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MONTGOMERY COUNTY MARYLAND

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Performance Audit of the Administration of the Montgomery County Employee Retirement Plans and Consolidated Retiree Health Benefits Trust

Board of Investment Trustees and Board of Trustees

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Executive Summary

Why We Did This Audit

This performance audit of the Montgomery County Employee Retirement Plans and the Consolidated Retiree Health Benefits Trust was predicated on complaints received by the OIG between 2017 and 2020 alleging a potential lack of internal controls.

We conducted this audit to determine whether controls over certain investment-related administrative processes operated effectively and whether expense reimbursements, invoice payments, and purchasing card transactions (P-Card) complied with applicable policies and regulations. This audit was announced in the OIG Revised Work Plan & Projected Budget, November 2019 – June 2021.

We did not evaluate investment strategies, individual investments, the County's investment portfolio, or investment decisions through this audit.

What We Found

1. Expense reports were not always submitted timely.
2. Invoices lacked evidence of the receipt of services and approvals.
3. A department P-Card log is not maintained as required.
4. P-Card transactions were not always approved timely in the JP Morgan PaymentNet system.
5. Separation of duties related to P-Card management is inadequate.

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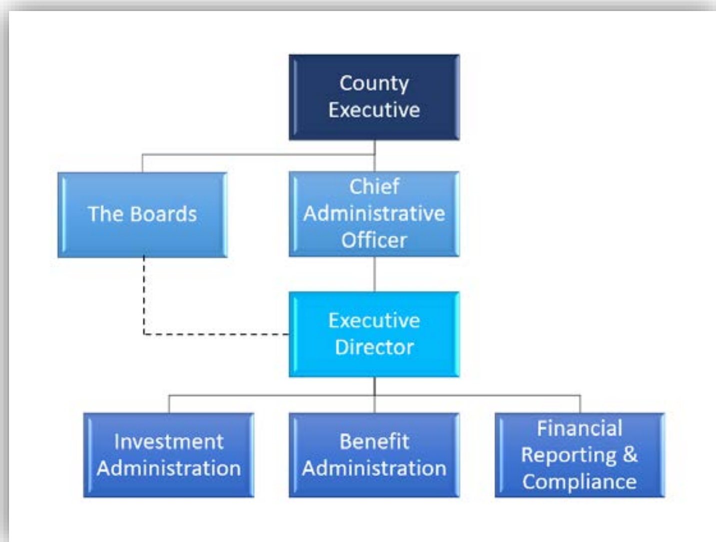
Background

The Montgomery County retirement trust fund is managed by the Board of Investment Trustees (BIT) and consists of all "the money and property, all investments made with that money and property, and all earnings, profits, increments, and other additions"[1] of the Employees' Retirement System (ERS), Retirement Savings Plans (RSP), and the Deferred Compensation Plan (DCP). Collectively, the three retirement plans are referred to as the Montgomery County Employee Retirement Plans (ERP). The BIT is composed of thirteen members appointed by the County Executive and confirmed by the County Council and has legal title to all cash and other property of the ERP.

In fiscal year 2008 the County established the Consolidated Retiree Health Benefits Trust (RHBT) to fund County and County-funded agency[2] retiree benefits such as health and life insurance. The RHBT is managed by a Board of Trustees (the Trustees) comprised of the BIT members and six additional individuals appointed by the County Executive and confirmed by the County Council. The Trustees have legal title to all RHBT assets. We will refer to the BIT and the Trustees collectively as "the Boards" throughout this report. The Boards administer approximately $7 billion[3] in retirement assets for 9,500 active employees and 6,500 retirees between all of the plans.

The day-to-day administration of the ERP and RHBT is overseen by an executive director (director). The director has "broad authority"[4] to manage three primary functional areas: Benefit Administration, Financial Reporting and Compliance, and Investment Administration. See *Figure 1*.[5]

Figure 1: *Administrative organizational structure*



[1] Montgomery County Code Sec. 33-58.
[2] Montgomery County Code Sec. 33-158 defines a County-funded agency as Montgomery College and Montgomery County Public Schools.
[3] As of June 30, 2020.
[4] ERP Statement of Investment Policy & Objectives, July 2020.
[5] Figure 1 was adapted from the ERP Fiscal Year 2020 Comprehensive Annual Financial Report, page 10.

The Boards have delegated to the director the authority to select and terminate investments and enter into and modify contracts[6] for the ERP and RHBT. The investment-related functions are conducted by staff investment officers and analysts, and all investment decisions are required to be unanimously approved by the Investment Committee which consists of the director, deputy executive director (deputy director), investment officers, and analysts.

Investment Administration

This performance audit (audit) focused primarily on the investment administration functional area overseen by the director. Investment administration involves performing due diligence procedures for hiring, terminating, and monitoring service providers; rebalancing portfolios; initiating capital calls; performing cash reconciliations; initiating, modifying, and executing contracts; performing reconciliations between Northern Trust Company (Northern Trust)[7] and investment managers; and reviewing invoices for payment.

The County Code requires that all funds in the ERP and RHBT portfolios are managed by external investment managers and exempts the Boards from Montgomery County Government procurement law when procuring goods and services for the ERP and the RHBT. Those contracted to provide services include investment consultants, investment managers, custodian banks, outside legal counsel, and other administrative service providers.

The Boards are also not subject to the requirements of Administrative Procedure 2-4 (AP 2-4), *Agreements between Montgomery County Government and Other Organizations*.[8] Each of the Boards created a governance manual and a statement of investment policy and objectives manual to document their own procurement processes and framework for managing the investment programs. Each of the governance manuals generally delineate the same four broad procurement processes:

1) Program requirements;
2) Research process;
3) Review and verification process; and
4) Selection of investment managers/finalists and contract process.

When hiring investment managers, the Boards determine the services necessary to meet the requirements of the program which can include hiring/terminating investment managers, the number of investment managers sought, urgency/timeframe for search, consultant support required, and whether outside legal counsel is needed. During the research process, the Investment Committee determines the search criteria, identifies sources, and generates a list

[6] ERP Governance Manual, July 2020 and RHBT Governance Manual, July 2020

[7] Northern Trust Company is a bank organized under the laws of the state of Illinois and is contracted by the Boards as the custodian of all ERP and RHBT assets.

[8] The County enacted AP 2-4 to “establish policies and procedures for the preparation, review, clearance, approval, and monitoring of an Agreement,” not subject to the County’s procurement regulations.

of possible candidates that will meet the Boards' needs. The Boards and Investment Committee may use various sources to identify eligible investment managers including, but not limited to, third-party databases, industry resources, marketing materials, and institutional investor contacts.

At the initiation of the verification process, investment consultants notify and provide private market investment manager candidate recommendations to the investment staff regarding managers they are currently qualifying through their own due diligence process. The informal notification allows the investment staff time to begin its own due diligence process on the prospective investment manager to be procured. During the due diligence process, the investment staff obtains and reviews various documents (e.g., due diligence questionnaire responses, private placement memorandums, performance information, case studies); conducts management interviews and onsite visits; conducts general internet background information searches; conducts reference calls; and incorporates environmental, social, and governance (ESG) considerations.

According to the ERP and RHBT governance manuals the director and investment staff are required to incorporate ESG considerations into all investments contemplated or made by the Boards and examine opportunities for ESG integration in existing investments.[9] The director is also responsible for ensuring that the Boards' ESG policy is part of the investment due diligence process. Additionally, the ESG policy applies to investment consultants and investment managers hired by the Boards to provide guidance on investment due diligence matters. *Figure 2* provides examples of ESG issues according to the Chartered Financial Analyst (CFA) Institute.[10]

Figure 2: *Examples of ESG Issues*

Environmental Issues	Social Issues	Governance Issues
Climate change and carbon emissions	Customer satisfaction	Board composition
Air and water pollution	Data protection and privacy	Audit committee structure
Biodiversity	Gender and diversity	Bribery and corruption
Deforestation	Employee engagement	Executive compensation
Energy efficiency	Community relations	Lobbying
Waste management	Human rights	Political contributions
Water scarcity	Labor standards	Whistleblower schemes

The governance manuals articulate the Boards' commitment to include emerging investment managers among their prospective investment manager candidates, including businesses owned by women, minorities, and people with disabilities, which we will collectively refer to as

[9] ERP Governance Manual, July 2020 and RHBT Governance Manual, July 2020

[10] CFA Institute, Environmental, Social, and Governance Issues in Investing, *A Guide for Investment Professionals*, October 2015.

diverse investment managers.[11] The County Code defines an emerging investment manager as "(1) an investment manager with assets or product assets below the 75th percentile of their respective peer group; or (2) a new or developing investment manager. New or developing investment manager means an investment manager: (1) raising its first or second private institutional investment fund; or (2) creating its first institutional product." Accordingly, the Boards, investment staff, and investment consultants committed to making "special efforts"[12] to ensure identification of possible eligible emerging investment managers in their search process.

Following the verification process, investment managers are selected and recommended for hire. The decision to hire an investment manager must be approved by the Investment Committee, the Office of the County Attorney (OCA), investment consultant, and the director. The approvals are documented in a delegation memorandum. The director does not sign the delegation memorandum approving the investment manager hiring until the investment consultant and the OCA have approved and signed the document.

Once the Investment Committee approves the hiring of a new private market investment manager, the investment staff submits an approved new account request to Northern Trust to establish an account where capital calls can be transacted. A capital call is a notice from the investment manager requesting a portion of the money committed to them by the Boards and as outlined in their legal agreements. Amongst other reasons, a capital call can be used for purchases or management fees/fund expenses. For public market investment managers, the investment manager submits an invoice to the director's office for payment of fees in accordance with their executed agreement.

In addition to procuring investment managers, the investment staff performs ongoing compliance monitoring which requires investment managers to provide responses to semi-annual risk questionnaires, quarterly compliance checklists, and annual vendor disclosures. Investment staff prepares a summary memorandum to the Boards which identifies any investment manager issues or material quantitative and qualitative changes to the investment manager that warrant mentioning to the Boards, and related corrective actions.

Expense Reimbursements, Invoice Payments, and Purchasing Card

Although the Boards are exempt from the County's procurement law when procuring goods and services for the ERP and the RHBT, they are required to follow certain other County policies, such as those governing expense reimbursements, invoice payments, and purchasing card (P-Card) management. Our audit therefore focused on evaluating the Boards' management of those business functions in accordance with applicable County policies.

[11] ERP Governance Manual, July 2020 and RHBT Governance Manual, July 2020
[12] Ibid.

OIG Audit Approach

The objective of our audit was to determine whether controls related to certain investment-related processes operated effectively and whether expense reimbursements, invoice payments, and P-Card transactions complied with applicable policies and regulations. We also sought to assess the Boards' good faith efforts to include businesses owned by women, minorities, and people with disabilities in their search for and consideration of investment managers. We did not evaluate investment strategies, individual investments, the County's investment portfolio, or investment decisions through this audit.

To accomplish these objectives, we assessed the effectiveness of controls in the following areas of investment administration: new private market investment managers hired, new investment manager accounts opened with Northern Trust, compliance monitoring checklists and questionnaires for all investment managers, and all capital call activity created during our scope period. We tested expense reimbursements, invoice payments, and P-Card transactions for compliance with specific sections of applicable County policies to include Administrative Procedure 1-2 (AP 1-2), Administrative Procedure 1-5 (AP 1-5), Accounts Payable Policies, *Financial Governing Principles and Standards, August 2, 2017* (Accounts Payable policy), and the Purchasing Card Program Policy and Procedure Manual (P-Card Manual). To assess the Boards' efforts to include diverse investment managers, we performed inquiries, reviewed the Boards' policies and reports, and conducted industry research.

We conducted this performance audit in accordance with generally accepted government auditing standards (GAGAS). Appendix A contains additional information on this audit's objectives, scope, and methodology and Appendix B includes a glossary of terminology used throughout the report.

Our audit focused primarily on the effectiveness of internal controls (controls) and compliance with County policies for certain business administration processes. We did not evaluate investment strategies, individual investments, the County's investment portfolio, or investment decisions through this audit. When assessing the effectiveness of controls, we are determining whether controls were applied consistently at relevant times during our audit scope period.[13]

Through the audit, we found that controls over the procurement and monitoring of investment managers, new investment manager account requests to Northern Trust, and capital call notices were reasonably effective within the scope of our audit. However, we noted instances where the Boards did not comply with County policies related to expense reimbursements, invoice payments, and P-Card transactions. We also found that there is a lack of separation of duties over purchasing card (P-Card) transactions.

Effectiveness of Controls

Based on our testing, controls designed over the procurement and monitoring of investment managers, new investment manager account requests to Northern Trust, and capital call notices appear to be reasonably effective. Although we did not identify significant[14] control deficiencies, we made several observations which present opportunities for the Boards to strengthen controls over the procurement and monitoring of investment managers. The observations primarily related to insurance policies for investment managers, organization of legal agreement documentation, and the timely completion of semi-annual risk questionnaires

We noted instances where the director's office could not provide us with adequate support of an investment manager's continued coverage of insurance policies on or prior to hiring. The Boards would benefit from ensuring that all investment managers' insurance policies are sufficient and adequate as outlined in its procedures prior to approving the hiring of the investment manager. Strengthening this control will further ensure that the exposure to loss is properly transferred to the investment manager and limit potential County liability.

During our testing, we also noted that the Boards maintain multiple signature pages for legal agreements instead of one complete, executed legal document containing all required signatures. In some instances, we noted that three sets of signature pages were maintained; one included only the director's approval; one included the approval of the investment manager or general partner; and one included a signature page capturing both the director and the OCA's approval. We were told by the Director that effective February 21, 2020, all legal agreements would include all required signatures on one document. In subsequent testing, we found that 2 out of 12 agreements for investment manager accounts opened after February 21, 2020, still did not have all the signatures on one document. The practice of maintaining

[13] Government Auditing Standards, Chapter 8.52; U.S. Government Accountability Office, 2018

[14] Significance is the relative importance of a matter within the context in which it is being considered, including quantitative and qualitative factors; Government Auditing Standards, Chapter 8.15; U.S. Government Accountability Office, 2018

multiple signature pages may give the impression that the agreements were not fully executed and approved by the OCA.

Regarding the ongoing compliance monitoring of investment managers, we noted a few instances where the Boards could not provide us with the requested investment managers' responses to the semi-annual risk questionnaire. Additionally, we received e-mail correspondence that showed the investment staff had not received the responses from the investment manager and subsequently had to request the information during our audit. The Boards should enhance the process for monitoring the completion of required compliance and semi-annual risk questionnaires to ensure that the investment staff can continue to adequately monitor investment manager performance.

Noncompliance with Administrative Policies

Through our audit we also tested the Boards' compliance with certain County policies. Although the Boards are exempt from the County's procurement law, they are required to follow County travel related policies, Accounts Payable policies, and the County's P-Card Manual. We discovered instances where the Boards failed to adhere to policies regarding expense reimbursements, invoice payments, and P-Card transactions. In addition, we discovered a lack of separation of duties regarding P-Card transactions.

Expense Reimbursements

Our performance audit focused on expense reimbursements related to the Boards' and investment staff's due diligence efforts and continuing education. Due diligence and continuing education expense reimbursement requests must meet several Board established criteria including, but not limited to, being solely in the interest of the beneficiaries and participants; meeting the Boards' objectives; and costs being reasonable and within established County regulations. Examples of expense reimbursement requests for due diligence and continuing education activities include local and non-local travel to meet with investment managers, attending conferences and association meetings, and obtaining professional certifications.

To evaluate whether expense reimbursements complied with the County's travel guidelines[15] and Accounts Payable policy, and the Boards' due diligence and continuing education policies, we sampled and tested 31 paid expense reimbursements, which totaled $12,373. We sought to determine whether expenses were supported by receipts and/or invoices; invoices adhered to requirements; expenses were for an allowable purpose; travel authorization requests were completed and approved; and expense reports were submitted timely.

During our testing, we observed that for one sample, a staff member's Due Diligence and Continuing Education Request Form (Request Form) was not approved until nearly two

[15] Administrative Procedure 1-2, Non-Local Travel Guidelines and Administrative Procedure 1-5, Local Travel Guidelines

months after expenses were incurred. AP 1-5 requires that "[t]he Travel Authorization Request must be signed by the department head or designee", and AP 1-2 requires that travel "must be approved by the department head or designee before it may be considered authorized travel for which the County will pay or reimburse reasonable and necessary travel expenses". The director's office procedures require staff to request travel authorization through the director in advance, including providing estimated expenses.

We also noted that for two separate travel occurrences, the director authorized her own travel by approving Request Forms where she was listed as one of the travelers. AP 1-5 and AP 1-2 do not explicitly restrict the director from authorizing her own travel but doing so poses a possible control deficiency related to inadequate separation of duties. We will address this policy deficiency with the County's Chief Administrative Officer in a separate report.

In addition to our observation regarding travel authorizations, we found instances where expense reports were submitted outside the timeframes established in relevant administrative policies.

Finding 1: Expense reports were not always submitted timely.

During our audit, we found that expense reports for 25 out of 31 randomly sampled expense reimbursement requests were submitted after the 30-day requirement established by policy. Per the Accounts Payable policy, "expense reports must be submitted within 30 days from the end of the business trip or from the date other business expenses are incurred". Some expense reports were submitted as late as six and seven months after the end of the business trip. Investment staff explained to us that the preparation of the related travel reports and other priorities prevented them from submitting the expense reports timely.

The sampling methodology we utilized allows us to infer with 95% confidence as much as 89.52% of the total population of expense reports will have similar instances of noncompliance with the Accounts Payable policy requirement for timely submission of expense reports.[16] Due to a lack of policy enforcement and monitoring, the Boards' noncompliance with County policy can result in an increase in errors in or lost receipts for expense reimbursements, and duplicate claims, which can inhibit management's ability to validate expense reimbursement requests.

[16] Refer to Table 4 in Appendix A for the sampling methodology. This projection is based on an 80.65% sampling deviation rate.

Recommendation 1

We recommend the County:

Enforce the office's compliance with Accounts Payable policy to ensure that expense reports are submitted within 30 days from the end of the business trip or from the date other business expenses are incurred.

Invoice Payments

Professional services providers include external legal counsel, physicians, consultants, information technology support, custodian, actuaries, external auditors, and investment managers. Public market investment managers are hired by the Boards to manage the funds of the ERP and RHBT portfolios. Generally, before authorizing payment of an invoice for professional services, the investment staff reviews the contracts for each service provider's fee schedule and compares the amounts listed on the invoice to the contract. Additionally, for invoiced public market investment manager fees the assigned internal portfolio manager (investment staff) compares the market values listed on the invoice to Northern Trust's market value by month and approves the invoice prior to submitting it to the director for final payment.

Our audit examined whether invoice payments related to the Boards' contracted service providers complied with the County's Accounts Payable policy. During the testing of invoice payments, we found that the Boards generally complied with the related Accounts Payable policy but did not properly document the receipt of services and approvals on invoices as required.

Finding 2: Invoices lacked evidence of the receipt of services and approvals.

Per the Accounts Payable policy, the person authorizing the transaction or approving the invoice should be separate from the person receiving the goods and services and the person processing the invoice in the County's Oracle E-Business Suite (Oracle). The Boards achieve separation of duties for processing invoices by utilizing the Department of Finance's Accounts Payable shared service function. However, the Boards are still responsible for ensuring adequate separation exists for approving the invoice and receiving the goods and services. The Accounts Payable policy allows for departments to utilize a manual process to adequately separate responsibilities if they are unable to do so in Oracle. Per the Accounts Payable policy, the manual process requires that all invoices have a receiver and approver signature and that the "purpose [or role] of each signature should be clearly noted on the invoices".[17] We examined whether purchasing responsibilities were separated as required by policy.

We found that all the samples of professional services[18] and public market investment manager fee invoices failed to include designated receiver and approver signatures. Invoice Payment Request forms attached to the invoices were signed by an approver but did not include the designated signature of a receiver on the request form or the invoice. The lack of a clear indication of separation of duties for purchases can lead to potential fraud or erroneous payments to service providers. When we inquired of the Director about our finding, she stated she was unaware of the policy directing the inclusion of the purpose of each signature on invoices.

Recommendation 2

We recommend the County:

a) Ensure the director and investment staff receive training on the Accounts Payable policy requirements specifically related to documenting evidence of the receipt of goods or services and approval on invoices.

b) Ensure the office updates its policies and procedures to be consistent with County policies in requiring that all invoices have a receiver and approver signature with the purpose of each signature clearly noted on the invoices.

P-Card Transactions

The Boards are assigned one County issued P-Card[19] with a pre-authorized limit of $30,000 and a single transaction limit of $10,000. Transactions can be approved by the director or deputy director in the P-Card management system, JP Morgan PaymentNet system.

Our audit included a review of whether P-Card transactions complied with specific sections of County policies and procedures. In doing so, we examined a sample of 35 transactions totaling $21,011. We sought to determine whether purchased items were allowable; excluded Maryland state sales and use tax; were supported by adequate documentation; were properly approved by the director or deputy director; were pre-approved by the authorized approver for travel-related expenses; were reviewed and approved timely; were reconciled to JP Morgan statements monthly; and whether the director's office maintained a P-Card log.

During our testing we found that although the Boards were mostly compliant with the County's P-Card Manual requirements, they did not maintain a P-Card log and did not

[17] Accounts Payable Policy
[18] As described in Appendix A, we excluded 14 samples from testing; therefore, we are referring to all 19 remaining samples we tested.
[19] The JP Morgan PaymentNet system lists the P-Card under the name of "BIT MCERP", but the P-Card is managed by the director's office.

approve P-Card transactions on a timely basis. Additionally, we noted a control deficiency related to the separation of P-Card duties.

Finding 3: A department P-Card log is not maintained as required.

Per the Accounts Payable Department P-Card Guidelines[20], a "[d]epartment P-Card log must be maintained by the custodian of the County Department P-Card". A custodian is a designated County department employee who is responsible for the safekeeping of the P-Card and collection of P-Card receipts and supporting documentation. A P-Card log should be maintained by credit card cycle and include various information to assist the custodian with the tracking and security of the physical P-Card. *Figure 3* below is an example of a P-Card Log included in the Accounts Payable Department P-Card Guidelines.

Figure 3: Sample Department P-Card Log

Date Card Issued	Signature to accept card	Date Card Returned	Signature to return card	Receipts Received Yes/No	Reason card will be used	Beginning Balance <u>$5,000</u>	Ending Balance
JAN 19, 2018							

January 2016

During our audit, we learned that at varying times during our scope period two different staff members were the designated P-Card custodians. We interviewed both custodians and learned that the Boards did not maintain a P-Card log during our scope period. We learned that between 2017 and the beginning of 2020, the custodian did not maintain a P-Card log because the office "was so small, and few staff members used the card". The custodian stated, "if one person borrowed [the P-Card], I would know; and the person bought supplies and returned it right away". We confirmed with Finance's Accounts Payable Section Manager that the P-Card log is required to be maintained by the custodian regardless of the department or office size. Due to the lack of enforcement of existing policy, the Boards were not compliant with the P-

[20] An Addendum to the County P-Card Manual (revised March 31, 2017)

Card Manual requirement resulting in inadequate custodial safekeeping of the P-Card and the potential for unaccounted and unauthorized purchases.

Recommendation 3

We recommend the County:

Ensure the office maintains a Department P-Card log as required by the P-Card Manual.

Finding 4: P-Card transactions were not always approved timely in the JP Morgan PaymentNet system.

Per the P-Card Manual, reconciled transactions must be approved by the transaction approver at least monthly.[21] The transaction approver is primarily responsible for the "validity of each transaction under his/her review".[22] Additional responsibilities include monitoring the legitimacy of the transaction, the accuracy of the accounting code, making sure there is no Maryland state sales and use tax charged, and ensuring proper documentation is maintained. The transaction approver is required to approve the P-Card transactions in the JP Morgan PaymentNet system and sign off on the JP Morgan Statement of Account for each cycle.

During our audit, we learned that the director and deputy director are the authorized transaction approvers for all P-Card transactions. During our testing, we attempted to obtain the JP Morgan PaymentNet system approval dates for P-Card transactions to assess the transaction approvers' compliance with the monthly approval requirement. However, we were only able to obtain the approval dates for 7 out of 35 randomly selected samples due to limitations within the system. We were informed by Finance's Accounts Payable Section Manager that the JP Morgan PaymentNet system only retains historical data for 2 years. Additionally, we learned that Finance's Accounts Payable Section does not maintain information related to approval dates; they only retain reports that show that the transaction approver approved the P-Card transactions. Therefore, we were unable to obtain the approval dates for the remaining 28 samples, which were older than two years.

For the seven samples for which data was available, we found that six of the seven were not timely approved by the transaction approver. Two samples were approved as late as nine months after the end of the credit card cycle and four samples were approved between two and three months after the credit card cycle end date. The sampling methodology we utilized

[21] P-Card Manual, March 31, 2017
[22] Ibid.

allows us to project with 95% confidence that as much as 30.68% of the total population of P-Card transactions will have similar instances of untimely approval.[23]

According to the P-Card Manual, there are two types of P-Card violations: egregious violations and minor violations. An egregious violation includes personal purchases, sharing the P-Card with other individuals, failure to timely reconcile or approve transactions or provide supporting documentation, and split purchases. The Boards' failure to approve transactions in a timely manner is deemed an egregious violation by County policy and can result in the revocation of the P-Card. Additionally, the Boards' lack of enforcement and noncompliance with the policy can diminish the approver's ability to validate the propriety of purchases and potentially lead to improper or wasteful spending.

Recommendation 4

We recommend the County:

Enforce the office's compliance with the P-Card Manual by requiring that transaction approvers review and approve reconciled transactions in the JP Morgan PaymentNet system at least monthly.

Finding 5: Separation of duties related to P-Card management is inadequate.

During our audit, we found that the Boards failed to separate duties related to P-Card management. The P-Card Manual requires that an adequate separation of duties exist between the different P-Card roles and responsibilities. For example, a transaction approver cannot be the same person as the purchaser of goods or services. In addition to the requirements of the P-Card Manual, the Boards are responsible for the design, implementation, and operating effectiveness of internal controls, which includes ensuring that proper separation of duties exists for key control activities. Separation of duties refers to the division of key duties and responsibilities among different people to reduce the risk of error, misuse, or fraud. This includes "separating the responsibilities for authorizing transactions, processing and recording them, reviewing the transactions, and handling any related assets so that no one individual controls all key aspects of a transaction or event."[24]

We found that 3 out of 35 randomly selected samples of P-Card transactions involving purchases that were made by and/or for the director, were also approved by the director resulting in a lack of separation of duties. *Table 1* shows the details for each of the three P-Card

[23] Refer to Table 5 in Appendix A for the sampling methodology. This projection is based on a 17.14% sampling deviation rate. The projection also assumes that there were no additional instances of noncompliance for the remaining 28 samples for which we could not obtain the approval dates.

[24] United States Government Accountability Office, Standards for Internal Control in the Federal Government, September 2014.

transactions that lacked evidence of separation of duties. We confirmed with Finance's Accounts Payable Section Manager that the transaction approver cannot also be the associated requestor or purchaser. Because of the lack of adequate separation of duties within the purchasing process, there is an increased risk of error or fraud.

Table 1: P-Card transactions that lacked evidence of separation of duties

Transaction Description	Transaction Amount	Purchaser	Receiver of Goods / Services	Approver
Bakery café	$68.28	Director	Director	Director
Office supplies	$556.47	Director	No indication provided	Director
American Airlines ticket	$280.20	Investment staff	Director (traveler)	Director

Recommendation 5

We recommend the County:

Ensure the office implements controls that establish an adequate separation of duties over P-Card transactions.

Diversity, Equity, and Inclusion Observation

The OIG is committed to seeking opportunities to address diversity, equity, and inclusion in all aspects of our work, including our audits and reviews. Our commitment is consistent with the County's advancement of racial equity and social justice. As such, we evaluated the Boards' efforts to identify businesses owned by women, minorities, and people with disabilities, in their search process and noted opportunities for enhancement. Our observations also seemingly align with industry and public sector efforts to promote diversity, equity, and inclusion in various aspects of the selection process for hiring investment managers. Our research found examples of ways the Boards can amplify their existing efforts such as demonstrating the importance of diversity, equity, and inclusion in their directives; leveraging guidance from industry associations on ways to augment existing processes and programs; and utilizing available data submitted by entities regarding their diversity and equity policies and practices.

Observation: The Boards, consistent with their fiduciary responsibility, could develop proactive processes to increase opportunities that enhance diversity, equity, and inclusion in their search for and consideration of investment managers.

The Boards' Current Efforts Towards Diversity, Equity, and Inclusion

During our audit, we learned that the Boards have adopted two practices they believe are applicable to diversity, equity, and inclusion without creating a preference for businesses owned by women, minorities, or people with disabilities.

The Emerging Investment Managers program articulates the Boards', investment staffs', and investment consultants' commitment to incorporating emerging investment managers, including businesses owned by women, minorities, and people with disabilities, among their prospective investment manager candidates.[25] The County Code defines an emerging investment manager as "(1) an investment manager with assets or product assets below the 75th percentile of their respective peer group; or (2) a new or developing investment manager. New or developing investment manager means an investment manager: (1) raising its first or second private institutional investment fund; or (2) creating its first institutional product." Accordingly, the Boards, investment staff, and consultants committed to making "special efforts"[26] to ensure identification of possible eligible emerging investment managers in their search process. Those special efforts include regular monitoring of information to identify possible candidates, regular reviews of emerging investment managers, staff interviews with emerging firms on an ongoing basis, and maintenance of research files on such firms to assist efforts when searches begin.[27] The Boards' Emerging Investment Managers program does not

[25] ERP Governance Manual, July 2020 and RHBT Governance Manual, July 2020

[26] Ibid.

[27] Ibid.

address how to further involve businesses owned by women, minorities, and people with disabilities that do not meet the definition of an emerging investment manager and do not consider diverse investment managers that are already fully established.

The Boards have also adopted an Environmental, Social, and Governance (ESG) policy, which requires the investment staff to incorporate ESG considerations "into all investments considered or made by the [Boards] and examine opportunities for ESG integration in existing investments."[28] The investment staff considers an investment manager's ESG policies throughout the selection process for hiring investment managers. The social component of ESG includes gender and diversity as shown in *Figure 2* on page 3 of this report, according to the Chartered Financial Analyst (CFA) Institute. During our audit, we learned that the investment staff incorporates social considerations into their investment process by including topics such as the culture of the firm, whether the firm has an equal opportunity policy, and whether any discrimination lawsuits were filed against the firm. The Director told us that the Boards believe that firms with strong ESG policies and practices will be more successful.

To enhance the Boards' ability to monitor ESG opportunities, on October 31, 2019, the Employee Retirement Plans became a signatory to the United Nations Principles for Responsible Investment (PRI). Becoming a signatory also means that the Employee Retirement Plans committed to the six PRI principles shown in *Table 2*.

Table 2: *Principles for Responsible Investment*

Principle 1	We will incorporate ESG issues into investment analysis and decision-making processes.
Principle 2	We will be active owners and incorporate ESG issues into our ownership policies and practices.
Principle 3	We will seek appropriate disclosure on ESG issues by the entities in which we invest.
Principle 4	We will promote acceptance and implementation of the Principles within the investment industry.
Principle 5	We will work together to enhance our effectiveness in implementing the Principles.
Principle 6	We will each report on our activities and progress towards implementing the Principles."

[28] Ibid.

The County's Racial Equity and Social Justice Law

The County's 2019 Racial Equity and Social Justice law established a racial equity and social justice framework which requires the County Executive to adopt a racial equity and social justice plan for the County and requires each Executive and Legislative Branch department and office to develop a racial equity and social justice action plan. The law took effect on March 2, 2020, during our audit scope period.[29]

> *" Racial equity and social justice means changes in policy, practice and allocation of County resources so that race or social justice constructs do not predict one's success, while also improving opportunities and outcomes for all people".[30]*

The County Code requires that the racial equity and social justice action plans must include, among other requirements, a community engagement process and the use of explicit racial equity and social justice considerations in establishing new programs and evaluating existing programs. The need for the action plan was predicated on the County finding that inequitable outcomes linked to race and social justice issues will persist in the County without intentional intervention; and the work to dismantle racial and social justice inequity must occur on an individual, institutional, and structural basis.[31]

Another Public Entity's Approach

Other public entity retirement systems are evolving through modern policy changes that reflect their commitment to diversity and inclusion in their programs while adhering to their fiduciary responsibility[32]. As an example, the Maryland-National Capital Park and Planning Commission Employees' Retirement System's (M-NCPPC ERS) adopted a Fair Consideration/Public Interest Policy within their Investment Policy. This policy affirmatively states that the M-NCPPC ERS Board "does not discriminate against minority-owned firms in its manager selection process. The Board desires that Staff and the Investment Consultant, identify, research, and evaluate qualified minority-owned managers". The policy also states that, "the Board...desires that Investment Managers give consideration to such managers and brokers in their efforts to fulfill the Fund's investment objectives, but only in compliance with their respective fiduciary duties to the Funds."[33] The policy defines a minority manager as "an

[29] Section 2-81C of Bill 27-19 became effective on August 1, 2020.
[30] County Code Sec. 2-64A. Office of Racial Equity and Social Justice.
[31] Ibid.
[32] According to the County Code Sec. 31-61C., a fiduciary must discharge the fiduciary's duties regarding the retirement systems only in the best interest of and to provide benefits to the participants and their beneficiaries; with care, skill, prudence, and diligence under the circumstances that a prudent person acting in a similar capacity and familiarity would use to conduct a similar enterprise; by diversifying the investments of the retirement systems to reduce the risk of loss; and according to a good faith interpretation of the law, documents ,and instruments governing the retirement systems.
[33] Employees' Retirement System, the Maryland-National Capital Park and Planning Commission, Statement of Investment Policy

investment manager or broker that is U.S. domiciled and is majority-owned by one, or any combination, of the following groups: African American, Asians (including Pacific Islanders), Native American, Hispanic American, women and [people with disabilities]."[34] Such a policy demonstrates a "tone at the top" for the importance of diversity, equity, and inclusion to fulfill the M-NCPPC ERS' investment objectives. "Tone at the Top" occurs when "the oversight body and management demonstrate the importance of integrity and ethical values through their directives, attitudes, and behavior".[35]

Advancements in the Industry

We also noted that several industry associations are advancing diversity, equity, and inclusion by developing ways in which organizations can further their related goals. We reviewed the CFA Institute's position on diversity and inclusion and found that they have produced several guidance materials related to ways organizations can mature their diversity and inclusion programs. To proactively consider businesses owned by women and minorities, the CFA Institute recommends that organizations ask for their consultants to propose diverse slates of firms consistent with the organization's definition of diversity; differentiate between emerging firms and diverse ownership; engage community stakeholders with the goal of creating opportunities for small, minority-owned, women-owned, veteran-owned, and local businesses; track the firm's level of spending with diverse suppliers; and report results and metrics by firm category.[36]

Furthermore, in September 2018, the Institutional Limited Partners Association (ILPA) expanded its standardized due diligence questionnaire to include elements to support the advancement of diversity and inclusion within the private equity industry. Some of the enhancements include a template to measure the ethnic and gender diversity at general partner firms and a set of questions to enhance understanding of a general partner's policies and procedures in areas such as hiring, promotions, family leave, mentoring and harassment and discrimination. Figure 4 shown is an excerpt from ILPA's expanded due diligence questionnaire.

[34] Ibid.

[35] United States Government Accountability Office, Standards for Internal Control in the Federal Government, September 2014.

[36] CFA Institute, "Driving Change: Diversity & Inclusion in Investment Management"; 2018 (https://www.cfainstitute.org/-/media/documents/survey/diversity-and-inclusion-report-full.ashx)

Figure 4: ILPA Diversity and Inclusion Questions

14.0	**Diversity and Inclusion**	**Yes**	**No**	**Reference***
14.1	Does the Firm have a formal Diversity and Inclusion policy or initiative? If 'yes', provide a copy of the policy (as referenced in Appendix A).	☐	☐	
14.2	(Only if 'no' to 14.1) Would you be willing to develop and implement a policy or initiative within one year?	☐	☐	
14.3	Does the Firm have a Code of Conduct that covers harassment, discrimination and/or workplace violence? If 'yes', provide a copy of the Code (as referenced in Appendix A).	☐	☐	
14.4	(Only if 'no' to 14.3) Would you be willing to develop and implement such a code within one year?	☐	☐	
14.5	(As noted in 14.3) Does the Firm require such a Code of Conduct at its portfolio companies?	☐	☐	
14.6	(Only if 'no' to 14.5) Would you be willing to require such a code at the Firm's current/future portfolio companies within one year?	☐	☐	
14.7	Does the Firm have a Family Leave policy?	☐	☐	
14.8	(Only if 'no' to 14.7) Would you be willing to develop and implement such a policy within one year?	☐	☐	
14.9	Does the Firm track the gender composition of employees taking family leave benefits? If 'yes', provide a summary of employees that have taken family leave in the last three years (as referenced in Appendix A).	☐	☐	
14.10	(Only if 'no' to 14.9) Would you be willing to begin tracking this information within one year?	☐	☐	
14.11	Does the Firm have a formal mentorship program for minorities and/or women?	☐	☐	
14.12	Does the Firm work with organizations that promote the attraction and retention of women and minorities within private equity? If "yes', provide a list of these organizations, as well as any additional programs you have embraced (as referenced in Appendix A).	☐	☐	
14.13	Has the Firm put procedures in place for the reporting and investigation of harassment and/or discrimination? If 'yes', provide these procedures (as referenced in Appendix A).	☐	☐	
14.14	(Only if 'no' to 14.13) Would you be willing to establish and communicate procedures within one year?	☐	☐	
14.15	Have there been any claims of sexual or general harassment, misconduct or discrimination against any current or former Firm employees (while employed by the Firm) within the last 5 years?	☐	☐	

SEC and Nasdaq Efforts

During our industry research, we learned that the Federal Security and Exchange Commission (SEC) has made considerable efforts in recent years to promote diversity, inclusion, and opportunity through fostering diversity in the regulated entities they oversee. Specifically, the SEC is promulgating ways in which regulated entities can assess and impart their diversity and equity policies and practices. In June 2015, the SEC joined with other federal financial regulatory agencies in issuing the Final Interagency Policy Statement Establishing Joint Standards for Assessing the Diversity Policies and Practices Regulated by the Agencies (Joint Standards). The Joint Standards provide a framework for regulated entities to voluntarily assess their diversity policies and practices in several key areas which can be accomplished through a form the SEC developed called the "Diversity Assessment Report for Entities Regulated by the SEC". The assessment form asks various questions about the regulated entities' organizational commitment to diversity and inclusion, implementation of employment practices to promote workforce diversity and inclusion, consideration of supplier diversity in procurement and business practices, practices to promote transparency of organizational diversity and inclusion, and evaluation of diversity policies and practices. Some of the successful practices reported by regulated entities for promoting diversity and inclusion include the following:

- Requiring diversity education for all managers, including unconscious bias training;
- Maintaining a diverse supplier repository;
- Hosting workshops and expos to support the development and inclusion of diverse vendors in procurement; and
- Partnering with external organizations promoting diversity and inclusion.

There is momentum behind additional efforts to increase access to information regarding diversity in publicly traded companies as evidenced by the SEC's adoption of a rule change proffered by Nasdaq Stock Market LLC ("Nasdaq") and formally adopted on August 6, 2021. Under the approved rule, Nasdaq can require public companies to publicly disclose the gender and racial diversity of their boards and eventually to have at least two diverse directors; one who self-identifies as a female and one who self-identifies as Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander, two or more races or ethnicities, or as LGBTQ+. The proposal also states that companies without two diverse directors would be required to explain why they did not meet the requirement.

Prior to approval, the SEC allowed for the public to submit comments regarding the proposed rules by Nasdaq. We noted that two comments in favor of the proposed rule were from entities that the Boards are affiliated with: Northern Trust and PRI. The comment letter from Fiona Reynolds, Chief Executive Officer (CEO) of PRI, stated, "the proposed rule change is a meaningful first step forward in long-overdue changes in the U.S. financial industry and society broadly. In signing the Principles for Responsible Investment, investors agree to incorporate material ESG factors in investment decisions, and this includes board and corporate diversity and inclusion".[37] The letter also referred to more than 125 investors, some of which are signatories to the PRI, who signed on to a letter by As You Sow, calling for companies to release relevant data on their workplace diversity and equity policies and practices and for investors to consider the data in their investment analyses. We reviewed the current signatories and noted that the Maryland State Retirement and Pension System was among the signatories.[38]

Opportunities Exist to Promote Diversity, Equity, and Inclusion

The advancements in the industry and ways other industry affiliates have tried to increase diversity, equity, and inclusion in their practices is aligned with the County's principles and touched upon in the Boards' current efforts. By developing additional tools and mechanisms to

[37] https://www.sec.gov/comments/sr-nasdaq-2020-081/srnasdaq2020081-8540914-230502.pdf
[38] https://www.asyousow.org/our-work/gender-workplace-equity-disclosure-statement

encourage and identify diverse investment managers, the Boards could amplify opportunities to further promote diversity, equity, and inclusion in their programs. Although the Boards have an Emerging Investment Managers program and an ESG policy, they do not specifically address how the Boards proactively identify or engage in outreach to diverse managers. According to the Diverse Asset Managers Initiative (DAMI), an emerging manager program provides opportunities for new and small firms, but it does not guarantee the achievement of equity and diversity.[39]

The Boards would benefit from mirroring the County's and industry's forward movement by developing additional procedures to ensure that a wide net is cast to include qualified businesses owned by women, minorities, and people with disabilities in their investment manager hiring practices. For example, the Board could develop tools to ensure investment staff, investment consultants, and investment managers exhaust good faith efforts to research and develop opportunities to increase diversity, equity, and inclusion in their processes and programs. The Boards could also develop mechanisms to proactively encourage and inform businesses owned by women, minorities, and people with disabilities of opportunities to conduct business on behalf of the trust funds. Lastly, the Boards could work to proactively identify eligible diverse investment managers, including businesses owned by women, minorities, and people with disabilities, in their search for and consideration of investment managers, all of which could be done consistent with their fiduciary responsibilities.

[39] https://www.sec.gov/files/amac-background-dami-fiduciary-guide.pdf

OIG COMMENTS TO THE CAO AND BOARDS' RESPONSE

The CAO and Boards' responses to our report are included in their entirety in Appendix C.

The draft report provided to the Chief Administrative Officer (CAO) and Boards directed recommendations to the Boards. Upon review and discussion, the CAO decided that the recommendations would be better addressed by his office. We had no objection and subsequently altered the wording of recommendations in the final version of the report to reflect this change. Additionally, the Boards provided comments reflecting their views on observations presented in the report. Nothing else caused us to alter our report.

The CAO and Boards' responses to this report are included in their entirety in Appendix A. The responses note general concurrence with the OIG's recommendations.

There are aspects of the response that we believe will require further monitoring and detail. We expect specifics of stated actions and plans to be included in the Internal Auditor's report on corrective actions which is expected in September in accordance with County Code §2-25A. The following comments are related to the CAO's responses to recommendations 1 and 4:

OIG RECOMMENDATION 1: We recommend the County enforce the office's compliance with the Accounts Payable policy to ensure that expense reports are submitted within 30 days from the end of the business trip or from the date other business expenses are incurred.

CAO Response to recommendation 1: We concur in principle. We recognize the importance of timely submission by an employee of claims for reimbursement of expenses incurred for approved County business travel. We also recognize that there are instances where, due to workload or other legitimate reasons, claims for reimbursement may be delayed. Even if submitted beyond the 30 days, such as claims for approved travel business expenses would need to be reimbursed by the County. As part of our planned revision to clarify the applicable Administrative Procedures (APs) – AP 1-2 and 1-5, we will reiterate this fact and emphasize the importance of timely submission of reimbursement claims.

OIG Comment to CAO Response to recommendation 1: The County's published Accounts Payable policy requires that "expense reports must be submitted within 30 days from the end of the business trip or from the date other business expenses are incurred." As this is the prevailing policy that all departments are expected to follow it served as the criteria for our testing. In testing against this criteria, we found that expense reports for over 80% of sampled expense reimbursement requests were submitted after the 30-day requirement. We believe our finding suggests a broader issue with compliance rather than infrequent occurrences attributable to workloads.

OIG RECOMMENDATION 4: We recommend the County enforce the office's compliance with the P-Card Manual by requiring that transaction approvers review and approve reconciled transactions in the JP Morgan PaymentNet system at least monthly.

CAO Response to recommendation 4: We concur. As it relates to program monitoring of this requirement, the County does enforce compliance with the P-Card manual. Consistent with the P-Card manual (Section I.G.c: Failure to Timely Reconcile or Approve Transactions), Accounts Payable notifies the Department Liaison and Transaction Approver by email of transactions not approved on a timely basis and requests a response. As referenced under the manual, those communications may extend to final warnings, suspensions of P-Card rights, or other actions. This monitoring occurred informally prior to July 2020; starting in July 2020, Finance began to more formally monitor timely reconciliation and approval on a monthly basis, with formal communication to departments. Accounts Payable did communicate to MCERP in September 2020, listing all transactions from the prior two years not yet approved in PaymentNet. MCERP advised Accounts Payable that there appeared to have been an internal issue with how the MCERP reviewer routed the transactions in PaymentNet. Subsequent to that notice and MCERP identifying the issue with their routing process and taking appropriate corrective action, Accounts Payable has not identified any late approvals from MCERP requiring follow up communication. I have directed the Department of Finance to continue its current monitoring of this situation in MCERP and take appropriate actions as required.

OIG Comment to CAO Response to recommendation 4: We appreciate the CAO's explanation of the Department of Finance's program monitoring role with respect to P-Card approvals. Because our testing was limited to a sample of transactions within our scope period we did not see the dozens of non-compliant transactions that were included in Accounts Payable's communication to the office in September 2020 and shared with the OIG after drafting of this report. In fact, due to limitations with the JP Morgan PaymentNet system we were only able to test 7 samples, 85% of which were not approved within the timeframe required by policy. We are reassured by the Department of Finance's vigilance in this area.

We have the following comments related to the Boards' response to our report:

We appreciate the Boards' attention to the observations made in our report. We understand the Boards' concerns related to the complaints that helped inform our approach to this audit. As we explained to the two Board Chairs and the others present during our exit conference, some of the complaints we received were examined through this audit, and some involved confidential personnel matters that were addressed by other entities. The extent to which those involved had a duty to report the allegations to the Boards' was beyond the scope of this audit.

As for the Boards' comments about the OIG's presentation of opportunities to further promote diversity, equity, and inclusion in their programs, we asked the Executive Director and senior-level staff whether they maintained data pertaining to the outcomes of diversity efforts but were told the information was not measured or reported. The Executive Director only supplied information after the report was completed and therefore, we did not have an opportunity to validate the stated claims. We hope the Boards will consider the various opportunities presented in our report to develop tools and procedures that will ensure a wide net is cast to include qualified businesses owned by women, minorities, and people with disabilities in their investment manager hiring practices.

APPENDIX A: OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

The objectives of this performance audit were to:

1) Assess the effectiveness of internal controls over the procurement and monitoring of investment managers;
2) Assess the effectiveness of internal controls over new investment manager account requests to Northern Trust and capital call notices to fund investment managers;
3) Evaluate whether expense reimbursements related to due diligence and continuing education, and invoice payments for professional services and public market investment manager fees comply with applicable policies, contracts, and regulations;
4) Evaluate whether P-Card transactions comply with established County policies and procedures; and
5) Assess the Boards' good faith efforts to include diverse investment managers, including businesses owned by women, minorities, and people with disabilities.

Scope and Methodology

The scope of our audit covered the period July 1, 2017, through November 30, 2020. We included all investment manager accounts opened at Northern Trust during our scope period; compliance monitoring checklists and questionnaires for all investment managers during calendar years 2019 and 2020; and all capital call activity created during our scope period.

We also limited the scope of our audit to include expense reimbursements, invoice payments, and P-Card transactions for the Employee's Retirement System, Retirement Savings Plan, and Consolidated Retiree Health Benefits Trust. We did not review expense reimbursements, invoice payments, or P-Card transactions for the Deferred Compensation Plan.

We conducted our audit fieldwork from November 2020, through July 2021. To accomplish our objectives, we conducted interviews with former investment staff to gain an understanding of the control environment during the employees' service; and conducted interviews with current investment staff, the Director, the Boards' former counsel, and external auditors to gain an understanding of the processes and controls over:

- The procurement of external investment managers;
- Monitoring and compliance of external investment managers;
- Movement of cash to fund external managers through capital call notices;
- Expense reimbursements related to due diligence and continuing education;

- Review and approval of invoice payments for professional services and public market manager fees; and
- Review and approval of employee P-Card transactions, and safekeeping of the department P-Card.

We also obtained and reviewed the following criteria for our performance audit:

- Legal authority including the Montgomery County Code, AP 1-2, and AP 1-5;
- ERP and RHBT Governance Manuals;
- ERP and RHBT Investment Policy and Objective;
- Various standard operating procedures related to investment administration, and invoice and P-Card processing;
- Accounts Payable Policies, *Financial Governing Principles and Standards*, *August 2, 2017*; and
- P-Card Manual.

To assess the effectiveness of internal controls over the procurement of investment managers, we obtained a random sample[40] from a population of all private market investment manager accounts opened with Northern Trust during our scope period using the sampling methodology shown in *Table 3* below. Based on our sampling methodology we can project the results of our testing to the population. We obtained and inspected various supporting documentation (e.g., due diligence write-ups and questionnaire responses, insurance policy approvals, legal documents, and delegation memorandums) for each sampled investment manager account to determine if each sampled account was properly approved; supported by due diligence writeups and investment consultants' analyses and recommendations; legal documents were reviewed and approved by the Boards' counsel for form and legality; and insurance policies were reviewed and approved by Finance. We also utilized the same random sample from our testing of the procurement of private market investment managers to determine whether new account requests were properly completed, approved, and sent to Northern Trust. To accomplish this, we obtained and inspected new manager request forms, Northern Trust account request forms, and e-mail correspondence.

To assesses the effectiveness of internal controls over the monitoring of investment managers, we obtained a random sample from a population of all public and private market investment manager accounts that were open with Northern Trust during our scope period using the sampling methodology shown in *Table 3* below. Based on our sampling methodology we can project the results of our testing to the population. We obtained and inspected various supporting documentation (e.g., disclosures and semi-annual risk and quarterly compliance

[40] A sample is a portion of a population that is examined or tested in order to obtain information or draw conclusions about the entire population.

questionnaire responses) for each sampled investment manager account to determine if each sampled account was actively registered with an appropriate securities regulator (e.g., the U.S. Securities and Exchange Commission and Financial Industry Regulatory Authority) and whether the Boards received and maintained completed disclosures and questionnaires from the investment managers. We also reviewed memos to the Boards to determine whether noncompliance issues were being identified and reported accordingly.

To assess the effectiveness of internal controls over capital call notices to fund investment managers, we obtained a random sample from a population of all capital call activity notices created during our scope period using the sampling methodology shown in *Table 3* below. Based on our sampling methodology we can project the results of our testing to the population. In addition to the 36 random samples, we made an additional ten judgmental selections to include the top 5 largest initial capital call notices (which total $4,861,106) and five transactions we deemed to be high-risk (which total $54,794,627). *Table 3* only shows our random sample selections and does not include the judgmental selections. We obtained and inspected various supporting documentation (e.g., capital call notices, Board meeting minutes, and e-mail correspondence) for each sampled capital call notice to determine if the capital call was properly initiated, created, approved, and reconciled.

Table 3: Sampling Methodology - Investment manager procurement, monitoring, new accounts, and capital call notices

Description	Population Size	Population $	Confidence Level	Tolerable Deviation Rate	Expected Deviation Rate	Sample Size	Sample $
Procurement of private market investment managers	99	N/A	95%	8%	0%	30	N/A
Monitoring of investment managers	257	N/A	95%	8%	0%	33	N/A
New accounts at Northern Trust	99	N/A	95%	8%	0%	30[41]	N/A
Capital call notices	1,266	$898,022,880	95%	8%	0%	36	$18,017,471
Totals	**1,721**	**$898,022,880**				**129**	**$18,017,471**

For expense reimbursements and invoice payments testing, we obtained and analyzed accounts payable invoice payments recorded to general ledger account codes for due diligence and continuing education, professional services, and public market manager fees.[42] We utilized check numbers with check dates within our scope period. *Table 4* shows the characteristics of the three

[41] This is the same sample we utilized for the procurement of private market investment managers testing.

[42] Accounts payable invoice payment details were obtained from the County's Enterprise Business Intelligence and Reporting application (BI).

populations and methodology used to conduct random sampling for our testing. We obtained and inspected various supporting documentation (e.g., invoices, expense reports, contracts, travel authorization request forms, and travel and conference reports/writeups) for each sampled expense reimbursement or invoice payment to determine if each payment was properly approved, supported by receipts and/or invoices, and complied with the County's policies. We also reviewed professional services and public market investment manager contracts to determine if amounts billed on the invoices agreed to the fee schedules in the contracts. We assessed the reliability of this data by reviewing documentation, tracing a total of 98 randomly selected records back to the source documents, and interviewing investment staff. We determined that the data was sufficiently reliable for our reporting purposes.

Table 4: Sampling Methodology - Expense reimbursements and invoice payments

Population	Population Size	Population $	Confidence Level	Tolerable Deviation Rate	Expected Deviation Rate	Sample Size	Sample $
Due diligence expense reimbursements	124	$40,308	95%	8%	0%	31	$12,373
Professional services invoice payments	219	$2,017,109	95%	8%	0%	33	$259,486
Public market manager fees invoice payments	376	$70,393,471	95%	8%	0%	34	$6,694,735
Totals	**719**	**$72,450,888**				**98**	**$6,966,594**

Based on our sampling methodology we can project the results of our testing to the due diligence and continuing education and public market manager fees population. We cannot project the results of our testing to the professional services population because during our audit we learned that 14 out of 33 samples included contracts maintained with, and invoice payments approved by other County departments. Since our audit was focused on the Boards' investment-related processes, we did not review those 14 samples for compliance with policies.[43] *Table 4* only shows our initial random sample selections and does not exclude the 14 professional services samples.

For P-Card transaction testing, we obtained and analyzed P-Card payments data by invoice number with general ledger dates during our scope period.[44] We obtained and inspected supporting documentation [e.g., invoices and/or receipt, JP Morgan Chase Bank (JP Morgan) statements, JP Morgan PaymentNet system transaction detail] for each sampled P-Card transaction to determine if each invoice payment was reconciled timely, properly approved, an allowable purchase, supported by documentation, and recorded in the P-Card log. *Table 5* shows the characteristics of the P-Card transaction population and methodology used to

[43] The 14 samples we excluded from our sample size related to four different suppliers.

[44] P-Card payments data was obtained from the Accounts Payable Details module in BI.

conduct random sampling for our testing. Based on our sampling methodology we can project the results of our testing to the population.

Table 5: Sampling Methodology - P-Card transaction testing

Population	Population Size	Population $	Confidence Level	Tolerable Deviation Rate	Expected Deviation Rate	Sample Size	Sample $
P-Card invoices	805	$343,659	95%	8%	0%	35	$21,011

To assess the Boards' good faith efforts to include diverse investment managers, including businesses owned by women, minorities, and people with disabilities, we performed inquiries of the Director and investment staff; reviewed the Boards' ESG policies; reviewed the annual emerging managers reports for fiscal years 2018 through 2020; and conducted research on the industry's efforts to include diverse investment managers in asset management.

Internal Controls

The Boards are responsible for the design, implementation, and operating effectiveness of the Boards' internal controls. We assessed the Boards' internal controls and compliance with policies and procedures necessary to satisfy our audit objectives. We determined that the principles of designing and implementing control activities within the control activities component of internal controls were significant to our audit objectives. We assessed whether internal controls are properly designed and implemented through walkthroughs. In addition, we tested the operating effectiveness of specific internal controls by reviewing and inspecting relevant documents and data and testing payments made by the ERP and RHBT. However, because our audit was limited to these internal control components and underlying principles, our audit may not have disclosed all internal control deficiencies that may have existed at the time of this audit.

Auditing Standards

We conducted this performance audit in accordance with generally accepted government auditing standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Scope Impairments

The timely issuance of our report, when the subject permits, is an important reporting goal for the OIG. In accordance with GAGAS, auditors should report any significant constraints imposed on the audit approach, including excessive delays in access to certain records or individuals.[45] During our fieldwork, we experienced excessive delays in receiving requested documentation, as late as four months after our initial request. After several follow-up requests, we also did not receive requested documentation for several samples; instead, we were provided with various explanations for the absence of documentation.

[45] Government Auditing Standards, Chapter 9.12; U.S. Government Accountability Office, 2018

APPENDIX B: GLOSSARY

Term	Definition
Capital Calls	A capital call is a notice from private market investment managers requesting a portion of the money committed to them by the Boards and as outlined in their legal agreements. Amongst other reasons, a capital call can be used for investment purchases or management fees/fund expenses.
Confidence Level	In statistical sampling, the confidence level refers to the reliability the auditor places on the sample results.
Control Deficiency	A deficiency in internal control exists when the design, implementation, or operation of a control does not allow management or personnel to achieve control objectives and address related risks.
Control Deficiency in Design	A deficiency in design exists when a necessary control is missing or is not properly designed so that even if the control operates as designed, the control objective would not be met.
Diverse Investment Managers	Businesses owned by women, minorities, and people with disabilities.
Emerging Investment Managers	An investment manager with assets or product assets below the 75th percentile of their respective peer group; or a new or developing investment manager. New or developing investment manager means an investment manager raising its first or second private institutional investment fund; or creating its first institutional product.
Equity	Equity means fair and just opportunities and outcomes for all people.
Expected Deviation Rate	In statistical sampling, the expected deviation rate represents the auditor's best estimate of the actual rate of noncompliance or failure rate of a control in a population.
Fraud	Involves obtaining something of value through willful misrepresentation. Whether an act is, in fact, fraud is determined through the judicial or other adjudicative system and is beyond auditors' professional responsibility.
Generally Accepted Government Auditing Standards (GAGAS)	Professional standards and guidance that provide a framework for conducting high-quality engagements with competence, integrity, objectivity, and independence.
Internal Controls	A process effected by an entity's oversight body, management, and other personnel that provides reasonable assurance that the objectives of an entity will be achieved. Internal controls are also referred to as controls throughout the report.

Term	Definition
Operating Effectiveness	The operating effectiveness of internal control is assessed by determining whether controls were applied at relevant times during the period under evaluation, the consistency with which they were applied, and by whom or by what means they were applied. Operating effectiveness is also referred to as effectiveness throughout the report.
Purchasing Card (P-Card)	A credit card issued by JP Morgan whereby charges to the credit card are paid by the County.
Performance Audit	Engagements that provide objective analysis, findings, and conclusions to assist management and those charged with governance and oversight to, among other things, improve program performance and operations, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability. In a performance audit, the auditors measure or evaluate the subject matter of the audit and present the resulting information as part of, or accompanying, the audit report.
Population	The entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions.
Racial Equity and Social Justice	Racial equity and social justice mean changes in policy, practice and allocation of County resources, so that race or social justice constructs do not predict one's success, while also improving opportunities and outcomes for all people.
Sample	A portion of a population that is examined or tested in order to obtain information or draw conclusions about the entire population.
Scope	The boundary of the audit and directly tied to the audit objectives. The scope defines the subject matter that the auditors will assess and report on, such as a particular program or aspect of a program, the necessary documents or records, the period reviewed, and the locations that will be included.
Significance	The relative importance of a matter within the context in which it is being considered, including quantitative and qualitative factors.
Tolerable Deviation Rate	A rate of deviation set by an auditor when the auditor seeks to obtain an appropriate level of assurance where the auditor's rate is not exceeded by the actual rate of deviation in the population.
Waste	The act of using or expending resources carelessly, extravagantly, or to no purpose. Waste can include activities that do not include abuse and does not necessarily involve a violation of law.

APPENDIX C: THE CAO AND BOARDS' RESPONSES

The Chief Administrative Officer provided the following response to our report:

OFFICE OF THE COUNTY EXECUTIVE

Marc Elrich
County Executive

Richard S. Madaleno
Chief Administrative Officer

MEMORANDUM

October 29, 2021

TO: Megan Davey Limarzi, Esq., Inspector General

FROM: Richard S. Madaleno, Chief Administrative Officer RSM

SUBJECT: OIG Confidential Draft Report – Performance Audit of the Administration of the Montgomery County Employee Retirement Plans and Consolidated Retiree Health Benefits Trust, OIG Publications #OIG-22-005

Thank you for the opportunity to respond to the issues identified in the draft report. It is important to highlight that this internal control review of Montgomery County Employee Retirement Plans (MCERP) focused on compliance with administrative processes and policies applicable to expense reimbursements, invoice payments, and purchasing card (P-Card) transactions. We are responding to the recommendations associated with strengthening internal controls in these areas. The report includes a separate observation that is appropriately addressed by the Boards.

Recommendation 1: We recommend the County enforce the Accounts Payable policy to ensure that expense reports are submitted within 30 days from the end of the business trip.

CAO Response: We concur in principle. We recognize the importance of timely submission by an employee of claims for reimbursement of expenses incurred for approved County business travel. We also recognize that there are instances where, due to workload or other legitimate reasons, claims for reimbursement may be delayed. Even if submitted beyond the 30 days, such as claims for approved travel business expenses would need to be reimbursed by the County. As part of our planned revision to clarify the applicable Administrative Procedures (APs) – AP 1-2 and 1-5, we will reiterate this fact and emphasize the importance of timely submission of reimbursement claims.

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October 29, 2021
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Recommendation 2(a): We recommend that the director and investment staff receive training on the Accounts Payable policy requirements specifically related to documenting evidence of the receipt of goods or services and approval on invoices.

CAO Response: We concur and will ensure that the director and appropriate MCERP staff receive training on the accounts payable requirements.

Recommendation 2(b): We recommend that MCERP amend their policies and procedures to be consistent with County policies in requiring that all invoices have a receiver and approver signature with the purpose of each signature clearly noted on the invoices.

CAO Response: We concur. While the Department of Finance enforces the requirement that there are two signatures reflected on the invoice in order to process and pay the invoice, we agree that MCERP is obligated to ensure clear notation on the invoices of the purpose of the signatures. MCERP has recently revised its standard operating procedures to more clearly identify the role associated with each signature.

Recommendation 3: We recommend that the office maintain a department P-Card log as required by the P-Card Manual.

CAO Response: We concur and have directed MCERP to take appropriate steps to ensure the P-Card log is maintained as required by the P-Card Manual. I have directed the MCERP Executive Director conduct quarterly reviews of the log to ensure it is being appropriately maintained.

Recommendation 4: We recommend that the County enforce compliance with the P-Card Manual by requiring that transaction approvers review and approve reconciled transactions in the JP Morgan PaymentNet system at least monthly.

CAO Response: We concur. As it relates to program monitoring of this requirement, the County does enforce compliance with the P-Card manual. Consistent with the P-Card manual (*Section I.G.c: Failure to Timely Reconcile or Approve Transactions*), Accounts Payable notifies the Department Liaison and Transaction Approver by email of transactions not approved on a timely basis and requests a response. As referenced under the manual, those communications may extend to final warnings, suspensions of P-Card rights, or other actions. This monitoring occurred informally prior to July 2020; starting in July 2020, Finance began to more formally monitor timely reconciliation and approval on a monthly basis, with formal communication to departments. Accounts Payable did communicate to MCERP in September 2020, listing all transactions from the prior two years not yet approved in PaymentNet. MCERP advised Accounts Payable that there appeared to have been an internal issue with how the MCERP reviewer routed the transactions in PaymentNet. Subsequent to that notice and MCERP identifying the issue with their routing process and taking appropriate corrective action, Accounts Payable has not identified any late approvals from MCERP requiring follow up communication. I have directed the Department of Finance to continue its current monitoring of this situation in MCERP and take appropriate actions as required.

Recommendation 5: We recommend that the County ensure that controls are implemented that establish separation of duties over P-Card transactions.

CAO Response: We concur and have directed the MCERP Executive Director to work with the Department of Finance's Accounts Payable staff to ensure that appropriate internal procedures are implemented to provide appropriate separation of duties as required in County policies.

Thank you for bringing these matters to our attention.

cc: Fariba Kassiri, Deputy Chief Administrative Officer
Linda Herman, Executive Director, Montgomery County Employee Retirement Plans
Jeffrey Buddle, Chair, Board of Investment Trustees
Barry Kaplan, Chair, Board of Trustees
Michael Coveyou, Director, Department of Finance
Bill Broglie, Internal Audit Manager

The Board Chairs for the Montgomery County Employee Retirement Plans and the Consolidated Retiree Health Benefits Trust provided the following response to our report:

MONTGOMERY COUNTY EMPLOYEE RETIREMENT PLANS

CONSOLIDATED RETIREE HEALTH BENEFITS TRUST

MEMORANDUM

October 28, 2021

TO: Megan Davey Limarzi, Esq., Inspector General

FROM: Jeffrey Buddle, Chair, Board of Investment Trustees
Employee Retirement Plans (ERP)

Barry Kaplan, Chair, Board of Trustees
Consolidated Retiree Health Benefits Trust (CRHBT)

SUBJECT: OIG Confidential Draft Report – Performance Audit of the Administration of the Montgomery County Employee Retirement Plans and Consolidated Retiree Health Benefits Trust, OIG Publication #OIG-22-005

Thank you for the opportunity to respond to the draft report. We are responding on behalf of the 13 members of the Board of Investment Trustees and the 19 members of the Consolidated Retiree Health Benefits Trust. The Boards take pride in rigorously exercising their fiduciary duty to oversee the Trust Funds' assets.

The Chief Administrative Officer has separately responded to the OIG's recommendations on compliance with County administrative processes and policies applicable to expense reimbursements, invoice payments, and purchasing card (P-Card) transactions. The report says on page 1 that the audit "was predicated on complaints received by the OIG between 2017 and 2020 alleging a potential lack of internal controls." Since the report does not say what the "complaints" are, we cannot assess whether they are valid. Our staff provided your office with more than 18,000 documents over a 13-month period. They also discussed with your office the special processes required by some of the investment managers and many other firms we work with (more than 130). We agree that once the County has established financial controls, it is incumbent on all departments to adhere to them in order to guard against any possible instances of fraud, waste, and abuse. The members of our two Boards -- some of whose service started nearly two decades ago – are aware of no instances of fraud, waste, and abuse. Nor does the report document a single instance.

The report includes "observations" on diversity, equity, and inclusion on pages 15-21. We agree that these are issues of great importance. The "observations" cited in the OIG's report do not acknowledge the Boards' results in this area, thereby leaving the impression that the Boards have not achieved an excellent record. The Boards have focused on these issues for many years -- for example, our work on Environmental, Social, and Governance (ESG) issues started in 2013, long before most other boards started to address them -- and we are recognized as industry leaders. We have developed strong policies and procedures related to the inclusion of minority firms in our procurement processes; more than one-fifth of the assets of both Trusts are invested with minority firms. In addition, the County Code requirement that we include emerging managers in our procurement processes has resulted in 23.3

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percent of ERS assets and 12.4 percent of CRHBT assets invested with such managers. We will continue to build on this record.

The report says on page 6 that the OIG "did not evaluate investment strategies, individual investments, the County's investment portfolio, or investment decisions through this audit." We take pride in the Boards' investment performance. The ERS' performance is in the top 10 percent of pension plans nationwide for the 10-year period ending June 30, 2021 and the top quartile for most other periods. While many pension funds are seriously underfunded, the ERS is now funded at 103 percent on an actuarial basis and 116 percent on a market basis. This performance has been of great benefit to County employees, retirees, and taxpayers. We will continue to build on this record as well.

Thank you again for the opportunity to respond to the draft report.

cc: Richard S. Madaleno, Chief Administrative Officer
Fariba Kassiri, Deputy Chief Administrative Officer
Bill Broglie, Internal Audit Manager
Board of Investment Trustees
Board of Trustees
Linda Herman, Executive Director, Montgomery County Employee Retirement Plans

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