State of Alaska
ALASKA RETIREMENT MANAGEMENT BOARD
AUDIT COMMITTEE MEETING

Robert B. Atwood Building
Conference Center, 1st Floor
550 W. 7th Avenue
Anchorage, Alaska

June 20, 2018

ATTENDANCE

Committee Present:	Rob Johnson *(chair)* Kris Erchinger Gayle Harbo Norm West
Committee Absent:	None

Department of Revenue Staff Present:
Pamela Leary (director, Treasury Division)
Bob Mitchell (chief investment officer)
Scott Jones (comptroller, Treasury Division)
Stephanie Alexander (board liaison)

Department of Administration Staff Present:
Commissioner Leslie Ridle *via telephone for part of the meeting*
Ajay Desai (director, Division of Retirement & Benefits)
Christina Maiquis (accountant V, Division of Retirement & Benefits) *via telephone*

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

I. CALL TO ORDER
CHAIR ROB JOHNSON called the meeting to order at 8:02 a.m.

II. ROLL CALL
All four committee members were present at roll call.

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

IV. A. APPROVAL OF AGENDA
MS. ERCHINGER moved to approve the agenda. MS. HARBO seconded. The agenda was approved without objection.

B. APPROVAL OF MINUTES
MS. HARBO moved to approve the minutes of the March 28, 2018 meeting. MS. ERCHINGER seconded. The minutes were approved as presented.

V. PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS AND APPEARANCES
There was no public comment by anyone in attendance at the meeting location or by telephone.

MR. AJAY DESAI, Director of the Division of Retirement & Benefits (DRB), announced that Kevin Worley had resigned as chief financial officer effective June 1. In lieu of Mr. Worley, MS. CHRISTINA MAIQUIS was attending this meeting by telephone to deliver DRB reports and provide any help.

VI. REPORTS

A. Review Independent Auditors' Audit Plan
[A copy of KPMG's slide presentation of the audit plan and strategy, dated June 20, 2018, is on file at the ARMB office.]

MR. DANIEL MITCHELL, KPMG lead audit managing director, presented the audit plan for the fiscal year ended June 30, 2018 for the Department of Revenue Treasury Division and the Department of Administration Division of Retirement & Benefits. He said KPMG would make sure the financial statements were prepared in accordance with GAAP (U.S. generally accepted accounting principles), and would conduct the audit under the U.S. generally accepted auditing standards. They would issue audit reports, management letters, and the required communications that are typically seen at the end of the year.

MR. MITCHELL said they understood that the timeline for the audit was changing this year and had held a discussion with Mr. Worley and the rest of the group prior to his departure. KPMG will do everything they can on their side to work with the respective parties to ensure that the accelerated timeline is met.

MR. MITCHELL mentioned that the audit team remained largely unchanged, which is good, given the State's accelerated timeline this year (*slide 3*). Melissa Beedle would be the lead audit manager, and Robert Lawson was the in-charge manager on the engagement.

Next was a review of the relevant factors affecting KPMG's risk assessment. He said there is the presumption on all audits that management can override the controls, and that is deemed a significant risk. KPMG will do expanded test work on journal entries in particular to ensure that they are specifically supported and have valid business purpose. The other area that rises to a significant risk continues to be the valuation of alternative investments. Given the significance of the alternative investments portfolio, not only to the schedule of invested assets reports, but also respectively as they are allocated out to each of the retirement systems, KPMG will spend a lot of time in this area. The valuation of these investments is critical to the overall system value. They had a quick kick-off call in advance of this meeting with Nick Katsanos, KPMG's EVS partner, to walk through any changes there. They also have a meeting with State Comptroller Scott Jones and his team this afternoon.

CHAIR JOHNSON asked if KPMG looks into the system controls from an information technology perspective.

MR. MITCHELL said they take a limited approach and definitely gain an understanding. They have cybersecurity questionnaires to go through, and if there is something that raises concern they will then expand test work. But they do substantive testing of the underlying transactions, which is where they would see if there was a significant IT risk in the way the transactions were processed. He added that if the committee had a concern in the area of cybersecurity fraud, KPMG could certainly take a deeper dive.

MS. ERCHINGER stated that she read articles about the future of accounting that say there will not be any accountants, and it will happen in short order. She asked for KPMG's take on that.

MR. MITCHELL replied that he leads KPMG's audit innovation for the Pacific Northwest and was recently at a conference in Chicago. KPMG is very aware of the changes, such as artificial intelligence, for example. It will not eliminate the audit function in its entirety but will be a combination of things. KPMG uses technology and clients have technology to accelerate audit timelines, to work smarter and do less judgmental things more efficiently by using bots and computer programs. That data still needs to be interpreted by people who have the expertise. He believes the number of people they hire will be scaled down, but the people hired are going to be more IT skilled. More importantly, colleges and universities have to rethink how they are preparing individuals who want careers in finance accounting to give them the right skills for the new technologies. KPMG started its own program for data analytics at Villanova University because they were seeing a gap in that market. Everything is being disrupted, not just the accounting world, and people need to think about where they will be in ten years. It is a hot topic right now.

MR. MITCHELL briefly explained the involvement of alternative investment specialists and actuarial specialists in the audit procedures. He then described the planned timeline, pointing out that the biggest challenge to KPMG is the timing of reports that come from Conduent, the State's primary actuary.

MS. ERCHINGER mentioned that the State has tried to identify these kinds of bottlenecks in its RFPs (requests for proposal) in the past to incentivize timeliness. This might be one of those opportunities to modify an RFP with an incentive for timeliness or disincentives for the timeline slipping. It really affects not only the audit but the secondary actuary's ability to review the actuarial valuations on time so the Board gets good information.

MR. MITCHELL next covered supplemental communications to the Committee and the Board, the first being the significant risks of management override of controls and the valuation of alternative investments, both of which he had explained earlier. He said there is generally an unadjusted audit difference relating to the roughly three-month lag by which management receives the alternative investment valuations. KPMG reports the difference in valuations: it has never been material, but they keep an eye on that just in case. Some larger differences in alternative investment valuations could happen if the market experienced a very volatile last quarter.

He said KPMG considers the level of materiality for each retirement system, and separately for the schedule of invested assets. He and Melissa Beedle will be working through those calculations soon to try and get those locked down in order to accelerate the audit process. Materiality determines the level of audit work they will do in each of the accounts. The primary benchmark is the value of the assets in each of the systems, but they also look at how that relates to total contributions and total distributions.

CHAIR JOHNSON said it always concerns him that there could be minor anomalies or errors that may be a precursor to something big that might develop. But looked at as a snapshot in time, it may not appear to be big, if measured on a dollar value basis.

MR. MITCHELL replied that KPMG identifies differences throughout the audit. There are some that get reported, for example, the investment reporting lag. There are other differences that may be below that threshold of reporting to this group that KPMG tracks to make sure that in aggregate there is a good reason why there is a difference. For example, they test hundreds of distributions and recalculate the benefit payment. If there is even the slightest difference there, even though they are using materiality, they actually put that through their sample program and extrapolate it to see if they have further concern. If there is a pattern in distributions throughout the year, and somebody was short-changing somebody five dollars on every distribution payment and parking it somewhere fraudulently, KPMG would be able to see and investigate why there is a difference. Contributions are calculated down to the dollar and treated the same way. Sometimes there are rounding differences, and other times they think there are differences but find that they did not have the right calculation. Investment income is a little more challenging, but they have two powerful tools. They actually confirm and triangulate back to the custodian, and they also do analytics by using the benchmarks for each of the investment classes to recalculate what they would expect the return to be for that particular investment class, compare it to what has been recorded, and then compare that to materiality. They have been within probably a quarter of their materiality in the last year in that area with this precision analytic.

MS. ERCHINGER asked, with respect to testing distributions, to what degree those kinds of processes rely on human intervention.

MR. MITCHELL said there is a lot of human intervention.

MS. ERCHINGER said she was thinking of the level of turnover in jobs, and that some of those calculations are very complex. She wondered how to minimize the opportunities for errors because of the human factor, especially given the prospect of less and less longevity in those positions.

MR. MITCHELL said how they planned to do that was probably best asked of management. But what he sees typically in the best control environments is being aware that that is a risk and being very proactive on cross-training. KPMG is sad to see Mr. Worley go, from a relationship standpoint, but there is a team that has worked with him and cross-trained and has done the audit process before. It is incredibly critical to use the notice period very wisely to do some shadowing. The biggest risk is in end-user spreadsheets. When he has seen material misstatements, it has been because of a mathematical calculation on an end-user spreadsheet that was not reviewed by the right level of people. An entity can have a disaster contingency plan for certain situations, but cross-training is absolutely critical. Having one person be responsible for so much is a real risk in Alaska, where oftentimes there is not enough staff. The staff performs many different functions and is putting fires out on a day-to-day basis.

Continuing with the required communications, MR. MITCHELL noted that there were no changes in the responsibilities between management, the Audit Committee and KPMG *[see slide 10 summary]*. He had a take-home document about audit quality for the committee that was put together by KPMG's chairman, entitled "Enhancing Audit Quality and Transparency." He said there has been a lot of press over the years about firms being sued, especially in the Big Four accounting space. The width of the band between the Big Four and the smaller regional firms is significant when looking at client sizes. There has been quite a bit of international press around KPMG recently. The U.S. firm and the international firm share the same brand but are completely different firms. The U.S. firm has a completely different management committee. The take-home document sets forth all the things that KPMG holds to be of significant value that they want to communicate to their clients and that they take the quality of the work they do seriously.

MR. MITCHELL explained that, with regards to KPMG's inspection process, every year one of his engagements is picked, and the PERS system was picked for quality review two months ago. He and Ms. Beedle had two weeks' notice before a four-person review team from KPMG's New York office went through the file with a fine-toothed comb to see if they had done a quality audit. In the end, they had one item to change in their work papers, which was essentially because of the complexity of the way the systems connect with the schedule of the invested assets reports and the allocation of the investments there. They had test work dispersed throughout the files but they did not really have the test work in the PERS file as a stand-alone of everything they did to test the allocation. They pulled that together in an Excel file and added a memo on the front, and that was the extent of the review. They had done the right amount of test work, and the reports were found to be correct, but they had to clarify the documentation to improve their performance. The review team had no comments on or changes to the financial statements.

MR. MITCHELL spoke briefly about KPMG's independence and how seriously they take it. They have a system of tracking independence. He has to sign independence confirmations in his own work papers that also report all the way up to their legal group, where he has to sign an affidavit every year. For example, if his spouse were a member of PERS, that would jeopardize his independence and he could not be a signing partner on that engagement.

At CHAIR JOHNSON's prompting, MR. MITCHELL explained the list of questions for the Audit Committee on slide 13. He started by asking if the committee had any concerns about fraud risks in the retirement systems or the schedule of invested assets that the auditors should know about as they start planning the audit.

MR. MITCHELL stated that if KPMG comes across any matters that involve management during the audit, he assumed the Chair was the contact person to communicate any concerns to.

MR. WEST indicated he did not have any responses to the posed questions listed on slide 13. However, he informed Mr. Mitchell that he should make himself aware independently of any changes in statutes that affect the retirement plans. The plans are affected by politics. The ARMB is kept informed by staff of any changes in statute and tries to analyze them. However, the trustees in managing and overseeing the plans are not independent experts on what the impacts might be. As he reads through some of the proposed legislation, he has been concerned that some of it is off the wall. Of course, some of it is done to appease this group or that group or to curry political favor, and most of it does not go anyplace. But, on the other hand, it may have more of a long-term impact on the plans, in terms of determining the liabilities and the assets, and making them comparable financial statements. He found the greatest value in the work that the profession does is so that the plans' figures are comparable to other state plans. That is beneficial to the committee, the Board and the staff because they believe what they do from an actuarial standpoint for their own planning and investment management allows them to properly fulfill their responsibilities. Regarding the list of questions that KPMG provided on slide 13, he felt the trustees were not really experts, and the auditors should provide their independent opinion of the impacts of the situations they raised and monitor them rather than wait for the committee to say. For example, the Board does not generally fire its staff because they chose a bad investment, because they are overseers for the most part. He did not think that the Treasury Division Director was able to affect her benefit one way or the other, depending upon the performance of a particular fund, so that kind of risk does not exist.

MR. MITCHELL stated that KPMG does look at statutes as they relate to benefit calculations, as an example. They make sure that the foundation of that benefit is calculated correctly. He said he would like to explore with Ms. Beedle if there is a tracking mechanism to show what statutory changes were made to an individual system so that KPMG understands what that population is. While they may look at a statute, they may miss a nuance that changes the statute in a way that could impact a particular calculation.

MS. ERCHINGER said she did not have any concerns about fraud or internal controls, and it is because of the staff, adding that it is all about the tone at the top. It is about getting to know the staff and working with them and listening to what they focus on when they talk about the controls they have implemented. She has accompanied staff on a visit to State Street Bank, and it was fascinating the multiple levels of controls that are in place by the team at the bank that works with the State of Alaska, whether it is on the investment side or the individual plan participant's investments. Because of the complexity of the work staff performs, and the fact that they do not have a deep bench, she would probably be more concerned if it were not for the quality of the staff that oversees those operations with a large base of assets and dealing with so many retirees and active members. Her ongoing concern has been with census data submitted from the National Guard Naval Militia Retirement System (NGNMRS) to the State. Now, audits of employers are bringing to light some of the deficiencies on the employer side and making the employers more accountable for the data that the retirement plans receive. That is not a reflection of the State, but it is an improvement in the overall reliability of the data.

MR. MITCHELL agreed that the NGNMRS census data has been very messed up. KPMG needs to regroup with DRB staff on the status of the work that Mr. Worley was doing on that because the military retirement system is somewhat unauditable at this point. The system definitely needs to have an audit. Fortunately, from a leg audit perspective and the State's CAFR (comprehensive audited financial report), the NGNMRS is clearly immaterial, so it does not hold up any issuance of financials. That audit is sort of on hold right now until the data is cleaned up, and then they have to recast back what the pension liability should be. It sounds like the pension liability will be less than what it has been reported, so, from a risk perspective, that is a good set of circumstances. The matter goes back to staff turnover, training consistency and application, which is very important for census data.

MR. MITCHELL said that when KPMG conducts test work of the individual PERS and TRS entities, they do find exceptions but they are few and far between these days. The marital status is probably the most common exception, and out of a sample size of 500 there will be five marital stats that are incorrect. That would not materially impact an actuarial valuation. Last year, KPMG's testing of the NGNMRS was finding every other test life had an issue, and it was a significant issue. That will be another challenge this year. KPMG will need validation at some point that NGNMRS has scrubbed that census data so they can re-audit it, but it will not hold them up on any of the other test work.

MS. ERCHINGER stated that the committee would be interested in knowing about any similar issues, even though it is ancillary to the overall audit. There may be some way to help improve the quality of that information from the employers' perspective, if the committee is aware of it.

MR. MITCHELL said KPMG usually has one dedicated staff who does all of the employer audits. They could have that person track what they are seeing that may not be an issue but is a sign of weakness that could blow up in a significant way if it goes in the wrong direction. He reiterated that employer staff turnover is the biggest challenge.

CHAIR JOHNSON inquired if KPMG needed specific responses to the questions posed under the Audit Committee inquiries on slide 13.

MR. MITCHELL responded that he was accepting what he heard from the committee today, that the answers were either no or were not outside of what had already been discussed.

Regarding the appropriate person for KPMG to contact for communication of audit matters, CHAIR JOHNSON said he did not find it specifically addressed in the committee charter. He asked committee members if they would be satisfied if the chair were the person to receive at least the initial communication. The chair has no authority to act on his/her own and would have to hold a meeting to discuss any information he had received from the auditor.

Fellow committee members Erchinger, Harbo and West indicated that was acceptable to them.

CHAIR JOHNSON commented that maybe that direction could be incorporated into the committee charter in the future.

Concluding his presentation, MR. MITCHELL drew attention to KPMG's Audit Innovation practice, explained on slides 19-22, some of which was applicable to the system audits and some less so. He said they would share the innovations with the committee as they get developed and become part of the audits.

B. Discussion of Division of Retirement & Benefits Audit Timeline

MS. CHRISTINA MAIQUIS, Accountant V in the Division of Retirement & Benefits, presented the timeline for the June 30, 2018 audits of the Division's financial statements and other audited schedules (*see the four-page spreadsheet schedule for June through December 28, 2018, included in the meeting packet*). The schedule has been pushed up to meet the Division of Finance's requirements for financial statements, as well as to meet the GASB 68 and 75 audit reports for December. The body of audit work remains the same as last year.

MS. ERCHINGER asked if the Division had concerns about meeting the shorter timeline, given Mr. Worley's resignation.

MS. MAIQUIS replied that she thought the Division could meet the timelines but would have to push to stay on track.

C. Forfeiture Update

MS. MAIQUIS reported that the Division sent notifications yesterday to all employers about the usage of forfeitures. They provided the forfeiture balances to employers and will start using the credits effective July 1, 2018.

MS. ERCHINGER said she fills the designated employer seat on the ARMB and has received employer phone calls asking about the State's plan for actually reducing future contributions until these credits are exhausted. The forfeitures are related to employer contributions into the defined contribution plan, where an employee for whom contributions were made was not vested when they terminated. The contributions are sitting there and they need to be refunded back to the employers. The notification to employers was to allow them to use up that balance over time by not contributing as much as normal.

Employers have asked her if there is an option to not use up the forfeiture balance that way but to get a check to repay them. The reasoning is a budgeting issue for employers, because not making any employer contributions for a period could be perceived as having lower personnel costs. The second question is whether employers can expect this to be an annual process, where the State will inform employers of their forfeiture balance at the end of each year.

MS. MAIQUIS said she understood that the State could not cut a check to an employer because it is an exclusive benefit and there are specific requirements that the forfeited money can only be used to cover future defined contribution plan employer contributions. Ongoing, the Division will send a monthly notification of the balances to employers, and there will be a new posting of employees that terminate and leave money in the system.

MS. ERCHINGER wondered if the committee should ask someone to look into the legislative language to address if an employer makes a contribution into a plan, and the contribution is not needed for retirement purposes, that the employer would be entitled to a refund of their over-contributions.

MR. AJAY DESAI, Director of the Division of Retirement & Benefits, stated that the Internal Revenue Service (IRS) has a clear guideline under ERISA that once a contribution from the employer hits a pension trust fund the money cannot be refunded directly back to the employer because it is part of the trust fund money. The only way that excess money from the employer can be returned back is as future credits to be used for the other plan members. Secondly, specifically for the Alaska plans, the design is pretty clear about the forfeitures, that these contributions are supposed to be credited back to the employer. Excess contributions are completely different than forfeitures: if the plan receives money above the threshold then those contributions, regardless of the rules, have to go back to the employer and cannot stay in the plan. He said he would bring the plan explanation to the next meeting.

MS. ERCHINGER said she appreciated that explanation. She said another employer question was why the forfeitures were not remaining in the defined contribution plan overall to help pay down the unfunded liability. That was another area for the committee to get additional information about.

MR. DESAI said that forfeiture could have been used toward the plan's unfunded liability, however, it is not clear in the statutes about how to deal with it.

MS. HARBO mentioned that there are over 200 employers, and the defined contribution plans started over 12 years ago. She asked if the committee could get a spreadsheet that shows the forfeiture balance for each employer.

MR. DESAI agreed to provide that as well.

D. Committee Requests: Areas of Interest/Review

There were no requests.

E. Review Legal Matters

MR. STUART GOERING, the ARMB's legal counsel from the Alaska Department of Law (DOL), described the process by which DOL formally responds to the inquiry from the ARMB about potential liabilities of the fund and that sort of thing. The auditors send a letter to DOL with very specific requests, that request is referred to an attorney, and then that attorney sends an inquiry to all attorneys in the Civil Division of DOL to make sure there is nothing lurking out there that may impact the retirement plans.

He was not aware of anything new, except for an update on the Supreme Court case that he brought to the committee's attention last year. The case involved a plaintiff by the name of Metcalfe and was remanded back to the Superior Court. It was certified as a class. The State filed for summary judgment. On May 10, the Superior Court granted the State's request for summary judgment and against the class. That judgment was actually entered on June 14, so the time for appeal on that decision has begun to run. If no appeal is filed by July 16, that matter will be behind for the State entirely. By the time the audit works its way through the process, the State will know that either the case is on appeal to the Supreme Court or there is no appeal.

Regarding the earlier question of whether the auditors should be tracking statutory and regulation changes, MR. GOERING pointed out that DOL is sort of the conduit for the State of Alaska for that kind of information, certainly in the executive branch. They write a bill review letter to the Governor for every bill that gets passed that explains the consequences of that bill before the Governor decides whether to let it become law or veto it. Also, all regulations (with minor exceptions) flow through DOL for review as well. One possibility would be for the letter that the auditors send to DOL to contain a request for any material changes in statutes or regulations that have occurred within the relevant time period. It is not the only way to handle that issue, but it is a way to satisfy the committee's concerns that the auditors are accounting for all legislative and regulatory changes that happen within the State of Alaska.

CHAIR JOHNSON asked if Mr. Goering interfaced much with Ice Miller, the firm that advises the Division of Retirement & Benefits on tax matters, and if there were any issues of note that they were reviewing and that the ARMB was engaged in.

MR. GOERING replied that he speaks regularly with the attorney who manages the Ice Miller contract, and she is good about making him aware of matters. As far as he knew, there were no issues. He added that the attorney would be a good resource to get answers if there are questions at the board level related to plan interpretation, IRS regulations or something like that. In his position he cannot contact Ice Miller directly.

F. DOR - Treasury

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

MR. SCOTT JONES, Comptroller in the Treasury Division of the Department of Revenue, referred to his June 1, 2018 memo to the Audit Committee on the State Street Bank and NRS audits of their internal controls *[included in the meeting packet and on file at the ARMB office]*. He explained that at the memo date he did not have the March 31 SOC-1 reports, however, staff did receive them subsequently and staff reviewed them with the bank. It was an unqualified opinion, and no material deficiencies were noted. Staff also reviewed the Barry Dunn report on the IT controls from NRS, the accounting provider for the State's retirement plans, and it also was an unmodified opinion and no material deviations.

MR. WEST asked if there were any recommendations in the SOC-1 reports.

MR. JONES said no, but the SOC-1 reports always contain a page that lists controls that need to be or should be considered by the entity. Staff notes those recommendations every year and provides KPMG responses as to whether or not they are applicable and, if they are, what staff does to mitigate the risks or the questions that are listed. In the report to the bank, they do note deviations. The most common occurrence in the most recent set of reports was that review of certain documents simply was not evident. The review was being done, but the person did not put their signature in the upper corner of the page to actually show that they had reviewed it.

MR. WEST asked the Director of the Treasury Division, Pam Leary, if the internal control auditor's recommendations on areas of concern could be provided to the committee on a regular basis, along with the management's responses. He said it was the most valuable part of the whole process to him because he was not so much interesting in the boiler-plate audit report. In their recommendations, the auditors are bringing their outside expertise and their review of similar organizations together, and he would like to see those ideas.

MR. MITCHELL noted that the SOC-1 reports generally do not contain the management letter comments. The auditors may issue a separate management letter that is a no material weakness letter that has no recommendations.

2. <u>Accounting/Financial Personnel Succession (Organization Chart)</u>

MS. LEARY stated that the Treasury Division believes very strongly in the importance of cross-training in succession planning. Asset Accounting cross-trains all of the staff members, and there is always a second to back up. Everyone has an assigned function and, in cases of vacations or absences, a backup individual can do that work. Asset Accounting also holds monthly team meetings to talk about any upcoming issues. The same is true with the Cash Management section, where cross-training is done for all of their functions. On the investment side, not only is there cross-training but there are cross-functional teams where parties from different areas of investment will work together on a particular project that the chief investment officer has requested. It is a great opportunity for staff to pursue different areas of interest, and it is an incentive to keeping the staff fully engaged intellectually as well.

MS. LEARY provided a new organization chart that will be effective July 1. She explained the difference that reflects the opportunities for the staff to pursue other areas of interest. She also pointed out the addition of two intern positions in the investment area this summer. There are only three vacancies currently: one on the investment team and two on the cash management team. Recruitment for those positions is underway.

G. DOA – Division of Retirement & Benefits – Personnel Structure

MR. DESAI reported that at this point the personnel structure at the higher level of the Division remains about the same as last year. Management has, however, made some significant changes in the Health Plan Section to keep in mind a succession plan, as well as upcoming projects for the health side. A senior manager position was created on the Pension Section side under Deputy Director Kathy Lea, which will allow balancing the pension operational work.

MR. DESAI had also provided an operational chart that listed the responsibilities of each section of DRB as it is currently structured, and which places the areas of operations (including member services, communications, information services, and administrative services) in separate sections that also report directly to him. He had found that working through the operational function on the benefit area created a disconnect, and the silo was the biggest issue amongst the different sections. He is recommending a new operational manager position that will work directly with the division chiefs and take on the operational work responsibility so the division chiefs can focus on more strategical work.

MR. DESAI had a second operational chart of what the personnel structure will look like in the future. He noted that the changes will occur more on the operational side but will directly affect the hierarchy on top.

CHAIR JOHNSON asked if the future structure involved creating new positions or upgrading existing positions.

MR. DESAI said information services had two high-level positions, one a range 23 and one a range 24. Those two positions were very important in their own areas five to seven years ago, but that is not the case today with the development of many new tools. Going forward with a new system [unintelligible], the Division does not need those higher-level positions within the IT. His proposal moves one of the IT higher-level positions to the operations side and the head count will remain the same.

MS. ERCHINGER commented that the integration of IT with operations is similar to the earlier discussion about how audits are changing. Also, in other organizations people need a higher level of IT background to be able to accomplish the general work of a department. She thought what Mr. Desai explained was a good approach.

MR. DESAI said he has seen in his career that the highest-level person of a department is responsible for everything – operational issues, HR issues, etc. – but at the same time dealing with those types of issues is very time consuming, which diverts them from their strategical work and true directional work. That is where a high-level person falls into that trap. An example is that he just lost a chief financial officer for the same reason. He wants to take a stand and see if the Division can somehow balance the operational work separately from the strategical work and have a special person to deal with those kinds of issues, rather than have a chief level person get involved with the technical issues.

H. Committee Performance – Self Assessment (per Charter)

There were no comments or recommendations.

I. Review Committee Charter and Action Plan

A copy of the charter was included in the meeting packet.

MR. WEST suggested taking up a change to the charter to make the committee chair the point of contact for the external auditors.

CHAIR JOHNSON indicated he would work with Ms. Alexander to draft an amendment to the charter to consider at the next meeting.

J. Further Meeting Schedule

The meeting calendar for the remainder of the calendar year was included in the packet.

MS. ALEXANDER pointed out that the tentative November teleconference to review the DRB financial statements probably needed to move up to October to meet the Division's deadline to issue the financial statements by November 5.

The third or fourth Wednesday in October was proposed for the teleconference.

VII. OTHER MATTERS TO PROPERLY COME BEFORE THE COMMITTEE

MS. LEARY stated that she and Mr. Jones were at State Street Bank in Boston last week and visited the bank's data management center. They also had a presentation on how State Street deals with cyber attacks and issues. She proposed a side trip for the Audit Committee and/or other board members to visit State Street's data management center in Boston, in conjunction with attending the Education Conference in New York City in October. She said it is interesting to see the controls where the retirement funds' data is stored.

MS. LEARY said that Bob Mitchell had been in touch with Fidelity Investments to discuss their cyber protection. Fidelity is also based in Boston and they were open to having a presentation for the board members as well.

CHAIR JOHNSON and MS. ERCHINGER both spoke in favor of the committee making time for some on-site due diligence on cyber security, especially in light of the literature out there on the topic. The Chair recommended that the Board as a whole participate in the visits. MS. LEARY said she would bring it up as part of her report at the board meeting.

VIII. PUBLIC / COMMITTEE MEMBER COMMENTS

There were no comments.

IX. ADJOURNMENT

Ms. Harbo moved to adjourn. Ms. Erchinger seconded. The meeting adjourned at 9:37 a.m.

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