

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

MINUTES OF THE MEETING OF November 10, 2022

The Audit Committee convened on Thursday November 10, 2022 at 9:30 a.m. via video conference call with the host site at 120 East Baltimore Street, Baltimore, Maryland.

Committee members present were: Richard E. Norman, Chairman
Thomas M. Brandt, Vice-Chairman
Michael Howard
Robert Sandlass

MSRA attendees were: Martin Noven, Executive Director
Kenneth Reott, Retirement Administrator
Kimberly O’Keefe, Deputy Retirement Administrator
Megan Myers, Deputy Retirement Administrator
David Rongione, Chief Internal Auditor
Melody Countess, Chief Operating Officer
Patricia Fitzhugh, Deputy Chief Operating Officer
Rachel Cohen, Principal Counsel
Emily J. Spiering, Assistant Attorney General
Andrew Palmer, Chief Investment Officer
Robert Burd, Deputy Chief Investment Officer
Greg Ricci, Managing Director of Administration &

Operations

Toni Voglino, Senior Compliance Officer
Robert Diehl, Chief Information Systems Officer
Thomas Montanye, Deputy Chief Information Systems
Officer
Angie Jenkins, Executive Assistant
Lauren Smith, Internal Audit Contract Manager
Richa Sultana, Internal Audit Manager

CliftonLarsonAllen attendee was: Remi Omisore

1. Minutes of the July 26, 2022 Audit Committee Meeting

On a motion made by Mr. Brandt and seconded by Mr. Howard, the minutes of the July 26, 2022 Audit Committee meeting were approved.

2. Presentation of FY 2022 Financial Statement Audit Results by CliftonLarsonAllen

Mr. Omisore presented the results of the FY 2022 Financial Statement Audit noting that this year was his first year as the audit principle on the Maryland State Retirement Agency’s (the Agency) audit engagement. He believes that him being a new person on the

engagement provided a fresh look on the financial statements. He continued by saying that they are substantially done with all the audit procedures. The major outstanding item is the test to be performed on the actuary reports that were approved a few weeks ago. He mentioned that there are certain required items that need to be communicated to the Audit Committee (AC) including the scope of the audit, management's responsibility, auditor's responsibility, matters related to internal controls etc. He continued by saying the scope of the engagement was June 30th financial statements including the balance sheet, income statements, supplemental data, the Annual Comprehensive Financial Report (ACFR) as well as the Schedule of Employer Allocations. This schedule provides information on Participating Governmental Units' (PGUs) components related to pension systems liability across various employers. He added that the audit also included a report on internal controls, and there were no material weaknesses or significant deficiencies identified. A separate internal control letter will be issued by CliftonLarsonAllen (CLA) along with recommendations. Mr. Omisore emphasized that the financial statements are management's responsibility and the auditor's responsibility is to issue an opinion on the fair presentation of the financial statements.

Mr. Omisore mentioned the audit included testing of recording contribution and pension benefit. Management's override of control is the biggest risk in the area as management can make fictitious journal entries. Testing was performed in this area to ensure revenue recognition for contribution was done in a timely manner. He continued by saying that under the required communications section, there were two items on significant accounting estimate that were related to investment portfolios – 1) estimates were deemed reasonable; 2) estimate uncertainly is disclosed in the financial statements. Mr. Omisore mentioned that CLA performed additional procedures to look at valuation and compared them against the benchmark and audited financial statements to ensure they are properly recorded.

Mr. Omisore provided detail on the new Generally Accepted Government Auditing Standards (GAGAS) noting that GAGAS is up to standard number 100. He mentioned that it took the Governmental Accounting Standards Board (GASB) 75 years to get to 50 standards however, within the next 20 years the additional 50 standards were added. He added that regulations are coming down quickly; however, the new standards do not have any significant impact on the Agency's system. There are two new statements – GASB Statement no. 87 and 96 that are related to building assets and liabilities, respectively. GASB Statement no. 87 is related to building lease. The old standard didn't require to record anything on the balance sheet; however, the new standard requires a recording of liability and asset for the present value of payments. As a result of the new standard, the balance sheet looks very different from prior years. Mr. Omisore continued the topic by mentioning that Statement no. 96 is related to IT subscriptions. The new standard requires creating a liability for IT subscriptions. As a result of this new standard, there is an increased liability reported on the balance sheet across all governmental agencies. Previously the IT subscriptions were not reported as liability.

He continued by saying the audit was conducted with a risk-based approach. The audit was planned to pay attention to high risk areas. He clarified that 100% of the items were not tested, and testing was performed only on the material items. As far as significant accounting policies are concerned, Mr. Omisore mentioned that they are all included in the disclosures and they are consistent with prior years.

Regarding significant accounting estimates, Mr. Omisore mentioned that the valuation of private equity is a difficult one. Another significant accounting estimate is the net pension liability. Mr. Omisore mentioned that no adjustments were made to these estimates and nothing concerning came to the auditor's attention. He added that the audit team did not experience any difficulties in obtaining information from management nor did they experience any arguments with management. Mr. Omisore added that from an internal control perspective, no significant deficiencies or material misstatements were noted by the auditors. All documents were consistent and needed no major changes.

Mr. Omisore then presented a 10 years graph on system performance. The graph compared the system performance against the assumed rate of return noting that the trend has remained consistent for last 10 years. He added that the contribution has a consistent trend of upward.

Mr. Omisore reviewed the next item which is the pension liability. The auditors used an actuary to review the pension liability. The actuary calculated what would be the pension liability if the current discount rate of 6.8% reduces or increases by 1%.

Mr. Omisore mentioned there were no significant adjustments to the financial statements and no matter to report in terms of internal control deficiencies. He mentioned that the audit will be completed in next couple of weeks. He does not anticipate any changes to the final financial statements compared to the draft version.

Mr. Howard asked whether there will be any management letter or listing of recommendations indicating the areas they Agency can improve on. Mr. Omisore replied that most recommendations were related to IT best practices, but none were significant, more like house cleaning items. They were verbally discussed with management and CLA does not anticipate putting these recommendations into a formal letter.

Mr. Brandt inquired about the materiality of the audit. Mr. Omisore mentioned that he does not have the exact number; however, it was close to multi million. He explained that the materiality is very high due to the assets that the Agency has in the portfolio. Mr. Brandt was concerned that an item might be considered immaterial from an auditor's point of view; however, it might be big enough mistake that needs corrective action. Mr. Omisore agreed by saying that in auditing the investment portfolio of 60 million, if the auditor's calculation was off by 1 million which was considered not material from an audit perspective; however, from a regular member's perspective it would be considered material.

Mr. Sandlass inquired whether the 6.8% discount rate was applied against the entire liability and not bifurcated. Mr. Omisore answered by saying it was done at the plan level. He added that when assets are pulled to pay benefit from a plan, all those assets become commingled, the systems are not broken apart. Mr. Sandlass mentioned that some other funds are not allowed to apply the discount rate against the entire plan if the plan is not well funded. Mr. Omisore agreed and added that if the fund is not well funded, usually the bond rate is used to perform the analysis.

Mr. Brandt mentioned when he first became a part of the Agency's Board, he ploughed through the annual reports and identified half dozen mistakes. He asked if he finds mistakes during his review of the financial statements, whether Mr. Omisore would reduce the audit fees. He also requested to take out some redundancy from the financial statements. Mr. Omisore answered by saying he will discuss the matter with his team to carefully review the financial statements and present the best document possible in front of the AC.

Mr. Howard requested whether a graph can be created for pension liability similar to the system performance graph. He would like to see how it compares against the assets. Mr. Omisore said he will add that graph to the final report. Mr. Sandlass added that in the ACFR, the assets are presented at market rate. From an actuarial standpoint, it is smoothed out, so it looks different in the ACFR.

3. Acceptance of the FY 2022 MSRPS Draft Financial Statements

Mr. Omisore advised that small changes have been made in relation to Statements on Auditing Standards (SAS), specifically the order of the opinion and wording on "going concern". He continued by saying these are not particularly important to the committee unless a government agency has recurring losses/liabilities that far exceed the assets. The standards require that these instances/events must be disclosed. He added that a couple entities have put themselves in "going concern". Some procedures were performed on these entities and some wording was put in the disclosure to be in compliance with the standard. The standard requires that the message is conveyed to the public. Mr. Omisore advised that the Agency's overall net position is healthy therefore no significant changes were made to the disclosures.

Mr. Brandt mentioned that the reference documents are very difficult to understand. For example, some of the terms have been changed for securities, stocks and bonds. He requested to make the document more user friendly. He requested that if technical terms are being used, those terms be explained in the notes. Mr. Omisore answered by saying GASB and Government Finance Officers Association (GFOA) design the template of the financial statements. All financial statements start from the same template and adjustments are made as deemed necessary. Mr. Omisore agrees that although the financial statements are designed for regular public, it's not so easy for them to understand.

Mr. Norman agreed with Mr. Brandt on making the financial statements easier to read. On a motion made by Mr. Brandt and seconded by Mr. Howard, the FY 2022 draft financial statements were approved.

4. CY 2023 Audit Committee Meeting Dates

Mr. Rongione reviewed the CY 2023 AC Meeting Dates:

- January 17, 2023
- April 18, 2023
- July 18, 2023
- November 14, 2023

On a motion made by Mr. Brandt and seconded by Mr. Howard, the AC meeting dates were approved.

5. Internal Audit Charter

Mr. Rongione mentioned that the AC Charter requires that the Internal Audit Charter to be approved by the committee every three years. The last approval was in November 2019. There have been no changes to the Charter since the last approval. Mr. Rongione is presenting it to the committee again for approval. On a motion made by Mr. Brandt and seconded by Mr. Howard, the Internal Audit Charter was approved.

6. Investment Compliance Report

Ms. Voglino introduced herself noting that she is the Senior Compliance Officer of the Investment Division. She added that her team had previously presented an annual report to the AC outlining various responsibilities and monitoring efforts of her team with a purpose of keeping the Board notified about any issues. Then she presented the investment compliance report noting that the Compliance team performs monitoring on the below items:

- *External Manager Investment Guideline Violations:* 53 mandates are managed by external managers. The Compliance team performed over 220,000 tests noting 2,056 violation alerts. 100% of the alerts were reviewed noting that 1,600 were false alerts. 358 of them needed corrective actions. Majority of the items were temporary and related to overweighing a security, position changes or overweight of cash. All the items were corrected by the managers.
- *Internal Manager Investment Guideline Violations:* Compliance team performs similar procedures for internal managers with a more stringent approach. They performed over 32,000 tests noting 1,300 violation alerts. 100% of the alerts were reviewed noting that 601 were false alerts, 256 alerts were related to corporate action which required no corrective actions, and lastly 479 true alerts which were related to changes in staffing or cash received. All the alerts were temporary and necessary corrective actions were taken by the managers.
- *External Manager Annual Compliance Questionnaire and Certificate (the*

“ACQ”): ACQ is performed on an annual basis which looks for any red flags. 86 managers participated and the Compliance team obtained a 100% completion rate. ACQ has two sections – 1) certification of compliance with investment guidelines, statements in the ACQ are factual, compliance with all representations in the agreement, and the required amount of insurance is in effect; 2) questions related to litigation and regulatory matters, fees and expenses, conflicts of interest, investment guideline compliance, organizational changes, ESG and diversity, and request of documents from managers including:

- Annual financial statements,
 - Policies on Ethics, ESG and diversity,
 - Personal trading,
 - Disaster recovery plans and SOC reports,
 - ADVs, and
 - Insurance certificates
- *Private and Commingled Annual Certification:* This certification is required to be submitted in the side letter. 284 funds were required to submit this certification and the Compliance team obtained a 100% completion rate. As part of this process the funds annually certify that:
 - The annual financial statements fairly represent the financial condition of the fund;
 - The general partner has no knowledge of any material breach of the partnership agreement;
 - All distributions have been made in accordance with the partnership agreement; and
 - The general partner is in compliance with provisions of the certain Payments and Contributions section of the agreement related to placement agents and political contributions.
 - *Personal Trading Monitoring:* This monitoring procedure ensures that the staff or any household members of the staff is not trading on any securities that are on restrictive list. In FY2022, staff had over 1,800 accounts of which 14 violations were noted. None of the violations were related to trading on securities that are on restrictive list. The violations were related to staff failing to obtain a pre-clearance. The Compliance team met with the staff to discuss and determine why violations occurred. In most instances the violations occurred because one of the household members did the trade and the staff was not aware of it. The Compliance team obtained 100% completion rate for the Personal Trading Disclosure and Attestation Statement.
 - *Conflicts of Interest:* Each conflict is reviewed and graded as follows:
 - Not a Conflict
 - Perception of a Conflict
 - Potential Conflict of Interest
 - Actual Conflict of Interest or
 - Material Conflict of Interest

100% of employees have submitted their Conflicts of Interest Disclosure Form and Attestation.

- *Code of Ethics:* All Investment Division staff must file a Code of Ethics Attestation within 30 days of hire and annually thereafter attesting that they have read, understand and are in compliance with the Maryland ethics laws and the Code of Ethics that are in the Investment Policy Manual. 100% of staff have completed the required Code of Ethics Attestation for FY2022.
- *Staff Training:* All Investment Division staff are required within 30 days of hire and annually thereafter to have training on the following:
 - Ethics
 - Conflicts of Interest
 - Material non-public information, and
 - Personal trading compliance.

100% of Investment Division staff completed the required training.

- *Regulatory Reporting:* The System is required to complete the 13F and the 13H filings for the SEC. The filings are complete, and no amendments needed to be done.

Ms. Voglino concluded her presentation emphasizing that if Compliance team identifies any red flags, the meeting might need to be moved to closed session to discuss the detail. Mr. Howard inquired who does Ms. Voglino report to. Ms. Voglino answered by saying she reports to Mr. Palmer. Both Mr. Howard and Mr. Brandt inquired whether her team should function independent of the Investment Division since her functionalities are very relevant to the Agency as whole. Mr. Palmer answered by saying he understands that the industry standard might be having the Compliance team under Legal Division, however, there were two reasons the Agency decided to put the Compliance team under Investment Division - 1) prosaic reason – create position and set compensation; 2) to implement compliance risk and governance in a more integrated fashion. He added by saying Ms. Voglino's work is involved in the decision-making process. He acknowledged that the current structure creates potential conflict if CIO is not compliant. This is why he suggested presenting the compliance report to the AC which facilitates creating a line of communication between the Compliance team and the committee. If something needs to be flagged, Ms. Voglino and her team can bring it to Mr. Rongione or AC's attention.

Mr. Sandlass further inquired about the monitoring process of trading on restricted securities. Ms. Voglino answered by saying trading is restricted for managers where there is material non-public information available, the Agency is getting ready to trade and the trade will not be considered as one of the Agency's passive accounts, and the Agency's system is trading. These restrictions are not applicable to external managers. External managers have a separate restrictive list of countries such as Iran, Sudan, Russia and China according to statutes. They also cannot trade in the Agency's portfolio.

7. Status of FY 2023 Audit Plan

Mr. Rongione reviewed the audit plan status noting that the ABBYY Scanning audit is progressing, and Internal Audit Division (IAD) is starting to wrap up fieldwork. He continued by saying IAD is currently in the planning phase of the Employee Portal and the Swift assessment audits. IAD's contractual auditor is also making progress on the Investment risk assessment and the PGU audits. He added by providing a timeline for the audits that haven't started as follows:

- CRM Cases audit - Starts in January 2023
- Daily Payments – Starts in January 2023
- Employer Portal – Starts in March 2023
- Annual Network Security – This was originally planned to begin in October 2022. Due to lack of staffing, IAD is behind schedule. IAD has conducted interviews for the position and expects someone to start in December 2022
- Annual IT General Controls – Starts in January 2023
- Annual IT Security Controls – Starts in March 2023
- The continuous audits are performed on a monthly basis
- Cybersecurity – Starts in January 2023
- Investment Audit 1 – TBD based on risk assessment – IAD expects the contract auditor to start this audit in January 2023
- Investment Audit 2 – Starts in March 2023

He ensured that all audits included in the FY23 audit plan will be completed by the year end. Mr. Brandt asked if there are any resources or timing issues. Mr. Rongione answered by saying he anticipates none at this time. He added that IAD was able to re-post the IT auditor position and interviewed some promising candidates. He expects someone to start in December 2022. Mr. Howard asked who is IAD using for contractual audit. Mr. Rongione answered by saying UHY LLP who is based in Columbia, MD.

8. Continuous Audit Dashboard

Mr. Rongione mentioned that the dashboard has been revised since the last meeting. All the charts in the left-hand column represent different data analytics performed, and the applicable number of samples and exceptions by quarter and fiscal year. He continued by saying, the right-hand column charts show the number of exceptions per test per fiscal year, as well as the number of remediated and remaining open issues. There are still 15 issues from FY22 that need to be remediated, and IAD will retest these prior to the next AC meeting.

9. Status of Open Issues Log

Mr. Rongione mentioned that IAD created an open issues dashboard that shows two charts detailing the open issues per division, and then the current remediation status. He added that several changes have been made in terms of how the issues are presented to the AC. The first change is that IAD created an open issues log per division, as opposed to one combined log. IAD also gave each finding a unique ID # that can be traced to the next

report, which is a remediation status document per division. Each division will complete this prior to every AC meeting. This report will detail the current status (whether it is in progress, resolved and ready for IAD to test or not started), remediation plan, any issues affecting remediation, and a revised remediation date.

Mr. Brandt mentioned that the IAD must be mindful about the old items. Mr. Rongione commented that as a result of the revised approach, Management investigated the issues in a more detail manner and the communication is now documented in a more formal way. There were 25 issues that were marked as ready for IAD to be tested, however, it was communicated to the IAD in early November and IAD did not have enough time to perform the testing. All 25 issues will be tested prior to next meeting and he expects to have these issues removed from the log. Mr. Howard asked about the issues that are in “Not started” status and what is causing that. Mr. Rongione said he will have to review each of those line items that were provided in the remediation plan report. Mr. Howard mentioned this discussion does not need to happen during this meeting. Mr. Rongione mentioned he will create a summary of the “Not Started” issues and present it to the AC during the next meeting.

Mr. Noven thanked Mr. Rongione and management for their team effort on the open issues. Mr. Brandt commented that these reports are very re-assuring.

10. FY22 Year End Reports

Mr. Rongione mentioned that this report was presented at the July 2022 AC meeting, however there were some data missing due to an issue with the audit management software. He mentioned that the green highlighted items (Total of Actual Hours for All Completed Audits is no more than 5% above the Audits’ Total Budgeted Hours and Percentage of Administrative Time) are the updated numbers on the performance report, and IAD has met the goals for both of these metrics. He continued by saying the next one is the time report which details the IAD hours and compares them to prior fiscal years.

11. Other Business

Mr. Norman mentioned the next AC meeting will be on January 17, 2023.

12. Motion by the Audit Committee to adjourn meeting

On a motion made by Mr. Sandlass and seconded by Mr. Howard, the meeting adjourned at 10:48 a.m.

Respectfully submitted,

David Rongione

David Rongione, Secretary