



INTERNAL AUDIT DIVISION

REPORT 2015/023

Audit of investment performance measurement and reporting in the Investment Management Division of the United Nations Joint Staff Pension Fund

Overall results relating to effective management and reporting of investment performance were initially assessed as satisfactory.

FINAL OVERALL RATING: SATISFACTORY

30 March 2015
Assignment No. AS2014/801/01

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AUDIT REPORT

Audit of investment performance measurement and reporting in the Investment Management Division of the United Nations Joint Staff Pension Fund

I. BACKGROUND

1. The Office of Internal Oversight Services (OIOS) conducted an audit of investment performance measurement and reporting in the Investment Management Division (IMD) of the United Nations Joint Staff Pension Fund (UNJSPF).
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. The Fund invested in a global portfolio of investments comprising equities, fixed income, real assets, alternative assets and short-term instruments. As at 30 September 2014, the preliminary market value of the Fund's assets was \$52.6 billion, and the asset allocation was: 62.1 per cent in equities; 24.5 per cent in fixed income; 5.2 per cent in real assets; 2.4 per cent in risk control products; 1.5 per cent in alternative investments; 0.3 per cent in commodities; and 4 per cent in cash and short-term positions.
4. The long-term objectives of IMD are: (i) to offset the Fund's current and future pension liabilities; (ii) to maintain an optimal risk adjusted profile; and (iii) to diversify the portfolio with respect to asset type, currency and geographical distribution. In its strategic framework, IMD established, as an expected accomplishment, a long-term annualized real rate of return on the investments of the Fund of 3.5 per cent.
5. The real rate of return was calculated by adjusting the nominal rate of return for the United States Consumer Price Index. The Fund's real rates of return for the last one, three and five year periods as at 31 December 2013 were 13.8, 5.6 and 8.4 per cent respectively.
6. Investment performance measurement is the quantification of the results achieved by an investment programme. IMD assigned the responsibility of monitoring and reporting of investment returns as well as risk to its Risk Management and Compliance Section. The calculation of the investment performance of the Fund was outsourced to an asset management firm, which was the master record keeper (MRK).

II. OBJECTIVE AND SCOPE

7. The audit was conducted to assess the adequacy and effectiveness of IMD governance, risk management and control processes in providing reasonable assurance regarding **effective management of investment performance measurement and reporting**.
8. This audit was included in the 2014 OIOS risk-based work plan due to the risk that inaccurate investment performance measurement and reporting could lead to unsound business decisions, flawed actuarial results and unreliable asset-liability management.
9. The key control tested for the audit was performance measurement reporting system. For the purpose of this audit, OIOS defined performance measurement reporting system as controls that provide

reasonable assurance that a robust system exists for accurate and timely measurement and reporting of investment performance.

10. The key control was assessed for the control objectives shown in Table 1.

11. OIOS conducted this audit from October 2014 to January 2015. The audit covered the period from 30 September 2009 to 30 September 2014. The audit reviewed the: (a) accuracy, completeness and timely measurement of investment performance; (b) oversight and supervision of the investment performance measurement and reporting process; and (c) management of the MRK contract relating to investment performance measurement.

12. 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

13. The IMD governance, risk management and control processes examined were initially assessed as **satisfactory**¹ in providing reasonable assurance regarding **effective management of investment performance measurement and reporting**. Investment performance measurement was outsourced to MRK, and IMD established controls to ensure that the performance calculation methodology was reliable and reported figures were accurate. The Risk Management and Compliance Section measured, monitored and reported investment performance in accordance with the IMD Risk Manual. IMD also monitored and assessed the quality of contractual services provided by MRK.

14. The initial overall rating was based on the assessment of the key control presented in Table 1 below. The final overall rating is **satisfactory**.

Table 1: Assessment of key control

Business objective	Key control	Control objectives			
		Effective and efficient operations	Accurate financial and operational reporting	Safeguarding of assets	Compliance with mandates, regulations and rules
Effective management of investment performance measurement and reporting	Performance management reporting system	Satisfactory	Satisfactory	Satisfactory	Satisfactory
FINAL OVERALL RATING: SATISFACTORY					

¹ A rating of “**satisfactory**” means that governance, risk management, and control processes are adequately designed and operating effectively to provide reasonable assurance regarding the achievement of control and/or business objectives under review.

Performance measurement reporting system

A. Reliability of the performance reporting system

The investment performance calculation methodology was reliable

15. The contract between MRK and IMD stated that MRK would use rate of return calculation methodologies that were consistent with industry standards, such as the Global Investment Performance Standards (GIPS²) to calculate and present investment performance. The IMD Risk Manual required IMD to ensure that all service providers produce investment reports that were consistent with GIPS.

16. The investment portfolio rates of return were calculated by MRK on a daily basis and performance data was provided to IMD via a web-based portal. The IMD Risk Management and Compliance Section verified the accuracy of MRK provided rates of return for publicly traded securities, which made up about 88 per cent of the portfolio, by cross checking the figures with those of Morgan Stanley Capital Index BarraOne on a weekly basis. OIOS reviewed four weekly comparison reports in September 2014 and concluded that IMD had adequate controls to verify the accuracy of performance figures reported by MRK.

17. OIOS conducted further tests to assess the reliability of the performance calculation methodology. For testing purpose, MRK granted OIOS access to its online performance reporting system. OIOS selected five securities from the portfolio and recalculated the rates of return for one, three and five year periods as at 30 September 2014 at the individual security level and compared the results with MRK reported figures. The results of the test were satisfactory.

18. Moreover, OIOS conducted tests to verify the accuracy of the calculation methodology at the aggregated asset class and whole portfolio levels for one-day return as of 30 September 2014. The review and testing of the formulas and calculations showed that they were consistent with GIPS.

19. Based on the audit reviews and tests, OIOS concluded that controls were adequate in providing assurance on the accuracy of performance calculations.

Controls to ensure completeness and accuracy of input data for investment performance calculation were adequate

20. GIPS stated that in order for performance calculations to be meaningful, the portfolio of investments must be complete and the pricing/valuation of assets must be accurate.

21. As part of the service agreement, MRK performed detailed verification of each transaction and daily reconciliation between the custody and accounting records. IMD Operations Section received daily and monthly exception reports from MRK and ensured that discrepancies, which were mainly due to timing issues, were resolved.

22. To further test the completeness of the investment portfolio, OIOS compared the total value and number of security holdings included in the performance accounts with the custody accounts maintained

² GIPS were issued by the Institute of Chartered Financial Analysts to provide an ethical framework for the calculation and presentation of the investment performance history of an investment management firm.

by MRK³ and another custodian bank as at 30 September 2014. There were no material differences between the total value of the custody and performance accounts.

23. To test the accuracy of pricing and valuation of securities, including the income from investments such as dividends and interest on bonds, OIOS selected 28 equity and fixed-income securities with total value of \$2.6 billion (or 5.5 per cent in value) from a population of 1,357 securities with total value of \$45.5 billion and compared them with other sources, i.e. Bloomberg prices. The results showed that the prices and related income of the selected securities reflected the market values. IMD relied on MRK for the accuracy of pricing and valuation of securities, and MRK controls on this were outlined in the Pricing Guidelines issued by MRK. OIOS noted that IMD also performed a year-end reconciliation of accrued bond income by using Bloomberg records.

24. The valuation of alternative assets and real assets was based on periodic audited/unaudited financial statements. The IMD Portfolio Manager for private equity tracked the delivery status of quarterly financial statements issued by General Partners/Fund Managers. IMD Portfolio Managers reviewed the financial statements together with capital account statements to establish the market value of the Fund's investments. From a population of 103 private equity and real assets investments with total value of \$3.3 billion, OIOS selected and reviewed 22 investments (21 per cent) with total value of \$746 million (22 per cent) and noted that the latest audited financial statements for the year-ended 2013 were obtained from the General Partners/Fund Managers of the selected private equity and real assets firms. OIOS reviewed the valuation of five private equity investments with total value of \$292 million (42 per cent of the private equity portfolio, which was \$687 million as at 30 September 2014) and noted that the valuations were accurately prepared and were based on the latest audited financial statements.

25. Based on the various tests conducted, observations made and walk-through of systems and main processes, OIOS concluded that the controls for ensuring completeness and accuracy of input data were satisfactory.

The Investment Management Division oversaw the contractual services of the master record keeper

26. IMD Risk Manual required the Risk Management and Compliance Section to perform on-site visits to MRK as part of its ongoing due diligence at least one a year.

27. OIOS obtained minutes of due diligence visits by IMD and established that IMD regularly visited MRK. In addition, MRK representatives also visited IMD at least once a year to discuss any concerns and recommendations of IMD. During the audit, OIOS joined IMD Risk Management and Compliance Section in its latest due diligence visit to MRK. Subject matter experts from the MRK Operations, Accounting, Valuations, Internal Audit and Performance Measurement Sections briefed IMD about the internal controls within the organization such as the risk and audit programmes, management metrics, activity checklists, data governance controls, daily/weekly/monthly data reviews and exception reports. Subsequently, IMD discussed with the MRK issues relating to performance reporting and other services. OIOS observed that IMD performed its oversight role during its due diligence visit to MRK.

28. To obtain further assurance on the design and operating effectiveness of internal controls on custody and fund services provided by MRK, OIOS obtained and reviewed the latest Service Organization Control 1⁴ audit report of MRK for the 12 months ended 31 March 2014. IMD Risk

³ Since MRK provided both custody and fund services, OIOS conducted further tests described in paragraphs 27 and 28 to ensure that there was adequate segregation of duties between the two functions.

⁴ This is a report issued by a certified public accounting firm on the effectiveness of the controls instituted by a service provider.

Management and Compliance Section obtained these reports every year. OIOS noted that 48 control objectives of MRK were tested by the independent auditors and no exceptions were found relating to the effectiveness of these controls. OIOS concluded that the controls established to review the services provided by MRK were satisfactory.

B. Oversight and supervision of the performance reporting system

Controls over the provision of investment reports were satisfactory

29. According to the IMD Risk Manual, the Risk Management and Compliance Section should monitor investment returns as well as risk, and advise investment staff and the Investments Committee on investment risks and associated returns. The Manual also required that IMD produce relevant investment reports in a timely fashion and report to the following stakeholders: (i) IMD Management and Portfolio Managers on a weekly basis; (ii) Investment Committee quarterly; (iii) Pension Board annually; and (iv) Fifth Committee biennially. IMD Investment Policy stated that the Investments Committee would review performance of the actual portfolio of the UNJSPF against its strategic benchmark.

30. A review of various reports presented to the Investments Committee (Investments Committee Quarterly Meetings 220, 221, 222 and 223 in 2014), and Fifth Committee (A/69/637 in December 2014) and Pension Board (A/69/9 in July 2014) showed that the Risk Management and Compliance Section reported investment performance as part of its the Risk Management Programme. OIOS compared the figures with the MRK online performance reporting system and the performance figures were consistent and complete. OIOS also noted that the Risk Management and Compliance Section provided IMD Management with performance figures, which were discussed during weekly IMD investment meetings.

31. OIOS reviewed minutes of Investment Committee meetings and recommendations by the Committee to the Representative of the Secretary-General for Investments of UNJSPF in 2014, and noted that committee members deliberated on investment performance data, which provided a basis for discussing various investment strategies. OIOS did not note any specific recommendation by the committee members regarding the format and content of the performance reporting for the period under reference. Based on the samples reviewed, OIOS concluded that controls over the provision of investment reports were satisfactory.

Provision of investment performance data for private equity and real assets was being centralized

32. IMD Risk Manual indicated that the Risk Management and Compliance Section was responsible to ensure that relevant investment reports were produced in a timely fashion using information obtained from MRK.

33. There were some inconsistencies in the performance measurements for the private equity portfolio reported in the Investments Committee presentation as of 30 September 2014. The returns were stated as 10 per cent in the Executive Summary and other parts of the Investments Committee presentation, while the Performance Dash Section of the same presentation stated them as 12.1 per cent. This was due to the information being extracted from both the MRK report and a report of an advisory firm by the Risk Management and Compliance Section and the Portfolio Manager of private equity respectively. At the time of the audit, IMD Management informed OIOS that they had identified the cause of the discrepancy, which was due to different valuation of one private equity investment, and that the advisory firm had since communicated with MRK to ensure that their methodologies and performance figures were consistent.

34. Although the IMD Risk Manual required that MRK provide all types of performance reports, IMD Portfolio Managers for private equity and real assets primarily used the figures provided by other advisory firms because MRK did not previously provide since-inception Internal Rates of Return for private equity and real asset portfolios. MRK started providing these rates of return for the private equity portfolio in June 2014. Furthermore, IMD stated that it would ensure the consistency of investment performance data by obtaining performance figures from a single authorized source and confirmed the role of the Risk and Compliance Section in reporting the individual performance of private equity and real assets portfolios. Therefore, OIOS did not make a recommendation on this issue.

C. Management of the master record keeper contract

The performance of the master record keeper was formally evaluated

35. According to the United Nations Procurement Manual, a performance evaluation report should be prepared annually for every contractor.

36. The contract with MRK was established in June 2012 after a competitive bidding process undertaken by the Procurement Division of the United Nations Secretariat. A review of the latest annual performance evaluation report for the period February 2013 to March 2014 showed that the performance of MRK was rated as satisfactory. However, there was no input by the Risk Management and Compliance Section; even though they were in direct receipt of some of the services of MRK. During the audit interviews, the Risk Management and Compliance Section, nevertheless, stated that they were satisfied with the quality of performance reporting services provided by MRK. IMD informed OIOS that all Sections receiving direct services from MRK would provide input to the performance evaluation process in the future. OIOS, therefore, did not make any recommendations in this area.

IV. ACKNOWLEDGEMENT

37. 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

APPENDIX I

Management Response

UNITED NATIONS
INTEROFFICE MEMORANDUM



NATIONS UNIES
MEMORANDUM INTERIEUR

TO: Muriette Lawrence-Hume, Officer-in-Charge
A: New York Audit Service, Internal Audit Division, OIOS 25 March 2015

THROUGH: Ms. Carol Boykin, CFA
PAR: Representative of the Secretary General
United Nations Joint Staff Pension Fund *25 March 2015*

FROM: Daniel Willey, Compliance Officer
DE: Investment Management Division
United Nations Joint Staff Pension Fund *D Willey 25 March 2015*

SUBJECT: **Detailed results of an audit of investment performance measurement and reporting in the**
OBJECT: **Investment Management Division of the United Nations Joint Staff Pension Fund**
(Assignment No. AS2014/801/01)

Reference is made to your memorandum dated 18 March 2015 providing the report on the above mentioned audit.

I am pleased to observe that the "overall results relating to effective and efficient management of investment performance measurement and reporting were satisfactory."

This is a fundamentally important confirmation of the quality of IMD's risk controls and monitoring processes as incorrect or inconsistent performance measurement and reporting can lead to false conclusions and misdirected investments.

I wish to thank you and OIOS for the positive interaction with IMD Staff during this examination.

Ms. Suzanne Bishopric, Director, Investment Management Division, UNJSPF
Mr. Ajit Singh, Chief Risk Officer, Investment Management Division, UNJSPF
Mr. Daniel Willey, Compliance Officer and Audit Focal Point, IMD
Ms. Cynthia Avena-Castillo, Professional Practices Section, Internal Audit Division, OIOS
Mr. Fernando Salon, Chief UNJSPF Audit Section, OIOS