

AUDITOR GENERAL'S DEPARTMENT
COMPENDIUM OF SPECIAL INVESTIGATIONS REPORT
ON THE MINISTRY OF LABOUR & SOCIAL SECURITY
NIF EQUITY MANAGEMENT AND REHABILITATION PROGRAMME



Auditor General's Overview

National Outcome #3: Effective Social Protection, of the Vision 2030 National Development Plan (NDP), outlines one of the national strategies to 'promote greater participation in, and viability of social insurance and pension schemes' to achieve the National Goal - *Jamaicans are empowered to achieve their fullest potential*. This is consistent with the Sustainable Development Goal - Target 1.3 to 'Implement nationally appropriate social protection systems and measures for all, including floors, and by 2030 achieve substantial coverage of the poor and the vulnerable'.

This report comprises a compendium of findings of special investigations of the acquisition of equity investments by the National Insurance Fund (NIF) and the Ministry of Labour and Social Security (MLSS) Rehabilitation Programme. The audits revealed poor governance practices and instances where actions of public officials were in contravention of Government policies and guidelines.

Whereas NIF Investment Policy established thresholds for the approval of investments by the National Insurance Advisory Board, the Minister of Finance and the Cabinet, there were transactions that breached the guidelines regarding approval levels as well as, created a conflict of interest. In the case of the MLSS, control deficiencies in the Rehabilitation Programme, led to breaches of the related policy. The Auditor General's Department warned the Ministry, that it had a high-risk exposure to irregular activities because of its failure to address these weaknesses in its control environment in a holistic manner; from as far back as 1990, in successive years and even more recently in our December 2015 – National Insurance Scheme (NIS) activity-based audit.

I wish to express my sincere thanks to the Management and staff of the entities for the cooperation and assistance given to the audit team.



Pamela Monroe Ellis, FCCA, FCA
Auditor General

Executive Summary

The National Insurance Fund was established under statutory powers contained in Section 39 of the National Insurance Act. The National Insurance Act designated the National Insurance Fund (NIF) as the vehicle into which all NIS contributions and interest, investment income, fines, fees, penalties or costs should be paid. Consistent with the provisions of the PBMA Act¹ and in accordance with Section 39(4) of the National Insurance (NI) Act, the Minister with responsibility for Finance approved NIF's Investment Policy (IP) in September 2014.

The Chief Technical Director of the NIF is responsible for administration of the investment portfolio of the National Insurance Fund; however, the Ministry of Finance approved Investment Policy limits the authority to approve investments to the National Insurance Advisory Board, the Minister of Finance and the Cabinet, within established thresholds. The General Guidelines of the Investment Policy states that the responsibility of the Chief Technical Director, Investments is to administer the investment portfolio of the NIF to ensure maximization of returns from investments, and that the portfolio mix is structured to maintain a prudent level of liquidity to facilitate timely payments of NIS benefits.

A special audit was conducted to determine whether proper due diligence was observed in relation to NIF's acquisition of equity investments, and if the transactions accorded with the guidelines of the Ministry of Finance approved Investment Policy. The audit focused on the purchasing decisions related to the acquisition of shares in 19 companies at a cost of \$2.78 billion and USD\$2.34 million, during the period February 2015 to September 2017. Our assessment of these areas reflected on two of the Auditor General's strategic themes namely, Governance and Resource Management.

The audit exercise commenced in November 2017 with a letter requesting information from the MLSS. Audit fieldwork started in December 2017 and the draft audit report was submitted to the MLSS and NIF for response on January 12, 2018. An Exit Interview was conducted with representatives from MLSS, NIF Board and the AuGD on January 23, 2018. MLSS submitted a response on February 5, 2018, for which relevant information was incorporated in the final report for submission to Parliament. The key findings and recommendations are outlined below:

¹ Section 4 of the PBMA Act

Key Findings

Conflict of Interest

1. Our audit of equity purchases revealed a conflict of interest, whereby NIF acquired listed shares², totalling \$27 million in two companies, owned by the spouse of a senior officer employed in NIF's Equity Management unit. In the first instance, NIF purchased 1.96 million shares on April 25, 2017, at \$6.18 per share at a cost of \$12.1 million. Prior to this transaction, NIF had also acquired shares in the same company, at prices ranging from \$5.00 to \$5.75, during the period April 21-24, 2017. In the other instance, NIF acquired 3.35 million shares at \$4.45 per share (\$14.9 million) on July 27, 2017; approximately three times the price paid (\$1.50), one month earlier in the IPO³ on June 28, 2017. However, the requisite approval from the Minister with responsibility for Finance was not sought for the acquisition of the shares, in breach of the Investment Policy.

Further, NIF did not present any evidence that the conflict of interest was brought to the attention of the Chief Technical Director (CTD) and the Board by the senior officer, contrary to the Ministry of Finance approved Staff Order. The Staff Order stipulates that *'that in order to address the potential for conflict of interest, officers should in all instances inform the appropriate authority of any such undertaking, seek clarification and get permission'*. In response to our draft report, the Permanent Secretary, MLSS by way of correspondence dated February 5, 2018, indicated that the senior officer:

"has advised that he disclosed orally to the former CTD that the shares purchased in a company⁴ by the NIF is likely to include shares being sold by his wife. However, the former CTD indicated that no such disclosure was made. The Investment Policy currently does not include a requirement to disclose such personal transactions. Recognizing the potential conflict that may arise, the policy will be reviewed and revised to address this deficiency".

NIF Response dated February 5, 2018.

Absence of Due Diligence

2. NIF did not faithfully conduct due diligence in deciding on equity investments to properly inform investment decisions and financial exposure. Between February 2015 and September 2017, NIF purchased shares in eight companies at an approximate cost of \$783 million. However, we found no evidence that the qualitative and quantitative assessments were done, as the investment proposals were not presented. NIF indicated *"no formal full analysis was done"* for these companies and *"purchases were made on the basis of already being in our portfolio and their past performance."* Nonetheless, NIF should have conducted reviews in accordance with its Investment Policy.

² Listed on the Junior Stock Market of the Jamaica Stock Exchange

³ Initial public offering

⁴ Company name redacted

The Investment Policy guidelines state that the responsibility is entrusted to the Investment Analyst-Equities:

“to ensure prudent management of the NIF Equity portfolios, as well as maintaining the integrity of the Fund by adhering to proper risk management guidelines and the prescribed parameters as set out by the key internal and external administrators”.

Lack of transparency and accountability in significant share acquisitions

3. The Investment Policy established thresholds for the approval of investments by the National Insurance Advisory Board, the Minister with responsibility for Finance and the Cabinet, within an established threshold. However, NIF purchased shares in two companies on the JSE Junior Market, in excess of the approved limits and at a cost of \$1.19 billion, without the review of the Investment Committee and the approval of the Board and Minister of Finance. The purchase of shares in 11 additional companies at a cost of \$903.26 million and USD\$340,200 was also undertaken without the review of the Investment Committee and the requisite approval of the Board. The transactions not only breached the investment policy guidelines regarding approval levels, but raises questions regarding transparency and accountability.⁵
4. Over three trade days in April 2017, NIF purchased 103.8 million shares in a company for \$522.4 million acquired through two brokerage firms from 34 shareholders. The total investment represented 0.56 per cent of NIF net asset value, and as such, the approval of the Minister of Finance was required to accord with the NIF Investment policy. Further, there was no evidence that the investment opportunity was reviewed by the Investment Committee and approved by the Board. We requested that NIF provide us with the due diligence report, which informed the investment decision to acquire the Company shares. Instead, NIF submitted an undated Technical Note that detailed industry and financial analyses based on audited financial information, as at March 2016, though the Company posted its unaudited Financial Statements for the Third Quarter ended December 31, 2016⁶. There is no evidence that the Technical Note was reviewed by the Chief Technical Director. Our review of the Technical Note provided, revealed that no conclusion was arrived at regarding purchase of the Company shares and we saw no evidence that NIF, in deciding to acquire the shares, contemplated the stocks’ fundamental standing (such as an industry analysis) and technical position (such as the stock’s price-earnings multiple, PE). The Board Minutes did not reveal the source of the offer and the offer document was not presented for audit scrutiny, despite our requests.

⁵ The GOJ Corporate Governance Framework states that accountability implies a relationship, a hierarchy and the duty of a body to explain and justify its conduct to another body.

⁶ See link: <https://www.jamstockex.com/lasm-unaudited-financial-statements-third-quarter-ended-december-2016/>