

**Wednesday, February 9, 2011**

To: Members of the Board of Retirement

From: Donald R. White, Chair

Subject: Summary of the February 9, 2011 Audit Committee Meeting

Audit Committee Chair Donald White called the February 9, 2011 Audit Committee Meeting to order at 1:00 p.m. The Committee members present were Annette Cain-Darnes, Keith Carson, and Liz Koppenhaver. Other Board members present were Elizabeth Rogers, and Alternate Member Darryl Walker. Members of the Staff present were Catherine Walker, Acting Chief Executive Officer; Robert Gaumer, Chief Counsel; Harsh Jadhav, Internal Auditor; Kathy Foster, Assistant Chief Executive Officer; Rose Kwong, Benefits Manager; J.P. Singh, Chief Financial Officer; Betty Tse, Chief Investment Officer; Victoria Arruda Human Resources Officer, and Latrena Walker, Project & Information Services Manager.

### **ACTION ITEMS**

**1. Review, Discussion, and Possible Motion to approve the External Audit Scope of Work and Timeline of Services to be performed by the external financial audit firm.**

Staff proposed, before taking action on this item, to take up the first information item, concerning the presentation of the Audit Work Plan by Williams Adley & Company, LLP (WACO) for the financial statements for the year ended December 31, 2010.

### **INFORMATION ITEMS:**

**1. 2011 External Audit Work Plan**

- **Presentation of the 2011 Audit and Communications Plan for the year ended December 31, 2010**

Staff introduced Robert Griffin, Managing Partner and Audrey Elbert, Senior Manager from Williams Adley & Co. LLP.

Robert Griffin stated that, same as last year, Ms. Charbet Duckett, will be the Concurring Partner and will be responsible for consultation on issues and review for compliance with Firm and Professional Standards. He then discussed WACO's audit responsibilities as the auditor for ACERA and the Audit Committee's role. He also discussed the important areas of planning and risk assessment. Audrey Elbert then explained their testing approach for several risk areas, including Investments, Contributions, Benefits, Cash Activity, Reserves, and compliance with the 1937 ACT, ACERA Policies and

Procedures, as well as, the Administrative Limitation. Trustee Elizabeth Rogers asked the auditors if, in prior years, they had any problems regarding how ACERA allocates expenses for the annual budget for purposes of the administrative limitation. Audrey Elbert answered that they had not had any issues in that area, and added that when they test the administrative limitation they look at the assumptions made by ACERA and compare them to their understanding of the law as it relates to be significant to the Financial Statements and in prior years they had not had any issues with regards to this matter.

The audit timeline was discussed pointing out that the planning and client assistance requirement process had started in January of 2011. Audit fieldwork is scheduled to begin late February 2011. The presentation of the Financial Statements to the Board will be in May 2011. If there are any management letter comments, they are expected to be presented to the Audit Committee in July. Other ACERA reporting deadlines were reviewed: State Controller's Report, June 30, 2011 and Comprehensive Annual Financial Report (CAFR) to Government Finance Officers Association, June 30, 2011. Staff commented that ACERA is also required under the 1937 ACT to submit a report by June 30<sup>th</sup> with the Office of Board of Supervisors, and the Auditor Controller. ACERA is also required to make the Popular Annual Financial Report (PAFR) available to all its members by June 30<sup>th</sup>.

**MOTION:**

After a brief discussion Trustee Annette Cain-Darnes moved and Trustee Keith Carson seconded her motion that the Audit Committee recommend to the Board of Retirement that the Board approve the External Audit Scope of Work and Timeline of Services to be performed by Williams Adley & Co. LLP. The motion carried.

**2. Audit Committee Concerns and /or Issues related to the Financial Audit**

No concerns were expressed by the Committee.

**3. 2011 Audit Committee Work Plan (Proposed)**

Staff presented the proposed 2011 Audit Committee Work Plan, and explained that dates are tentative and subject to change.

*Internal Audit*

**4. Presentation of the 2011 Internal Audit Work Plan , Annual Risk Assessment, and the results from the Vendor Compliance Audit**

Staff presented the Internal Audit Department Report, which is included in the Risk Assessment Process, Internal Audit Plan – 2011 (Proposed), and Results of the Vendor Compliance Audit.

With regards to the Risk Assessment Process, staff explained that last year, they had reviewed with management, the baseline risks specific to public pension funds. Risks covered benefits, accounting, investments, legal, IT, actuarial and human resource risks.

This year the risk assessment was updated to account for new risks, elimination of non-risks, and changes in risk rankings from last year. The process required line managers and senior executives to identify, rate and rank key risks related to their department.

Input from the risk assessment was combined with the broad areas of concern Audit Committee Chairman, Mr. Donald White had raised at the last Board Meeting. In addition, staff proposed conducting an Enterprise Risk Management Feasibility Study, which will provide the Trustees and Staff with a cost/benefit analysis of whether undergoing a full Enterprise Risk Management process will be beneficial for ACERA.

At this point Trustee Annette Cain-Darnes explained that ACERA had already conducted an Enterprise Risk Assessment three years ago. Staff mentioned they had reviewed the prior study and would evaluate if there would be any additional benefit in conducting a more current Enterprise Risk Management Feasibility Study.

The top risks from each department were summarized to help prioritize audit effort and develop the Internal Audit Plan for 2011. Three areas of risk were identified as priority for this year.

- Accounting/Administrative Department: Risk that financial statements have material errors and/or irregularities.
- Benefits Department: Risk that death of retiree is not received/recorded promptly, resulting in overpayments.
- Investments Department: Risk that management oversight is not sufficient to maintain integrity that the Custodian Bank is charging the appropriate fees and providing the right level of service, as it relates to the securities lending function.

The Proposed 2011 Audit Plan was presented, as well as the internal audit report on the results of the Vendor Compliance Audit. The objective of this audit was to provide a third party review of the contract terms for payment, delivery and compliance, and to determine if the vendor was meeting those requirements.

Four controls were tested, and results showed that there were no ineffective controls. All of the controls tested were determined to be either effective or partially effective.

- Control 1: Tested if ACERA was charged for vendor inefficiencies (Control was effective).
- Control 2: Tested if vendor was in compliance with insurance requirements (Control was partially effective) and conflict of interest disclosures (Control was effective).
- Control 3: Tested if vendor was in compliance with general contract requirements (Control was partially effective).
- Control 4: Tested if contract deliverables were received (Control was effective).

Key Findings:

The Investment Department use of watch lists and fee reduction measures is a best practice that can be deployed throughout the organization. The internal process for monitoring insurance levels can be improved. A central repository for contractually required insurance documents should be maintained.

**TRUSTEE/PUBLIC INPUT**

None

**FUTURE DISCUSSION ITEMS**

*External Audit*

- Presentation of the December 31, 2010 Audited Financial Statements and possible motion recommending approval of this report.
- Brief Overview of the Financial Position for the Years Ended December 31, 2010 and 2009.

*Internal Audit*

- Progress Report on Internal Audit Work Plan
- Review completed audits
- New Internal Audit Initiatives

**RECOMMENDATIONS**

The Audit Committee recommends to the Board of Retirement that the Board approve the External Audit Scope of Work and Timeline of Services performed by Williams Adley & Co. LLP.

**ESTABLISHMENT OF NEXT MEETING DATE**

May 18, 2011 at 1:00 pm

**MEETING ADJOURNED**

The meeting adjourned at 1:56 pm