix Investment Policy (IPS). The City of Phoenix's Treasury and Debt Management Division ("Treasury Division") within the Finance Department is the custodian of all City funds. The Division is responsible for monitoring compliance with the IPS strategies and objectives to ensure investments are managed within approved risk tolerances. In addition, the Financial Accounting and Reporting Division (FAR) within the Finance Department is responsible for daily balancing/monitoring of the City's pooled cash account, reconciling the City's investments, allocating interest earnings to all City funds, and preparing and filing monthly financial statements.

Our internal audit focused on evaluating the processes and internal controls over Investment Policy Statement (IPS) compliance, investment transactions and approvals, user access management, investment performance reporting, daily and monthly investment activity reconciliations, document retention, and reconciliation of the investment system to the City's financial systems. In addition, we tested to determine if backup and recovery processes were in place over key investment software.



## Observations, Recommendations and Management Responses

As a result of our testing, REDW identified the following observation:

### 1) Monthly Investment Reconciliations

The City of Phoenix Investment Policy statement requires the FAR Division to have procedures in place to reconcile receipts and statements to the City's position and transaction records on a monthly basis. The IPS also requires separation of duties between those who authorize and record transactions. While the FAR Division did have monthly reconciliation procedures in place, we determined there were no defined timelines to ensure the reconciliations were performed timely. As a result, our testing of 12 monthly reconciliations performed in 2023, 5 (February through June 2023) were not completed by the last business day of the subsequent month. Variances ranged from 14 to 145 days past the recommended completion date per best practices. Additional inquiry determined that as a result of vacancies and turnover, the reconciliations process had lapsed and no back-ups had been designated to ensure it occurred timely.

Lastly, our testing determined 2 reconciliations were prepared and reviewed by the same individual. Further inquiry determined these two reconciliations were utilized as a training tool for a new preparer however, the Fiscal Manager signed off as both the preparer and reviewer in each case.

**Potential Risk – Low:** An absence of defined timelines and designated back-ups over monthly reconciliations increases the risk that errors may not be caught timely. Since investing activities are also reconciled daily between the investment management system and the financial accounting system, we have placed this risk at low.

**Recommendation:** The FAR Division should update their reconciliation procedures to include defined timelines regarding when reconciliations must be completed by. In addition, a back-up preparer and a back-up reviewer should be identified and trained on proper procedure in the event that the division experiences turnover or in the case that employees go on extended leave to ensure the reconciliation process does not lapse.

## Process Improvement Opportunity

### 1) Investment Advisor Roles & Responsibilities

In accordance with best practices, the IPS should define the duties and responsibilities of all parties involved in the management of investments. Our testing determined the role of the external investment advisor, who the City of Phoenix contracts with to provide advisory investment services, was not defined in the IPS. The Finance Department should update the IPS to include duties and responsibilities of the Investment Advisor.

## Scope and Procedures Performed

In order to gain an understanding of the controls and processes, we interviewed the following personnel:

- Kim Grant, Finance, Treasury and Debt Management Deputy Finance Director
- Jodi Nicholson, Financial Accounting and Reporting Fiscal Manager
- Therese Ranger, Financial Accounting and Reporting Accountant IV

- Ben Kozik, Treasury and Debt Management Division Investment Manager
- Jon Super, Treasury and Debt Management Division Investment and Debt Manager

In order to gain an understanding of the processes and controls in place we read relevant portions of:

- City of Phoenix Investment Policy (dated July 17, 2023)
- Phoenix City Code, Chapter 13, Article I. – City Monies and Bonds
- Investment Manager Procedures (not dated)
- Monthly Investment Reconciliation Procedures (update January 2022)

### ***We performed the following testwork:***

***Components of an Investment Policy Statement:*** We compared the City of Phoenix's Investment Policy to the Chartered Financial Analyst (CFA) Institute's and Fi360's recommended components of an IPS and tested to determine if key components such as roles and responsibilities of internal/external investment staff, return and risk requirements, investment objectives, performance measurement components, and various other items were sufficiently described.

***Compliance with the Investment Policy Statement:*** Utilizing the December 31, 2023, monthly performance report, corresponding holdings listings, and statements, we tested to ensure investment activity, reporting, and performance were in alignment with the following Investment Policy requirements:

- Transactions relating to investments were with authorized financial institutions and had a broker/dealer questionnaire and certification on file with the City of Phoenix;
- Accounts were adequately collateralized at a minimum of 102%;
- All investments held were authorized investments;
- Authorized investments held were at or under the maximum asset allocation percentage per issuer per the Investment Policy;
- All issuers were authorized issuers; and,
- Maximum maturities did not exceed 5 years per the Investment Policy and State Statute.

In addition, we tested to determine if the IPS was reviewed in accordance with annual review requirements for 2023.

***Investment Transactions and Approvals:*** We obtained a listing of all purchases and sales that occurred in 2023. Of 1,571 purchases (no sales occurred as City of Phoenix holds to maturity), we selected 6 purchases and tested to determine if:

- The City maintained documentation of the justification/rational for completing the trade;
- Documentation was maintained to support the competitive bidding process and the most advantageous bid was selected (if three bids were not obtained, justification was in place to support why);
- A trade ticket was prepared prior to initiating/releasing the trade by the City and custody bank;

- Broker confirmations were maintained to support the trade; and,
- Trade was initiated, approved and released by the proper personnel per the Investment Policy Appendix E, and initiator(s) were not allowed to authorize or release transactions.

We also evaluated system controls to determine if the system had built in controls to prevent the authorizer, initiator, and releaser from being the same individual.

**Authorized Listings and Terminated Employees:** We obtained a listing of authorized personnel who had the ability to approve trades through the custody bank. In addition, we obtained a listing of all active investment personnel from the City of Phoenix as of January 2024 and tested to determine if authorized traders via the custody bank were active investment personnel. In addition, we evaluated the process to remove trading privileges with the custody bank in the event of an employee termination to ensure proper controls were in place to remove access on or before the termination date.

**Incident Response and Data Recovery:** We obtained the service level agreement from the custody bank and the investment software vendor and tested to determine if a clause was included regarding steps to be taken in the event of a system failure to ensure investment processes could continue.

In addition, we tested to determine if the Investments team, in collaboration with other applicable departments such as IT, had a plan in place regarding how investments functionality would be restored in the event of a network outage or catastrophic loss.

**Daily Investments Reporting:** We selected 5 days in 2023 and obtained the daily reports that were prepared. We tested to determine if the daily reports contained:

- Prior day's closing (current day's opening) banking activity and balances;
- Current day's investment calculation worksheet;
- Current day's transaction authorizations;
- Current day's reconciled transaction audit report;
- Current day's portfolio holdings;
- Cash flow projection for next business day; and,
- Daily activity was accurately captured and posted in the investment system and accounting system.

**Monthly Performance Reporting:** We selected 3 months from 2023 (March, July, and October) and obtained the monthly performance reports that were prepared by the Investments team. We tested to determine if the monthly performance reports contained:

- Security Descriptions;
- Purchase Settlement Date;
- Call Date (if any);
- Final Maturity Date;
- Coupon Rate;
- Yield;

- Current Par;
- Amortized Cost (Book Value);
- Market Value (per the pricing source);
- Unrealized Gain or Loss in Dollars;
- Unrealized Gain or Loss in Points ;
- Average Life; and,
- Duration at Market (per the pricing source).

In addition, we verified that monthly activity was accurately captured and posted in the investment system and accounting system by selecting 5 holdings included in each packet and verifying that it was properly recorded in the financial accounting system.

**Investment Committee:** We read Investment Committee Meeting Minutes from 2022 and 2023 to ensure relevant reports were provided and reviewed, performance of the investments were properly presented and discussed, and decisions were documented. In addition, we tested to determine that the Investment Committee was acting in accordance with their roles and responsibilities per the Investment Policy.

**Monthly Investment Reconciliations:** We obtained the completed reconciliation packets for 2023 and tested each investment reconciliation to determine if:

- All cash/investing activity (bond interest, principal and interest payments, dividends, etc.) was included in the reconciliation and was supported;
- Beginning and ending balances were included in the reconciliation and were supported;
- Formulas were functioning appropriately and plug numbers did not exist;
- Variances were investigated and properly resolved (including making necessary adjustments) within a reasonable timeframe (within 60 days of month-end for the month being closed);
- Reconciliation was completed by the last business day of the following month; and,
- Reconciliation was reviewed and approved by the Fiscal Manager, or designee.

In addition, we tested to ensure supporting documentation was maintained in an organized and accessible manner so that it was readily available for the reconciliation.

**Reconciliation to the Financial Accounting System:** We obtained all journal entries and adjusting journal entries prepared and posted in 2023. We tested to determine if:

- Journal entries were reflective of information prepared by the investment management team and agreed to monthly statements, reports, and reconciliations;
- Journal entries were prepared and posted by the appropriate personnel;
- Information was provided to Accounting and was posted timely; and,
- Accounting performed necessary procedures to validate information provided to supporting documentation.

\* \* \* \* \*

This report is intended for the information and use of the City of Phoenix and others within the organization.

We discussed and resolved other minor observations with management and received excellent cooperation and assistance from personnel of the City of Phoenix previously mentioned in this report during the course of our interviews and testing. We sincerely appreciate the courtesy extended to our personnel.

*REDW* LLC

Phoenix, Arizona  
April 12, 2024