

State of Alaska
ALASKA RETIREMENT MANAGEMENT BOARD
AUDIT COMMITTEE MEETING

Location:

Alaska State Museum, Lecture Hall
395 Whittier Street, Juneau, Alaska

December 11, 2019

ATTENDANCE

Committee Present: Robert Johnson, *chair*
Lorne Bretz, *(arrived late)*
Gayle Harbo
Norman West

Committee Absent: None

Other Trustees Present: Acting Commissioner Mike Barnhill, *(arrived late)*
Bob Williams, *(arrived late)*

Department of Revenue Staff Present:

Bob Mitchell (chief investment officer)
Pamela Leary (director, Treasury Division)
Kayla Wisner (comptroller)
Scott Jones (DOR)
Stephanie Alexander (board liaison)

Department of Administration Staff Present:

Kevin Worley (CFO, Division of Retirement & Benefits (DRB))
Ajay Desai (DRB, DOA)

Others Present:

Stuart Goering (assistant attorney general, Department of Law)
David Kershner (Buck)
Scott Young (Buck)
Melissa Beedle (KPMG)
Beth Stuart (KPMG) (phone)

I. CALL TO ORDER

CHAIR ROBERT JOHNSON called the meeting to order at 8:02 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 - September 18, 2019

MS. HARBO moved to approve the Minutes of September 18, 2019. MR. WEST seconded the motion. The Minutes of September 18, 2019 were approved without objection.

Approval of Minutes - October 14, 2019

MS. HARBO moved to approve the Minutes of October 14, 2019. MR. WEST seconded the motion. The Minutes of October 14, 2019 were approved without objection.

V. PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS, AND APPEARANCES - None

VI. A. Review of Financial Statements / Letter to Audit Committee

CHAIR JOHNSON introduced KEVIN WORLEY, CFO, DRB, and BETH STUART and MELISSA BEEDLE, KPMG, to review the financial statements. MS. BEEDLE noted the presentation of KPMG audit results of the 2019 financial statements has been provided to members. As of the end of October, KPMG has issued reports on PERS, TRS, JRS, DCP, and SBS.

MS. BEEDLE indicated the financial statement for NGNMRS is still pending due to census data issues. MR. WORLEY explained additional work and confirmation regarding the NGNMRS data is ongoing and he expects a final audit report by the next Board meeting.

MS. BEEDLE informed the audits were performed in accordance with generally accepted auditing standards. There were no significant changes to the audit plan presented to the Audit Committee at the June meeting. Unmodified opinions were issued on each of the System's financial statements. The audit reports included other-matter paragraphs discussing the required supplementary information and the supplemental schedules.

MS. BEEDLE advised KPMG expects to issue unmodified opinions on allocation in accordance with the GASB 68 and GASB 75 schedules for the Systems in the next few weeks. The significant audit estimates identified were the net pension liability and net OPEB liability amounts. Additional discussion on this will occur later in the presentation. The management override of controls was the only significant risk identified. This risk is inherent in every audit. MS. BEEDLE discussed the review process KPMG conducted and no bias was found. There were no other significant audit matters and no new applicable accounting pronouncements. There were no identified significant deficiencies or material weaknesses related to internal controls. There were no identified issues with related party transactions and no matters to report on any communication topics

MS. BEEDLE informed KPMG will review the upcoming Comprehensive Annual Financial Report (CAFR) for PERS and TRS to ensure consistency with the audited financial statements. No separate opinion will be issued for the CAFR per best practices and historical industry norm. MR. WORLEY advised the CAFR should be available for review next week. CHAIR JOHNSON inquired as to KPMG's protocol for communication to the Committee regarding any identified issues with the CAFR. MS. BEEDLE explained any materially incorrect items or inconsistencies would be reported to the Committee. There were no matters to report at this time.

MR. WORLEY announced staff received the Government Finance Officer's Association award for financial excellence in reporting for June 30, 2018. He expressed appreciation to staff, Buck, and KPMG for their efforts.

MS. BEEDLE discussed the calculation of the net pension liabilities and net OPEB Liabilities are considered significant accounting estimates. Management uses Buck to calculate those liabilities. The census data provided for the valuations is audited. There were no changes to the process in the current year. There were significant changes to the assumptions, as a result of the adoption of the new experience study. The experience study and assumptions were reviewed by KPMG's internal actuaries and were deemed reasonable and supported with no indication of management bias.

MS. BEEDLE explained the responsibilities of KPMG during the audit. The purpose of the audit is to express an opinion on the financial statements. Internal controls are considered for implications, but not for the purpose of expressing an opinion. MS. BEEDLE provided the Committee with the informational link to KPMG's annual audit quality and transparency reports.

B. GASB 68/75 Schedule for Participating Employer

MR. WORLEY corrected the Agenda and noted the title should read GASB 68/75 Schedules for Participating Employer. He explained the GASB 68 and GASB 75 allocation schedules are of the June 30, 2019 PERS and TRS net pension liability for the Defined Benefit Pension plans and the net OPEB liability/asset for the post-employment benefit plans; Occupational Death and Disability, Retiree Medical Plan for DCR, Retiree Medical Plan for DB, and the Alaska Retiree Healthcare Trust.

MR. WORLEY discussed the Defined Benefit Pension and Defined Benefit Alaska Retiree Healthcare Trust allocation methods are based on projected future contributions' present value, which Buck allocates to each participating employer. The other plans' allocations are based on actual contributions. MR. WORLEY indicated the schedules are currently under review by KPMG. He requested feedback from the Committee regarding questions, comments, or corrections of the schedules for consideration in the final report.

CHAIR JOHNSON reiterated the possibility of conducting a separate meeting focusing on the GASB schedules, if deemed necessary by the Committee. MR. WORLEY noted a follow-up teleconference call could occur, if necessary. Otherwise, any questions or comments can be

addressed at today's meeting, which would allow the schedules to be issued within a few weeks.

CHAIR JOHNSON requested information regarding subjective elements factored in the calculations. MR. WORLEY does not believe any of the conclusions are subjective. The estimates are based on the mathematics of projected future allocations. CHAIR JOHNSON inquired if the receiving municipalities have the opportunity to comment on the allocation schedule. MR. WORLEY noted the allocations are audited and he does not recall previous instances of questions or comments. Four of the schedules use the clear allocation methodology based on actual contributions. Staff believes the projected additional State contributions are determined using the best allocation methodology.

MR. WEST asked if the liabilities of DB participants follow them when they transfer to another unit, specifically in reference to the Alaska Gasline Development Authority's unfunded liability. MR. WORLEY explained the liabilities transfer with the employees because of the cost-share plan. MR. WEST inquired if any disclosure is made regarding the liability remaining with the employee, rather than the employer.

CHAIR JOHNSON advised Trustee and ACTING COMMISSIONER BARNHILL joined the meeting and requested to comment. ACTING COMMISSIONER BARNHILL informed the issue expressed by MR. WEST was debated by the Legislature in 2007 and 2008. The Legislature resolved the issue by shifting to a cost-share system. Under the cost-share system, the rates are fixed and the methodology issue becomes moot. The unfunded liability is shared on a pro rata basis. MR. WORLEY agreed with the characterization.

MR. WEST moved that the Audit Committee approve the financial statements for recommendation to the full Board. MS. HARBO seconded the motion.

The motion was approved without objection.

MR. WEST moved that the Audit Committee approve the presented GASB 68 schedule and GASB 75 schedule for recommendation to the full Board. MS. HARBO seconded the motion.

The motion was approved without objection.

C. Information Update: Employer Audit Report

MR. WORLEY noted the Audit Unit Report for the 2nd Quarter of State Fiscal Year 2020 has been provided to members. The highlighted items are in audit or undergoing an alternate process. Common audit issues included elected officials enrolled in PERS incorrectly, PERS part-time eligible employees not enrolled, and TRS enrollment errors. Issues are resolved through the employer.

MS. HARBO requested verification the City of Elim and the City of Hooper Bay have approximately one or two employees each and are included in the delinquent PERS contribution category. MR. WORLEY agreed and noted staff continues to work with those

employers to enroll additional eligible employees. One of the cities on the delinquent list has not been able to pay due to lack of funding. MS. HARBO inquired if School Board members and City Council members in small villages are still allowed to enroll in PERS. MR. WORLEY indicated he would follow-up with the answer.

MR. WORLEY continued the presentation and explained the majority of the audits have transitioned to desk audits due to budget restrictions. Travel to northern and western Alaska will occur to audit employers who have not been audited in some time. Four of the scheduled eight trips were approved. Desk audits take additional time because the data has to be provided by the employer.

CHAIR JOHNSON applauded MR. WORLEY for the efforts enacted to save money. He asked if a quantifiable correlation can be shown between the money saved by not traveling and the efficiency lost by issues encountered with desk audits. MR. WORLEY indicated he cannot quantify the comparison. In some situations, it makes more sense for a person to be onsite to communicate the seriousness of conducting the audits.

MR. WORLEY reported MELANIE HELMICK, DRB State Social Security Administrator and Division Auditor, attended the National Conference of State Social Security Administrators in September. It is the intent for the other Division Auditor to obtain additional Social Security training in order to conduct Social Security audits out in the field or as a desk audit.

MS. HARBO expressed concern three of the unapproved travel audits are for large employers; Municipality of Anchorage, Matanuska-Susitna Borough School District, and University of Alaska. She asked for the audit schedule, and asked the reason for the unapproved travel. MR. WORLEY noted these employers are on a four-year audit cycle. It is possible that shifts in the travel budget may occur to encapsulate these employers or the travel schedule may be reworked. The large employer audits are conducted onsite over three to five days. Much of the work is completed ahead of time and offsite.

MR. BRETZ inquired about the delinquency rates and if any improvement had occurred. MR. WORLEY offered to provide a report at the March meeting. He noted the list has not grown. Funds for one employer have been fully secured and funds for another employer have been partially secured. The smaller employers continue to lag behind. One employer was subject to House Bill 47, and no funds have been collected to-date. Communications are ongoing to develop a plan forward.

CHAIR JOHNSON asked if there is a way to calculate what part of the contribution rate is attributed to non-payments by employers. MR. WORLEY requested DAVID KERSHNER, Buck, to comment. MR. KERSHNER explained the unfunded liability created by the deficiency in assets could be calculated. CHAIR JOHNSON requested the information. MR. WORLEY noted the data will be based on estimates. The contribution non-payment amounts are approximate figures because the employers do not provide payroll information.

D. Committee meeting with Independent Auditors

MR. WORLEY advised the Committee meeting with independent auditors separate from staff occurred recently. There was no objection to foregoing the item during today's meeting.

E. Indirect FX Services

CHAR JOHNSON requested PAMELA LEARY, Director, Treasury Division, to present on Indirect FX Services. MS. LEARY announced KAYLA WISNER has been promoted to the role of State Comptroller, and SCOTT JONES, former State Comptroller, is present in the audience. MS. LEARY noted she will provide a brief overview of the new Treasury organizational structure at the Operations Committee meeting. The highlights include expanding the middle office to include an information/operations/performance special projects group. A number of projects, including the development of in-house performance capabilities, are now under the auspices of the middle office.

MS. LEARY informed the educational presentation that MS. WISNER will present today is one of the projects conducted by asset accounting to ensure fund pricing is correct for all of the managed funds. MS. WISNER explained Treasury Staff and the ARM Board Trustees have the responsibility to monitor investments. This duty extends to the execution of foreign currency transactions (FX). The presentation provides an overview of findings and observations for the subset of indirect FX transactions. MS. WISNER explained the difference between State Street direct FX service transactions, State Street indirect FX service transactions, and other FX broker transactions. Out of the 64,058 FX transactions processed between July 1, 2011 and June 30, 2018, 47% used brokers other than State Street, 34% used State Street direct services, and 19% used State Street indirect services.

MS. WISNER advised she relied on the State Street Investment Manger Guide for the methodology and service analysis presented. The analysis included 12,022 indirect FX transactions of all active managers and all currencies. MS. WISNER reviewed the types of services offered; security settlements and holdings (SSH), hourly pricing (HPS), and automated dividend and automated dividend and interest income repatriation (AIR). As of October 2018, forward points are supplied by WM Reuters or Thomson Reuters. MS. WISNER explained the trade rate recalculation process. All transactions were settled in their proper location and no hedging was used. Ninety percent of all transactions were properly executed. MS. WISNER reported the specific analysis results for each of the services, including;

- Number of transactions
- Total cost of service
- Number of cross-currency transactions
- Differences in recalculation of trade rates
- Number of transactions that did not properly apply forward points
- Gross cost
- Median benefit/cost
- Netting benefit

MS. WISNER advised of the future plan to revisit the analysis and reevaluate the indirect services and application of forward points. She directed the Committee's attention to the appendix slides containing definitions, service components, and transactions by calendar year.

MR. WEST inquired if State Street's local fiduciary and custodial services are trading with State Street's foreign exchange, as an inclusive in-house transaction. MS. WISNER agreed. The gross cost of the indirect FX transactions of \$3 million paid to State Street is an additional fee and is not reflected in the State Street fee for fiduciary and custodial services. MR. WEST asked if there are readily available FX providers that could be utilized, other than State Street. MS. WISNER reiterated 47% of the total indirect FX transactions were with brokers other than State Street. The managers negotiate pricing with State Street and other brokers for the direct FX services and decide who to utilize. MR. WEST inquired if managers choose State Street for FX transactions because State Street is our custodian. MS. WISNER noted she would follow-up with the answer.

ACTING COMMISSIONER BARNHILL expressed appreciation to MS. WISNER for the extensive presentation. He asked if regular testing will be adopted going forward. MS. WISNER noted the intent is to conduct regular analysis. Staff will weigh the benefits of conducting an annual analysis or an analysis every five years and determine the best course. ACTING COMMISSIONER BARNHILL requested the median cost of settling FX transactions compared with the portfolio's cost. MS. WISNER explained State Street provides the cost information only for their indirect FX transactions. She will confer with the bank and other custodians to see if other reporting data or schedules are available.

ACTING COMMISSIONER BARNHILL requested MR. MITCHELL reach out to peer pension organizations to inquire about information regarding their cost to settle FX transactions. MR. MITCHELL agreed that was an option and another option would be to contact the international equity managers and report on their feedback.

F. Future Audit Committee Topics -None

G. Further Meeting Schedule

MS. ALEXANDER stated the 2019-2020 meeting schedule is attached and there were no changes. The 2020-2021 meeting schedule is also attached, but the specific dates have yet to be determined.

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 9:14 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.