

AGENDA

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

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

July 17, 2013 – 9:00 a.m.

2013 COMMITTEE MEMBERS:

**ALAN BERNSTEIN
YVES CHERY
MARK SALADINO
HERMAN B. SANTOS
MICHAEL SCHNEIDER
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. APPROVAL OF THE MINUTES OF THE REGULAR AUDIT COMMITTEE MEETING OF MARCH 20, 2013 (Attached)**
- IV. PUBLIC COMMENT**
- V. REPORTS**
 - A. Internal Audit Staffing Report**
Richard Bendall, Chief Internal Auditor
(Verbal presentation only)
 - B. Audit Plan Status Report – Fiscal Year ended June 30, 2013**
Richard Bendall, Chief Audit Executive
Nathan Amick, Internal Auditor
(Memo dated July 2, 2013)
 - C. Recommendation Follow-up Overview (June 28, 2013)**
Sarah Marks, Principal Internal Auditor
(Memo dated July 1, 2013)

- D. Status of Other External Audits Not Conducted at the Discretion of Internal Audit
Richard Bendall, Chief Audit Executive
(Verbal Presentation Only)
- E. Risk Management Process and Organizational Risk Assessment
Richard Bendall, Chief Audit Executive
Sarah Marks, Principal Internal Auditor
(Memo dated June 28, 2013)

VI. ACTION ITEMS

- A. Recommendation as submitted by Richard Bendall, Chief Audit Executive and Sarah Marks, Principal Internal Auditor, that the Audit Committee approve the Fiscal Years 2013-2016 Audit Plan
(Memo dated July 3, 2013)

VII. FOR INFORMATION ONLY

- A. Division Profiles are presented in the following format.
 - 1. Risk Assessment
 - 2. Audit Plan
 - 3. Work Completed / In Progress
 - 4. Audit Reports
- B. Systems
- C. Claims Processing
- D. FASD
- E. Investments
- F. Member Services
- G. Communications
- H. Disability Retirement
- I. Executive Office
- J. Human Resources
- K. Retiree Health Care

- L. Administrative Services
- M. Internal Audit
- N. Quality Assurance
- O. Legal
- P. Disability Litigation

VIII. CONSULTANT COMMENTS

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

IX. GOOD OF THE ORDER

(For discussion purposes only)

X. 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.**

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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**

July 17, 2013 – 9:00 a.m.

COMMITTEE MEMBERS

Present: Alan Bernstein
Mark J. Saladino
Michael Schneider
Leonard Unger

Absent: Yves Chery
Herman B. Santos

BOARD MEMBERS AT LARGE

Vivian Gray

AUDIT COMMITTEE CONSULTANT

Timothy O'Brien

STAFF PRESENT

Robert Hill	Beulah Auten
John Popowich	Carlos Barrios
Richard Bendall	Julieta Bryan
Sarah Marks	Bernie Buenaflor
Nathan Amick	Roxana Castillo
Sylvia Botros	Calvin Chang
Leisha Collins	Ted Granger
Elvia Gonzalez	Kimberly Hines
George Lunde	Theodore King
Quoc Nguyen	James Pu
David Redman	Roberta Van Nortrick
	Robb Van Der Volgen

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

As former Vice-Chair, Mr. Schneider opened the meeting and called for the nomination of the Chair, Vice-Chair, and Secretary of the Audit Committee for the 2013 Calendar Year. Mr. Unger nominated Mr. Schneider for Chair. Mr. Schneider nominated Mr. Unger for the position of Chair. Mr. Unger declined the nomination. Mr. Saladino moved to close nominations. Mr. Schneider was unanimously elected the Chair of the 2013 Audit Committee.

Mr. Schneider then called for the nomination of Vice-Chair. Mr. Saladino nominated Mr. Bernstein. Mr. Unger moved to close nominations. Mr. Bernstein was unanimously elected for the position of Vice-Chair of the 2013 Audit Committee.

Mr. Schneider then called for the nomination of Secretary. Mr. Schneider nominated Mr. Unger. A second was offered by Mr. Bernstein. Mr. Schneider moved to close nomination. A second was offered by Mr. Saladino. Mr. Unger was unanimously elected for the position of Secretary of the 2013 Audit Committee.

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

Mr. Schneider called for a motion to approve the Minutes of the Audit Committee Meeting of December 6, 2012. A motion for approval was presented by Mr. Saladino. A second was provided by Mr. Bernstein. Mr. Unger abstained due to his absence from the meeting. The Minutes were approved.

III. APPROVAL OF THE MINUTES OF THE REGULAR AUDIT COMMITTEE MEETING OF MARCH 20, 2013

Mr. Schneider called for a motion to approve the Minutes of the Audit Committee Meeting of March 20, 2013. A motion for approval was presented by Mr. Saladino. A second was provided by Mr. Bernstein. The Minutes were approved.

IV. PUBLIC COMMENT

No items to report.

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V. REPORTS

- A. Internal Audit Staffing Report
- Richard Bendall, Chief Audit Executive
(Verbal Presentation Only)

Mr. Bendall noted that Internal Audit has had consistent staff all year long with no turnover. Ms. Darla Vidger has returned from maternity leave. Ms. Leisha Collins is participating on a part-time basis in the Management Rotation Program.

- B. Audit Plan Status Report [FYE June 30, 2013]
- Richard Bendall, Chief Audit Executive
 - Nathan Amick, Internal Auditor
(Verbal Presentation Only)

Mr. Bendall briefly described the reporting schedule for the annual Audit Plans and then an overview of the Meeting Book and how it is organized. Mr. Bendall then provided the June 30, 2013 Fiscal Year End Audit Report. During the year, Internal Audit completed 26 projects with 31 projects in progress. Mr. Bendall noted that the Audit Plan and staff resources were impacted by the significant changes brought about by OPEB, PEPR, GASB 67 & 68, and the Custodial Bank Review. Mr. Bendall highlighted several special projects and assignments including the Active Member Death Case and Process Review, Management Rotation Program, Custodial Bank Transition, High-Risk Member Verification Process.

Mr. Saladino asked whether the High-Risk Member Verification only applied to members over 90 years of age or if there were other situations such as online account access where high-risk verification would be required. Mr. Bendall and Ms. Marks clarified that the high-risk verification process is usually triggered by telephone requests requiring additional verification or suspicious account activity found by Member Services and/or Claims Processing that may require investigation. Mr. Bendall further clarified that the High-Risk Member Verification Process is done on an ad-hoc basis, but the Over-90 and Foreign Retiree Testing is a much broader verification process. Mr. Saladino asked if the 884 number provided in the report refers the total number of accounts tested. Ms. Marks clarified that the 884 number represented the number of actual hours logged for testing and verification.

Mr. Saladino noted that in the last couple years he has received many more calls than ever before from members with retirement calculation issues related to complicated accounts.

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B. Audit Plan Status Report [FYE June 30, 2013] – **Continued**

- Richard Bendall, Chief Audit Executive
- Nathan Amick, Internal Auditor
(Verbal Presentation Only)

Mr. Saladino observed that, in most cases, by the time LACERA audits the account at retirement there are issues that would have been easier to resolve had LACERA done it earlier. Mr. Saladino asked if there was a plan in place to address these complicated accounts.

Mr. Buenaflor explained that this ongoing challenge is being addressed by Claims Processing in a number of ways including exception reporting and the projects that have been scheduled to address issues found. In addition to these measures, Claims Processing has instituted a pro-active approach with the In-Line Quality Control function. Mr. Buenaflor also noted that Claims Processing has asked Internal Audit to perform a Consulting Review of every process to identify other areas of risk that can be mitigated.

Mr. Bendall noted that the 2014 – 2016 Audit Plan includes several projects where Internal Audit will be partnering with the Claims Processing Division. Mr. Saladino noted that this was good as High-Risk Member Verifications should not be the only area where Internal Audit is involved with investigating issues with member's accounts. Mr. Bendall clarified that Internal Audit is very involved with auditing of processes and procedures.

Mr. Bendall discussed the Custodial Bank Transition process and commended the work of the Investment Office including David Kushner and June Kim; Legal Office especially Robb Van Der Volgen, Christine Roseland, and John Harrington; Systems Division including Roxana Castillo; the entire Financial and Accounting Services Division; Project Manager, Robert Hill; and finally in Internal Audit, Sarah Marks, Quoc Nguyen, George Lunde.

C. Recommendation Follow-up Overview [June 28, 2013]

- Sarah Marks, Principal Internal Auditor
(Memo dated July 1, 2013)

Ms. Marks briefly described the nature and schedule of the Recommendation Follow-Up Report and how it provides a status of management's progress toward audit recommendations. Ms. Marks explained that during the 5-month period between February and June of 2013, there were 28 new recommendations including those from the Systems Penetration Testing conducted earlier this calendar year. There were 27 recommendations that were implemented and closed.

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C. Recommendation Follow-up Overview [June 28, 2013] – **Continued**

- Sarah Marks, Principal Internal Auditor
(Memo dated July 1, 2013)

There were 7 recommendations that were closed where Management accepted the risk associated with those recommendations. There were also 65 recommendations that were either pending or that were in the process of being addressed by Management.

Ms. Marks also briefly touched on the concept of Management “accepting risk,” where Management identifies that risks either cannot be mitigated or the costs to remedy them outweighs the benefits.

Mr. Schneider asked who determines the cost of remediation. Ms. Marks clarified that Management is responsible for the decision with the input of Internal Audit. She further clarified that, if Internal Audit believes that Management is inappropriately accepting risk, it is discussed with Management. If an appropriate course of action is unable to be found, Internal Audit would bring the risk assessment to the Executive Office and/or the Audit Committee. However, this has never been necessary as Management and Internal Audit are always able to find a mutually agreeable approach to addressing unacceptable risks.

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

- Richard Bendall, Chief Audit Executive
(Verbal Presentation Only)

Mr. Bendall noted to the Committee and Chair that the presentation was going to transition to the Risk Management Process and Organizational Risk Assessment Agenda Item.

E. Risk Management Process and Organizational Risk Assessment

- Richard Bendall, Chief Audit Executive
- Sarah Marks, Principal Internal Auditor
(Memo dated June 28, 2013)

Mr. Bendall provided the Committee a reminder that as Board Members and Audit Committee Members, the responsibility for the management of LACERA’s risk ultimately resides with them. Internal Audit is oftentimes misconstrued as holding the primary responsibility for risks and controls; however, “risk management” is a Board and Management function. “Risk assessment,” on the other hand, *is* an Internal Audit function. Mr. Bendall noted that LACERA does not have an official Enterprise Risk Management or Governance Risk and Control process. Mr. Bendall also noted that some bigger pension funds such as CALPERS have implemented this function as an arm of Management.

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- E. Risk Management Process and Organizational Risk Assessment – **Continued**
- Richard Bendall, Chief Audit Executive
 - Sarah Marks, Principal Internal Auditor
(Memo dated June 28, 2013)

Mr. Bendall explained that a number of years ago it was determined that LACERA was not going to implement an official Enterprise Risk Management process, but it may be looked at again in the future. Mr. Bendall noted that our risk management process is currently adequate with most of the building blocks of Enterprise Risk Management in place without the benefit of a formal process.

Mr. Schneider noted that it may be that the Boards of Retirement and Investments are not aware of the option or possible decision by default to choose not to implement a formal Enterprise Risk Management process. Mr. Schneider suggested providing a simple report to both Boards regarding their decision by default to not implement an Enterprise Risk Management process and any possible rational or considered opinion regarding the reasons LACERA would choose not to implement this process. Mr. Bendall said that it would be done.

Mr. Saladino asked that the report also include some insight from the staff perspective on what the triggers are to make it appropriate to shift to the Enterprise Risk Management (ERM) model. Mr. Saladino added that if it is simply based on the size of the fund, in his opinion, LACERA is big enough to warrant a formal ERM process. Mr. Bendall responded that he would. Mr. Saladino clarified that he was not asking for a proposal to implementing the ERM model, but the implementation triggers and pros and cons of making the shift. Mr. Schneider clarified that he felt this report would be of interest to both Boards.

Ms. Marks then presented a brief overview of LACERA's Risk Assessment Process and what information Internal Audit uses to develop a comparison of divisional risk levels on an annual basis.

VI. ACTION ITEMS

- A. Recommendation as submitted by Richard Bendall, Chief Audit Executive, and Sarah Marks, Principal Internal Auditor, that the Audit Committee approve the Fiscal Years 2014-2016 Audit Plan
(Memo dated July 3, 2013)

Mr. Bendall presented an overview of the new three-year audit plan and the annual revision process.

Ms. Marks briefly discussed details of the 2014-2016 Audit Plan followed by Mr. Bendall who highlighted significant planned projects.

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- A. Recommendation as submitted by Richard Bendall, Chief Audit Executive, and Sarah Marks, Principal Internal Auditor, that the Audit Committee approve the Fiscal Years 2014-2016 Audit Plan -**Continued**
(Memo dated July 3, 2013)

Mr. Bernstein inquired when the last Disaster Recovery exercise had been completed and where they generally take place. Mr. Bendall responded it had last been performed in October 2012 and that they are generally performed in various offsite locations. Mr. Saladino then asked whose equipment LACERA uses to perform these exercises. Mr. Pu clarified that LACERA contracts with IBM for general equipment, however, LACERA provides the proprietary equipment that is used and stored in alternate locations. Mr. Saladino inquired whether or not the same security level that is maintained at LACERA is applied to these alternate locations. Mr. Pu explained that the same level of security is applied and briefly clarified how this is accomplished.

Mr. Bernstein requested the memo from the last Disaster Recovery exercise for review. Ms. Marks offered to do so. Mr. Unger inquired about the availability of offsite facilities we currently have under contract in the event of a regional disaster and if they are shared with other companies. Mr. Pu responded that the facilities are shared and this is always a concern as the facilities are provided on a first come, first served basis. However, he clarified that LACERA maintains a co-location service that offers the assurance of an alternate location to where operations can be moved in the event of a regional disaster.

Mr. Bendall then asked for approval on the three-year audit plan. It was moved by Mr. Schneider. A second was provided by Mr. Bernstein. The 2014-2016 Audit Plan was approved.

VII. FOR INFORMATION ONLY

- A. Division Profiles and Completed Projects
- Richard Bendall, Chief Audit Executive

Mr. Bendall provided an overview of the Division Profiles and welcomed any questions.

1. Claims Processing Division

- Quoc Nguyen, Senior Internal Auditor
- Sylvia Botros, Internal Auditor

a. *Supervisory Payroll Procedures Consulting Review*

Mr. Nguyen provided a brief overview of three projects completed within the last year in Claims Processing. The first project discussed by Mr. Nguyen was the Supervisory Payroll Procedures consulting review.

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Mr. Unger inquired as to when the last review was performed in the described area. Mr. Nguyen explained the specific payroll processes had been reviewed from the specialists' perspective within the past fiscal year, but current review was taken from the perspective of the supervisor.

b. Special Death Benefits / Active Death Process Audit

Mr. Nguyen briefly explained the purpose and scope of this process audit immediately followed by Ms. Botros who discussed the results of the work performed. Mr. Saladino asked for an explanation of "special death benefits." Mr. Nguyen clarified that "special death benefits" are a rare type of benefit available to survivors of safety members that lost their lives in a particularly violent manner while on duty. Mr. Schneider asked if there was a follow-up process. Mr. Nguyen clarified that Internal Audit actively manages its ongoing Recommendation Follow-Up Process.

c. Service-Connected Death and Disability Tax Code Audit

Mr. Nguyen briefly explained that during the review of the Special Death Benefits/Active Death Process, a tax reporting discrepancy was found, however it was determined the previous findings were *not* indicative of a systemic issue.

2. Executive Office

- Nathan Amick, Internal Auditor

Rehired Retirees Process Audit

Mr. Amick provided a brief follow-up on rehired retiree compliance auditing, the new PEPRA rules, and the monitoring process that is being performed by LACERA in cooperation with the County. Mr. Saladino asked how LACERA identifies rehired retirees. Mr. Amick responded we identify them using ACL. Mr. Bernstein asked where the responsibility falls for monitoring rehired retirees and if there is any negative impact on the members if they work too many hours. Mr. Amick responded that the County Department Heads in cooperation with their Human Resources Divisions and the County Executive Office work together to ensure the County remains in compliance.

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VIII. CONSULTANT COMMENTS

Timothy O'Brien – Audit Committee Consultant

No additional comments.

IX. GOOD OF THE ORDER

Mr. Unger congratulated all new Board officers.

All Board members in attendance offered appreciation to Mr. Bendall and the Internal Audit staff for an excellent and enlightening report.

X. ADJOURNMENT

The meeting was adjourned at 10:15 a.m.

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