State of Alaska
ALASKA RETIREMENT MANAGEMENT BOARD
AUDIT COMMITTEE MEETING

Captain Cook Hotel – Club Room II
939 W. 5th Avenue
Anchorage, Alaska

June 23, 2016

ATTENDANCE

Committee Present: Kris Erchinger
Gayle Harbo
Rob Johnson

Committee Absent: None

Department of Revenue Staff Present:
Pamela Leary (Treasury Division director)
Gary Bader (chief investment officer)
Scott Jones (state comptroller)
Judy Hall (board liaison)

Department of Administration Staff Present:
John Boucher (deputy commissioner)
Jim Puckett (chief operations officer, Retirement & Benefits Division) *on-line*
Kevin Worley (chief finance officer, Retirement & Benefits Division)
Melanie Helmick (senior audit and review analyst, Retirement & Benefits Division) *on-line*

Others Present:
Mike Hayhurst (KPMG)
Daniel Mitchell (KPMG)
Stuart Goering (ARMB legal counsel, Department of Law)

CALL TO ORDER
MS. ERCHINGER called the meeting to order at 10:00 a.m.

ROLL CALL
All three committee members were present.

PUBLIC MEETING NOTICE
MS. HALL confirmed that public meeting notice requirements had been met.

ELECTION OF COMMITTEE CHAIR

MS. HARBO nominated Rob Johnson for Audit Committee chair. MS. ERCHINGER seconded.

MR. JOHNSON was present and said he was honored to accept the position of committee chair.

APPROVAL OF AGENDA

MS. HARBO moved to approve the agenda and MS. ERCHINGER seconded. Without objection, the agenda was approved.

APPROVAL OF MINUTES – February 17, 2016

MS. ERCHINGER moved to approve the minutes of the February 17, 2016 meeting. MS. HARBO seconded. The minutes were approved as presented.

PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS AND APPEARANCES

There was no one from the public who wished to address the committee. MS. HALL reported that there were no communications to the committee.

REPORTS

A. Review Independent Auditors' Audit Plan, Discuss Scope, Staffing Locations, Sensitive and Risk Areas, Compliance, Reliance upon Management, and General Audit Approach

[A copy of KPMG's audit plan for the Department of Revenue and Division of Retirement & Benefits for the period ended June 30, 2016 is on file at the ARMB office.]

MIKE HAYHURST, lead engagement audit partner at KPMG, spent a few minutes talking about the audit scopes for the Treasury Division and the Division of Retirement and Benefits. He noted that KPMG will also be issuing opinions on the audit of scheduled employer allocations and the allocation method to be used for audit of the pension amounts by employer for the Public Employees' Retirement System (PERS) and the Teachers' Retirement System (TRS). Those are referred to as the GASB 68 schedules that the employers and their auditors then can use to record the information they are required to report under GASB 68.

Regarding the client service team, MR. HAYHURST said that, with his move to Boise, the lead engagement partner role was transitioning to Daniel Mitchell. Mr. Mitchell will be taking over for the Treasury Division audit, as well as the Retirement and Benefit Plan audit for 2016. Mr. Hayhurst is still on the GASB 68 schedules that are close to being finalized and issued for FY2015. He still technically has about three years left in his allowed term, so during that time period he is able to stay on as a client service partner, attend these meetings, and be as involved as he needs to be with the team.

MR. HAYHURST stated that the concurring partner did time out this last year (and retired). Lee Imlay is the engagement quality concurring review partner in the Salt Lake City office. Historically for the Retirement and Benefit plans, the people that KPMG has gotten involved are the benefit plan specialist partners, as opposed to the GASB specialists. The benefit plan specialists are much more cognizant of defined benefit/defined contribution OPEB-type risks and issues and things that are going through the systems. KPMG attaches Jeff Markert and Scott Mornetzky on more of the technical GASB items that come up, especially regarding things that have been issued that apply to either Treasury under the fair value of assets or GASB 68 or the upcoming OPEB (other post-employment benefits) rules.

MR. HAYHURST announced that Melissa Beedle is still the lead audit engagement manager. The Treasury senior auditor is Sam Strobe, which has been the case for the last couple of years. Mr. Strobe works on the investment portfolio and the alternative investment work that KPMG does for the Alaska Permanent Fund Corporation, as well as some of the Native corporation clients that have alternative investment funds. He has a lot of background in auditing and working with Nick Katsanos, who is KPMG's investment valuation specialist. Allie Dold is the senior on the Retirement and Benefit plans and has worked on the plans in the past as well. The other KPMG specialists are Dennis Polisner, an actuary, and Katherine Perkins, who works on the plans that require a tax review.

CHAIR JOHNSON asked who set the time limits for audit partners to work on a particular audit.

MR. HAYHURST said it is an American Institute of Certified Public Accountants (AICPA) principle around partner rotations at ten years for private companies. Since the State is not under Yellow Book Standards, KPMG is not doing governmental auditing standards but AICPA standards. The ten years is under those rules.

MS. ERCHINGER asked who on the KPMG team has expertise in the area of the upcoming OPEB (other post-employment benefits) requirements, because it will be dealing more with the medical side.

MR. HAYHURST replied that Daniel Mitchell audits the couple of health and welfare plans that KPMG already has. The scale for the Alaska plans is larger but the issues are very similar. KPMG also pulls in Lee Imlay and their benefit plan specialists. The concurring partner comes more with the benefit plan side as well. He added that he and Mr. Mitchell went successfully through Department of Law review on a health and welfare plan about three years ago.

MR. MITCHELL gave a brief overview of his nearly 20 years with KPMG, where he has been involved in benefit plans of all nature since he started with the firm. He assured the committee that it would not see a significant change in the way things are done because of continuity on the audit team. He has worked with all the people on the client service team since they started.

MR. MITCHELL stated that KPMG is required to set a level of materiality for each of the benefit plans before they plan the audit, and they are doing that this week. It is a little bit more complicated for these financial statements because of the interaction between the Treasury Division and the other plans. KPMG does a lot of triangulation to make sure they have the right level of materiality set, and that materiality then drives the level of test work they perform. Ultimately, if there are any audit differences, the level of materiality will drive what KPMG reports as an audit difference.

MR. MITCHELL presented a diagram of the audit plan timeline as a year-round process (slide 8). He noted that presenting the audit plan to the committee is the kick-off, and KPMG is getting ready for the first round of field work. He said KPMG's responsibility is to report to the Audit Committee and committee chair, Mr. Johnson, if there is anything that comes up during the audit that they have concerns about. KPMG has interaction with management and works through any concerns with management initially, but if something rises to a level of concern that they feel they need to communicate with the committee, under professional standards their responsibility is direct communication with the committee. If it is okay with Chair Johnson, KPMG would make that contact through him.

MR. MITCHELL said if the committee had any concerns from a risk perspective or had anything they wanted KPMG to focus upon in the audit, to contact him at any time and he would build those into the audit plan.

MR. HAYHURST commented that the committee dialogue in other sections of the meetings helps KPMG get a sense for concerns and areas of focus so they then talk about the impact a potential item would have in the audit process or from a risk standpoint.

CHAIR JOHNSON mentioned that he had not participated in the discussions over the past couple of years about the relatively controversial assignment of pension liabilities under GASB 68. He asked if KPMG planned to talk about that. He also asked if in the audit review KPMG drew any particular conclusions as to how debt liability should be assigned, given that at least in the State of Alaska there are differences of opinion from the State side and the municipal side.

MR. HAYHURST stated that KPMG's responsibility is to audit the information and ultimately issue an opinion as to whether or not the schedules are done in accordance with generally accepted accounting principles. In this case, that is based on what the General Accounting Standards Board issued under GASB 68. There are a couple of methodologies that GASB said could be considered for allocating the liabilities but, for the most part, the concept is that whatever methodology is used should be reflective of ultimately the long-term contributions over the cycle of what it is going to be for those plans. KPMG does not set policy or get into whether the policy that has been set around cap limits and contributions, etc. is appropriate or not appropriate. However, this year KPMG had a fair amount of input into the methodology that the State selected, partly because of the additional contribution to the plans that the State made in the current year and some changes they were doing in the closed-loop cycle that came into being in the current year. It highlighted what former chair Martin Pihl and Ms. Erchinger had as issues in 2014 – that the new process would whipsaw the liability up and down. KPMG knew they would have to address that in 2015. As a result, it almost precluded using the historical method in 2015. Instead, they looked at just what contributions were in 2015 and allocated the liability based on that because so much would swing to the State and then a year later swing to the employers. The Division of Retirement & Benefits worked with the actuary, Buck Consultants, and KPMG had input into trying to figure out how it was going to work to then look at the closed-loop cycle on an actuarial basis. Ultimately, there is a change in proportion in the current year. It does swing more to the employers because of the way the additional amount impacts with the cap, but it should stabilize. There might be some changes in proportion looking forward but not the big whipsaws that would happen with the historical method of calculating the liabilities.

Regarding the Chair's question about whether KPMG has input into what drives the methodology this year, MR. HAYHURST said they had input into that. KPMG did not think the State could meet the rules under GASB to use historical the way it could have in fiscal year 2014 and needed to move to an actuarial methodology. To try to further mitigate the initial change of proportion stuff, KPMG looked through to 2017 when the actuarial contributions would kick in, based on the contributions that were made in 2014. So from 2017 out to the end of the closed-loop cycle (2039), what are the total expected actuarial contributions if everything came to fruition on the actuarial assumptions around return on investments, employer compensation increases, etc., here are the total expected contributions, and how much of that is related to the State as an employer and to all the other employers and to the State as a non-employer funding entity, and what does that percentage look like. That is the methodology in the current year.

MR. HAYHURST stated that it was a lot of work over four or five months for Buck to get the actuarial numbers. Because of the time involved, and because the contributions had not been made and some of the changes in the closed-loop cycle were not effective until fiscal year 2015, using the actuarial method in 2014 would not have produced the same answer as this year. There would not have been the $1 billion additional funding to PERS and $2 billion additional funding to TRS as investments in the funds earning money to work into the actuarial projection. So there would still have been a fairly big swing in proportion this year.

CHAIR JOHNSON remarked that the delivery of the audit this year would contain some significant explanations of all those actions.

MR. HAYHURST replied that the audit report itself would not. He and Division of Retirement & Benefits chief finance officer Kevin Worley have been tasked with trying to come up with a white paper that can explain everything. He is supposed to provide some explanation of why KPMG concurs that that was the appropriate method.

Deputy commissioner JOHN BOUCHER stated that there has been a concern about this since it was brought up at the Fairbanks meeting over a year ago. In the process, the Department of Administration, because of the rough roll-out of GASB 68, engaged with some municipal finance officers in a meeting and communicated the impact of using the historical method to calculate the pension liability for fiscal year 2015 that Mr. Hayhurst just described. While the municipalities and political subdivisions may have wanted a one-year reprieve from this, it was not an option. So the decision was recently made to move forward with the pension liability allocation schedules on the actuarial basis for FY2015. The department hopes to have those schedules out by the end of July. They want to have some explanation of why this is growing and how things ended up here to help educate people and alleviate suspicion. A group of people in the Alaska Municipal League are getting up to speed on this and hopefully will help carry the message.

CHAIR JOHNSON asked Mr. Boucher what role the ARMB should have, if any, in some of the decision-making that he had just described.

MR. BOUCHER said he did not know that the ARMB could decide anything. The department concluded that it could not offer a choice for the FY2015 allocation – other than to go against KPMG's advice and get a qualified opinion.

MR. HAYHURST stressed that KPMG just deals with GASB and does not get involved in public policy. It was not like a one-year reprieve would then allocate the net pension liability somewhat consistent with how it was allocated in FY2014 and then start seeing the shift more to the employers because of seeing the $3 billion impact interplaying with the cap through the closed-loop cycle. It would have been taking the pension liability allocated in 2014 and swinging it way to the State and then a year later swinging it way back to the employers. KPMG looked at it from the employer side, that they would have trouble as an auditor all of a sudden taking that recorded liability down to some lower figure, knowing that the liability was then going to go up beyond where it was in 2014. That is the reason to go to an actuarial method now, although not many people want to do that because it is so much work. It is about the only way, given the fairly unique factors in the State of Alaska of a substantive legislative contribution to the retirement plans and changes made in the actuarial assumptions and methods around the timeline and so forth, that the pension liability allocation can get done and actually feel comfortable that it meets the spirit of where they were going in the GASB.

MS. ERCHINGER said it was safe to say that if the State had not made the significant contributions to the retirement plans, then KPMG probably would not have recommended going with the actuarial method. The substantial impact of that action drove KPMG's decision.

MR. HAYHURST agreed, with the caveat that it is hard to see what the situation would have been without the $3 billion total contribution. However, without that contribution, the historical method would have been more stable over time – although probably shifting more to the State. If it had not made those contributions, things were going to build and get out of control budget-wise, which is part of why the legislature bit the bullet and put the money in.

MS. ERCHINGER said that clearly it is possible to change the method used for allocating the net pension liability, because first it was the historical method and now there is a decision to use the actuarial method. She asked if it was possible in the future that KPMG could recommend going back to the historical method because the actuarial method is so much costlier and involved and pretty much gets to the same ultimate result.

MR. HAYHURST said he has had some conversations with KPMG's Jeff Markert and Melissa Beedle about there possibly being a point in time to go back to the historical method. There is probably some noise in the next three to five years, but if that stabilized and the percentage of what the employer is paying is sort of what it is long term, and that change is gradual on the state side….[incomplete]. As the minimum pension liability gets paid down, and the actuarial contributions that are required therefore decline, one gets to where that employer contribution cap is and then the state assistance is going to hopefully go away. While an employer could see it as the employers are funding the whole thing, the good news is that the net pension liability has gone down far enough that the state and the ARMB and everybody have dug themselves out of a fairly deep hole. So if the shifting is kind of gradual going forward, and every year is going to be fairly stable as it works through, you might be able to switch to historical, if it does not cause a big change in proportion and it makes sense from a cost/benefit standpoint.

MR. HAYHURST reported that one thing KPMG is looking for when looking at the SOC-1 reports is that these service providers are getting much more sophisticated and their systems are getting much more complex, as well as the fact that they are now using service providers to support them or even have multiple subsidiary companies within their own company. For example, an offshoot company in Australia may be doing the actual system implementation and update work for State Street Bank. What is happening is the SOC-1 auditors are now getting much better about scoping certain things out and saying this is not included. If KPMG thinks that that is an important component, in order to rely on that SOC-1 report KPMG will also have to do additional tests. They are finding that it is sometimes better to just increase their risk statement up to a moderate or even a high and not rely on those controls. The work KPMG has to do is still more efficient than having to figure out how to go to all the things that are scoped out of the service auditor reports.

MR. MITCHELL said he likes to “touch” the transactions, he wants to see the things being paid, and he wants to see the contributions coming in. He wants to be able to sit in front of the committee at final and say that KPMG has touched this number of transactions and has not had any exceptions, or there are these certain exceptions.

MR. MITCHELL continued his presentation, running through a list of external experts involved in the audit process (on slides 10 and 11). He then talked about risk assessment (slide 13), specifically the presumption that there is a significant risk of management override of controls due to fraud. KPMG is not expecting to see that, but they do take a close look at significant estimates and focus on potential top-sided entries, entries that are made around the actuarial estimates, and entries that are made around investment accounts, to ensure that there is no manipulation of those accounts due to fraud.

Under risk assessment for Treasury, MR. MITCHELL said the significant risk is around the valuation of alternative investments that could result in the misstatement of investments on the financial statements. KPMG will be testing design and implementation of internal controls but most likely not testing the operating effectiveness of those. They will assess and categorize inherent risk of the alternative investment portfolio, peeling away the layers. Alternative investments are not just one group of investments that are a certain risk, so they break the portfolio apart and focus more on those investments that have more risk associated with them. Then they sample investments by confirming investments with fund managers, they obtain copies of fund quarterly financial statements, and most importantly from an audit evidence perspective, they do back-testing and benchmarking analysis, working closely with the state comptroller on that. They have already had a kick-off meeting with Nick Katsanos, KPMG’s alternative investment specialist, to plan the approach this year.

MR. BADER asked, if the ARMB were to make a large investment in a private entity and it was valued at cost, how KPMG’s alternative investment specialist would deal with that.

MR. HAYHURST replied that it is a good question around whether the ARMB would be investing in a financial instrument or taking legal ownership of underlying assets that would be consolidated into the financial statements in a different way.

MR. MITCHELL reviewed risk assessment for the Division of Retirement & Benefits. There are three significant risks: (1) retirement obligations evaluated improperly by actuaries; (2) payroll and census data reported incorrectly from employers; and (3) net pension liability allocations not reported appropriately. On the first, KPMG will send actuarial confirmations out and, with the assistance of the KPMG actuary, test underlying assumptions. A very critical piece is making sure that they are testing the completeness and accuracy of the census data that goes to the actuary.

CHAIR JOHNSON related that the ARMB had a report from Buck Consultants that referred to some of the actuarial assumptions. Buck described a large savings by way of lower medical claims costs. The Board was surprised there was that much savings on the medical payments side. Buck explained their analysis as being based largely on proxy data. As a consequence, the Board caveated its interim adoption of that information on the grounds that the actuary did not have better data. He asked if KPMG was going to go into that issue more or if they had looked at it and drawn any conclusions about the adequacy of those proxies.

MR. MITCHELL responded that it sounds like it is a significant assumption and they would certainly want to look at it because it has impact to the ultimate obligation that would be booked. If it is significant, they will definitely challenge if it makes sense. They will use their actuarial team because those people see so many of these reports and have a global view of what are reasonable assumptions. KPMG has not made a conclusion on it at this point because they have not seen the actuarial reports yet. Because the committee has brought it up today, he would add it to a list of items that KPMG will make sure to look at and address.

CHAIR JOHNSON noted that an issue might be whether the actuary and the auditor are dealing with the same years, because KPMG is auditing something that has already occurred.

MR. MITCHELL stated that KPMG’s actuarial group will be very in-tune with what is on the forefront, not just historically. They are also involved in doing these exact same kind of actuarial analyses with KPMG’s non-audit clients. While KPMG cannot do those services for Alaska, they may as an advisory service provide that same analysis that Buck provides, so there is good perspective there.

MS. ERCHINGER said that to her the question related to the financial statements is how that flows into the long-term liabilities of the plans.

MR. HAYHURST said that some of the actuarial work is more from an expected contribution setting, but it does not necessarily feed into an actual liability number on the set of financials. It is fairly interesting that the benefit plan financials themselves may not book a lot of the actuarial information, so one may not see a big gain running through the financials. It is more what you are anticipating from future funding levels actuarially determined. It is a complex interplay.

MR. MITCHELL took up where he left off reviewing risk assessment for the Division of Retirement & Benefits (slide 15). On the second item, KPMG, consistent with what they did last year, will be selecting employers for testing underlying payroll and census data to ensure that the data is complete and accurate as it gets recorded.

MR. HAYHURST noted that this will be the third year for KPMG testing the underlying census data. He added that it is not a small effort on KPMG's part, or on DRB's part to coordinate it, or on the part of each employer around the state who opens their records to the system's auditors.

MR. MITCHELL recalled that there have been some minor exceptions found in the prior data testing. He thought it was important to accumulate the exceptions and work with Mr. Worley so that everybody understands what they are and to filter them through to the actuaries to ask about any impact as a result of these differences.

Commenting on the payroll and census data testing, MS. ERCHINGER said the auditor is focused a lot on the materiality. From this committee's standpoint, it may focus more on the immaterial items. But they are important because they lead to questions about integrity of the contributions and whether the ARMB can trust that what is being reported to the Department of Administration is accurate. The committee has expressed concern in the past about some of the smaller employers who maybe are not remitting their contributions to the department because they do not have the money to forward those contributions. Their employees are supposed to be members of the retirement system, but either the employer is not deducting from the employees or they are not remitting the contributions. She asked, if KPMG identified any of those issues but they are immaterial, how that plays into the audit.

MR. MITCHELL said his philosophy is to communicate all differences in the data back to the client, regardless of how small the differences are.

MR. HAYHURST pointed out that KPMG has an allocated risk matrix when looking at the employers and the census data. So for those employers that represent zero to two percent of the total contributions into the system, KPMG does not even scope those in. Most of the employers that Ms. Erchinger spoke of are in that group, so KPMG would not necessarily be going to those employers. They clearly are not material to the plan financials themselves. KPMG finds that the small employers create a bit of interesting interplay on how to deal with them in the GASB 68 schedules. Those employers who fall in the bucket that represents 2% to 5% of total contributions are on a 10-year cycle for data audits. The employers who are in the 5% to 15% of total contributions are on a five-year cycle. KPMG tests those employers who are above 15% of total contributions every year. The State of Alaska is one huge employer, and KPMG scopes up the sample and sort of haphazardly selects the people, which may take them to several different places within the state.

MS. ERCHINGER said she thought it was sometimes helpful to have the auditors officially point something out that they have noticed because it gets the attention of elected officials who may not care what the administration says. So for the employers that are below 2% of total contributions, KPMG may not typically test them specifically, but when they are aware that there is an issue she hoped it could at least be a footnote somewhere so there is official documentation that the auditor has reviewed the data and believes an issue is out of scope and immaterial but it is still a policy issue and something the Audit Committee has expressed concern about a number of times.

MR. HAYHURST said KPMG looks at the internal employer audit reports every year and makes an assessment. They have looked at those numbers and have determined that they do not impact the audit opinion. Having seen that be the case for two or three years, however, and having been a conversation topic at the committee level, it would not be totally unusual to have a management recommendation letter. It is not an internal control deficiency letter that would rise to a significant deficiency or material weakness, just because of the nature of it. But a management recommendation letter could say that this has been an identified issue and it continues to be one, and if something is not put in place, and more and more employers choose to go this path, it could rise to the level of a significant deficiency. It is more of a warning type letter.

MR. MITCHELL made a note of that, saying that as long as KPMG focuses on their required communications, which typically is reporting significant deficiencies and material weaknesses, in this instance they could issue a management letter and highlight those performance improvement observations.

MR. MITCHELL wrapped up on slide 15 on KPMG's testing of net pension liability allocations. He then briefly touched on the objectives of an audit (slide 17) before noting that the list of responsibilities of management and the Audit Committee for an audit and the responsibilities of KPMG have not changed since last year (slides 19-21). He drew attention to a list of KPMG's responsibilities for other information in documents containing the audited financial statements. They do not render an opinion over that, but they are required to read that other information to see if there are any material inconsistencies with the results of their audit. Those are primarily the CAFRs (comprehensive annual financial reports) for PERS and TRS.

MR. MITCHELL drew attention to a diagram of KPMG's audit approach (slide 24). He said KPMG has not revamped its audit approach this year; it is the same as it has been for the past couple of years. Slide 26 was an explanation of KPMG's independence as an auditor and the quality control surrounding it. The only project that KPMG was reporting outside of the audit was an advisory project between the Department of Revenue and the Alaska Permanent Fund Corporation. It is a permitted service by a separate KPMG team and does not impair the audit that KPMG will be performing over the retirement plans and the Treasury Division. Lastly, he mentioned the process for reporting to the committee if there is a breach of independence and how that affects the audit (slide 28).

B. Discussion of Division of Retirement & Benefits Audit Schedule

MR. WORLEY reviewed the two-page FY2016 Audit Schedule for DRB in the meeting packet *(on file at the ARMB office).* He noted that in May the division notified the employers that KPMG had selected for census data audits so they could be prepared. This year KPMG provided a portal that employers can upload information to so it makes the process a lot easier. Employers have been positive in their feedback on that new feature. Last year the committee chair had spoken up for a couple of additional weeks for DRB to get the financial statements edited and finalized so the committee could conduct more of a review of the statements at its fall meeting instead of making a lot of edits. The revised date for the Audit Committee review of the financial statements is November 3, 2016.

MR. WORLEY reported that he had meetings yesterday with two CPA firms about GASB 67 and GASB 68 reports. The two takeaways from those meetings was the timing of the reports for this year and the timing for release of those reports in the future. He learned that the spring is a good time for people to get those reports, primarily because of September 30 year-end and calendar year-end financial statement issuers. This year the division is looking at finishing up the Buck reports and then having KPMG audit them and hopefully have those done at the end of July or early August. He would like to get those on the schedule for presentation to the Audit Committee at next February's meeting so they could be issued soon thereafter.

Committee members agreed with the schedule that Mr. Worley proposed.

C. Employer Audit Update

JIM PUCKETT, chief operating officer of the Division of Retirement and Benefits, and MELANIE HELMICK, the division auditor, joined the meeting by telephone. Because the meeting was running behind, MR. PUCKETT asked if committee members had any questions about the three-page memorandum report on the third and fourth quarter audit unit activity provided in the packet *(on file at the ARMB office)*.

MS. ERCHINGER thanked the audit unit for the work they did in the past year and for increasing the number of employer audits completed. She said it looked like a great plan ahead for future audits, and it was nice to know in advance which employers would be audited. It demonstrated some real improvements in the process and effectiveness. She thanked Ms. Helmick and Mr. Puckett.

MS. HARBO said she echoed Ms. Erchinger's remarks. She referred to a question in the prior meeting minutes about whether rehired retirees have the option to return to status where they are putting money into the retirement program or if they could continue to get their retirement checks. She also wondered, if they do that, if they are on Social Security.

MS. HELMICK replied that whether or not the retiree is enrolled back into the retirement system depends on how many hours they are working. Whether or not the retiree is enrolled in Social Security would depend on if the employer was a Section 218 Social Security employer or a mandatory employer.

MS. HARBO asked what adjunct employees in the University of Alaska system are considered, and if they contribute to Social Security.

MS. HELMICK said that in the past adjunct employees have been considered temporary employees. For the university, they were incorrectly enrolled in Social Security. That is an issue the audit unit staff found last May and have been working on with the university. The over $2 million in Social Security withholding errors reported in the June 23rd written report was a university error.

Staff is still working with the Social Security Administration and the Internal Revenue Service to fix that.

MR. PUCKETT stated that the new audit regulations will be public noticed in the near future. He received a final copy from the Department of Law yesterday afternoon that he will be reviewing. Then he will be talking to the commissioner's office next week to finalize arrangements for a public hearing and publishing notices.

MS. ERCHINGER requested copies for the Audit Committee when the new regulations are ready to go public.

MR. PUCKETT said absolutely, that the committee is on the list of people to receive a copy.

D. Committee Requests: Areas of Interest/Review

Committee members had made comments and requests during KPMG's presentation of the audit plan earlier in the agenda and had nothing to add at this time.

E. Discuss Any Significant Changes to Applicable Accounting Principles and Any Items Required to be Communicated to the Independent Auditors

CHAIR JOHNSON called on KPMG's Mike Hayhurst, state comptroller Scott Jones, and CFO Kevin Worley for any items that would fit into this category.

MR. HAYHURST indicated that KPMG had included those items at the end of their presentation. MR. JONES and MR. WORLEY had nothing to add.

F. Review Any Legal Matters that May Impact Fund's Financial Statements, the ARMB's Compliance with Applicable Laws and Regulations, and Any Inquiries Received from Regulators or Governmental Agencies

Board legal counsel STUART GOERING stated that for audit purposes Mr. Worley always makes a request to all the attorneys in the Department of Law generally. That happens in the normal course of business. At this time, he was not aware of anything that would affect the pension plans.

MS. ERCHINGER asked that Mr. Goering be prepared at the board meeting tomorrow to talk about the legal implications of the legislative intent language that plans to study whether or not to shift investment of assets held by the ARMB to the Alaska Permanent Fund Corporation.

MR. GOERING said he would be ready to do that.

G. Department of Revenue – Treasury Division

1. <u>SSAE16 – Reporting on Controls at a Service Organization</u>

State comptroller SCOTT JONES referred to a memorandum in the packet regarding State Street Bank and NRS SSAE16 Audits *(memo dated June 8, 2016 is on file at the ARMB office)*. As an update to the memo, he said Treasury has received the March 31, 2016 reports from State Street. He has reviewed them, as well as the user controls that are listed in there and any new items or changes that are applicable to the Treasury Division. March's was another unqualified opinion.

2. Personnel Succession (Organization Chart)

Treasury Division director PAMELA LEARY referred to an organizational chart in the packet that highlighted the current staffing of the Treasury Division *(on file)*. She said the chart reflects three additional positions that were in the budget the legislature passed: two investment officers and one accountant. Compared to the chart she presented last year, staffing is net one additional position due to reducing some of the support staff. Since last year, three investment officers left, three new investment officers were hired, and there were two additional investment officer positions added in the budget last year. Those also remain vacant. She hopes to hire for the new accountant IV position shortly.

MS. ERCHINGER asked if the vacant positions were vacant due to not finding applicants or because the State has a freeze on hiring.

MS. LEARY replied that the two vacant investment positions added last year were part of the hiring freeze. There was a long process where Mr. Bader and his staff looked to fill five vacant positions, and they wound up with two positions still open to be hired.

H. Department of Administration – Division of Retirement & Benefits
Personnel Succession (Organization Chart)

MR. BOUCHER handed out copies of the organization chart *(on file)*. He reported that the top level management positions have been stable, and he anticipated that they would continue to be stable. The one senior position that retired is the data processing manager, and they are currently in the process of recruiting for that key IT leadership position. Other than that position, the workforce is fairly stable. Probably most notable is that the audit section is fully staffed. Mr. Denis, who is the junior auditor, is just about to finish his cycle of training. Management anticipates that he will be capable of going on audits by himself very shortly. The capacity in the audit section is significantly enhanced from where it was a year to 1-1/2 years ago.

MR. BOUCHER announced that the Governor's Office recently gave permission to examine and re-do how the Division of Retirement and Benefits is structured. A little over two years ago, four leadership positions that report directly to the Commissioner's Office were created within DRB: chief finance officer, chief pension officer, chief health officer, and chief operations officer. This is the structure he inherited when he became deputy commissioner. Since then, he and the commissioner have reached the conclusion that this is not a sustainable way to run retirement and benefits. They are looking to replace this model with more of a director model. All the pieces needed to go through the personnel process are not complete yet. They anticipate going out for recruitment of a director in a relatively short time horizon.

MR. JOHNSON said he had wondered how the chiefs structure would be sustainable without a director leading it. He asked if the Commissioner's Office was contemplating a director who was independent from the four chiefs or if there would be one paramount chief who would also be director.

MR. BOUCHER said they have encouraged all the sitting chiefs to apply for the directorship. With personnel constraints, they are not sure if they will retain all of the chiefs, but it is still an issue to be worked out.

I. Committee Performance – Self-Assessment (per Charter)

MS. ERCHINGER stated that the committee has brought up a lot of good issues over the last couple of years. It has not been easy because there have been GASB changes that have had some serious implications on all participating employers across the state. These have been good discussions that have resulted in some rethinking of things, which is important for the committee to do, regardless of which direction the outcome is. Given the time the committee has to work together, she thought it had accomplished quite a few good things. She did not see any need to make changes to the committee charter at this time.

J. Review Committee Charter and Action Plan

There was no discussion.

K. Further Meeting Schedule

The next meetings are Wednesday, September 28, 2016 in Anchorage, a November 3, 2016 teleconference for DRB review of financial statements, and Wednesday, December 7, 2016 in Anchorage.

The September meeting in Fairbanks has been moved to Anchorage to save travel time and costs. The Board will consider and adopt the proposed 2017 meeting schedule at tomorrow's meeting.

MS. HALL reported that Mr. Wesley resigned from the Board as he is running for public office.

OTHER MATTERS TO PROPERLY COME BEFORE THE COMMITTEE

There were no other matters.

PUBLIC/COMMITTEE MEMBER COMMENTS

There were no comments.

ADJOURNMENT

The meeting adjourned at 11:37 a.m., on a motion made by Ms. Harbo and seconded by Ms. Erchinger.

Note: An outside contractor prepared the summary minutes from staff's recording of the meeting. For in-depth discussion and presentation details, please refer to the recording and staff reports and written presentation materials on file at the ARMB office.

Confidential Office Services
Karen Pearce Brown