

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

MINUTES OF THE MEETING OF April 21, 2020

The Audit Committee convened on Tuesday April 21, 2020 at 10:30 a.m. via video conference call with the host site at 120 East Baltimore Street, Baltimore, Maryland.

Committee members present were: David B. Hamilton, Chairman
Richard E. Norman, Vice-Chairman
F. Patrick Hughes
Michael J. Stafford
Jamaal Craddock

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

A. Minutes of the January 21, 2020 Audit Committee Meeting

On a motion made by Mr. Norman and seconded by Mr. Stafford, the minutes of the January 21, 2020 Audit Committee meeting were ratified.

B. Securities Lending Financial Statements Disclosure

Mr. Kenderdine mentioned that one of our trustees, Ms. Herman, had identified two disclosure issues with the Agency's CAFR report. The disclosures were not in compliance with the GASB standards. Ms. Countess explained that the Agency has included the cash and cash equivalents in the Level 1 risk category in the footnote related to GASB 72 to be more transparent. She mentioned that the inclusion of cash and cash equivalents in this footnote is immaterial and will not change the independent auditor's opinion. Ms. Countess agreed that moving forward, it is best to remove the cash and cash equivalents from the Level 1 risk category and include a reconciliation or a footnote to identify the difference. The second issue identified was related to GASB 28 disclosure where the Agency reported the collateral for securities lent as both assets and liabilities. Ms. Countess presented two options with examples for the Audit Committee – 1) continue with the current presentation; 2) moving forward remove the non-cash collateral from both assets and liabilities as well as the corresponding footnote. Ms. Countess mentioned that option #1 does not materially change the CAFR report as it does not have an effect on the net position however, option #2 is better aligned with GASB 28. Trustee Stafford asked how these issues were identified. Mr. Kenderdine mentioned that Ms. Herman compared the Agency's CAFR report with the Montgomery County report, as well as other State Agencies' reports. She noted that our Agency's reporting was not consistent with the other Agencies and brought this issue to the management for

further review. On a motion made by Mr. Norman and seconded by Mr. Stafford, option #2 was approved.

C. Presentation of Portfolio Management and Ongoing Due Diligence Audit by BD & Co.

Mr. Binford from BD & Co. presented the audit report of the Portfolio Management and Ongoing Due Diligence audit. He mentioned that Mr. Bengston from BD & Co. was also present on the call. Mr. Binford said this audit was completed last quarter and the scope period of the audit was 8/1/18 to 8/31/19. He mentioned that the overall rating of the audit is “Green” which means the control environment is effective. There were three issues identified during this audit which are all low risks. Mr. Binford said once the audit recommendations are implemented, it will enhance the control environment.

Mr. Binford said that as part of the audit procedures, they reviewed initial due diligence for any new investments including public and private funds. They also reviewed many other documents related to the annual compliance procedures, periodic reports, private account asset evaluations, and monitoring of TIPS funds. Then Mr. Binford presented the three audit issues in detail:

- 1) Compliance alerts should be reviewed on a monthly basis and must be cleared within 30 days. 3 of 4 months reviewed by BD & Co. were not reviewed in a timely manner. This is because the Agency’s compliance officer, was on extended leave and there was no other person trained to complete this review. Once the compliance officer returned from leave, they completed the reviews for all months that were not previously cleared and was able to catch up prior to the issuance of the audit report. The audit recommendation is to have a backup employee who is cross-trained to perform these reviews. Especially with more investments coming in-house, it is important not having to rely on only one person to comply with various requirements. Management has agreed and currently actively searching for additional investment compliance staff.
- 2) Issue #2 and #3 are both related to the Code Red software. Code Red is currently not the Agency’s book of record for investments. It is used for document storage and as a workflow application. 2 of 25 private asset fund valuations had incorrect balances however, the variances were immaterial. In addition, 4 of 25 capital call documents were not entered in Code Red. The audit recommendation is to set up a formal process to verify and review all documents have been entered into Code Red. Additional audit recommendation is to create a tolerance threshold when manually entering the capital valuations. A long-term audit recommendation is to enhance the use of Code Red by eliminating manual entry and creating an interface between State Street and Code Red which will feed information directly into Code Red from the custodian account.

Mr. Norman asked whether management anticipates using Code Red to maintain records or merely as a tool to assist with reporting. Mr. Burd mentioned that prior to Code Red, all documents were stored in internal network drives. Code Red has created more efficiency within the Investment Division and is currently being used for document storage and as a workflow application. Mr. Norman asked Mr. Burd about the future aspect of Code Red. Mr. Burd answered by saying that the Investment Division wants the Code Red to be in agreement with the book of records. He acknowledged that the private equity team miss-entered or failed to enter some values in Code Red. He emphasized that this error did not have any impact on the books and records and all values were reported accurately on the actual books and records.

D. Financial Statement Audit Contract

Mr. Rongione mentioned that the General Accounting Division of the Comptroller of Maryland issued a Request for Proposal (RFP) for statewide audit services. The contract was awarded to CliftonLarsonAllen, LLP (CLA) on March 4th, 2020. Mr. Hamilton mentioned that the Audit Committee will review and confirm the independence of the external auditor. He also asked who will be the main point of contact at CLA. Mr. Rongione answered by saying Thomas Rey will be the main point person for the Agency. Mr. Hughes asked whether there are any independence issues with appointing CLA as the Agency's financial statements auditor since they currently audit the Participating Government Units (PGUs). Mr. Rongione mentioned the Agency has requested a letter from CLA stating compliance with GASB in terms of independence. He also mentioned that the service provided to PGUs is an agreed upon procedures engagement, meaning they are attest service. Mr. Rongione added by saying that in his opinion, there is no independence issues since both engagements are attest services and CLA will not be auditing their own work.

E. Audit Committee Self Eval. and Internal Audit Eval.

Mr. Hamilton mentioned that Mr. Rongione had reached out to him regarding the self-evaluation because he had not received responses from majority of the members. Mr. Rongione informed Mr. Hamilton via email that the Charter allows for a one year extension by the Chairman in extenuating circumstance. Mr. Hamilton mentioned that he had responded to Mr. Rongione's email and granted an extension given the current circumstances. Mr. Rongione said that next year he will send out evaluations to the committee members.

F. Staffing Update

Mr. Rongione mentioned Internal Audit Division (IAD) has hired Greg Busch as the new IT Audit Manager. Prior to joining the Agency, Greg had worked for the Office of Legislative Audits (OLA) performing network and general IT security audits. Mr. Hamilton welcomed Mr. Busch to the IAD team.

G. Status of Audit Plan

Mr. Rongione reviewed the status of the FY2020 audit plan noting that IAD has completed half of the audit plan. IAD has completed the planning phase of the MDS audit and currently in the fieldwork phase of testing controls.

H. Open Issues Log

Mr. Rongione said the listing of open issues have been included in the Agenda packet for the Audit Committee's review. He mentioned that his team reviews the listing on a quarterly basis and work with the management to perform further testing in order to verify whether the issues have been remediated.

I. Agency Wide Risk Assessment

Mr. Rongione mentioned that IAD will begin the annual risk assessment process by sending out questionnaires to the Audit Committee members, Executive Director, Executive Staff as well as the Unit Directors. Based on the responses, IAD will perform an assessment of the risks based on their likelihood and impact within the business processes. Mr. Rongione said the business processes will then be ranked based on the risk ratings, and the highest risk areas will be included in the FY21 audit plan. Mr. Rongione also mentioned that the risk assessment and the FY21 audit plan will be presented at the July 2020 Audit Committee meeting for the Committee's approval.

Mr. Hamilton asked whether the COVID-19 Pandemic will be a part of the risk assessment. Mr. Rongione answered by saying that the most important factor during this Pandemic was having a business continuity plan. Mr. Rongione said the Agency is able to perform all necessary duties

remotely without any issues. He also mentioned we have not experienced any issues with moving forward with the audits. Mr. Hamilton asked Ms. Cohen's opinion regarding this matter and whether the Legal Division had any issues with force majeure contract clauses. Ms. Cohen mentioned that they experienced some issues with open procurement; however, none related to force majeure clauses.

J. Completed Audits

Mr. Rongione mentioned that IAD has recently completed the CRM – Data Conversion/Integration audit. The overall report of the audit is "Green". He mentioned the scope of the audit included the process of implementing CRM which occurred during August 2019. The audit revealed two minor issues and the management has agreed with the issues identified.

K. Other Business

Mr. Rongione mentioned that the next Audit Committee meeting would be on July 21, 2020.

L. Motion to Adjourn

On a motion by Mr. Norman, and seconded by Mr. Hughes, the Committee approved to adjourn the meeting at 11:08 a.m.

Respectfully submitted,

David Rongione, Secretary