

**State of Alaska**  
**ALASKA RETIREMENT MANAGEMENT BOARD**  
**AUDIT COMMITTEE MEETING**

**Location:**  
Alaska State Museum  
Lecture Hall  
395 Whittier Street  
Juneau, Alaska

**April 3, 2019**

**ATTENDANCE**

**Committee Present:** Robert Johnson, *chair*  
Gayle Harbo  
Norm West

**Committee Absent:** None

**Other Trustees Present:** Lorne Bretz  
Tom Brice  
Allen Hippler

**Department of Revenue Staff Present:**  
Bob Mitchell (chief investment officer)  
Pamela Leary (director, Treasury Division)  
Scott Jones (comptroller)  
Kayla Wisner (deputy comptroller)  
James McKnight (senior compliance officer)  
Stephanie Alexander (board liaison)  
Coltin Lanz (administrative assistant)

**Department of Administration Staff Present:**  
Ajay Desai (director, Division of Retirement & Benefits)  
Kevin Worley (CFO, Division of Retirement & Benefits)  
Roberto Aceveda (counseling and education manager, Division of Retirement & Benefits)  
Lea (chief pension officer)  
Melanie Helmick (state social security administrator)

**Others Present:**  
Stuart Goering (assistant attorney general, Department of Law)  
Sam Trivett (public)

**I. CALL TO ORDER**

CHAIR ROBERT JOHNSON called the meeting to order at 9:00 a.m.

## **II. ROLL CALL**

CHAIR JOHNSON, MS. HARBO and MR. WEST were present at roll call.

## **III. PUBLIC MEETING NOTICE**

Board liaison STEPHANIE ALEXANDER confirmed public meeting notice had been met.

### **IV. A. Approval of Agenda**

MS. HARBO moved to approve the agenda. MR. WEST seconded the motion. The agenda was approved without objection.

### **B. Approval of Minutes - November 13, 2018 and December 12, 2018**

MS. HARBO moved to approve the minutes of the November 13, 2018 meeting and the minutes of December 12, 2018 meeting. MR. WEST seconded the motion. The minutes were approved without objection.

## **V. PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS, AND APPEARANCES**

SAM TRIVETT expressed appreciation to members for their service.

CHAIR JOHNSON welcomed Trustees BRETZ, BRICE, and HIPPLER to the meeting, as well as Deputy Commissioner of Revenue GREG SAMORAJSKI and Director, Division of Retirement & Benefits (DRB) AJAY DESAI.

### **VI. A. Employer Audits**

KEVIN WORLEY, CFO, DRB introduced MELANIE HELMICK, State Social Security Administrator, to present the results of the 3<sup>rd</sup> Quarter FY19 internal employer audit presentation. MS. HELMICK noted a correction to the prior report and clarified there are four FY18 State audits to be completed. There are 39 scheduled audits for FY19, of which five have been completed. The desk audits revealed issues. Staff has addressed these issues and helped the employers come into compliance. One of the issues was employees not enrolled in PERS who should be enrolled in PERS.

MS. HELMICK informed the Committee previously inquired as to the occurrence of push-back from employers regarding requests to provide records. She noted recent experience of push-back from small employers primarily due to the employers falling behind on payments or lack of adequate staffing. MS. HELMICK created a letter of noncompliance and the one issuance to-date resulted in a response. The first bonafide term finding occurred since the new IRS code regulations were instituted January 1, 2018, whereas retirees have to wait six months before returning to work.

MS. HELMICK informed the Social Security Section 218 agreement has been modified 189 times since the agreement was implemented when Alaska was a territory. The latest modification regarded three employees in Aniak. MS. HELMICK advised the 2020 budget has been presented to MR. WORLEY, which includes the list of 59 employer audits. Over

the last four years, all 240 employers have been audited at least once. The larger systems are typically audited every two or three years.

MS. HELMICK provided a follow-up from the last meeting regarding the city of Nenana withholding PERS contributions and not submitting to the Division. MS. HELMICK conducted the audit and verified withholdings were being made, but not submitted. Subsequently, the State Troopers are undergoing an investigation. MS. HELMICK informed there is another undisclosed city undergoing audit for a similar situation.

MR. WORLEY advised travel budgets have been cut by 50% because of the budget crisis. Additional desk audits are being implemented as a result. The need remains for auditors to travel in the field conducting onsite audits and providing education to employers.

MS. HARBO noted a previous discussion and inquired if the funding for travel is supplied by the pension funds, rather than general budget funds. MS. HELMICK agreed funding for travel is supplied by the pension funds, rather than general budget funds. However, she is also responsible for the State Social Security Administrator work while in the field. Therefore her travel is funded by both the pension fund and a separate FICA fund. MS. HARBO reminded the Committee about discussions regarding the need for more auditing personnel, in addition to the current two employees who are responsible for auditing the entire state.

CHAIR JOHNSON hopes MR. DESAI and others involved in the budgeting process are looking for the exceptions that exist in the Governor's mandate on limiting travel, specifically with respect to entities that are quasi-independent, travel that yields funds for the State overall, and concerning fiduciary responsibility.

**B. GASB 68 / 75 update for PERS / TRS Defined Benefit Pension & OPEB**

MR. WORLEY explained the eight funds administered by DRB undergo annual audits. As a supplement, allocation schedules for the net pension liability and the net OPEB liability of the plans are created and issued. The original auditor deadline for the issuance of the reports was May 31<sup>st</sup>. The review is ahead of schedule with an anticipated early issue date of April 30<sup>th</sup>. A final update will be provided at the June Audit Committee meeting.

**C. FY 2019 Audit RFP Update**

MR. WORLEY noted June 30, 2019 is the final day under the current contract with the external auditors KPMG. The FY19 audit RFP is being released this week with an anticipation of issuing a contract in May. The RFP is for a two-year contract with options for a three-year extension and a subsequent five-year extension, totaling a 10-year contract at approximately \$5.5 million. The responses will be reviewed by two representatives from DRB and two representatives from Department of Revenue (DOR).

MR. WEST inquired about previous RFP submittals. MR. WORLEY described the previous RFP resulted in bids from three audit firms. Two of the firms were located in Anchorage and one was located in Idaho. The travel budget was delineated from the audit work during the prior bid, and the current RFP will ask for a combined lump-sum amount. MR. WORLEY did not have the breakdown of KPMG's total contract or current travel amount and can

provide the information upon request. MR. WORLEY believes additional work KPMG performed outside of their normal contract costs included the census data issues with the National Guard audits and work concerning the TPA health data issues. MR. WEST requested the cost additions and their frequency in comparison to the old contract and the new contract be provided after the RFP responses are received. MR. WORLEY agreed.

MR. WEST expressed interest in viewing the contract language regarding the location of the meetings in Juneau and Anchorage. MR. WORLEY noted the RFP identifies Juneau as the main area for presentations, particularly the April and September meetings. Any changes in venue would be reviewed to determine if contract revisions are necessary.

CHAIR JOHNSON requested MR. WEST be included as a representative on the RFP response review committee. MR. WORLEY agreed and MR. WEST agreed.

#### **D. Compliance Report and Update**

CHAIR JOHNSON introduced Senior Compliance Officer JAMES MCKNIGHT who provided the update on the 2018 Investment Compliance Program. He explained the securities from the ARMB funds are automatically tested daily, both internally and through Bloomberg's compliance rules testing. MR. MCKNIGHT reviewed the summary of other compliance tests and findings conducted daily and monthly in 2018.

- No instances of leverage existing.
- 19 instances of funds exceeding their cash allocation.
- 30 valid overdrafts, mostly with external managers, resulting in fees of \$9,592.85.
- 12 confirmed Bloomberg violations.
- One accounting error by State Street concerning repo transactions.
- 47,652 internal trades, with one State Street error.
- One instance of the plan drifting outside the asset allocation in the JRS plan.
- Six current face differences identified as a result of the monthly holdings reconciliation, attributable to State Street's cash flow timing differences.
- One instance of a manager purchasing a company on the Iran List.
- 10 ARMB rebalances and 139 other ARMB asset allocation transfer letters, with one State Street error.

MR. MCKNIGHT noted the overall trend shows a decrease in violations from 2012 to 2018. Commission recapture is reconciled each month between managers and State Street. The rebated commissions were down about 76% from 2017, primarily due to the increase in internally managed funds and the current low broker commission rate. All manager proxy votes are collected by September 1 each year. A statement was received indicating all proxies were voted in accordance with ARMB policy. One Freedom of Information Act request was received for the proxy voting records by a company who offers information on global shareholder voting.

CHAIR JOHNSON suggested the ARMB proxy policy be reviewed and discussed by the Audit Committee and the Operations Committee. MR. MCKNIGHT agreed to the suggestion and noted he will include the proxy policy in the next investment compliance presentation.

MR. MCKNIGHT reported the movement from external management to internal management continues. A greater level of attention is required for internally managed assets and one of the compliance challenges in 2019 will be the increase in the daily workload for staff. MS. HARBO believes increasing internally managed assets is beneficial.

**E. Internal Audit Presentation / Discussion**

MR. WORLEY and Comptroller SCOTT JONES gave the presentation regarding internal audit functions. The Association of Public Pension Fund Auditors (APPFA) is the leading entity on standards for internal audits of retirement systems and the source for best practices. They define the mission and objectives of an internal audit department (IAD) as providing independent, objective assurance, and consulting services designed to add value and improve the organization's operations. The objectives of the IAD's assurance services are to provide independent assurance to the Board of Trustees, Audit Committee, and management that:

- The organization's assets are safeguarded.
- Operating efficiency is enhanced.
- Compliance is maintained with prescribed laws and the organization's policies.

MR. JONES gave a detailed description of each of the objectives as it relates to the Treasury Division.

MR. WEST requested clarification regarding who performs the internal audit review. MR. JONES explained the Treasury Division does not have an internal auditor. Staff is performing the internal audit-like functions described. The benefits of having an internal auditor include formalizing the processes and procedures that are currently informal and creating an independent function of the audit work. MR. WEST agreed there is great value to utilizing an independent auditor.

PAMELA LEARY, Director, Treasury Division, advised this presentation is in response to a request by the Audit Committee to discuss internal audit functions and a cost/benefit analysis to consider the addition of an internal auditor. She informed MR. MCKNIGHT currently reports to the Deputy Commissioner.

MR. WORLEY gave a detailed description as to the DRB Internal Audit Section. The mission is to ensure State of Alaska retirement system compliance for all participating employers, which includes PERS, TRS, SBS, and Deferred Compensation. DRB currently has two internal auditors who conduct audits in accordance with Generally Accepted Government Auditing Standards and through International Standards for the Professional Practice of Internal Auditing. Audit reports are submitted to DRB management and DRB regional counselors to resolve issues and concerns. Results are reported to the employer, DRB management, and the ARMB Audit Committee.

MR. WORLEY described DRB performs additional compliance work through obtaining annual System and Organization Control (SOC) reports from each of the DRB's contracted third-party service organizations and administrators. MR. WORLEY expressed appreciation to the two internal auditors who contribute important benefits to the Division.

MR. JONES showed the Committee an example of an internal audit and described the audit plans and operating budget. He reviewed the general costs of adding an internal auditor include salaries, benefits, training, audit software, and other overhead. The benefits of adding internal auditors include potential savings during the annual audit, deployment of current staff to more value-added activities, the addition of layers that do not currently exist, the independent function of the audit work directly reporting to the Audit Committee, and the formalization of processes and procedures.

MR. JONES discussed the Institute of Internal Auditors (IIA) published an RFP to define and measure the value of internal audit. The final product is due by December 31, 2019. MR. JONES will provide the Audit Committee the conclusions after they become available and most likely during the June 2020 meeting.

MR. WEST asked who currently reviews Treasury Division's processes. MR. JONES noted function review is the responsibility of each section chief. Staff is competent and the compliance checks and balances work is ongoing. Processes are examined to determine how to increase efficiency. The external auditors provide a sample audit of every step of the process. He informed no implementations of any GASB requirements are occurring this year.

**F. Future Audit Committee Topics**

MR. WORLEY noted discussion should occur regarding a timeline for providing information to the Audit Committee regarding the Division's retirement system financial statements that will be issued the second week of October. CHAIR JOHNSON requested MR. WORLEY consult with MS. ALEXANDER regarding the timing issues.

CHAIR JOHNSON noted future topics include the proxy policy and the results of the IIA RFP regarding the cost-benefits of internal auditors.

**G. Further Meeting Schedule**

MS. ALEXANDER informed the future meeting scheduled provided will have location changes that are to be determined. She will update the Committee when those occur.

**VII. OTHER MATTERS TO PROPERLY COME BEFORE THE COMMITTEE**

None

**VIII. PUBLIC / MEMBER COMMENTS**

None

**IX. ADJOURNMENT**

MS. HARBO moved to adjourn the meeting. MR. WEST seconded the motion. The motion passed without objection.

The meeting was adjourned at 10:10 a.m.

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