

AGENDA

MEETING OF THE AUDIT COMMITTEE AND BOARD OF RETIREMENT AND/OR BOARD OF INVESTMENTS*

**LOS ANGELES COUNTY EMPLOYEES RETIREMENT ASSOCIATION
300 N. Lake Avenue, Suite 810
Pasadena, CA 91101**

March 20, 2013 – 9:00 a.m.

2013 COMMITTEE MEMBERS:

Alan Bernstein
Yves Chery
Mark J. Saladino
Michael Schneider
Herman B. Santos
Leonard Unger

CONSULTANT:

Timothy O'Brien – Audit Committee Consultant

- I. ELECTION OF AUDIT COMMITTEE CHAIR, VICE CHAIR, AND SECRETARY FOR CALENDAR YEAR 2013

- II. APPROVAL OF THE MINUTES OF THE REGULAR AUDIT COMMITTEE MEETING OF December 6, 2012 (Attached)

- III. PUBLIC COMMENT

- IV. REPORTS
 - A. Audit Plan Status Overview (February 28, 2013)
Richard Bendall, Chief Audit Executive
(Memo dated March 12, 2013)

 - B. Recommendation Follow-up Overview (February 28, 2013)
Sarah Marks, Principal Internal Auditor
(Memo dated March 12, 2013)

- C. Division Reviews
 - a. Risk Assessment
 - b. Audit Plans
 - c. Work Completed/In Progress
 - d. Recommendation Follow-Up
 - e. Reports
 - 1. Systems Division
 - i. Presentation by Brad MacKenzie, CEO
Clear Skies Security, LLC.
 - ii. Report - Penetration Testing
Memo dated March 11, 2013
 - 2. Claims Processing Division
 - 3. Member Services Division
 - 4. Investments
 - 5. FASD
 - 6. Communications
 - 7. Disability Retirement
 - 8. Executive Management
 - 9. Retiree Health Care
 - 10. Quality Assurance
 - 11. Human Resources
 - 12. Administrative Services
 - 13. Legal
 - 14. Internal Audit
 - i. Los Angeles County Rehired Retirees
 - 15. Disability Litigation

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D. Status of Other External Audits Not Conducted at the Discretion of Internal Audit

Sarah Marks, Principal Internal Auditor
(Verbal Presentation Only)

IBM Software Audit

V. FOR INFORMATION ONLY

A. Consolidated Recommendation Follow-Up Report (February 28, 2013)

VI. CONSULTANT COMMENTS

Timothy O'Brien – Audit Committee Consultant
(Verbal presentation only)

VII. GOOD OF THE ORDER

(For discussion purposes only)

VIII. ADJOURNMENT

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***The Board of Retirement and Board of Investments have adopted a policy permitting any member of the Boards to attend a standing committee meeting open to the public. In the event five (5) or more members of either the Board of Retirement and/or the Board of Investments (including members appointed to the Committee) are in attendance, the meeting shall constitute a joint meeting of the Committee and the Board of Retirement and/or Board of Investments. Members of the Board of Retirement and Board of Investments who are not members of the Committee may attend and participate in a meeting of a Board Committee but may not vote on any matter discussed at the meeting. Except as set forth in the Committee's Charter, the only action the Committee may take at the meeting is approval of a recommendation to take further action at a subsequent meeting of the Board.**

Documents subject to public disclosure that relate to an agenda item for an open session of the Board and/or Committee that are distributed less than 72 hours prior to the meeting will be available for public inspection at the time they are distributed to a majority of the members of any such Board and/or Committee at LACERA's offices at 300 N. Lake Avenue, Suite 820, Pasadena, CA 91101 during normal business hours [e.g., 8:00 a.m. to 5:00 p.m. Monday through Friday].

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MINUTES OF THE AUDIT COMMITTEE

REGULAR MEETING OF THE AUDIT COMMITTEE AND BOARD OF RETIREMENT AND/OR BOARD OF INVESTMENTS*

**LOS ANGELES COUNTY EMPLOYEES RETIREMENT ASSOCIATION
300 N. Lake Avenue, Suite 810
Pasadena, CA 91101**

March 20, 2013 – 9:00 a.m.

COMMITTEE MEMBERS

Present: Alan Bernstein
Yves Chery
Mark J. Saladino

Absent: Les Robbins
Herman B. Santos
Michael Schneider
Leonard Unger

BOARD MEMBERS AT LARGE

None

AUDIT COMMITTEE CONSULTANT

Timothy O'Brien

STAFF PRESENT

Gregg Rademacher	Carlos Barrios	Gary Smith
Robert Hill	Bernie Buenaflor	Roberta Van Nortrick
John Popowich	Roxana Castillo	Robb Van Der Volgen
Richard Bendall	Kathy Delino	Robert Wright
Sarah Marks	Kimberly Hines	
Nathan Amick	Walter Howey	
Sylvia Botros	Francisco Jaranilla	
Leisha Collins	John Nogales	
Elvia Gonzalez	Eddie Paz	
George Lunde	Mary Phillips	
Quoc Nguyen	James Pu	
David Redman	Susana Seeckts	

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I. ELECTION OF AUDIT COMMITTEE CHAIR, VICE-CHAIR, AND SECRETARY FOR CALENDAR YEAR 2013

A motion was not presented as the required Committee Members were not in attendance to proceed with the election.

II. APPROVAL OF THE MINUTES OF THE REGULAR AUDIT COMMITTEE MEETING OF DECEMBER 6, 2012

A motion was not presented as the required Committee Members were not in attendance to approve the December 6, 2012 Meeting Minutes.

III. PUBLIC COMMENT

No items to report.

IV. REPORTS

A. Audit Plan Status Overview [February 28, 2013]

- Richard Bendall, Chief Audit Executive
(Memo dated March 12, 2013: *Verbal Presentation Only*)

Mr. Bendall briefly described the nature of the 2012-2013 Audit Plan and how it details organizational risk for each division and how Internal Audit allocates resources based on identified risk. Mr. Bendall also noted that an orientation package will be sent to all new Audit Committee Members.

B. Recommendation Follow-up Overview [February 28, 2013]

- Sarah Marks, Principal Internal Auditor
(Memo dated March 12, 2013)

Ms. Marks briefly described the nature of the Recommendation Follow-Up Report and how it provides a status of management's progress toward audit recommendations. Ms. Marks explained that over the last few years Internal Audit has been consolidating operations from multiple databases to a formal audit software platform which has caused delays in providing recommendation status reports to Executive Management. Ms. Marks explained that these status reports will be provided to Executive Management and the Audit Committee with greater regularity moving forward.

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C. Systems Division Risk Assessment and Audit Work

- Richard Bendall, Chief Audit Executive

Mr. Bendall presented a brief overview of the Systems Division Risk Assessment and future projects including a Disaster Recovery Test and an elective Governance Review contracted by Systems. Mr. Bendall explained that the Systems Division is considered high risk due to importance and that high quality controls are in place and effectively mitigating risks.

D. Systems Penetration Assessment by Clear Skies Security, LLC

- George Lunde, Senior Internal Auditor

Mr. Lunde provided a brief background of systems penetration testing at LACERA. Mr. Lunde explained that past systems penetration testing has proven that LACERA's security system is very effective. Brad MacKenzie, CEO, Clear Skies Security, LLC gave a summary of their background, audit findings, as well as some brief comments about cyber security. During the first phase of their assessment, Clear Skies targeted LACERA's network for seven days. Their goals were to determine if LACERA security teams identify the attack and if so, what response was delivered. The second phase was the assessment of the My LACERA portal for seven days. They concluded that LACERA is doing a really good job and it is obvious that application best practices are being followed. They were not able to tamper with the data. Password security was excellent. An issue was found was with the middleware framework resulting from an error by the third party vendor which the vendor instantly remediated. This minor vulnerability had never been exploited by anyone before. The recommended improvements included a web application firewall. Mr. Saladino asked if the vendor charged LACERA to fix the discovered issue. Mr. MacKenzie responded that they did not. Mr. Bernstein asked if Mr. MacKenzie would recommend more frequent penetration testing. Mr. MacKenzie responded that proactive internal testing would be effective with annual penetration testing.

E. Claims Processing Risk Assessment and Audit Work

- Quoc Nguyen, Senior Internal Auditor

Mr. Nguyen presented a background and overview of the Claims Processing Division Risk Assessment and audit work both planned and in progress. Mr. Nguyen explained that the high risk factor included in the Risk Assessment is due to the importance and complexity of the work in Claims Processing. Mr. Nguyen stated that the primary objective of the four (4) reviews in progress is "to determine whether staff has the proper procedures in place to ensure that the transactions are processed accurately, timely, efficiently, and with the proper controls in place to address risks." Following Mr. Nguyen's brief overview of the Review of the Active Death Process, Mr. Chery asked the reason safety members were specifically addressed in the review.

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E. Claims Processing Risk Assessment and Audit Work (*continued*)

- Quoc Nguyen, Senior Internal Auditor

Mr. Nguyen and Mr. Bendall clarified that, although the audit stemmed from a previous audit where issues were discovered with benefits paid to some of the safety member survivors, the audit would cover all members and not just safety members. Mr. Nguyen also provided a brief overview of the Special Payments Audit as well as two consulting projects; the Supervisor Payroll Procedures and the Process and Inventory Gap Analysis requested by the Claims Processing Division Manager. Mr. Nguyen also briefly introduced the two audit projects planned for the coming year that include a review of Complex Payment Calculations and Root Cause Analysis. Mr. Chery inquired about the timeline to completion on the Active Death Process Audit. Mr. Nguyen responded that fieldwork and test work has been completed and a draft report is being prepared and the audit report will be included in the next Audit Committee meeting materials. Mr. Chery asked if any issues found would also be addressed by the next meeting. Mr. Nguyen responded that many of the recommendations would be related to process improvements and management is already implementing or planning to implement these recommendations. Mr. Bendall also clarified that the Report provided to the Committee will include management responses and any issues that require instant remediation will either be addressed immediately or a date of completion will be provided. Mr. Nguyen also added that management had already recognized some of the issues with the Active Death Process and some of the fixes are already under way and details will be included in the report. Mr. Chery asked if any General Members were included impacted in the Violent Death Review. Mr. Bendall clarified that the Violent Death Review only applied to Safety Members. Mr. Nguyen also briefly discussed the Consulting Review that was requested the Claims Processing Division Manager.

F. Investments Risk Assessment and Audit Work

- Sarah Marks, Principal Internal Auditor
- Leisha Collins, Senior Internal Auditor

Ms. Marks presented a brief summary of the Investments Division Risk Assessment followed by Ms. Collins who gave a brief overview of audit work both planned and in progress for the Investments Division. Ms. Collins' presentation included an overview of the Title Holding Company (THC) and Advisory Audits. Ms. Collins explained that test work is expected to be completed by the end of the quarter and a report will be issued by the next Audit Committee Meeting. Ms. Collins also discussed the Hiring of the External Auditors project which included a Request for Proposal (RFP) issued in February. The RFP received a response of eleven (11) bids from various accounting firms with experience in real estate audits. Ms. Collins stated that the proposals will be reviewed and due diligence will be performed including a thorough review of references and fee assessment.

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- F. Investments Risk Assessment and Audit Work (*continued*)
- Sarah Marks, Principal Internal Auditor
 - Leisha Collins, Senior Internal Auditor

A selection of five (5) accounting firms will be made for the pre-approved audit pool and recommended to the CEO for final approval by April 2013. The external audits will then start at the end of the Fiscal Year, the financial reports will be issued by mid-September 2013, and then those final Audited Financial Statements will be included in LACERA's Annual Financial Report. The approved five (5) accounting firms will remain in that audit pool for five (5) years provided they continue to meet LACERA's service requirements. Ms. Collins explained that this process allows LACERA to save a significant amount of time and money.

- G. Financial & Accounting Services Division, Custodial Bank Transition
- Richard Bendall, Chief Audit Executive

Mr. Bendall presented a brief update of the Custodial Bank Transition project, Internal Audit's participation, as well as a related look at Investment Compliance requested by David Kushner. Mr. Saladino asked if an audit will be conducted by an audit firm to be selected by State Street. Mr. Bendall responded that various reconciliation and other audit tests will be performed throughout the transition by both LACERA and State Street.

- H. Financial & Accounting Services Division, Government Accounting Standards Board (GASB) 67 & 68 Task Force
- David Redman, Senior Internal Auditor

Mr. Redman provided an overview of the GASB 67 & 68 Task Force and its progress to date. Mr. Redman explained that implementation guides for GASB 67 & 68 have not yet been issued. Mr. Bendall clarified that LACERA is in compliance with current requirements, but that GASB 67 & 68 would change the financial reporting requirements for the County of Los Angeles. Mr. O'Brien commented that in his experience going through the same process, it is important to involve and inform elected officials of the impact of GASB 67 & 68. Mr. Redman offered that the relevant elected officials will be notified of expected changes.

- I. Los Angeles County Rehired Retirees Audit – Final Report Presentation
- Nathan Amick, Internal Auditor

Mr. Amick presented an overview of the 2012 Los Angeles County Rehired Retirees Audit. Mr. Amick discussed that LACERA provides the County the option to rehire its retirees for a maximum of 960 hours per fiscal year without affecting the retiree's status or benefit. LACERA has annually performed an audit of Rehired Retirees since 2009. Mr. Amick explained that testing included maximum allowed hours, medical examinations, as well as the 90-day break in service.

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I. Los Angeles County Rehired Retirees Audit – Final Report Presentation

(continued)

- Nathan Amick, Internal Auditor

Mr. Saladino then asked if the 90-day break in service was not required for retirees who had reached retirement age. Mr. Rademacher clarified that LACERA and the County follow the new rules for rehiring retirees under PEPRA as well as the IRS rules. Mr. Rademacher explained that PEPRA requires a 180-day break in service with some exceptions that can be made the County Board of Supervisors, however, these exceptions must still satisfy IRS rules for a bona fide separation of the retiree is under the minimum retirement age. Mr. Saladino asked if a procedure had been established to proactively address rehired retirees who are nearing the 960-hour limit.

J. Public Employees Pension Reform Act (PEPRA) Employer Auditing

- Quoc Nguyen, Senior Internal Auditor

Mr. Nguyen presented a brief overview of the new PEPRA employer audit provisions, compensation and felony reporting requirements, and related work both planned and in progress. Mr. Nguyen explained that LACERA expects to satisfy the new compensation monitoring requirements by monitoring and testing compliance of bi-weekly compensation reports from the County Payroll as well as continuing the practice auditing member accounts prior to retirement. Mr. Saladino asked how often payroll testing would be performed. Mr. Nguyen responded that payroll monitoring will be conducted on an on-going basis, but the payroll tests are in the process of being designed. Mr. Nguyen then explained that LACERA is in the planning phase with the County regarding PEPRA's requirement to monitor the reporting of felony convictions. Mr. Saladino asked if there had been any plans to establish procedures for the Board of Retirement with regard to County audits and establishing associated costs. Mr. Nguyen explained that this is a work in progress right now as LACERA is still working out the details of how and when audits will be conducted. Mr. Chery agreed with Mr. Saladino that it will be important to develop guidelines for the Board of Retirement in cooperation with the County.

K. Internal Audit Division – Audit Work Summary

- Richard Bendall, Chief Audit Executive

Mr. Bendall presented a brief summary of the Quality Assurance Review, automated auditing, special investigations, and made mention of audit work both planned and in progress. Following his summary, Mr. Bendall invited questions from the Audit Committee. Mr. Chery asked about the planned review of Medicare Advantage Part D Forms for Retiree Health Care and how many members will be affected. Mr. Nguyen clarified the review is still in the planning phase and test work has not yet been performed to determine impact.

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- L. Status of External Audits Not Conducted at the Discretion of Internal Audit
 - Sarah Marks, Principal Internal Auditor
(Verbal Presentation Only)

Ms. Marks provided an overview of the compliance audit of IBM software that has been contracted between IBM and KPMG. A non-disclosure agreement has been received and KPMG will begin testing under the supervision of LACERA System Division staff.

V. FOR INFORMATION ONLY

- A. Consolidated Recommendation Follow-Up Report [February 28, 2013]

This Report was presented earlier in the meeting.

VI. CONSULTANT COMMENTS

Timothy O'Brien – Audit Committee Consultant

No additional comments.

VII. GOOD OF THE ORDER

Mr. Chery commented that it was very crowded Boardroom.

Mr. Saladino wished everyone a "Happy Spring."

Mr. Bendall welcomed back Messrs. Chery, Saladino, and Bernstein to the Committee.

Ms. Marks commented that although she loved working with all the Committee members, it was refreshing to see new members and hear their perspectives.

VIII. ADJOURNMENT

The meeting was adjourned at 11:15 a.m.

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