



Office of Internal Oversight Services

INTERNAL AUDIT DIVISION

AUDIT REPORT 2013/071

Audit of the management of the real assets investments of the United Nations Joint Staff Pension Fund

Overall results relating to the effective management of the real assets investments of UNJSPF were partially satisfactory. Implementation of seven important recommendations remains in progress.

FINAL OVERALL RATING: PARTIALLY SATISFACTORY

03 September 2013

Assignment No. AS2012/801/01

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AUDIT REPORT

Audit of the management of the real assets investments of the United Nations Joint Staff Pension Fund

I. BACKGROUND

1. The Office of Internal Oversight Services (OIOS) conducted an audit of the management of the real assets investments of the United Nations Joint Staff Pension Fund (UNJSPF or the Fund) by the Investment Management Division (IMD).

2. In accordance with its mandate, OIOS provides assurance and advice on the adequacy and effectiveness of the United Nations internal control system, the primary objectives of which are to ensure (a) efficient and effective operations; (b) accurate financial and operational reporting; (c) safeguarding of assets; and (d) compliance with mandates, regulations and rules.

3. UNJSPF comprises the Secretariat, which is responsible for pension administration matters, and IMD, which is responsible for the investment of the Fund's assets. The management and administration of the investments of the Fund is the fiduciary responsibility of the Secretary-General of the United Nations. At the time of the audit's fieldwork, this responsibility had been delegated to the Assistant Secretary-General of the Office of Central Support Services in his role as the Representative of the Secretary-General (RSG) for the Investments of UNJSPF¹. The Representative was assisted by IMD, which managed the Fund's portfolio on a day-to-day basis.

4. All UNJSPF investments must meet the criteria of safety, profitability, liquidity and convertibility as stipulated by the General Assembly. As at 31 December 2011, the market value of the Fund's assets was \$39.7 billion, and the asset allocation was: 59.1 per cent in equities, 31.0 per cent in fixed income, 4.8 per cent in real estate, 4.6 per cent in short-term instruments and 0.5 per cent in alternative investments.

5. IMD investments in real estate, infrastructure, timberland and farmland are collectively referred to as real assets investments. As at 31 December 2011, the market value of the real estate investments was \$1.9 billion, and their gross unfunded commitments stood at \$0.5 billion. The composition of IMD real estate investments as at 31 December 2011 is shown in Table 1 below.

¹ As and from 19 February 2013, the Secretary-General delegated to the Assistant Secretary-General for Programme Planning, Budget and Accounts, and Controller the authority to act on his behalf in all matters involving the fiduciary duties of the Secretary-General relating to the investments of the assets of UNJSPF.

Table 1
Composition of IMD real estate investments as at 31 December 2011

<i>Type of real estate investments</i>	<i>Number of investments</i>	<i>Market value (millions of US dollars)</i>	<i>Percentage of total real estate portfolio</i>
Core return	11	850	43.9
Enhanced return	11	278	14.3
High return	34	649	33.5
Real Estate Investment Trust	4	156	8.1
Real Estate Operating Company	1	5	0.2
Total	61	1,938	100.0

6. In 2011, IMD made commitments to two infrastructure investments, for \$50 million each. As at 31 December 2011, approximately \$17 million had been drawn down (or funds called by the fund managers) between the two funds. No investments had been made in timberland and farmland.

7. The Fund's real estate benchmark, the National Council of Real Estate Investment Fiduciaries Fund Index – Open End Diversified Core Equity (NCREIF-ODCE), is an index of investment returns reporting on the results of 30 open-end funds pursuing a core strategy. The risk/return profile of the benchmark is more closely aligned with the risk/return profile of IMD's core return investments which comprised 44 per cent of the real estate portfolio as shown in Table 1 above. Because much of the remainder of IMD's real estate portfolio comprised investments in enhanced and opportunistic strategies, (i.e., investments with a higher risk/return profile), IMD added a risk premium of 100 basis points to the benchmark. As indicated in Table 2 below, the real estate portfolio underperformed relative to the benchmark over the one-year and five-year periods ended 31 December 2011.

Table 2
IMD real estate portfolio net returns compared to benchmark returns for the periods ended 31 December 2011

<i>Return on investment</i>	<i>Percentage of return</i>		
	<i>1-year period</i>	<i>3-year period</i>	<i>5-year period</i>
IMD real estate actual return	10.4	0.6	(3.7)
Benchmark: NCREIF-ODCE + 100bps	16.0	(1.7)	(0.1)

8. Comments provided by IMD are incorporated in *italics*.

II. OBJECTIVE AND SCOPE

9. The audit was conducted to assess the adequacy and effectiveness of UNJSPF governance, risk management and control processes in providing reasonable assurance regarding **the effective management of the real assets investments of UNJSPF**.

10. This audit was included in the OIOS 2012 risk-based audit plan due to risks related to the complexity of managing real asset investments.

11. The key controls tested for the audit were: (a) risk management and strategic planning; and (b) performance monitoring and reporting. For the purpose of this audit, OIOS defined these key controls as follows:

(a) **Risk management and strategic planning** – controls that provide reasonable assurance that risks relating to the investments of the Fund are identified and assessed, and that action is taken to mitigate them.

(b) **Performance monitoring and reporting** – controls that provide reasonable assurance that sound metrics are established for measuring, monitoring and reporting investment performance.

12. The key controls were assessed for the control objectives shown in Table 3. Certain control objectives (shown in Table 3 as “Not assessed”) were not relevant to the scope defined for this audit.

13. OIOS conducted this audit from 22 March to May 2012. The audit covered the period from 1 January 2010 to 31 December 2011.

14. OIOS conducted an activity-level risk assessment to identify and assess specific risk exposures, and to confirm the relevance of the selected key controls in mitigating associated risks. Through interviews, analytical reviews and tests of controls, OIOS assessed the existence and adequacy of internal controls and conducted necessary tests to determine their effectiveness.

III. AUDIT RESULTS

15. The UNJSPF governance, risk management and control processes examined were assessed as **partially satisfactory** in providing reasonable assurance regarding **the effective management of the real assets investments of the Fund**. OIOS made seven recommendations to address issues identified in the audit. The risk management and strategic planning key control was assessed as partially satisfactory because there was a need to assess anti-money laundering controls, and to demonstrate adherence to the principles for responsible investments, during Fund Manager due diligence reviews. IMD needed to annually evaluate the performance of its real assets investment advisor. Also, IMD needed to establish real assets investment limits specific to a single general partner. The performance monitoring and reporting key control was assessed as partially satisfactory because there was a need to incorporate infrastructure, timberland and farmland investments in the Fund’s overall performance benchmark. In addition, the real estate component of the overall benchmark needed to include the same risk premium that IMD added to its real estate benchmark.

16. The initial overall rating was based on the assessment of key controls presented in Table 3 below. The final overall rating is **partially satisfactory** as implementation of seven important recommendations remain in progress.

Table 3: Assessment of key controls

Business objective(s)	Key controls	Control objectives			
		Efficient and effective operations	Accurate financial and operational reporting	Safeguarding of assets	Compliance with mandates, regulations and rules
Effective management of the real assets investments of UNJSPF	(a) Risk management and strategic planning	Partially satisfactory	Not assessed	Partially satisfactory	Partially satisfactory
	(b) Performance monitoring and reporting	Partially satisfactory	Not assessed	Partially satisfactory	Satisfactory
FINAL OVERALL RATING: PARTIALLY SATISFACTORY					

A. Risk management and strategic planning

Need to assess anti-money laundering controls during Fund Manager due diligence reviews

17. There was no evidence to demonstrate IMD’s review of the adequacy and effectiveness of the anti-money laundering controls implemented by fund managers. One input to the due diligence process was the questionnaire that fund managers were asked to complete in preparation for IMD’s site visits. This questionnaire did not cover the controls established to prevent and detect money-laundering activities.

18. The absence of evidence of anti-money laundering due diligence controls by fund managers exposed UNJSPF to the risk of reputational damage.

(1) IMD should assess anti-money laundering controls during its Fund Manager due diligence reviews.

IMD accepted recommendation 1 and stated that it will incorporate this as a control in the due diligence questionnaire for private real assets investments. It should be noted that such due diligence is an ongoing process and is subject to persistent staffing issues within IMD. Recommendation 1 remains open pending receipt of the updated due diligence questionnaire for private real assets investments.

Need to demonstrate compliance with the IMD Investments Manual relating to environmental, social, and corporate governance issues

19. The United Nations Secretary-General established the Principles for Responsible Investments in 2005. The Principles state “as institutional investors, we have a duty to act in the best long-term interests of our beneficiaries and that in this fiduciary role, environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios.” The IMD Investments Manual states that, “where consistent with their fiduciary responsibilities, IMD commits to inter alia incorporating ESG issues into investment analysis and decision-making processes, seeking appropriate disclosure on ESG issues by the entities in which they invest, and promoting acceptance and implementation of the Principles within the investment industry.”

20. There was no evidence of IMD's compliance with its guidelines to seek disclosure on ESG issues by the entities in which it invests.

(2) IMD should assess adherence to the principles for responsible investments during its Fund Manager due diligence reviews.

IMD accepted recommendation 2 and stated that it will update the due diligence questionnaire as described. Recommendation 2 remains open pending receipt of the updated due diligence questionnaire.

Need to complete the real assets advisor's performance evaluations

21. The agreement with the real assets advisor was amended in September 2010 to include the provision of real estate, infrastructure, timberland and farmland investment advisory services and related advice.

22. With regard to the advisor's performance evaluations, the IMD Investments Manual provides for an evaluation by IMD staff at the end of the fiscal year (31 March). This evaluation includes the following evaluation elements and the respective weightings:

- Communication between the Advisor and IMD staff during the year – total 65 points;
- Advice received on the portfolio – total 15 points;
- Due diligence work for each individual real asset fund where UNJSPF is invested – total 20 points;
- Services as a strategic partner – up to 10 additional points (optional); and compliance and organizational issues (qualitative).

23. The 2010 and 2011 performance evaluations for the Advisor were not completed. This exposed UNJSPF to the risks of reputational damage or financial loss.

(3) IMD should perform timely performance evaluations of the real assets advisor in accordance with the procedures outlined in the IMD Investment Manual.

IMD accepted recommendation 3 and stated that the IMD Policy, Procedures, and Risk Manuals are undergoing a review process that will examine the appropriateness and timing of all IMD advisory performance evaluations. Recommendation 3 remains open pending receipt of the completed real assets advisor performance evaluations.

Need to establish real assets investment position limits

24. Although the IMD Investment Manual provides for limits of a particular real assets fund, the Manual does not provide for limits relating to a single general partner. Such limits are recognized in the industry to support risk mitigation.

(4) IMD should establish real assets investment limits specific to a single general partner in the Investment Manual and monitor the exposure on an ongoing basis.

IMD accepted recommendation 4 and stated that in concurrence with the RSG, the IMD Director, the Senior Investment Officer, and IMD Risk and Compliance, formal investment limits as described

will be established. The final compliance with such limits will be subject to the discretion of the RSG with supporting documentation. Recommendation 4 remains open pending the implementation of the recommended investment limits.

B. Performance monitoring and reporting

Need to assign a real assets investment benchmark to the Fund's overall policy blended benchmark

25. IMD utilized a benchmark comprised of a blend of indices to measure the overall relative performance of the Fund portfolio. The Fund's blended benchmark consisted of 60 per cent in equities, 31 per cent in fixed income securities, 6 per cent in real estate and 3 per cent in short-term investment indices. Given the inclusion of the infrastructure, timberland and farmland investments as part of the real assets strategy, IMD needed to select a benchmark to reflect the profile of real assets investments.

(5) IMD should review its performance benchmark for the real estate portfolio and factor in the Fund's infrastructure, timberland and farmland investments, as appropriate, based on the timing of actual investments.

IMD accepted recommendation 5 and stated that a benchmarks analysis consultancy is expected to be completed in June 2013 and would be considered by the Investments Committee. Recommendation 5 remains open pending the outcome of the benchmark consultancy.

Need to assign infrastructure, timberland and farmland benchmarks to the real assets benchmark to measure relative performance of the real assets investments

26. IMD made commitments to investment in infrastructure and had not yet selected a benchmark against which to measure investment performance. Although IMD had not yet made investments in timberland and farmland, it is important to select benchmarks for these sub-asset classes as benchmarks guide the level of risk to be taken in pursuit of returns.

(6) IMD should identify appropriate benchmarks for measuring and reporting the risk and performance of the Fund's infrastructure, timberland and farmland investments, in readiness for when investments are made.

IMD accepted recommendation 6 and stated that a benchmarks analysis consultancy is expected to be completed in June 2013 and would be considered by the Investments Committee. IMD further stated that, as the issue date for the Request for Proposal (RFP) for the consultancy is subject to interaction with the Procurement Division, a target date cannot be provided with confidence. In January 2013, IMD completed the technical evaluation of the proposals received and submitted the results to the Procurement Division for them to complete the financial evaluation. Recommendation 6 remains open pending the outcome of the benchmark consultancy.

Real estate component of the Fund's overall benchmark needed to include a formally defined risk premium

27. The IMD real estate investments were collectively benchmarked against the real estate policy benchmark NCREIF-ODCE + 100 basis points. The NCREIF-ODCE index reported the results of 28 open-ended funds pursuing a core (or stable) strategy. Given the IMD real estate portfolio had investments in both enhanced and high return strategies with some investments denominated in foreign currencies, IMD added a risk premium of 100 basis points to the real estate policy benchmark to

compensate for the additional risk undertaken by IMD relative to the index strategy of the benchmark. The real estate component of the Fund's overall performance benchmark, however, did not include this risk premium.

(7) IMD should add to the Fund's overall benchmark the risk premium used to measure the performance of real estate, and document the rationale for the value of the premium.

IMD accepted recommendation 7 and stated that the benchmark is subject to revision following an imminent benchmarks analysis consultancy. Recommendation 7 remains open pending the outcome of the benchmark consultancy.

IV. ACKNOWLEDGEMENT

28. OIOS wishes to express its appreciation to the Management and staff of IMD for the assistance and cooperation extended to the auditors during this assignment.

(Signed) David Kanja
Assistant Secretary-General for Internal Oversight Services

STATUS OF AUDIT RECOMMENDATIONS

Audit of the management of the real assets investments of the United Nations Joint Staff Pension Fund

Recom. no.	Recommendation	Critical ² / Important ³	C/ O ⁴	Actions needed to close recommendation	Implementation date ⁵
1	IMD should assess anti-money laundering controls during its Fund Manager due diligence reviews.	Important	O	Issuance of the updated due diligence questionnaire for private real assets investments.	30 September 2013
2	IMD should assess adherence to the principles for responsible investments during its Fund Manager due diligence reviews.	Important	O	Issuance of the updated due diligence questionnaire for private real assets investments.	30 September 2013
3	IMD should perform timely performance evaluations of the real assets advisor in accordance with the procedures outlined in the IMD Investment Manual.	Important	O	Issuance of the completed real assets advisor performance evaluations.	30 September 2013
4	IMD should establish real assets investment limits specific to a single general partner in the Investment Manual and monitor the exposure on an ongoing basis.	Important	O	Implementation of the recommended investment limits.	30 September 2013
5	IMD should review its performance benchmark for the real estate portfolio and factor in the Fund's infrastructure, timberland and farmland investments, as appropriate, based on the timing of actual investments.	Important	O	Submission of the outcome of the benchmark consultancy.	31 December 2013
6	IMD should identify appropriate benchmarks for measuring and reporting the risk and performance of the Fund's infrastructure, timberland and farmland investments, in readiness for when investments are made.	Important	O	Submission of the outcome of the benchmark consultancy.	31 December 2013
7	IMD should add to the Fund's overall benchmark the risk premium used to measure the performance of real estate, and document the rationale for the value of the premium.	Important	O	Submission of the outcome of the benchmark consultancy.	31 December 2013

² Critical recommendations address significant and/or pervasive deficiencies or weaknesses in governance, risk management or internal control processes, such that reasonable assurance cannot be provided regarding the achievement of control and/or business objectives under review.

³ Important recommendations address important deficiencies or weaknesses in governance, risk management or internal control processes, such that reasonable assurance may be at risk regarding the achievement of control and/or business objectives under review.

⁴ C = closed, O = open

⁵ Date provided by IMD in response to recommendations.

APPENDIX I

Management Response

UNITED NATIONS



NATIONS UNIES

UNITED NATIONS JOINT STAFF PENSION FUND
CAISSE COMMUNE DES PENSIONS DU PERSONNEL DES NATIONS UNIES

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MEMORANDUM

Ref:

New York, 26 July 2013

To / Ms. Carmen Vierula, Chief, New York
A: Audit
Service Internal Audit Division, OIOS

From / De : Maria Eugenia CASAR
Representative of the Secretary General
for the Investments of the Fund

A handwritten signature in black ink, appearing to read "M. Casar".

Subject / IMD response to OIOS Assignment No. AS2012/801/01- Audit of real assets investments of
Object: the United Nations Joint Staff Pension Fund

Reference is made to your memorandum dated 9 May 2013 providing the report on the above mention audit.

I am pleased to provide IMD's comments on the findings and recommendations as requested.

Please find attached the Annex to the audit recommendations which details IMD's responses to the findings.

I wish to thank you and OIOS for the recommendations made following the review of the real assets investments of the UNJSPF and for the positive interaction with IMD Staff regarding this matter.

cc: Ms. Suzanne Bishopric
Mr. Toru Shindo
Mr. Ajit Singh
Mr. Daniel Willey
Ms. Zelda Tangonan-Fourcade
Mr. Kamel Kessaci
Mr. Fernando Salon
Ms. Anna Halasan

AUDIT RECOMMENDATIONS

Audit of the management of the real assets investments of the UNJSPF

Rec. no.	Recommendation	Critical ¹ / Important ²	Accepted? (Yes/No)	Title of responsible individual	Implementati on date	Client comments
1.	IMD should assess anti-money laundering controls during its Fund Manager due diligence reviews.	Important	Yes	Senior Investment Officer-Real Estate	30 September 2013	A question(s) specific to this matter will be written into the due diligence questionnaire and noted in the review.
2.	IMD should assess adherence to the principles for responsible investments during its Fund Manager due diligence reviews.	Important	Yes	Senior Investment Officer-Real Estate	30 September 2013	A question(s) specific to this matter will be written into the due diligence questionnaire and noted in the review.
3.	IMD should perform timely performance evaluations of the real assets advisor in accordance with the procedures outlined in the IMD Investment Manual.	Important	Yes	Senior Investment Officer-Real Estate	30 September 2013	
4.	IMD should establish real assets investment limits specific to a single general partner in the Investment Manual and monitor the exposure on an ongoing basis.	Important	Yes	Deputy Director of Investments Deputy Director of Risk and Compliance Senior Investment Officer-Real Estate	30 September 2013	

¹ Critical recommendations address significant and/or pervasive deficiency or weakness in governance, risk management or internal control processes, such that reasonable assurance cannot be provided regarding the achievement of control and/or business objectives under review.

² Important recommendations address important deficiencies or weaknesses in governance, risk management or internal control processes, such that reasonable assurance may be at risk regarding the achievement of control and/or business objectives under review.

Rec. no.	Recommendation	Critical ¹ / Important ²	Accepted? (Yes/No)	Title of responsible individual	Implementation date	Client comments
5.	IMD should review its performance benchmark for the real estate portfolio and factor in the Fund's infrastructure, timberland and farmland investments, as appropriate, based on the timing of actual investments.	Important	Yes	Deputy Director of Investments, Senior Investment Officer-Real Estate	31 December 2013	Contingent on the completion, review and implementation of the Benchmarking Consultancy Report.
6.	IMD should identify appropriate benchmarks for measuring and reporting the risk and performance of the Fund's infrastructure, timberland and farmland investments, in readiness for when investments are made.	Important	Yes	Deputy Director of Investments, Senior Investment Officer-Real Estate	31 December 2013	Contingent on the completion, review and implementation of the Benchmarking Consultancy Report.
7.	IMD should add to the Fund's overall benchmark the risk premium used to measure the performance of real estate, and document the rationale for the value of the premium.	Important	Yes		31 December 2013	Contingent on the completion, review and implementation of the Benchmarking Consultancy Report.