

**THE AUDIT COMMITTEE
of the
BOARD OF TRUSTEES
MARYLAND STATE RETIREMENT AND PENSION SYSTEM**

MINUTES OF THE MEETING OF November 10, 2016

The Audit Committee met on Thursday November 10, 2016 at 9:33 a.m., in the Board Room of the Maryland State Retirement Agency at 120 East Baltimore Street, Baltimore, Maryland.

Committee members present were: James A. Bush, Jr., Chairman
Theresa Lochte
Richard E. Norman
David B. Hamilton (by phone)

Other Board members present were: James M. Harkins

MSRA attendees were: R. Dean Kenderdine, Executive Director
David Rongione, Chief Internal Auditor
Margaret Bury, Retirement Administrator
Harvey Raitzyk, Deputy Retirement Administrator
Ken Reott, Deputy Retirement Administrator
Rachel Cohen, Principal Counsel
Melody Countess, Chief Operating Officer
Michelle Lowery, Deputy Chief Operating Officer
Andrew Palmer, Chief Investment Officer
Patricia Wild, Managing Dir. Investment Admin. & Accounting
Toni Voglino, Investments Compliance Officer
Stephen Reilly, Managing Director, Investments
Ira Greenstein, Chief Information Systems Officer
Michael Golden, Director of External Affairs
Brian Feilinger, Internal Audit Contract Manager
Lauren Smith, Internal Audit Supervisor

SB & Company attendees were: Graylin Smith, Client Service Partner
William Seymour, Engagement Partner
Tiana Wynn, Senior Manager
Eric Marcus, Audit Manager

The Hackett Group attendees were: Toni Hackett Antrum, President
Chris Tobe, Investment Consultant

A. Minutes of the August 16, 2016 Audit Committee Meeting

On a motion made by Ms. Lochte, and seconded by Mr. Norman, the minutes of the August 16, 2016 Audit Committee meeting were approved.

B. Presentation of FY 2016 MSRPS Financial Statement Audit Results by SB & Company

Mr. William Seymour presented the Committee with their FY 2016 financial statement audit results. He informed the Committee that the statements will receive an unmodified opinion. The audit noted no significant deficiencies, instances of fraud, or material weaknesses in internal control. He stated that SB & Company had an open relationship with management, and received their full cooperation. The audit included GASB 67 and 68 requirements, as well as GASB 72, which was new this year.

Mr. Seymour discussed SB & Company's audit approach, and indicated that the COSO model was used to assess the Agency's control environment. SB & Company evaluated key processes, and found that adequate controls were in place, and were effective. There were no significant adjustments to major accounts.

Mr. Seymour noted that for FY 2016, contributions plus investment income were less than benefits payments. This was due to investment performance.

Mr. Seymour generally described how investments were categorized for purposes of valuation. Level 1 investments had values that were readily determinable. Level 3 investments had values that could not be readily determined, due to a lack of transparency. Level 2 investments were somewhere in between, with significant observable inputs.

Mr. Seymour told the Committee that there were no significant items disclosed in the Required Communications section. He added that SB & Company received the full cooperation of Agency management. Mr. Kenderdine expressed his appreciation of the relationship that the Agency has with SB & Company. He noted that they were especially helpful in dealing with the System's participating employers for GASB 67 and 68.

C. Acceptance of the FY 2016 MSRPS Draft Financial Statements

On a motion made by Ms. Lochte, and seconded by Mr. Norman, the Committee accepted the FY 2016 MSRPS Draft Financial Statements.

D. Credit/Debt Operational Audit – Results Presented by The Hackett Group

Ms. Antrum and Mr. Tobe discussed the Hackett Group's operational audit of Credit/Debt strategy investments. Audit objectives were to determine if Credit/Debt investments were properly monitored and valued, and if they were compliant with the System's investment guidelines. Ms. Antrum noted that 11 of the System's 42 Credit/Debt investments were traditional, public investments, while the remainder are private investments. Traditional controls, such as the custodial bank, are not present for private investments.

Mr. Tobe stated that there are industry-wide problems with private investments

associated with valuations, fees, and expenses. He noted that recently-proposed ILPA standards would provide a standard format for private investments to report fees, performance, and other metrics. Adoption of ILPA standards would help to provide additional controls.

The audit disclosed the need for additional documentation with regard to the reconciliation of private investments' financial statements, or K-1 forms, to quarterly reports submitted by managers. Specifically, the reconciliations should be signed and dated by the individual performing the reconciliation. The audit also identified a need for a secondary review of public manager invoices

Additionally, the audit found that private manager fees were not always consistent with fee rates specified in contract side letters. To address this, the audit recommended adopting a requirement for private investments to report in accordance with ILPA standards. Mr. Tobe noted that this has started to happen for some of the investments.

Mr. Bush commented that the Agency should compel investment managers to meet its requirements, rather than the other way around.

Ms. Antrum noted that the audit also recommended that staffing be increased to enable the System to properly monitor these complex investments.

E. Status of FY 2017 Audit Plan

Mr. Rongione provided the Committee with a status update for the FY 2017 audit plan. Staff is currently performing a Power of Attorney audit and a EFT Application Processing audit. The Network and Server Maintenance and Support audit and the Credit/Debt Strategies audit were recently completed.

F. Status of Open Issues Log

Mr. Rongione provided a summary of open audit issues. For FY 2017, a total of 18 issues were closed, and 11 new issues were added, bringing the balance of currently open issues to 15. The Committee also received a listing of the open audit issues.

G. Internal Audit Staffing Update

Mr. Rongione provided the Committee with an organizational chart of the Internal Audit Division, which included potential new positions. These included the addition of two auditors, who would be dedicated to auditing critical controls, similar to what is done for Sarbanes-Oxley. Also proposed are an information technology auditor, and an enterprise risk management (ERM) manager. Two more audit positions would be added to bring currently outsourced employer audits in-house, for cost savings.

Mr. Bush indicated his support for additional Internal Audit staffing. He noted that as more demands on the Agency's business operations need to be met, there

are also increased requirements for Internal Audit. He expressed concerns that a business process could break down, but was not audited.

H. Completed Audits

Mr. Rongione summarized the results of the recently-completed audit of Network/Server Maintenance, describing the objectives and findings. He noted that the audit had an overall rating of “green”. The audit found that the tool used to monitor hardware and software performance did not utilize its tracking feature for documenting the resolution of alerts. The audit also found that user rights were not always rescinded timely for terminated employees. Mr. Rongione noted that this issue occurred only after the Agency’s human resources staff was transferred to the Department of Budget and Management. Agency management has agreed to implement corrective actions to address problems identified in the audit.

I. Other Business

The next Audit Committee meeting will be held on February 21, 2017, immediately following the Board of Trustees meeting.

J. Motion to Adjourn

On a motion by Ms. Lochte, and seconded by Mr. Norman, the Committee adjourned the meeting at 10:14 a.m.

Respectfully submitted,

David Rongione, Secretary