PVS Audit Committee Comments on

Treasurer's Report and [Investment] Recommendations of December 1, 2009

December 7, 2009

BACKGROUND: The PVS General Chairman asked the Audit Committee during the USAS convention in September to review and provide a report for the Board regarding a series of anticipated proposals from the PVS Treasurer pertaining to modifying PVS investment policies and practices. Specifically the proposal made at that time were to (a) close our current mutual fund with Dain Raucher (RBC) , transfer the balance to First Western (FW) and (b) increase the amount invested in mutual fund type accounts from approximately $95,000 to $250,000. This item was discussed in general terms at the October Board meeting, but no specific motions were provided to the Board and no votes were taken on the matter. Questions were raised if FW would provide the type of management RBC if they had less than $250,000 to manage and whether it was appropriate for PVS to increase its mutual type holdings from $100,000 to $250.000. Most Board members who spoke on the matter indicated they were NOT comfortable with PVS substantially increasing the amount of funds PVS had invested in mutual funds.

No proposal was received in time for the topic to be put on the November Board agenda and thus there was limited discussion of the matter at the meeting. However, a draft set of proposals on how to amend PVS's investment policy (not investment practices) was provided to the Audit Committee in advance of the meeting and the Audit Committee provided its comments on that proposal to the Treasurer.

The Treasurer provided a series of recommendations on December 1 which was provided to the Board on December 3rd for its consideration.

AUDIT COMMITTEE REVIEW: As requested, the Audit Committee has reviewed this recommendation. **The Audit Committee has major concerns with the report and its recommendations** for the following reasons:

1. The Audit Committee does NOT agree with the Treasurer's statement that the "The recommended actions are not very dramatic." Rather the Committee believes they are very far reaching proposals and warrant the Board's serious and in-depth consideration of the pro and cons.
2. Specifically, the proposal would increase the PVS has invested in mutual type funds from about $100,000 to $500,000. This is an increase from about 1/6th to 5/6th of what the PVS Treasurer has determined are PVS's "investible assets." PVS Treasurer's have consistently told the PVS House that PVS objective to have one year's worth of expenses in reserve for a rainy day. PVS's FY2010 budget shows annual expenses of about $750,000 (after adjusting for USA-S share of annual dues we collect for them.) In contrast, PVS's current assets on hand as of 8/31/09 were only $713,000. This stated objective suggests the assets need to able to be sold quickly with minimal risk of having a loss of principle when they are sold. Given this year's budget reflects almost a $50,000 deficit and the purchase of more timing equipment is being actively discussed the Board should not assume that PVS's will not have to liquidate some of its current assets.

3. The Treasurer Is also recommending that the $500,000 invested in mutual type funds be split 60/40 between equities vs fixed income. This would mean about $300,000 would be in equities – this would increase the assets PVS has invested in equities from about $50,000 –this would be a 6 fold increase.
4. The Audit Committee agrees such a change in how PVS invests its assets will increase its expected rate of return, but it important to recognize it will come with increased risk of loss of value as well. No quantitative information has been provided so the Board can assess whether the expected increase in the rate of return is appropriate given the added downside risk to PVS's investments.
5. The recommendations being made are in fundamental conflict with PVS's written Investment policy that was adopted by the Board at its March 2007 meeting – after thoughtful deliberations at several meetings. Our current policy states mutual fund holdings shall be limited to 25%, this proposal if approved would increase that to 83%. The change in policy would also result in 50% of PVS's investible assets being in equities. This is a significantly higher percentage than USA Swimming has in its mutual fund holdings.
6. The Audit Committee also feels strongly that changes in actual investment practices should follow from (not precede) any needed changes in PVS's formal investment In contrast, the Treasurer proposes that the changes in Investment Policy be addressed at a later date. The Audit Committee also does NOT agree that the necessary changes to PVS's investment policy to permit this recommendation to be implemented are "relatively minor." Under the current 25% cap on investments in mutual funds, no more than $150,000 should be so invested.
7. The Treasurer has continued to <u>not</u> address the dilemma created by the fact FW will not actively manage unless PVS gives them $250,000 to manage, This is in contrast to RBC who was willing to actively manage the smaller amounts PVS gave them – initially $50,000 and now about $100,000. The Audit Committee does not feel it is a sufficient reason to increase the amount it has under active managements simply because FW will not otherwise provide the service.
8. The Audit Committee acknowledges that with USA-S having moved its fund to FW, that RBC can no longer manage PVS's assets as it has in the past. However, it does not follow as asserted by the Treasurer that PVS assets are no longer in "professionally managed account" or the person in charge of our account is not a professional. No information has been offered to support the implied assertion the PVS's returns have suffered as a result.
9. No explanation has been given by the Treasurer as to why he has revised his prior recommendation to increase PVS's mutual fund type holdings of $250,000 to now increase it to $500,000. PVS current mutual fund holdings are currently about $100,000.
10. The Treasurer states that it is "…the recommendation of FW that LSCs with up to $100,000 to invest should focus on CDs. From $100,000 to $250,000, these accounts also should include life cycle funds that diversify the portfolio and provide a greater return. At $250,000, FW recommends that LSCs follow the investment portfolio allocation of USA-S,…" The Audit Committee notes this recommendation is coming from FW which has a vested interest, not the USA-S professional staff or the USA-S Treasurer. It is also not clear why FW would recommend the same dollar thresholds be appropriate for a small LSC with less than 1000 members as it is for the biggest that have in excess of 10,000 members.

Some other statements are made the Treasurer's December1 report that warrant comment by the Audit Committee.

1. Why is stated that PVS is invested approximately 95% in cash? The numbers presented within the paper state that RBC holds about $97,000 of $600,000 PVS has available for investable assets – this is means far less than 95% of PVS current assets are in cash.
2. It is stated that "…During FY '09, the equities provided a negative return on investment, following the direction of the markets. The remaining investments in fixed income and CDs provided $21,325 of income on invested assets of approximately $497,000, for a return of about 4.3% after fees. During this same time period, the professionally managed fixed income assets of USA Swimming returned 8% after fees. By not utilizing the professional managers chosen by USA-S, PVS left over $18,000 on the table." PVS's fiscal year ends August 31 whereas USA-S's ends December 31. Thus, it appears unlikely that investment returns for comparable time periods are being compared --- more likely USA-S returns for the period 1/1/08-12/31/08 are being compared with PVS returns for the period 9//1/08-8/31/09.
3. Even if the time periods are identical, the basis for the assertion "…PVS left over $18,000 on the table…" is not clear. It is always possible with the benefit of hindsight to demonstrate that one investment strategy was historically better than another.
4. If in fact, USA-S got a superior return on its fixed income investments over a comparable time period, it is presumably because it invested in fixed income assets involving greater risk and/or longer maturities. Without knowing what these maturities were or the degree of greater risk taken on by USA-S, it is not possible to say whether they would have been an appropriate investment for PVS.
5. While it true fixed income returns are now declining, extending one's maturities right now may not prove to be prudent. As the economy starts to recover, interest rates will presumably again start to rise and if one is locked into long term maturities, one will have to defer being able to take advantage of these improving opportunities.
6. Reference is made to fact several meetings have been held to prepare a "LSC Investment Plan." Has this plan been committed to writing? Was it presented at Investment Committee meeting at the most recent USAS convention? If such a plan exists, it has not come to the attention of the PVS Audit Committee. Is it possible for the PVS Board and Audit Committee to see this plan so it can evaluate what is being proposed against this "model plan."
7. It is proposed that if PVS opens an account at FW that we tell FW to follow the procedures of USA-S except as modified by PVS. First, what are the current guidelines USA-S is providing FW regarding how its assets should be managed and secondly, would (and if so, how) PVS ask that a different policy be adopted for investment of its funds.
8. While the statement that PVS's assets have grown in recent year is certainly true, this is not assured in the future for several reasons. Thus, PVS's investment policy should not be built on this assumption. The current economic climate could well impact both revenue (in terms of participation) and expenses as government units look for more revenue. PVS's adopted 2010 budget already projects a $48,000 deficit (which if it happens implies a cash drawdown) and. in

addition, there is also active discussion within the Board of buying up to 4 new sets of timing equipment, which if authorized will involve an immediate cash draw.