

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 16, 2014 – 9:00 a.m.

2014 COMMITTEE MEMBERS

Michael Schneider, *Chair*
David Green, *Vice-Chair*
Shawn Kehoe, *Secretary*
John Barger
Alan Bernstein
Yves Chery

AUDIT COMMITTEE CONSULTANT

Timothy O'Brien

I. EXECUTIVE SUMMARY

Richard Bendall, *Chief Audit Executive*
(Memo Dated: June 30, 2014)

II. APPROVAL OF THE MINUTES OF THE REGULAR AUDIT COMMITTEE MEETING OF MARCH 19, 2014

III. PUBLIC COMMENT

IV. REPORTS

- A. Internal Audit Staffing Report
Richard Bendall, *Chief Audit Executive*
(Verbal Presentation)
- B. Audit Plan Status Report: July 1, 2013 – June 30, 2014
Richard Bendall, *Chief Audit Executive*
Nathan Amick, Internal Auditor
(Memo Dated: June 30, 2013)
- C. Internal Audit: Highlights of Work Performed
Richard Bendall, *Chief Audit Executive*
(Verbal Presentation)

- D. Audit Recommendations Follow-Up Reporting: March 31 – May 31, 2014
Quoc Nguyen, *Senior Internal Auditor*
(Memo Dated: June 26, 2013)
- E. Status of Other External Audits Not Conducted at the Discretion of Internal Audit
Richard Bendall, *Chief Audit Executive*
(Verbal Presentation)
 - 1. **IBM Software License Review**
Sarah Marks, *Principal Internal Auditor*
(Memo Dated: June 18, 2013)
- F. Risk Management Process Assessment and Organizational Risk Assessment
Richard Bendall, *Chief Audit Executive*
Leisha Collins, *Senior Internal Auditor*
(Memo Dated: June 25, 2014)
- G. Organizational Risk Assessment: FY 2014-2015
Leisha Collins, *Senior Internal Auditor*
(Verbal Presentation)

V. ACTION ITEMS

- A. Recommendation that the Audit Committee Approve the **Rolling Three-Year Audit Plan, Fiscal Years 2015-2017** as submitted by Richard Bendall, *Chief Audit Executive* and Leisha Collins, *Senior Internal Auditor*
(Memo Dated: June 25, 2014)
- B. Recommendation to Extend the Financial Audit Service Contract as submitted by Richard Bendall, *Chief Audit Executive*
(Memo Dated: June 19, 2014)

VI. FOR INFORMATION ONLY

- A. Systems Update
 - 1. **Technology Security—Our Perspective**
James Pu, *Chief Security Officer*
(Memo Dated: June 12, 2014)
 - 2. **Information Technology Risk Management: Disaster Recovery & Co-Location**
James Pu, *Chief Security Officer*
(Memo Dated: June 12, 2014)

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VII. CONSULTANT COMMENTS

Timothy O'Brien, *Audit Committee Consultant*
(*Verbal Presentation*)

VIII. GOOD OF THE ORDER

(*For Information Purposes Only*)

IX. 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 16, 2014 – 9:02 a.m.

2014 COMMITTEE MEMBERS

Present: Michael Schneider, *Chair*
David Green, *Vice-Chair*
Shawn Kehoe, *Secretary*
John Barger
Alan Bernstein
Yves Chery

Absent: None

BOARD MEMBERS AT LARGE

None

AUDIT COMMITTEE CONSULTANT

Timothy O'Brien, *Audit Committee Consultant*

STAFF, ADVISORS, AND PARTICIPANTS

Gregg Rademacher	Beulah Auten
Robert Hill	Bernie Buenaflor
John Popowich	Roxana Castillo
Richard Bendall	Annette Cleary
Nathan Amick	Gloria Harriel
Sylvia Botros	Louis Gittens
Leisha Collins	Kimberly Hines
Elvia Gonzalez	Leilani Ignacio
George Lunde	James Pu
Quoc Nguyen	Roberta Van Nortrick
David Redman	Robb Van Der Volgen
Darla Vidger	

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I. EXECUTIVE SUMMARY

- Richard Bendall, *Chief Audit Executive*

Richard Bendall provided an overview of the July 16, 2014 Audit Committee meeting and updates to the Audit Committee meeting book. Mr. Chery commented that updated book format is very easy to follow.

II. APPROVAL - MINUTES OF THE REGULAR AUDIT COMMITTEE MEETING OF MARCH 19, 2014

Mr. Schneider called for a motion to approve the Minutes of the Audit Committee Meeting of March 19, 2014. A motion for approval was presented by Mr. Chery. A second was provided by Mr. Green. The Minutes were approved.

III. PUBLIC COMMENT

No items to report.

IV. REPORTS

A. Internal Audit Staffing Report

- Richard Bendall, *Chief Audit Executive*

Mr. Bendall noted that there were no changes to staffing during the last period.

A. Audit Plan Status Report [July 1, 2013 – June 30, 2014]

- Richard Bendall, *Chief Audit Executive*
- Nathan Amick, *Internal Auditor*
(Memo Dated: June 30, 2013)

Mr. Bendall described the Audit Plan cycle and gave a high level recap of work hours performed since the last Audit Committee meeting.

B. Internal Audit: Highlights of Work Performed

- Richard Bendall, *Chief Audit Executive*

Mr. Bendall briefly discussed the pension life cycle and the risks, audit work and internal controls that correspond with each phase of that process.

Mr. Bendall then provided an overview of the audit work performed in the Systems area. Mr. Schneider had a question regarding network security risks and how these were being addressed. Mr. Bendall provided some additional details regarding external network penetration testing that is regularly scheduled by Internal Audit. Mr. Bendall also imparted that Mr. Pu, LACERA's Information Security Officer, would also address these issues later in the meeting during his presentation.

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Mr. Schneider asked a question regarding Internal Audit's role in safeguarding assets and the due diligence relating to investments. He stated concerns about the potential for fraud within the investment areas.

Mr. Bendall responded that type of risks mentioned would be more likely in asset classes such as private equity. Mr. Bendall added that the most effective control over these types of assets is indeed the due diligence and oversight process performed by the Investment Office prior to and after investment.

Mr. Barger asked when the last time Internal Audit reviewed the due diligence files in the Investment Office for the Private Equity Partnerships in LACERA's portfolio. Ms. Marks replied that it had been four or five years.

A lengthy discussion followed relating to Internal Audit's role in the oversight and audit of the Investment Office and also over the adequacy of Investment controls.

Following this discussion, Mr. Bendall discussed the projects completed and in progress in the Claims Processing Division. Mr. Schneider asked for clarification on the review cycle of the audits. Mr. Bendall responded that system, legal or other process changes require that Internal Audit perform recurring audits on a periodic basis. Mr. Schneider then asked if there were any disciplinary issues that have been found during the review cycle. Mr. Bendall responded that although rare, it has happened in the past when issues have to be appropriately addressed by a manager.

Mr. Bendall continued on to provide summary details of the Internal Audit projects completed and in progress in the Financial and Accounting Services Division and the Investments Division. Mr. Schneider asked whether the audit reports and recommendations from the external audits performed in each one of the real estate title holding corporations go directly to LACERA. Ms. Marks responded that Internal Audit receives all of these reports and any findings are discussed with LACERA.

Ms. Marks then presented a summary of the Medicare Part D Drug Subsidy review. Mr. Bendall followed with a highlight of Internal Audit projects completed and in progress related in the other areas of the organization including those relating to PEPRAs compliance.

Mr. Barger and Mr. Kehoe returned to the Investments auditing discussion. The Committee concluded that they would like an independent assessment of internal auditing best practices specifically relating to investments auditing and

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the practices of other public pension funds and like entities, public or private. The specific best practices in which the Committee expressed interest included the appropriate staff size of Internal Audit and audit staff qualifications, as well as the scope and frequency of investments audit work performed.

Mr. Rademacher observed that for this kind of operational issue, a review may be performed by an outside firm as a special project; and he believed that such a review would most likely fall under the Executive discretionary budget limit. Mr. Rademacher added that, should the project budget fall outside of that range, it would be brought back to the Committee for further review.

C. **Recommendation Follow-Up Report** [March 31 – May 31, 2014]

- Quoc Nguyen, *Senior Internal Auditor*
(Memo Dated: June 26, 2013)

Mr. Nguyen described the nature and schedule of the Recommendation Follow-Up Report and how it provides the status of management's progress toward audit recommendations.

Mr. Nguyen gave an overview of the Recommendation Aging Report. He summarized that between March 1, 2014 and May 31, 2014, there were 5 new recommendations made and, since the last Audit Committee meeting, there were 5 recommendations implemented by Management. Currently, there are 61 audit recommendations pending implementation.

Mr. Schneider asked whether implementation of the recommendations was mandatory. Mr. Bendall clarified that while not "mandatory," Management most often agrees to implement the recommendations provided in the Recommendation Follow-Up Report. When Ms. Marks indicated that Management does have the ability to disagree with recommendations, Mr. Bendall added that such recommendation disagreements are almost always resolved.

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

- Sarah Marks, *Principal Internal Auditor*

Ms. Marks noted since the last period there were two external reviews performed: (1) The compliance review of the Early Retiree Reinsurance Program was conducted by the Center for Medicare and Medicaid Services with a report soon to be presented to the Insurance and Benefits Legislative Committee by Retiree Health Care; and (2) the KPMG Software Licensing review with 5 FileNet products found to be under-licensed (which were subsequently resolved).

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Mr. Chery asked about the more proactive review procedures for software licensing. Mr. Pu explained that a year-over-year review is now being performed regarding software licenses. Mr. Kehoe asked what the exposure for violations was in this area. Mr. Pu responded there were no losses in this particular case with FileNet.

E. **Risk Management Process Assessment and Organizational Risk Assessment**

- Richard Bendall, *Chief Audit Executive*
- Leisha Collins, *Senior Internal Auditor*
(Memo Dated: June 25, 2014)

Ms. Collins presented an overview of the Risk Assessment Cycle and Process as well as the Division Risk Profiles. Mr. Schneider asked about the Audit Committee's input in the Risk Management process. Ms. Collins answered that Internal Audit would evaluate its Risk Management process based on feedback from this meeting.

Mr. Barger commented about the efficient utilization of the Audit Committee Consultant as a resource in this process. Ms. Marks clarified that Internal Audit does receive feedback and input from the Audit Committee Consultant. Additional related discussion related to opportunity areas followed.

Ms. Collins explained the current Risk Assessment scores. Mr. Schneider commented that the Risk Assessment score associated with the Investments Office seemed low compared to the inherent risks. Ms. Marks explained that due to redundant controls in the Investments Office, the residual risks remaining in the Investments Division are relatively low.

Ms. Collins then completed her summary of the Risk Assessment process and how it relates to the Audit Plan.

V. ACTION ITEMS

- A. Recommendation that the Audit Committee Approve the **Rolling Three-Year Audit Plan, Fiscal Years 2015-2017** as submitted by Richard Bendall, *Chief Audit - Executive* and Leisha Collins, *Senior Internal Auditor*
(Memo Dated: June 25, 2014)

Mr. Schneider called for a motion to approve the Rolling Three-Year Audit Plan, Fiscal Years 2015-2017. The motion for approval was introduced by Mr. Chery. A second was given by Mr. Green. The Audit Plan was unanimously approved.

Ms. Collins then provided a quick summary of the Audit Plan process and format. Ms. Marks noted some specific projects that particularly addressed some of the concerns mentioned in the meeting.

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- B. Recommendation to Extend the Financial Audit Service Contract as submitted by Richard Bendall, *Chief Audit Executive*
(Memo Dated: June 19, 2014)

There was discussion regarding how often LACERA is required or recommended to change auditing firms. Mr. Bendall responded that California State law does not require changing audit firms, but only the managing and concurring audit partners within a specific firm.

Mr. Schneider called for a motion to extend the Financial Audit Service Contract. The motion for approval was presented by Mr. Kehoe, the second was provided by Mr. Green, and the extension was unanimously approved.

VI. FOR INFORMATION ONLY

- A. Systems Update

1. Technology Security—Our Perspective

- James Pu, *Chief Information Officer*
(Memo Dated: June 12, 2014)

Mr. Pu presented a detailed report on technology security, current risks, and LACERA's perspective on how to mitigate these risks.

The Committee asked that this topic be presented to both Boards at the Board Offsite on a regular, recurring basis due to the ever-changing nature of the risks involved.

2. Information Technology Risk Management: Disaster Recovery & Co-Location

- James Pu, *Chief Information Officer*
(Memo Dated: June 12, 2014)

Mr. Pu provided a report of the LACERA "co-location" program and the benefits of this program over and above a robust disaster recovery program. He also discussed State Street's role in this process, ensuring member benefits and LACERA taxes are paid in the event of a disaster or if LACERA systems are down.

Mr. Chery asked if there were any risks associated with the co-location data transmission process. Mr. Pu explained how any inherent risks are mitigated by LACERA controls including the redundant systems maintained by LACERA.

In conclusion, Mr. Pu discussed the robust security of LACERA's disaster recovery sites and information.

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F. CONSULTANT COMMENTS

Timothy O'Brien, *Audit Committee Consultant*

Mr. O'Brien had no additional comments.

G. GOOD OF THE ORDER

Mr. Green thanked Mr. Pu for his presentations and all the hard work. Mr. Bernstein also thanked everyone for their presentations. Ms. Marks thanked Leisha Collins, Quoc Nguyen, Richard Bendall, and Darla Vidger for filling in the gaps while she was on medical leave.

H. ADJOURNMENT

The meeting was adjourned at 11:18 a.m.