

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

MINUTES OF THE MEETING OF November 12, 2019

The Audit Committee met on Tuesday November 12, 2019 at 9:30 a.m., in the Ante Room of the Maryland State Retirement Agency at 120 East Baltimore Street, Baltimore, Maryland.

Committee members present were: David B. Hamilton, Chairman (by phone)
Richard E. Norman, Vice-Chairman
Michael J. Stafford (by phone)

MSRA attendees were: R. Dean Kenderdine, Executive Director
David Rongione, Chief Internal Auditor
Harvey Raitzyk, Retirement Administrator
Kenneth Reott, Deputy Retirement Administrator
Rachel Cohen, Principal Counsel
Melody Countess, Chief Operating Officer
Patricia Fitzhugh, Deputy Chief Operating Officer
Patricia Wild, Managing Director
Lauren Smith, Internal Audit Contract Manager
Richa Sultana, Internal Audit Supervisor

SB & Co attendees were: William Seymour, Engagement Partner
Graylin Smith, Managing Partner
Tiana Wynn, Senior Manager

CliftonLarsonAllen attendees were: Thomas Rey, Principal
Steve Maranto, Director

A. Minutes of the July 26, 2019 Audit Committee Meeting

On a motion made by Mr. Hamilton and seconded by Mr. Stafford, the minutes of the July 26, 2019 Audit Committee meeting were ratified.

B. Presentation of FY 2019 Financial Statement Audit Results by SB & Company

Mr. Seymour of SB & Company presented the results of the FY 2019 Financial Statement Audit. He mentioned that the audit was performed in accordance with Generally Accepted Accounting Principles (GAAP) and the Firm Standards. Mr. Graylin Smith and Ms. Tiana Wynn from SB & Company were also present during the meeting. Mr. Seymour mentioned that the scope of the audit included June 30, 2019 financial statements, a review of the comprehensive annual report and an audit of the schedule of contributions and pension amounts. The audit report will include an unmodified opinion meaning a clean opinion on the financial statements. Their audit steps did not discover any instances of fraud however, Mr. Seymour emphasized that their audit is not a fraud

audit. Fraud audit steps are designed and conducted in a different manner compared to the financial statements audit. Mr. Seymour noted that no material weaknesses were identified in the Agency's internal controls. He also mentioned SB & Company received full cooperation from management during this audit.

Mr. Seymour noted that for the purpose of GASB 67 and 68 reporting to PGUs, an unmodified opinion will be issued on the 2018 schedule of contributions and pension amounts. Mr. Seymour highlighted a few items from the financial statements indicating the investment is up by 5 billion and funding percentage increased from 71.2% to 72.9%. Mr. Seymour also reviewed the fair value measurements of Level 1, Level 2 and Level 3 investments noting that all amounts appear reasonable. He described the nature of all three levels of investments and noted that Level 1 is the least risky investment and Level 3 is the riskiest. Then he reviewed the schedule of funding progress and employer net pension liability noting that the difference is mainly due to actuarial value. He reviewed the industry and economic highlights mentioning that defined benefit plans are facing challenges related to mortality rate. Lower mortality rate means the cost to maintain the plan is becoming more expensive. He also mentioned cyber security remains to be a risky item for the industry.

Mr. Seymour then reviewed the items that are required to be communicated with management by AICPA noting that there were no significant items or issues to be communicated as the audit was a clean audit. He also mentioned their responsibility related to fraud while performing a financial statements audit and no instances of fraud were noted during their audit. Mr. Seymour mentioned that SB & Company performed an assessment of control environment by following COSO framework and all areas were assessed as "Effective". He also mentioned that their evaluation of key processes related to financial reporting process were also assessed as "Effective". He noted that their presentation included a copy of the draft financial statements to be presented to the Audit Committee.

On a motion made by Mr. Hamilton and seconded by Mr. Stafford, MSRPS draft financial statements were accepted.

C. Participating Employer Audits – FY 2019 Results Presented by CliftonLarsonAllen

Mr. Rey and Mr. Maranto from CLA presented the results of FY 2019 compliance review of local government employers. Mr. Maranto mentioned that they perform this review for roughly 150 PGU's on a 3 year rotating basis in order to ensure accuracy of contribution amounts, sick leave balance and demographic and payroll data. He described the six objectives of their review and reviewed the findings by each objective as follows:

Objective #1 – 7 of 52 participating employers failed to enroll one or more eligible employees. 1 employer had similar findings in both current and previous audit.

Objective #2 – No findings were identified for this objective.

Objective #3 – 21 of 52 participating employers misreported payroll data. 9 employers had similar findings in both current and previous audit.

Objective #4 – 7 of 52 participating employers reported incorrect employee and salary information

in the annual billing report for employer contribution. 2 employers had similar finding in both current and previous audit.

Objective #5 - 18 of 52 participating employers misreported unused sick leave balance. 9 employers had similar findings in both current and previous audit.

Objective #6 - No findings were identified for this objective.

Mr. Maranto reviewed the graphs included in their report that shows year-to-year analysis of the same set of employers. First graph showed the number of participating employers with findings by objective. The second graph showed the number of findings by objective for the same participating employers. These graphs are an indication whether the compliance level has improved and corrective actions have been taken for the findings identified in previous audits. Mr. Maranto pointed out that there has been significant improvements in many areas i.e. previous review showed that employers failed to enroll almost 900 eligible employees where the current audit shows employers only failed to enroll 35 eligible employees.

Mr. Rey thanked the Agency for engaging CLA for performing a compliance review of local government employers. He also mentioned significant improvements have been made by many PGUs. The Agency had engaged CLA pre GASB 67 and SB and Company relies on CLA's compliance review. Mr. Rongione asked if CLA was not performing this review then whether SB and Company will have to perform additional testing. Mr. Rey mentioned that although he can't speak to what type of testing SB and Company will be performing, he can assure they would have to do some level of testing at the employer level. Mr. Raitzyk thanked CLA for their work as their work is a tremendous value add for the Agency. Mr. Kenderdine mentioned that the Agency reviews each of the finding closely and sends letters out to each PGU for their finding. He mentioned that 90% of the time the PGU has already taken corrective actions for the identified issues. Mr. Maranto seconded Dean's comment and mentioned that CLA holds exit meeting with each employer which gives them an opportunity to correct the issues by the time they receive a letter from the Agency.

D. CY 2020 Audit Committee Meeting Dates

On a motion made by Mr. Norman and seconded by Mr. Stafford, the following meeting dates for CY 2020 were approved: January 21, 2020, April 21, 2020, July 21, 2020 and November 10, 2020.

E. Internal Audit Charter

Mr. Rongione mentioned that the Audit Committee Charter requires the Internal Audit Division Charter to be approved every three years, with the last approval in 2016. IAD's peer review identified two minor changes. IAD has updated the Charter accordingly to include Core Principles for the Professional Practice of Internal Auditing and Code of Ethics.

On a motion made by Mr. Norman and seconded by Mr. Stafford, the Internal Audit Charter was approved.

F. Internal Audit Staffing Update

Mr. Rongione mentioned that the IT auditor position remains open. The position has been reposted and he is hopeful to receive applications from qualified candidates.

G. Status of FY 2020 Audit Plan

Mr. Rongione noted that IAD has scheduled an exit meeting for the Retiree Withholding Tax audit this week. IAD has also started the CRM audit and the Entrance conference is scheduled this week as well. Mr. Stafford asked about the current investment status of managing funds internally without having an order management system in place and whether the outside auditors are concerned about this matter. Mr. Rongione mentioned that we have very limited budget for investment audits and outside auditors have not been engaged to perform an audit of the procedures of managing the funds internally. Mr. Stafford asked for clarification if the same person is buying the bonds, managing the portfolio, pricing the bonds, measuring the performance and recording data. Ms. Wild mentioned that the allocation that are being managed internally are relatively small, approximately 20 securities with an approximate value of \$500 million. She also mentioned that the pricing of the bond and performance is measured by the Custodian bank. Internal staff is mainly responsible for buying, selling and monitoring the securities therefore a segregation of duty is in place. Mr. Palmer is performing a cost benefit analysis of implementing an order management system. Mr. Stafford requested that an agenda item be placed on the Audit Committee meeting in January to further discuss tracking the securities without an order management system, and the associated risks.

H. Status of Open Issues Log

Mr. Rongione presented the status of the open issue log noting that no significant changes from the prior meeting. IAD closed out 1 issue. Follow-up testing for the issues related to Investment audits will be performed by BD & Company. Some issues included on the issues log will be remediated with the MPAS Plus implementation. The remaining issues are being reviewed by the Agency and IAD will perform follow-up testing to close out the issues.

I. Completed Audits

Mr. Rongione noted that Internal Audit Division has completed a special project of Date of Birth analysis. An issue was identified during the close session of the Administrative Committee meeting held on August 6, 2019. This special project was a data analysis of the date of birth changes for retirees and active participants, from year to year. Mr. Raitzyk mentioned that Administration is currently looking into the analysis and will issue a response to IAD shortly.

J. Other Business

Mr. Rongione mentioned that next Audit Committee meeting will be on January 21, 2020 after the Board of Trustees meeting.

K. Motion to Adjourn

On a motion by Mr. Norman, and seconded by Mr. Stafford, the Committee approved to adjourn the meeting at 10.30 a.m.

Respectfully submitted,

David Rongione, Secretary