

ORANGE COUNTY EMPLOYEES RETIREMENT SYSTEM

BOARD OF RETIREMENT
2223 WELLINGTON AVENUE, SUITE 100
SANTA ANA, CA 92701

AUDIT COMMITTEE MEETING
March 29, 2017
9:00 a.m.

AGENDA

This agenda contains a brief general description of each item to be considered. Except as otherwise provided by law, no action shall be taken on any item not appearing in the following agenda.

A. [2016 FINANCIAL STATEMENT AUDIT – ENTRANCE CONFERENCE](#)

Introduction by Tracy Bowman, Director of Finance, and Presentations by Linda Hurley, Macias Gini & O'Connell

Recommendation: Receive and file Macias Gini & O'Connell, LLP's (MGO) 2016 Service Plan.

B. [AUDIT OF CITY OF SAN JUAN CAPISTRANO PAYROLL TRANSMITTALS](#)

Presentation by David James, Director of Internal Audit

Recommendation: Receive and file.

C. [CONSIDERATION OF REVISIONS TO THE INTERNAL AUDIT CHARTER AND AUDIT COMMITTEE CHARTER](#)

Presentation by David James, Director of Internal Audit

Recommendation: Take appropriate action.

D. [DIRECTION FROM THE BOARD OF RETIREMENT – INVESTMENT FEES](#)

Presentation by David James, Director of Internal Audit

Recommendation: Take appropriate action.

E. [STATUS OF INTERNAL AUDITS AND AUDIT PROJECTS](#)

Presentation by David James, Director of Internal Audit

Recommendation: Receive and file.

***** END OF INDIVIDUAL ITEMS AGENDA *****

CLOSED SESSION ITEM

**F. THREAT TO PUBLIC SERVICES OR FACILITIES
(GOVERNMENT CODE SECTION 54957)**

*Consultation with Jon Gossard, OCERS Security Operations Manager, and Gina M. Ratto,
OCERS Chief Legal Officer*

Recommendation: Receive and file.

******* END OF CLOSED SESSION ITEMS AGENDA *******

PUBLIC COMMENTS: The public, plan members, beneficiaries, and/or representatives may speak to any subject matter contained in the agenda *either* at the time the item is addressed *or* at this time, provided that no action may be taken on any item not appearing on this agenda unless authorized by law. Persons who want to address items on the agenda should provide written notice to the Secretary of the Committee prior to the Committee's discussion on the item by filling out the Public Comment Form located in the back of the room. When addressing the Committee, please state your name for the record prior to providing your comments. Speakers will be limited to three minutes.

COMMITTEE MEMBER COMMENTS

CHIEF EXECUTIVE OFFICER/STAFF COMMENTS

ADJOURNMENT

NOTICE OF NEXT MEETINGS

GOVERNANCE COMMITTEE MEETING

**April 5, 2017
9:00 a.m.**

**ORANGE COUNTY EMPLOYEES RETIREMENT SYSTEM
2223 E. WELLINGTON AVENUE, SUITE 100
SANTA ANA, CA 92701**

REGULAR BOARD MEETING

**April 17, 2017
9:00 a.m.**

**ORANGE COUNTY EMPLOYEES RETIREMENT SYSTEM
2223 E. WELLINGTON AVENUE, SUITE 100
SANTA ANA, CA 92701**

Audit Committee Meeting
March 29, 2017

All supporting documentation is available for public review in the retirement office during regular business hours, 8:00 a.m. – 5:00 p.m., Monday through Thursday and 8:00 a.m. – 4:30 p.m. on Friday.

It is OCERS' intention to comply with the Americans with Disabilities Act ("ADA") in all respects. If, as an attendee or participant at this meeting, you will need any special assistance beyond that normally provided, OCERS will attempt to accommodate your needs in a reasonable manner. Please contact OCERS via email at adminsupport@ocers.org or by calling 714-558-6200 as soon as possible prior to the meeting to tell us about your needs and to determine if accommodation is feasible. We would appreciate at least 48 hours' notice, if possible. Please also advise us if you plan to attend meetings on a regular basis.

A



Memorandum

DATE: March 20, 2017
TO: Members of the Audit Committee
FROM: Brenda Shott, Assistant CEO, Finance and Internal Operations
SUBJECT: 2016 Financial Statement Audit – Entrance Conference

Recommendation

Receive and file Macias Gini & O’Connell, LLP’s (MGO) 2016 Audit Service Plan.

Background/Discussion

Attached is the 2016 Audit Service Plan prepared by Linda Hurley, CPA and Partner at MGO. This plan includes the engagement service team for the financial statement audit; timeline for deliverables; highlights of MGO’s audit approach, scope and objectives; and overall summary of audit responsibilities.

Submitted by:

A handwritten signature in blue ink that reads "Brenda M Shott". The signature is written in a cursive style and is positioned above a horizontal line.

Brenda Shott
Assistant CEO, Finance and Internal Operations



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ORANGE COUNTY EMPLOYEES RETIREMENT SYSTEM

FY 2016 Audit Service Plan

PREPARED FOR YOU BY:

Macias Gini & O'Connell LLP
Linda Hurley, CPA/PARTNER
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949.296.4340 | lhurley@mgocpa.com



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OUR APPROACH, LIKE OUR PLAN THAT FOLLOWS, IS ALL ABOUT CLEAR COMMUNICATION, INNOVATION, A WILLINGNESS TO ALWAYS GO THE EXTRA MILE, AND FULL TRANSPARENCY — BECAUSE THAT'S WHAT IT TAKES TO DELIVER THE HIGHEST LEVEL OF ASSURANCE.

On behalf of Macias Gini & O'Connell LLP (MGO) we are pleased to present our 2016 Audit Service Plan (Plan) for the Orange County Employees Retirement System ("Retirement System"). In preparing our Plan we have drawn on our experience in serving the Retirement System in prior years and numerous retirement systems within California. This Plan presents our engagement service team; timeline for deliverables; highlights our audit approach, scope and objectives; and summarizes audit responsibilities under *Government Auditing Standards*, issued by the Comptroller General of the United States. Also included in this document is a summary of recent technical developments in governmental accounting and financial reporting that may impact the Retirement System.

We are committed to serving the Retirement System so that retirees, current employees, elected officials, and management continue to have the utmost confidence in the Retirement System's financial statements, internal control systems, and compliance with laws and regulations. We dedicate the resources of our team and provide ongoing access to our very best resources to exceed the Retirement Board's and management's expectations.

We appreciate the opportunity to be of service and look forward to discussing the highlights of our Plan with the Retirement Board and management.



Linda C. Hurley, CPA

PARTNER

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SECTION 1

Overview of MGO Audit Services



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Our goal is to continuously exceed the expectations of management and the Retirement Board in providing efficient, cost-effective, and high-quality services to the Retirement System.

MGO Objectives.

Our mission is to be the professional service firm that consistently exceeds the expectations of our clients and our people. Our objective is to deliver seamless, high quality, and timely service to the Retirement System in all areas in which we provide professional services. These include accounting and auditing, consulting, tax and other specialized services. We will meet our objectives by identifying opportunities to provide value added services to the Retirement System. In order to accomplish this, we will:

- Identify and resolve reporting, accounting and audit issues timely and effectively;
- Regularly communicate with the Retirement System;
- Complete our audit on a timely basis;
- Provide seamless service across the organization;
- Understand your organization, culture, programs and services;
- Provide the suited experienced professionals;
- Utilize specialists where unique skill sets are required;
- Apply our technical knowledge to identify solutions to organizational and financial issues;
- Respond to critical issues with a sense of urgency;
- Act as another set of “eyes and ears”;
- Meet all deadlines; and
- Communicate key findings to top management and the Retirement Board.

Our focus is on the Retirement System's Critical Audit Areas and Operational Changes.

Through planned face-to-face meetings with the Retirement Board, the Executive Director, and key management personnel throughout the year, we will directly ascertain the Retirement System's expectations of us and we will communicate our responsibilities to the Retirement System under professional standards. We will listen to what members of management and the Retirement Board expect from us. We will also ask them to tell us what service attributes are most important to them. We will use this information to develop a comprehensive audit approach to respond to identified issues and service needs for 2016.

Audit Services.

Our audit services emphasize comprehensive planning and risk assessment to fulfill our professional responsibilities and enable us to be responsive to the needs of the Retirement System's management and the Retirement Board.

Our Service Team.

An important part of successfully implementing our plan is identifying and utilizing the appropriate resources. We have selected an engagement team that is committed to carrying out our service plan. Linda Hurley, Engagement Partner, leads our service team. Kelsey DeCasas, Engagement Manager, will support Linda in providing quality service to the Retirement System.

Quality and Responsive Service.

We provide service, which stresses responsive attention year-round. Close communication with our clients is one of our top service qualities. We will work with you as business advisors, and we will place special emphasis on being actively involved in understanding all significant financial and reporting matters.

Accordingly, we will meet with you regularly to stay abreast of your service needs and special concerns. You can call upon us as a resource at any time.

Audit Approach.

Our audit approach carefully considers the identification of key risk areas and allocation of appropriate resources.

Professionals with more than ten years of governmental auditing and accounting experience lead all phases of our audit. With our experienced leaders in the field, our efficiency and effectiveness increase when dealing with complex accounting and auditing issues.

Our audit procedures include analytical reviews, verification of balances and transactions based on independent supporting documentation using statistical and judgmental sampling techniques, confirmation of key balances, and the analysis of key assumptions supporting significant estimates made by management.

This document further presents discussions on our approach to the services we will provide to the Retirement System, details our framework for planning and performing the audit, and sets forth our audit scope and timing.

SECTION 2

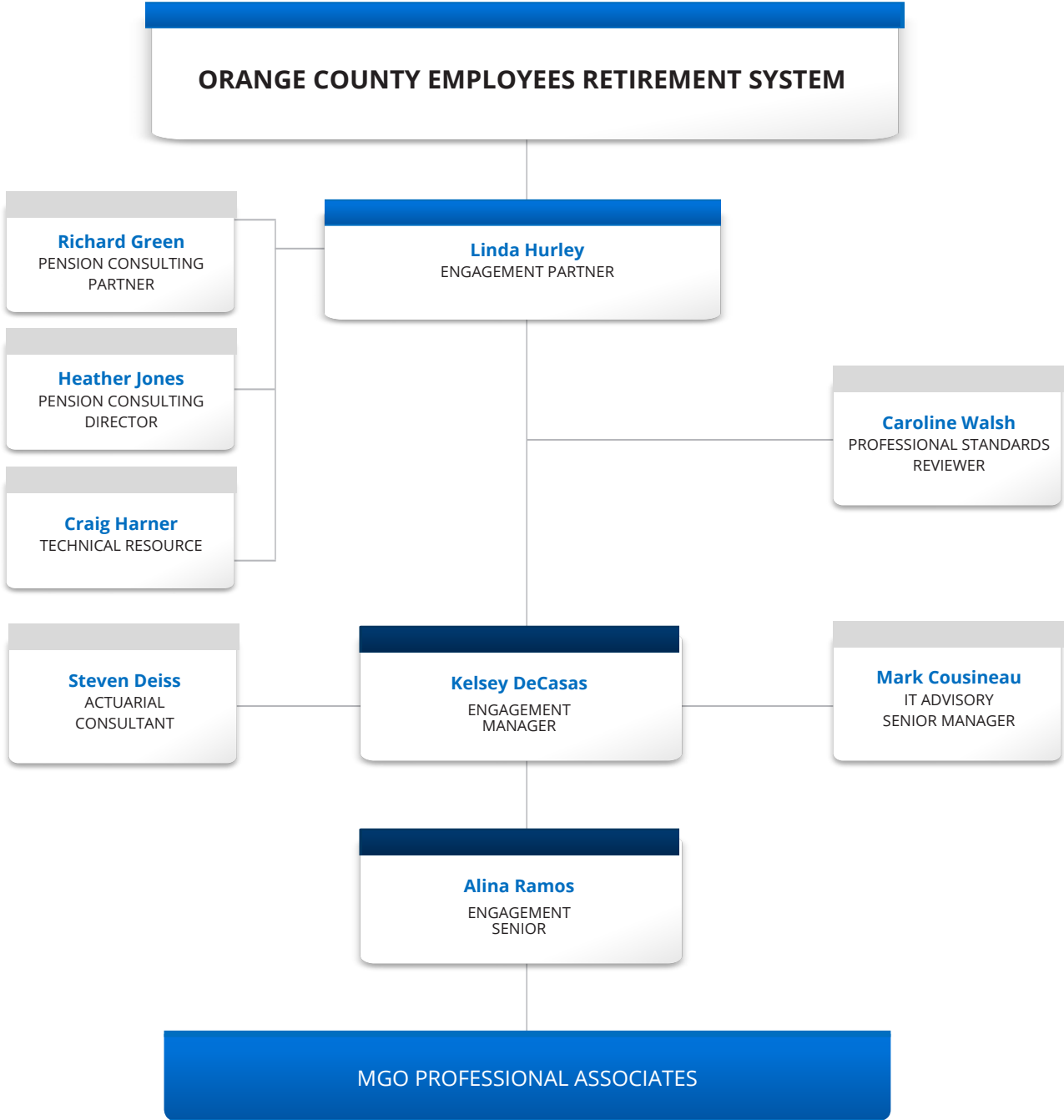
Your Engagement Professionals



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The engagement team selected to serve the Retirement System represents the strong, balanced blend of talent, professional skills, and industry experience that is most critical to working effectively with retirement systems of your size and magnitude.

The MGO Team is integrated to allow us to respond to your needs. We are committed to providing the resources necessary to meet the timeline that has been established by the Retirement System. This commitment includes providing the appropriate number and level of staffing to meet your needs.



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SECTION 3

The Audit Timeline

We recognize the importance of timely completion of audit tasks and deliverables. The timing of our audit procedures will be coordinated with the Retirement System to minimize disruption of the Retirement System's operations and ensure timely delivery of all reports by your deadlines.

Government-related entities often depend on a structure of interlocking relationships for managing public programs and resources. Our philosophy for a successful engagement is based on organization, communication, and coordination between the two parties responsible for the completion of the audit – the accounting firm and the client. We take coordination seriously and regard it as an integral factor to the relationship. We welcome the Retirement System's involvement in the planning process and believe that monitoring progress will result in timely financial reporting.

We are committed to delivering the Retirement System's reports according to the proposed time plan.

AUDIT TIMELINE	
Planning	DATES
Client services planning meeting	3/29
Submit Audit Plan to Retirement Board	3/29
Execution of Tests of Controls	
On-site fieldwork	4/3 - 4/7
Execution of Substantive Procedures	
Receipt of final client trial balances and prepared by client items	4/10
Perform year-end fieldwork	4/10 - 5/26
Reporting	
Issuance of Comprehensive Annual Financial Report	6/2
Issuance of Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards	6/2
Issuance of Independent Auditor's Report on Schedule of Pension Amounts by Employer	6/2
Issuance of Report to the Audit Committee	6/2
Audit Committee Presentation	
Presentation of audit results	TBD

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SECTION 4

Understanding the Audit

PLANNING

TIMELY INVOLVEMENT WITH RISKS AND ISSUES

Planning the Retirement System's audits is a continuous process. Our ongoing attention to changes in the Retirement System's economic and operating environment enables us to react to changing circumstances and unanticipated events and enhances our understanding of the Retirement System. The objectives of the planning phase are to develop an audit plan that 1) effectively and efficiently meets our professional responsibilities and 2) meets or exceeds the expectations and needs of the management of the Retirement System.

To accomplish our planning objectives, we will:

- Document our understanding of the internal and external factors affecting the Retirement System, which enables us to identify and evaluate relevant areas of risk.
- Document our understanding of the Retirement System control environment, accounting systems and control procedures for significant audit areas and transaction streams.
- Finalize an audit plan that identifies critical audit areas and procedures to address such risks.
- Ensure that our plan provides appropriate audit coverage.
- Coordinate our audit services with the support of Retirement System personnel for maximum efficiency.
- Develop and execute an audit plan that provides a basis for the issuance of our opinion and is designed to deliver our services effectively and efficiently.
- Strive to add value.

CLIENT SERVICE PROGRAM

The Retirement System receives the direct attention of one of our most knowledgeable and experienced professionals, Linda Hurley. Linda will review our annual client service plan and the reports prepared on the results of each year's work, and the assignment of personnel to the engagement. In addition, she will assure that your specialized needs receive priority access to top resources from anywhere in our organization.

ENVIRONMENTAL ASSESSMENT

In addition, our planning process evaluates the Retirement System's financial reporting risks based on the broader environment in which the Retirement System operates, drawing upon our knowledge of economic and operational changes affecting the Retirement System, including the impact of:

- Recent economic trends and their effect on the Retirement System's plan net position
- Retirement System's current funded status
- Receipt of the annual required contribution

PERFORMANCE – EXECUTION OF AUDIT PLAN

Our audit scope must be designed to provide sufficient audit coverage to enable us to express an opinion on the Retirement System's financial statements, as well as addressing all known audit risks, which could materially impact those financial statements.

Performance generally includes the following steps:

- Performance of audit tests and evaluation of results
- Development of organizational insights
- Review of financial statements and subsequent events
- Obtaining management representations

During the course of the audit, we use our knowledge gained during the planning phase related to your current organizational strategies, economic conditions, internal control, and the identified risks to tailor our audit procedures.

APPROACH TO CRITICAL AUDIT AREAS

We have identified certain critical audit areas facing the Retirement System. During our planning phase of the audit, we expand our understanding of these critical audit areas and obtain further information as needed in order to appropriately design audit procedures to address these issues.

- Implementation of GASB Statement No. 72 - investment valuation at fair value, including alternative investments, real estate, derivative instruments and securities lending activities
- Employer and Employee Contributions, including the proper calculation of employer and employee contributions based on pensionable earnings and approved contribution rates
- Retirement benefits deductions, including eligibility of retirees and accurate calculation and disbursements of monthly benefits
- Reasonableness of actuarial assumptions and calculations for pension and other postemployment benefits
- Implementation of the Vitech V-3 Pension Administration System Solution (PASS)
- Implementation considerations of GASB Statement No. 74 related to Orange County Fire Authority (OCFA)

TIMING OF OUR WORK

We have timed our work to coincide with key activities that are taking place in the Retirement System throughout the year. The Audit Timeline section of this Plan outlines the timing of our procedures.

THE RESULT

Our process is designed to enable us to issue the independent auditor's reports within the agreed upon timeline. The result of our work will also include the timely delivery of observations and recommendations regarding the control environment and operations of your organization. Such communications will be delivered both formally, through the reports to management, as well as through regular meetings with management.

REPORTING

SCOPE AND RESPONSIBILITY

Our audits are conducted in accordance with auditing standards generally accepted in the United States of America (GAAS) and the standards applicable to financial audits contained in *Government Auditing Standards* (GAS), issued by the Comptroller General of the United States for the purpose of expressing opinion on the fair presentation of the Retirement System's financial statements in conformity with accounting principles generally accepted in the United States of America. In addition, we will perform certain limited procedures involving required supplementary information mandated by the Governmental Accounting Standards Board as required by GAAS. Our audits are designed to obtain reasonable (as opposed to absolute) assurance about whether the financial statements are fairly presented.

REPORTING RESPONSIBILITY UNDER AUDITING STANDARDS GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA AND GAS

We will also report directly to management and to you matters coming to our attention during the course of our audit that we believe are deficiencies. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements in a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected in a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. In addition to communications about our responsibilities under U.S. generally accepted auditing standards and the planned scope and timing of the audit, we will communicate to you certain other matters related to the conduct of our audit, including where appropriate the following matters:

- Qualitative Aspects of Accounting Practices
- Corrected and Uncorrected Misstatements
- Difficulties Encountered in Performing the Audit
- Disagreements with Management
- Representations
- Management Consultations with Other Independent Accountants
- Other Audit Findings or Issues
- Other Information in Documents Containing Audited Financial Statements

MANAGEMENT COMMENTS

One of the primary service objectives is to make constructive and timely recommendations and to provide advice to you and management on matters we believe warrant attention. We have tailored our audit approach to focus on those risks that are important to achieving control and reporting objectives. We have the benefit of being objective outsiders in considering the information we gather. The result is that we are able to add the perspective of our experience and expertise to translate our audit findings into recommendations and insights concerning existing or potential problems. We will keep management and you apprised of any matters that we believe warrant consideration whenever they come to our attention.

ASSESSMENT – CLIENT SERVICE SATISFACTION

We conclude the client service cycle by obtaining direct feedback as to whether we have met the Retirement System's expectations through service quality assessment meetings with management – the same individuals with whom we established expectations during our planning process. In addition to communicating with management regarding the effectiveness of our services, we use the assessment results to identify the most effective way to deliver our services as well as those areas where we need to focus and improve during the upcoming year. Our assessment process requests feedback from management on the following questions:

- Based on your most recent experience, how likely is it that you would recommend MGO (Macias Gini & O'Connell LLP) to a friend or colleague?
- What is the primary reason behind the rating you provided?
- What is one thing we could be doing differently to increase the value of our services to you?

Once we receive the response to this feedback, we identify opportunities to add value; to identify the most experienced people within our organization to best respond to the Retirement System's needs and to monitor the delivery of such services to ensure we exceed your service expectation.

In addition, we will hold recurring meetings with management to discuss emerging issues. The key objective of these meetings is to consolidate our combined knowledge of the Retirement System's organizational changes and new programs or initiatives. Such meetings will result in a better understanding of the challenges facing the Retirement System and will enable us to proactively identify opportunities and bring creative ideas to the attention of management of the Retirement System.

SECTION 5

Our Role and Your Responsibilities

We are pleased to confirm our understanding of the services we are to provide the Orange County Employees Retirement System ("Retirement System") for the year ended December 31, 2016. We will audit the Retirement System's statements of fiduciary net position as of December 31, 2016 and the related statements of changes in fiduciary net position for the fiscal year then ended, which comprise the Retirement System's basic financial statements.

Accounting standards generally accepted in the United States provide for certain required supplementary information (RSI), such as management's discussion and analysis (MD&A), to supplement the Retirement System's basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. As part of our engagement, we will apply certain limited procedures to the Retirement System's RSI in accordance with auditing standards generally accepted in the United States of America. These limited procedures will consist of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We will not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance. The following RSI is required by generally accepted accounting principles and will be subjected to certain limited procedures, but will not be audited:

1. Management's Discussion and Analysis
2. Schedule of Changes in Net Pension Liability of Participating Employers
3. Schedule of Investment Returns
4. Schedule of Employer Contributions
5. Significant Factors Affecting Trends in Actuarial Information - Pension Plan

We have also been engaged to report on supplementary information other than RSI that accompanies the Retirement System's financial statements. We will subject the following supplementary information to the auditing procedures applied in our audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America and will provide an opinion on it in relation to the financial statements as a whole:

1. Schedule of Administrative Expenses
2. Schedule of Investment Expenses
3. Schedule of Payments for Professional Services
4. Statement of Changes in Assets and Liabilities - OPEB Agency Fund

The Retirement System's Comprehensive Annual Financial Report (CAFR) will also include introductory, investment, actuarial, and statistical sections prepared by the Retirement Systems that will not be subjected to the auditing procedures applied in our audit of the financial statements, and for which our auditor's report will not provide any opinion or any assurance.

Our engagement also includes an audit of the Schedule of Pension Amounts by Employer (Schedule) for the year ended December 31, 2016, relating to a cost-sharing multiple-employer pension plan under the requirements of Governmental Accounting Standards Board (GASB) Statement No. 68, *Accounting and Financial Reporting for Pension Plans, an Amendment of GASB Statement No. 27*.

AUDIT OBJECTIVES

The objective of our audit is the expression of an opinion as to whether the Retirement System's basic financial statements are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles and to report on the fairness of the supplementary information referred to in the preceding paragraphs when considered in relation to the financial statements as a whole. Our audit will be conducted in accordance with auditing standards generally accepted in the United States of America and the standards for financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and will include tests of the accounting records of the Retirement System and other procedures we consider necessary to enable us to express such opinion. We will issue a written report upon completion of our audit of the Retirement System's financial statements. Our report will be addressed to the Board of Retirement (Board) or the Retirement System. We cannot provide assurance that an unmodified opinion will be expressed. Circumstances may arise in which it is necessary for us to modify our opinions or add emphasis-of-matter or other-matter paragraphs. If our opinion on the financial statements are other than unmodified, we will discuss the reasons with management and the Board in advance. If, for any reason, we are unable to complete the audit or are unable to form or have not formed an opinion, we may decline to express an opinion or to issue a report, or may withdraw from this engagement.

We will also provide a report (that does not include an opinion) on internal control related to the financial statements and compliance with the provisions of laws, regulations, and the provisions of contracts and grant agreements, noncompliance with which could have a material effect on the financial statements as required by *Government Auditing Standards*. The report on internal control and compliance and other matters will include a paragraph that states (1) that the purpose of the report is solely to describe the scope of testing of internal control and compliance, and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control on compliance, and (2) that the report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. The paragraph will also state that the report is not suitable for any other purpose. If during our audit we become aware that the Retirement System is subject to an audit requirement that is not encompassed in the terms of this engagement, we will communicate to management and those charged with governance that an audit in accordance with U.S. generally accepted auditing standards and the standards for financial audits contained in *Government Auditing Standards* may not satisfy the relevant legal, regulatory, or contractual requirements.

MANAGEMENT RESPONSIBILITIES

Management is responsible for the financial statements and all accompanying information as well as all representations contained therein.

Management is responsible for making all management decisions and performing all management functions relating to the financial statements and related notes and for accepting full responsibility for such decisions. Further, management is required to designate an individual with suitable skill, knowledge, or experience to oversee any nonaudit services we provide and for evaluating the adequacy and results of those services and accepting responsibility for them.

Management is responsible for establishing and maintaining effective internal controls, including evaluating and monitoring ongoing activities, to help ensure that appropriate goals and objectives are met; following laws and regulations; and ensuring that management is reliable and financial information is reliable and properly reported. Management is also responsible for implementing systems designed to achieve compliance with applicable laws, regulations, contracts, and grant agreements. Management is also responsible for the selection and application of accounting principles, for the preparation and fair presentation of the financial statements in conformity with U.S. generally accepted accounting principles, and for compliance with applicable laws and regulations and the provisions of contracts and grant agreements.

Management is also responsible for making all financial records and related information available to us and for the accuracy and completeness of that information. Management is also responsible for providing us with (1) access to all information of which management is aware that is relevant to the preparation and fair presentation of the financial statements, (2) additional information that we may request for the purpose of the audit, and (3) unrestricted access to persons within the government from whom we determine it necessary to obtain audit evidence.

Management's responsibilities include adjusting the financial statements to correct material misstatements and for confirming to us in the written representation letter that the effects of any uncorrected misstatements aggregated by us during the current engagement and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

Management is responsible for the design and implementation of programs and controls to prevent and detect fraud, and for informing us about all known or suspected fraud affecting the government involving (1) management, (2) employees who have significant roles in internal control, and (3) others where the fraud or illegal acts could have a material effect on the financial statements. Management's responsibilities include informing us of any knowledge of any allegations of fraud or suspected fraud affecting the government received in communications from employees, former employees, grantors, regulators, or others. In addition, management is responsible for identifying and ensuring that the entity complies with applicable laws, regulations, contracts, agreements, and grants, and for taking timely and appropriate steps to remedy any fraud, illegal acts, violations of contracts or grant agreements, or abuse that we may report.

Management is responsible for the preparation of the supplementary information in conformity with U.S. generally accepted accounting principles. Management agrees to include our report on the supplementary information in any document that contains and indicates that we have reported on the supplementary information. Management also agrees to include the audited financial statements with any presentation of the supplementary information that includes our report thereon. Management's responsibilities include acknowledging to us in the written representation letter that (1) management is responsible for presentation of the supplementary information in accordance with GAAP; (2) management believes the supplementary information, including its form and content, is fairly presented in accordance with GAAP; (3) the methods of measurement or presentation have not changed from those used in the prior period (or, if they have changed, the reasons for such changes); and (4) management has disclosed to us any significant assumptions or interpretations underlying the measurement or presentation of the supplementary information.

Management is responsible for establishing and maintaining a process for tracking the status of audit findings and recommendations. Management is also responsible for identifying for us previous financial audits, attestation engagements, performance audits or other studies related to the objectives discussed in the Audit Objectives section of this letter. This responsibility includes relaying to us corrective actions taken to address significant findings and recommendations resulting from those audits, attestation engagements, performance audits, or other studies. Management is also responsible for providing management's views on our current findings, conclusions, and recommendations, as well as the planned corrective actions, for the report, and for the timing and format for providing that information.

With regard to the electronic dissemination of audited financial statements, including financial statements published electronically on the Retirement System's website, management understands that electronic sites are a means to distribute information and, therefore, we are not required to read the information contained in these sites or to consider the consistency of other information in the electronic site with the original document. With regard to using the auditor's reports, management understands that a written consent must be obtained from us prior to reproduce or use our reports in bond offering official statements or other documents.

AUDIT PROCEDURES—GENERAL

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; therefore, our audit will involve judgment about the number of transactions to be examined and the areas to be tested. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We will plan and perform the audit to obtain reasonable rather than absolute assurance about whether the financial statements are free of material misstatement, whether from (1) errors, (2) fraudulent financial reporting, (3) misappropriation of assets, or (4) violations of laws or governmental regulations that are attributable to the entity or to acts by management or employees acting on behalf of the entity. Because the determination of abuse is subjective, *Government Auditing Standards* do not expect auditors to provide reasonable assurance of detecting abuse.

Because of the inherent limitations of an audit, combined with the inherent limitations of internal control, and because we will not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us, even though the audit is properly planned and performed in accordance with U.S. Generally accepted auditing standards and *Government Auditing Standards*. In addition, an audit is not designed to detect immaterial misstatements or violations of laws or governmental regulations that do not have a direct and material effect on the financial statements. However, we will inform management of any material errors, fraudulent financial reporting, or misappropriation of assets that come to our attention. We will also inform management of any violations of laws or governmental regulations that come to our attention, unless clearly inconsequential, and of any material abuse that comes to our attention. Our responsibility as auditors is limited to the period covered by our audit and does not extend to later periods for which we are not engaged as auditors.

Our procedures will include tests of documentary evidence supporting the transactions recorded in the accounts, and may include direct confirmation of certain assets and liabilities by correspondence with selected individuals, funding sources, creditors, and financial institutions. We will request written representations from the Retirement System's attorneys as part of the engagement, and they may bill the Retirement System for responding to this inquiry. At the conclusion of our audit, we will require certain written representations from management about the financial statements; compliance with laws, regulations, contracts, and grant agreements; and other responsibilities required by generally accepted auditing standards.

AUDIT PROCEDURES—INTERNAL CONTROLS

Our audit will include obtaining an understanding of the entity and its environment, including internal control, sufficient to assess the risks of material misstatement of the financial statements and to design the nature, timing, and extent of further audit procedures. Tests of controls may be performed to test the effectiveness of certain controls that we consider relevant to preventing and detecting errors and fraud that are material to the financial statements and to preventing and detecting misstatements resulting from illegal acts and other noncompliance matters that have a direct and material effect on the financial statements. Our tests, if performed, will be less in scope than would be necessary to render an opinion on internal control and, accordingly, no opinion will be expressed in our report on internal control issued pursuant to *Government Auditing Standards*.

An audit is not designed to provide assurance on internal control or to identify significant deficiencies or material weaknesses. However, during the audit, we will communicate to management and those charged with governance internal control related matters that are required to be communicated under AICPA Professional Standards and *Government Auditing Standards*.

AUDIT PROCEDURES—COMPLIANCE

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we will perform tests of the Retirement System's compliance with the provisions of applicable laws, regulations, contracts, agreements, and grants. However, the objective of our audit will not be to provide an opinion on overall compliance and we will not express such an opinion in our report on compliance issued pursuant to *Government Auditing Standards*.

AUDIT ADMINISTRATION AND OTHERS

We may from time to time, and depending on the circumstances, use third-party service providers in serving the Retirement System's account. We may share confidential information about the Retirement System with these service providers, but remain committed to maintaining the confidentiality and security of the information. Accordingly, we maintain internal policies, procedures, and safeguards to protect the confidentiality of any personal information. In addition, we will secure confidentiality agreements with all service providers to maintain the confidentiality of the Retirement System's information and we will take reasonable precautions to determine that they have appropriate procedures in place to prevent the unauthorized release of any confidential information to others. In the event that we are unable to secure an appropriate confidentiality agreement, the Retirement System will be asked to provide consent prior to the sharing of any confidential information with the third-party service provider. Furthermore, we will remain responsible for the work provided by any such third-party service providers.

We understand that the Retirement System's employees will prepare all confirmations we request and will locate any documents selected by us for testing.

We will provide copies of our reports to the Retirement System; however, management is responsible for distribution of the reports and the financial statements. Unless restricted by law or regulation, or containing privileged and confidential information, copies of our reports are to be made available for public inspection.

The audit documentation for this engagement is the property of Macias Gini & O'Connell LLP and constitutes confidential information. However, subject to applicable laws and regulations, audit documentation and appropriate individuals will be made available upon request and in a timely manner to the California State Controller's Office or the U.S. Government Accountability Office for purposes of a quality review of the audit, to resolve audit findings, or to carry out oversight responsibilities. We will notify the Retirement System of any such request. If requested, access to such audit documentation will be provided under the supervision of Macias Gini & O'Connell LLP personnel. Furthermore, upon request, we may provide copies of selected audit documentation to the aforementioned parties. These parties may intend, or decide, to distribute the copies or information contained therein to others, including other governmental agencies.

The audit documentation for this engagement will be retained for a minimum of seven years after the report release date or for any additional period requested by the California State Controller's Office.

In connection with this engagement, we may communicate with management or others via e-mail transmission. As e-mail can be intercepted and read, disclosed, or otherwise used or communicated by an unintended third party, or may not be delivered to each of the parties to whom they are directed and only to such parties, we cannot guarantee or warrant that e-mail from us will be properly delivered and read only by the addressee. Therefore, we specifically disclaim and waive any liability or responsibility whatsoever for interception or unintentional disclosure or communication of e-mail transmissions, or for the unauthorized use or failed delivery of e-mail transmitted by us in connection with the performance of this engagement. In that regard, management agrees that we shall have no liability for any loss of damage to any person or entity resulting from the use of e-mail transmissions, including any consequential, incidental, direct, indirect, or special damages, such as loss of revenues or anticipated profits, or disclosure or communication of confidential or proprietary information.

With regards to the electronic dissemination of audited financial statements, including financial statements published electronically on the Retirement System's website, management understands that electronic sites are a means to distribute information and, therefore, we are not required to read the information contained in these sites or to consider the consistency of other information in the electronic site with the original document.

Professional and certain regulatory standards require us to be independent in both fact and appearance, with respect to the Retirement System in the performance of our services. Any discussions that the Retirement System has with personnel of our firm regarding employment could pose a threat to our independence. Therefore, the Retirement System agrees to inform us prior to any such discussions so that we can implement appropriate safeguards to maintain our independence.

Government Auditing Standards require that we provide you with a copy of our most recent external peer review report and any letter of comment, and any subsequent peer review reports and letters of comment received during the period of the contract. Our 2015 peer review is presented on the next page.



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September 17, 2015

System Review Report

To the Partners of Macias Gini & O'Connell LLP
and the National Peer Review Committee

We have reviewed the system of quality control for the accounting and auditing practice of Macias Gini & O'Connell, LLP (the firm) applicable to engagements not subject to PCAOB permanent inspection in effect for the year ended March 31, 2015. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. As a part of our peer review, we considered reviews by regulatory entities, if applicable, in determining the nature and extent of our procedures. The firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Our responsibility is to express an opinion on the design of the system of quality control and the firm's compliance therewith based on our review. The nature, objectives, scope, limitations of, and the procedures performed in a System Review are described in the standards at www.aicpa.org/prsummary.

As required by the standards, engagements selected for review included engagements performed under *Government Auditing Standards* and audits of employee benefit plans.

In our opinion, the system of quality control for the accounting and auditing practice of Macias Gini & O'Connell, LLP applicable to engagements not subject to PCAOB permanent inspection in effect for the year ended March 31, 2015, has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)* or *fail*. Macias Gini & O'Connell, LLP has received a peer review rating of *pass*.

Carr, Riggs & Ingram, LLC

CARR, RIGGS & INGRAM, LLC

SECTION 6

Changes in the World of Governmental Accounting

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The following is a summary of the more recent and relevant accounting and reporting developments, which may have an impact on the Retirement System's financial statements or those of its participating employers. We will have ongoing discussions with management about these as well as other developments in an effort to be prepared in advance for their implementation.

GOVERNMENTAL ACCOUNTING STANDARDS BOARD (GASB) PRONOUNCEMENTS

FISCAL YEAR 2016 IMPLEMENTATION

GASB STATEMENT NO. 72, FAIR VALUE MEASUREMENT AND APPLICATION

Statement No. 72 addresses accounting and financial reporting issues related to fair value measurements. The definition of fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This Statement provides guidance for determining a fair value measurement for financial reporting purposes. This Statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements.

GASB STATEMENT NO. 76, THE HIERARCHY OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES FOR STATE AND LOCAL GOVERNMENTS

Statement No. 76 reduces the GAAP hierarchy to two categories of authoritative GAAP and addresses the use of authoritative and nonauthoritative literature in the event that the accounting treatment for a transaction or other event is not specified within the source of authoritative GAAP. The statement improves financial reporting by having governments apply financial reporting guidance with less variation, which will improve the usefulness of financial statement information for making decisions and assessing accountability and enhance the comparability of financial statement information among governments.

Questions?

The West Coast is our home.

WE HAVE CHEERFUL OFFICES THROUGHOUT CALIFORNIA.

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A new breed
of professional
services firm

B



Memorandum

DATE: March 20, 2017
TO: Members of the Audit Committee
FROM: David James, CPA, Director of Internal Audit
SUBJECT: **AUDIT OF CITY OF SAN JUAN CAPISTRANO PAYROLL TRANSMITTALS**

Recommendation

Receive and file.

Background/Discussion

The OCERS Internal Audit Division has completed an independent audit of the procedures for transmitting and processing payroll data between the City of San Juan Capistrano (SJC) and OCERS. Based on our audit, Internal Audit has determined that SJC has adequate controls to ensure accurate, complete, and timely transmittal of payroll data to OCERS. SJC should make improvements to its payroll system for uploading salary records for employees on leave status and for employees subject to IRS pensionable salary limitations into the V3 system. SJC should also correct certain employment dates that have repeatedly reoccurred in V3 payroll transmittal exception reports. Finally, OCERS' Member Services should work with SJC to correct one member's contribution rate and begin collection efforts for underpaid contributions. Details of our audit, findings, recommendations, and management responses are in the report following.

Submitted by:

The OCERS logo is repeated here, with the text "D.J. - Approved" to its right.

OCERS D.J. - Approved

David James, CPA
Director of Internal Audit



**Audit of City of San Juan Capistrano
Payroll Transmittals**

Report Date: March 22, 2017

Internal Audit Department

Director of Internal Audit: David James, CPA, MBA

Internal Auditor: Mark Adviento, CPA

OCERS Internal Audit
Audit of San Juan Capistrano Payroll Transmittals
March 22, 2017

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Conclusion / Executive Summary

The OCERS Internal Audit Division has completed an independent audit of the procedures for transmitting and processing payroll data between the City of San Juan Capistrano (SJC) and OCERS. Based on our audit, Internal Audit has determined that SJC has adequate controls to ensure accurate, complete, and timely transmittal of payroll data to OCERS. SJC should make improvements to its payroll system for uploading salary records for employees on leave status and for employees subject to IRS pensionable salary limitations into the V3 system. SJC should also correct certain employment dates that have repeatedly reoccurred in V3 payroll transmittal exception reports. Finally, OCERS' Member Services should work with SJC to correct one member's contribution rate and begin collection efforts for underpaid contributions. The details of our findings and recommendations are discussed further in the "Findings, Recommendations, and Management Responses" section of the report.

Objective, Scope, and Methodology

The objective of the audit was to determine the accuracy, completeness, effectiveness, efficiency, and timeliness of the procedures for transmitting and processing SJC payroll data between SJC and OCERS. The scope of the review included payroll transmittals from January 2015 through September 2016. The methodology included, but was not limited to, the following:

- Review SJC's policies and procedures for the payroll transmittal process.
- Interview staff at SJC and OCERS involved in the payroll transmittal process to get an understanding of the processes in place, identify existing controls, and determine the efficiency of the processes.
- Determine whether the controls in place appear to be effective and functioning as designed.
- Trace sample transactions from SJC's payroll transmittal records to OCERS' V3 system and OCERS' cash receipts to determine accuracy, completeness, and timeliness.
- Trace sample transactions from SJC's payroll transmittal records to its source documents to determine the accuracy and completeness of data transmitted to OCERS.

We planned and performed this review to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our review objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our review objective. We would like to thank SJC management and staff for their cooperation.

Background

Each biweekly pay period, SJC's payroll accountant (accountant) collects a paper timesheet from SJC's 82 full time employees. The accountant reviews these timesheets for the appropriate supervisory approvals and also for authorizations for any time off taken such as for vacation or medical leave of absence. The accountant then enters hours worked or leave time used for each employee into SJC's payroll software GEMS (Government e-Management Solutions) for each pay period. Authorized employee status changes such as promotions or step increases are entered into GEMS by Human Resources. Human Resources also verbally updates payroll staff with upcoming payroll changes such as new hires, terminations, promotions, or transfers. With both timesheet data and authorized employee status changes entered into GEMS, the accountant generates a preliminary payroll report the week before payday Friday.

The preliminary payroll report also includes exception reports that identify potential payroll anomalies. Thresholds are programmed into GEMS to identify such anomalies, and one example includes flagging excessive gross pay. Other exceptions flagged by GEMS include new employee, terminated employees, or changes in employee profiles such as pay rates increases. Once these items have been researched or confirmed by the accountant, all timesheets and the preliminary payroll report are submitted to the Senior Accountant for supervisory review.

SJC Management Review of Payroll

The Senior Accountant reviews the timesheets and the preliminary payroll for accuracy and completeness. Once the review is completed and any errors identified by the review are corrected, the payroll accountant runs the final payroll report. The Senior Accountant signs off on the cover page of the final payroll report indicating evidence of her review and provides the payroll report to the Controller for an analytical review. Once approved by the Controller, the accountant then creates the journal entries from GEMS for posting in the General Ledger; payroll checks are cut, and electronic payment wire instructions are sent to the bank.

Payroll Transmittal to OCERS

SJC has reconfigured GEMS to create the required electronic payroll file to be uploaded into V3 via V3's employee self-service module (ESS). The file contains several data fields for the current pay period including employee name, pensionable salary, earnable salary, employee contributions, and employer contributions. To ensure that the transmittal file is accurate and complete, V3 performs a series of automated checks of SJC's transmittal files against V3's expected values. Significant errors prevent the file

from posting to V3 unless the errors are corrected by SJC personnel, who may discuss the errors with OCERS' Member Services staff.

SJC electronically wires the employee contributions for the pay period to OCERS' bank. SJC's accountant emails OCERS' Finance division a spreadsheet containing a listing of employees, pensionable salary and pay items, and employee and employer contribution calculations. The spreadsheet is automatically generated by GEMS. The total of employee contributions on the spreadsheet should match with the amount wired to OCERS' bank. SJC's employer contributions are not paid each pay period, but are prepaid for the entire year in January; a true-up employer contributions billing or refund is calculated by OCERS Finance division at year-end.

OCERS' Finance Division's Reconciliation and Recordkeeping

OCERS' Finance division records SJC's employee contributions wire on the general ledger. The Finance division performs a three-way match between 1) the V3 transmittal transaction summary total of employee and employer contributions released into V3 by SJC; and 2) the dollar total of employee and employer contributions within SJC's biweekly transmittal email to OCERS; and 3) the dollar amount wired to OCERS' bank from SJC for employee only contributions. Any discrepancies in amounts are forwarded back to SJC to be researched and cleared. Since SJC prepays employer contributions at the beginning of the year, Finance keeps a running tally of SJC's transmitted biweekly employer contributions to make a final adjustment against SJC's prepayment amount at calendar year-end.

Internal Audit Testwork

Internal Audit tested 60 payroll transactions from 38 personnel that were posted to OCERS' pension administration system from January 2015 through September 2016. For each payroll transaction tested, Internal Audit traced hours worked, pensionable salary, pensionable pay items, employee contribution amount, and employee contribution rate between SJC's payroll and human resource records and V3 for accuracy. Internal Audit also verified that timesheets were properly approved by a supervisor and that SJC's final payroll reports were reviewed by the SJC management. Finally, Internal Audit tested for the timeliness of contributions amounts wired by SJC to OCERS.

For each employee tested, Internal Audit traced name, social security number, age of entry into OCERS, entry date into OCERS, and date of birth from V3 against Member Affidavits to ensure correct employee contribution rates.

To test for completeness of SJC payroll data sent to OCERS, Internal Audit traced total employee contributions from SJC's 20 contributions spreadsheets tested against cash receipts wired to OCERS' bank and recorded by OCERS' Finance division. For employer contributions, we recalculated amounts stated on SJC's payroll reports against OCERS' Finance division spreadsheet used to true-up employer contribution amounts at calendar year-end.

Internal Audit also reviewed the benefit calculations for recent SJC retirees and noted no exceptions related to compensation earnable or ad-hoc enhancements indicative of pension spiking. SJC also does not hire OCERS' retirees who would then be subject to a 960 hour annual limit. Finally, OCERS has not been notified by law enforcement or the District Attorney of any SJC payees subject to PEPRA's felony conviction statute requiring a reduction in benefit payments.

Findings, Recommendations and Management Responses

Finding #1 – Payroll Transmittal Records (Significant)

As set by IRS rules section 401(a), upon reaching certain limits in pensionable salary, which are lower for PEPRA members, individuals are not allowed to pay further contributions into a pension system. Member Services informed Internal Audit that SJC properly stopped deducting contributions for one employee who had reached the PEPRA limit in pay period #19, 2016, before reciprocity had been established. OCERS verified reciprocity for this employee on December 21, 2016.

However, SJC' GEMS system, as it is currently designed, must drop the employee entirely off of the V3 payroll transmittal file in order to stop reporting contributions from an employee who has hit the above limit.

OCERS needs to continue receiving pay records showing hours worked by these members in order to update the member's years of service credit. OCERS also needs to continue receiving the member's earnable salary records in order to update the member's current final average salary used for benefit calculations and for OCERS' actuary to properly determine the actuarial accrued liability. According to SJC, there are four other employees whose salaries are subject to 401(a) limits in 2017.

Recommendation

SJC should consider the costs and benefits of adjusting GEMS to continue reporting pay records, including zero contributions, for employees who have reached the contribution limits set by IRS rule 401 (a) in the V3 payroll transmittal file, instead of dropping the employee off the V3 transmittal file. If not feasible, SJC should submit manual payroll adjustments into V3 that contain the payroll records required by OCERS for every subsequent pay period until year-end.

Management Response

San Juan Capistrano will submit manual payroll adjustments into V3 that contain the payroll records required by OCERS for every subsequent pay period until year-end.

Finding #2 – Contribution Basis Dates (Minor)

Internal Audit reviewed V3's payroll exception reporting for SJC for each pay period since V3 went live in December 2015. From a total of 82 SJC employees, V3 detected a consistent error message for 13 employees stating that the *“Reported contribution basis date (on SJC's transmittal file) does not match contribution basis date on file (in V3)”* from pay period #1, 2016 through pay period #22, 2016. The contribution amounts did reflect correct entry age and plan membership. These differences were automatically

captured by V3's automated validation process as "exceptions" after SJC's payroll data was uploaded into V3. These are not the same as more serious "fatal errors" which V3 does not allow into a member's payroll record.

For five of these employees, SJC's payroll transmittal files did not reflect a contribution basis date reflecting reciprocity established between OCERS and a reciprocal system. OCERS notifies plan sponsors of the proper contribution basis date when reciprocity has been established so that the employer can update its payroll transmittal records. A listing of these employees and their proper contribution basis dates have been provided to SJC for correction. The contribution basis dates are correct in the V3 system.

For the remaining employees, the contribution basis date on SJC's payroll transmittal file reflected the start date with SJC, instead of the enrollment date with OCERS, because the employee had originally started with SJC in a job classification not eligible for OCERS' membership. A listing of these employees and their proper contribution basis dates have been provided to SJC for correction. The above referenced exceptions occur because of a limitation associated with SJC's payroll system, GEMS, which is being evaluated by SJC's management for replacement.

Recommendation

For the 13 employees with exceptions, SJC's V3 transmittal file should reflect the correct reciprocal start date or the correct enrollment date with OCERS in the transmittal file field labeled "Reported Contribution Basis Date" in order to prevent these payroll exceptions from occurring again in V3. Although payroll data can be submitted into V3 with exceptions such as above, SJC should fix the cause(s) for such exceptions so that they do not recur in the future. V3's validation process provides automated reporting for the benefit of plan sponsors to identify and correct such exceptions.

Management Response

San Juan Capistrano concurs with this recommendation, which has been addressed based on information provided by OCERS' Member Services to SJC's Payroll Accountant.

Finding #3 – Earnable Salary Records for Employees on Leave of Absence (Significant)

SJC's GEMS payroll system currently does not have an option for reporting full earnable salary records for employees on a leave of absence status such as medical leave or workers compensation leave, nor can it report a member status code that reflects a leave of absence when creating the V3 payroll transmittal file.

If such employees were out on leave, the employee's full earnable salary records would thus not be included in SJC's V3 payroll transmittal. However, V3 still needs earnable

salary records for employees, even if they are on leave. Earnable salary records are needed for the proper reporting of salary records to OCERS' actuary for calculating the actuarial accrued liability and also to update the member's current final average salary used for benefit calculations.

Recommendation

SJC should consider the costs and benefits of adjusting GEMS to report earnable salary for employees on a leave of absence status, and to report a member status code reflecting a leave of absence when creating the V3 payroll transmittal file. If not feasible, SJC should submit manual payroll adjustments into V3 that contain earnable salary payroll records required by OCERS during each pay period that the employee is out on a leave of absence.

Management Response

San Juan Capistrano will submit manual payroll adjustments into V3 that contain earnable salary payroll records required by OCERS during each pay period that the employee is out on leave of absence.

Finding #4 – Entry Age (Minor)

For one member tested, Internal Audit noted that CalPERS' reciprocity certification letter to OCERS incorrectly stated an entry age of 36 when the calculated age of entry based on date of birth and date of entry was 38. Member Services confirmed this error with CalPERS. OCERS used the entry age of 36 when establishing the member with OCERS. Thus the member has underpaid contributions for nearly 10 years of service with SJC with an incorrect entry age of 36 instead of 38. Internal Audit estimates this amount of underpaid contributions to be approximately \$2,500 plus approximately \$500 in interest.

Recommendation

Member Services should update V3 records to reflect the member's correct age of entry and reciprocal contribution basis date. Member Services should inform SJC of the member's correct age of entry and correct contribution basis date using the Member Notification of Change Form. Member Services should also finalize the final amount of underpaid contributions due from the member plus interest so that SJC can begin collection efforts via payroll deductions.

Management Response

Member Services will notify the member that there was an error in the contribution basis date used to collect contributions since their date of entry. Member Services will update V3 accordingly and finalize the calculation of contributions due from the member plus

interest. OCERS staff will offer the member a payment plan pursuant to our standard process and work with SJC to establish the collection via payroll deductions from the member's biweekly paycheck.

Finding #	Finding	Rec #	Recommendation
1	SJC' GEMS system drops an employee entirely off of the V3 payroll transmittal file in order to stop reporting contributions subject to IRS 401(a) limits. OCERS needs to continue receiving pay records to update the member's years of service credit and salary records.	1	SJC should consider the costs and benefits of adjusting GEMS or making manual adjustments to the transmittal file to continue reporting to OCERS pay records, including zero contributions, for employees who have reached the IRS rule 401 (a) limit. (Significant)
2	From a total of 82 SJC employees, V3 detected a consistent error message for 13 employees related to contribution basis dates from pay period #1, 2016 through pay period #22, 2016.	2	SJC's V3 transmittal file should reflect the correct reciprocal start date or the correct enrollment date with OCERS in the transmittal file field labeled "Reported Contribution Basis Date" in order to prevent these payroll exceptions from occurring again in V3. (Minor)
3	SJC's GEMS payroll system currently does not have an option for reporting full earnable salary records for employees on a leave of absence status.	3	SJC should consider the costs and benefits of adjusting GEMS to report earnable salary for employees on a leave of absence status. If not feasible, SJC should submit manual payroll adjustments into V3. (Significant)
4	One member has underpaid contributions of approximately \$2,500 for nearly 10 years of service with SJC due to an incorrect entry age.	4	Member Services should update V3 records to reflect the correct age of entry and finalize the final amount of underpaid contributions so that SJC can begin collection efforts via payroll deductions. (Minor)

Report Item Classifications

For reporting our audit findings and recommendations, we classify the report items in three categories:

Critical – a control deficiency that is a critical exception to a business process or goal. Management should address immediately.

Significant – a significant deficiency in the design or operation of internal controls. Management should address promptly with corrective action.

Minor – will meaningfully enhance the design or operation of specific internal controls or improve upon a general business process. Management should address in a reasonable amount of time.

C

Memorandum

DATE: March 20, 2017
TO: Members of the Audit Committee
FROM: David James, CPA, Director of Internal Audit
SUBJECT: **CONSIDERATION OF REVISIONS TO THE INTERNAL AUDIT CHARTER AND AUDIT COMMITTEE CHARTER**

Recommendation

Take appropriate action.

Background/Discussion

At the Audit Committee meeting on February 28, 2017, the Audit Committee Charter and Internal Audit Charter were presented for review and comments by Committee members. Committee members indicated several changes that are incorporated in the following redline versions. These revised versions of the two charters are presented for the Committee's consideration.

Submitted by:

ORANGE COUNTY
CCERS D.J. - Approved
EMPLOYEES RETIREMENT SYSTEM

David James, CPA
Director of Internal Audit

Introduction

1. The Board of Retirement has established an Audit Committee to assist it in overseeing the audit function within OCERS. The Audit Committee is an advisory committee to the Board of Retirement, and its recommendations are subject to final approval by the Board. Notwithstanding the preceding sentence, with respect to those matters expressly assigned to it in this Audit Committee Charter, the Audit Committee has final authority.

Purpose

2. The Audit Committee provides oversight of OCERS' internal and external audit activities. The Audit Committee assists the Board in ensuring the independence of the internal audit functions and ensuring that appropriate action is taken on audit recommendations. The Audit Committee helps promote and enhance effective internal controls for OCERS operations, and oversees communication between external auditors, internal auditors, and management.

Membership

3. The Audit Committee will consist of four members of the Board of Retirement. The Board Chair will appoint members of the Audit Committee as provided in the OCERS By-Laws and designate one member to serve as the Committee Chair.

Ideally, members should have expertise in accounting, auditing, financial reporting, and internal control. Although these desired traits are not mandatory, members should be sufficiently knowledgeable about these topics to make informed decisions with the assistance of a financial expert.

Meetings

4. The Audit Committee will meet at least quarterly, with authority to convene additional meetings as circumstances require. All Audit Committee members are expected to attend each meeting. The Director of Internal Audit and Internal Audit staff will attend all Audit Committee meetings. Meeting notices will be provided to interested parties in conformance with applicable laws, regulations, customs, and practices. All meetings are subject to the Brown Act. Meeting agendas will be prepared and provided in advance to members, along with appropriate briefing materials. Minutes of meetings will be prepared. Minutes of the meeting will contain a record of persons present, decisions taken, and a high-level summary of the discussion.

Responsibilities and Duties

5. The Audit Committee's key areas of responsibility are:
 - a. *Law and Ethics*: The Audit Committee will provide the policy and framework for compliance with laws and regulations, mechanisms for assessment of compliance, and communication with the Board on OCERS policies.
 - b. *Financial Reporting Process*: The Audit Committee will:

OCERS Board Charter

Audit Committee Charter

1. Oversee Monitor management's processes for the reporting of all financial information, including management's reviewing with the external auditor regarding their scope, plan, duties, responsibilities, and the timing and engagement fee of the annual financial audit;
 2. Resolve disagreements between the internal auditor, external auditor, and /or management regarding financial reporting and internal control risks identified in the audit;
 3. Review the audited financial statements with the external auditor and senior management;
 4. Review management letters with management;
 5. Review the findings or comments of regulatory agencies concerning financial statements or other information regarding OCERS;
 6. Review the external auditor's assessments of the appropriate application of accounting principles by OCERS management;
 7. Review all matters required to be disclosed by accounting standards, including significant changes in those standards; and
 8. Meet with senior management, at least annually, to discuss the effectiveness of the internal financial and operational control policies. Annually, the Audit Committee chairperson shall meet with the external auditor to hear the external auditor's concerns, if any, that have arisen during the course of the annual external audit.
- c. *Oversight of the External Auditors:* The Audit Committee will:
1. Appoint, compensate, retain, and oversee the work of external auditors engaged for the purpose of issuing an independent audit report or performing other independent audits, reviews, or attest services;
 2. Select external audit services for the Comprehensive Annual Financial Report;
 3. Review the engagement of the external auditor at least every three years for performance, independence, and the impact of non-audit services; and
 4. Approve other audits, agreed upon procedures, and non-audit work to be conducted by the external auditors.
- d. *Oversight of Internal Audit:* The Audit Committee will:
1. Approve all decisions regarding the performance evaluation, appointment, or removal of the Director of Internal Audit;
 2. Approve the compensation and salary adjustments of the Director of Internal Audit in accordance with OCERS' merit pool adjustment process and budgeting process;
 3. Review the charters and policies assigned to Audit Committee at least once every three years in accordance with the schedule set forth in the OCERS Charters and Policies Review Schedule and recommend the same for approval by the Board of Retirement;

OCERS Board Charter

Audit Committee Charter

4. Review and approve the risk assessment and annual Internal Audit Plan prepared by the Director of Internal Audit;
 5. Receive and review internal and external audit reports and management responses;
 6. Review significant recommendations from audits during the year and management's responses, and make appropriate recommendations to the Board; and
 7. Make appropriate inquiries of the Director of Internal Audit to determine whether there is audit scope or budgetary limitations that impede the ability of the internal audit activity to carry out its responsibilities.
- e. *Internal Control and Risk Management:* The Audit Committee will review management responsibilities for:
1. The adequacy of OCERS' internal controls, including information systems;
 2. Material risks facing OCERS and management's actions to minimize risk;
 3. Risks from external organizations such as service providers, vendors, investment managers, consultants, and plan sponsors; and
 4. Special investigations and whistleblower mechanisms. The Audit Committee can retain independent counsel, accountants, or other specialists to assist in the conduct of an investigation.

Reporting

6. The Audit Committee will:
 - a. Report to the Board of Retirement its activities and the results of its reviews; and
 - b. Review significant changes in accounting standards, policies, or practices that may impact OCERS and report the results of that review to the Board of Retirement.

Charter Review

7. The Audit Committee will review this Charter at least once every three (3) years and recommend any amendments to the Board for approval as necessary to ensure that the Charter remains relevant and appropriate.

Charter History

8. The Audit Committee Charter was adopted by the Board of Retirement on November 18, 2002, and amended on January 17, 2012, ~~and~~ July 20, 2015, and March 29, 2017.



OCERS Board Charter Audit Committee Charter

Secretary's Certificate

I, the undersigned, the duly appointed Secretary of the Orange County Employees Retirement System, hereby certify the adoption of this policy.

A handwritten signature in blue ink that reads "Steve Delaney". The signature is written over a light blue rectangular background.

Steve Delaney, Secretary of the Board

7/20/153/29/17

Date

Introduction

1. The Board of Retirement has established an Audit Committee to assist it in overseeing the audit function within OCERS. The Audit Committee is an advisory committee to the Board of Retirement, and its recommendations are subject to final approval by the Board. Notwithstanding the preceding sentence, with respect to those matters expressly assigned to it in this Audit Committee Charter, the Audit Committee has final authority.

Purpose

2. The Audit Committee provides oversight of OCERS' internal and external audit activities. The Audit Committee assists the Board in ensuring the independence of the internal audit functions and ensuring that appropriate action is taken on audit recommendations. The Audit Committee helps promote and enhance effective internal controls for OCERS operations, and oversees communication between external auditors, internal auditors, and management.

Membership

3. The Audit Committee will consist of four members of the Board of Retirement. The Board Chair will appoint members of the Audit Committee as provided in the OCERS By-Laws and designate one member to serve as the Committee Chair.

Ideally, members should have expertise in accounting, auditing, financial reporting, and internal control. Although these desired traits are not mandatory, members should be sufficiently knowledgeable about these topics to make informed decisions with the assistance of a financial expert.

Meetings

4. The Audit Committee will meet at least quarterly, with authority to convene additional meetings as circumstances require. All Audit Committee members are expected to attend each meeting. The Director of Internal Audit and Internal Audit staff will attend all Audit Committee meetings. Meeting notices will be provided to interested parties in conformance with applicable laws, regulations, customs, and practices. All meetings are subject to the Brown Act. Meeting agendas will be prepared and provided in advance to members, along with appropriate briefing materials. Minutes of meetings will be prepared. Minutes of the meeting will contain a record of persons present, decisions taken, and a high-level summary of the discussion.

Responsibilities and Duties

5. The Audit Committee's key areas of responsibility are:
 - a. *Law and Ethics*: The Audit Committee will provide the policy and framework for compliance with laws and regulations, mechanisms for assessment of compliance, and communication with the Board on OCERS policies.
 - b. *Financial Reporting Process*: The Audit Committee will:

OCERS Board Charter **Audit Committee Charter**

1. Monitor management's processes for the reporting of all financial information, including management's review with the external auditor regarding their scope, plan, duties, responsibilities, and the timing and engagement fee of the annual financial audit;
 2. Resolve disagreements between the internal auditor, external auditor, and /or management regarding financial reporting and internal control risks identified in the audit;
 3. Review the audited financial statements with the external auditor and senior management;
 4. Review management letters with management;
 5. Review the findings or comments of regulatory agencies concerning financial statements or other information regarding OCERS;
 6. Review the external auditor's assessments of the appropriate application of accounting principles by OCERS management;
 7. Review all matters required to be disclosed by accounting standards, including significant changes in those standards; and
 8. Meet with senior management, at least annually, to discuss the effectiveness of the internal financial and operational control policies. Annually, the Audit Committee chairperson shall meet with the external auditor to hear the external auditor's concerns, if any, that have arisen during the course of the annual external audit.
- c. *Oversight of the External Auditors:* The Audit Committee will:
1. Appoint, compensate, retain, and oversee the work of external auditors engaged for the purpose of issuing an independent audit report or performing other independent audits, reviews, or attest services;
 2. Select external audit services for the Comprehensive Annual Financial Report;
 3. Review the engagement of the external auditor at least every three years for performance, independence, and the impact of non-audit services; and
 4. Approve other audits, agreed upon procedures, and non-audit work to be conducted by the external auditors.
- d. *Oversight of Internal Audit:* The Audit Committee will:
1. Approve all decisions regarding the performance evaluation, appointment, or removal of the Director of Internal Audit;
 2. Approve the compensation and salary adjustments of the Director of Internal Audit in accordance with OCERS' merit pool adjustment process and budgeting process;
 3. Review the charters and policies assigned to Audit Committee at least once every three years in accordance with the schedule set forth in the OCERS Charters and Policies Review Schedule and recommend the same for approval by the Board of Retirement;
 4. Review and approve the risk assessment and annual Internal Audit Plan prepared by the Director of Internal Audit;

OCERS Board Charter

Audit Committee Charter

5. Receive and review internal and external audit reports and management responses;
 6. Review significant recommendations from audits during the year and management's responses, and make appropriate recommendations to the Board; and
 7. Make appropriate inquiries of the Director of Internal Audit to determine whether there is audit scope or budgetary limitations that impede the ability of the internal audit activity to carry out its responsibilities.
- e. *Internal Control and Risk Management:* The Audit Committee will review management responsibilities for:
1. The adequacy of OCERS' internal controls, including information systems;
 2. Material risks facing OCERS and management's actions to minimize risk;
 3. Risks from external organizations such as service providers, vendors, investment managers, consultants, and plan sponsors; and
 4. Special investigations and whistleblower mechanisms. The Audit Committee can retain independent counsel, accountants, or other specialists to assist in the conduct of an investigation.

Reporting

6. The Audit Committee will:
 - a. Report to the Board of Retirement its activities and the results of its reviews; and
 - b. Review significant changes in accounting standards, policies, or practices that may impact OCERS and report the results of that review to the Board of Retirement.

Charter Review

7. The Audit Committee will review this Charter at least once every three (3) years and recommend any amendments to the Board for approval as necessary to ensure that the Charter remains relevant and appropriate.

Charter History

8. The Audit Committee Charter was adopted by the Board of Retirement on November 18, 2002, and amended on January 17, 2012, July 20, 2015, and March 29, 2017.



OCERS Board Charter

Audit Committee Charter

Secretary's Certificate

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A handwritten signature in blue ink that reads "Steve Delaney". The signature is written in a cursive style and is contained within a thin black rectangular border.

3/29/17

Steve Delaney, Secretary of the Board

Date

Introduction

The Audit Committee of OCERS oversees the Internal Audit Division under the following provisions:

Mission of the Internal Audit Division

1. The mission of the Internal Audit Division is to provide reliable, independent and objective evaluations and consulting services to the Audit Committee and OCERS' management relating to business and financial operations. Internal Audit assists the Board of Retirement and management to achieve their objectives by testing and reporting on the effectiveness of internal control systems, risk management, and governance processes.

Independence of the Director of Internal Audit

2. The internal audit activity must be independent, and internal auditors must be objective in performing their work. Independence is the freedom from conditions that threaten the ability of Internal Audit to carry out its responsibilities in an unbiased manner.
3. Internal Audit shall not participate in any management activity or management relationship that may impair or be presumed to impair their unbiased assessment. This participation includes those activities or relationships that may be in conflict with the interests of the organization, in accordance with the Institute of Internal Auditors' Code of Ethics.

Independence is the fundamental principle that guides the reporting relationship of the internal auditor. Internal auditor independence is strongly emphasized by authoritative bodies such as the Institute of Internal Auditors, the American Institute of Certified Public Accountants, and the Government Accountability Office. The Director of Internal Audit will follow recognized professional standards established by the Institute of Internal Auditors and be free of operational and management responsibilities that would conflict with the standards. Any potential impairment to independence will be communicated to the Audit Committee.

Organizational Reporting

4. To achieve the degree of independence necessary to effectively carry out the responsibilities of the internal audit activity, the Director of Internal Audit will have direct access to senior management and the Board of Retirement. This can be achieved by a dual-reporting relationship. The Director of Internal Audit will report functionally to the Audit Committee and administratively to the Chief Executive Officer.

Functionally reporting to the Audit Committee involves the Audit Committee:

1. Reviewing and recommending changes to the Internal Audit Charter to the Board of Retirement;
2. Approving the risk-based Internal Audit plan;
3. Receiving communications from the Director of Internal Audit on the results of audit activities;

OCERS Board Charter Internal Audit Charter

4. Approving all decisions regarding the performance evaluation, appointment, or removal of the Director of Internal Audit;
5. Approving the compensation and salary adjustments of the Director of Internal Audit;
6. Making appropriate inquiries of the Director of Internal Audit to determine whether there is audit scope or budgetary limitations that impede the ability of Internal Audit to carry out its responsibilities.

Administrative reporting is the reporting relationship within the OCERS management structure that facilitates the daily operations of the internal audit activity, which includes:

1. Budgeting and management accounting;
2. Human resource administration, including personnel evaluations, leave request approval, and compensation;
3. Internal communications and information flows;
4. Administration of the Internal Audit Division's policies and procedures.

Objectives and Scope

5. The objective of Internal Audit is to assist the Board of Retirement and management in the effective discharge of their fiduciary responsibilities. Internal Audit will furnish them with audits, analysis, evaluations, recommendations, and information. Objectives include promoting effective internal controls, helping provide assurance that the organization's assets are safeguarded; compliance is maintained with prescribed laws, Board, and management policies; the reliability and integrity of OCERS' data is maintained; and procedures and operating efficiency are enhanced.

The scope of Internal Audit includes the examination and evaluation of the adequacy of OCERS' system of internal controls, risk management and governance processes. The scope includes:

1. Reviewing the reliability and integrity of financial and business information systems, and the means used to identify, measure, classify and report such information;
2. Reviewing the systems and processes established to ensure compliance with those policies, plans, procedures, laws, and regulations that are fundamental to the operations of OCERS and could have a significant impact on operations, financial reports, and disclosures;
3. Reviewing the means of safeguarding assets and verifying the existence of such assets;
4. Monitoring and evaluating the effectiveness of OCERS' risk management systems, including identifying internal and external risks;
5. **Reviewing Auditing** the accuracy of data transmitted to OCERS by external parties.
6. Evaluating the quality of performance of external auditors and the degree of coordination with Internal Audit;
7. For consulting and advisory services, Internal Audit may provide assessments and advice to identify risks and internal controls for projects.

Authority and Responsibility

6. The Internal Audit Division is established by the OCERS Board of Retirement pursuant to applicable laws and regulations, customs of corporate governance, and best practices. This Charter and all future amendments are approved by the Audit Committee and adopted by the Board of Retirement by a majority vote.

The responsibility of OCERS Internal Audit is to serve the Board of Retirement in a manner that is consistent with the International Professional Practices Framework of the Institute of Internal Auditors, as required by California Government Code 1236. In addition, when appropriate, OCERS Internal Audit follows professional standards promulgated by the Government Accountability Office, the American Institute of Certified Public Accountants, and the Information Systems Audit and Control Association.

OCERS Internal Audit is responsible for:

1. Establishing policies and procedures for auditing, and directing and performing its technical and administrative functions;
2. Developing and executing a comprehensive audit program for the evaluation of internal controls established over OCERS' financial and business activities;
3. Preparing an annual audit plan that identifies audit projects addressing areas of highest risk to OCERS operations;
4. **Assisting Auditing** management's stewardship of OCERS' trust funds and resources and their compliance with policies and procedures;
5. Recommending improvements in internal controls to help:
 - a. Safeguard trust funds and resources,
 - b. Ensure data is not compromised,
 - c. Ensure compliance with laws and regulations;
6. **Reviewing Auditing** procedures and records for accuracy and completeness to accomplish and report on intended objectives;
7. Producing reports on the results of audits, including findings and recommendations;
8. Following-up on actions taken to correct reported deficiencies;
9. Creating and maintaining a mechanism (i.e., **OCERS' Ethics, Compliance, and Fraud Hotline**) for reporting financial statement fraud, other fraud, and inappropriate activities;
10. Conducting special investigations and analysis as needed.
- ~~11. Creating and maintaining a mechanism for reporting financial statement fraud, other fraud, and inappropriate activities~~

OCERS Board Charter Internal Audit Charter

Internal Audit Access to Personnel and Information

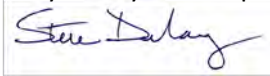
7. Except where prohibited by law, Internal Audit will have complete and unrestricted access to all OCERS personnel, records, files, information systems, and assets. The Director of Internal Audit will inform the Audit Committee whenever significant barriers or resistance to access to personnel or information occurs.

Charter History

8. The Audit Committee will review this Charter at least once every three (3) years and recommend any amendments to the Board for approval as necessary to ensure that the Charter remains relevant and appropriate.
9. The OCERS Internal Audit Charter was adopted by the Board of Retirement on November 18, 2002 and amended on August 19, 2008, January 17, 2012, and July 20, 2015.

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~~7/20/15~~3/29/17

Steve Delaney, Secretary of the Board

Date

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OCERS Board Charter Internal Audit Charter

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3. Reviewing the means of safeguarding assets and verifying the existence of such assets;
4. Monitoring and evaluating the effectiveness of OCERS' risk management systems, including identifying internal and external risks;
5. Auditing the accuracy of data transmitted to OCERS by external parties.
6. Evaluating the quality of performance of external auditors and the degree of coordination with Internal Audit;
7. For consulting and advisory services, Internal Audit may provide assessments and advice to identify risks and internal controls for projects.

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5. Recommending improvements in internal controls to help:
 - a. Safeguard trust funds and resources,
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9. Creating and maintaining a mechanism (i.e., OCERS' Ethics, Compliance, and Fraud Hotline) for reporting financial statement fraud, other fraud, and inappropriate activities;
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OCERS Board Charter Internal Audit Charter

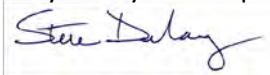
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Secretary's Certificate

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3/29/17

Steve Delaney, Secretary of the Board

Date

D

Memorandum

DATE: March 20, 2017
TO: Members of the Audit Committee
FROM: David James, CPA, Director of Internal Audit
SUBJECT: **DIRECTION FROM THE BOARD OF RETIREMENT – INVESTMENT FEES**

Recommendation

Take appropriate action.

Background/Discussion

At the March 20, 2017 Board meeting, the Board of Retirement was presented a recommendation for an amendment to OCERS' Administrative and Investment Budget for 2016 in the amount of \$28 million. The Board voted to accept the staff recommendation to approve the budget amendment. In addition, the Board directed that the issue of investment fees be transferred to the Audit Committee for further study and recommendation.

In addition, effective for new investment commitments on January 1, 2017, California Government Code Section 7514.7, (Assembly Bill No. 2833), says:

“It is the intent of the Legislature in enacting this section to increase the transparency of fees paid by public investment funds to alternative investment vehicles. Public investment funds pay significant fees to alternative investment vehicles and do not have sufficient information regarding the character and amount of those fees. As fiduciaries, public investment fund trustees have a duty to maximize investment returns in order to ensure promised benefits are adequately funded and to minimize taxpayer costs. Because fees paid to alternative investment vehicles reduce returns, public investment fund trustees need to be able to see and understand all of the fees they are charged.”

“Every public investment fund shall require each alternative investment vehicle in which it invests to make the following disclosures at least annually the fees and expenses that the public investment fund pays directly to the alternative investment vehicle, the fund manager, or related parties...”

For the past three years, OCERS' Investments division has presented an annual report on investment fees to the Investment Committee. This report broadly covers all fees paid by OCERS, both direct and indirect through funds. This annual fee report is required by the Investment Fee policy, adopted in April 2013. As of July 2016, much of the fee information is presented on a summary basis. Fees are presented by dollar amounts by asset class. For hedge funds, fees were presented by basis points. Although the fee data is currently provided in summary form, the underlying detail may or may not be sufficient if provided in a public meeting in order to comply with Section 7514.7 of the Government Code.

The Audit Committee can consider directing an audit of investment fees be performed by Internal Audit or by an outside auditor through an RFP. In the past, Internal Audit has performed investment fees audits of Bridgewater, Abbott Capital, and Pantheon. Depending on the scope and time to audit contemplated, a fee audit could involve a compilation of fees by manager and type, and analysis of those fees. An audit could include a breakdown of fees by investment managers as specified in agreements, such as management fees, performance fees, transactions fees, carried interest, and administrative costs. Contract provisions could be considered such as hurdle rates, ratchets, clawback provisions, distribution waterfalls, and other special contract terms. In

addition, a recalculation of fees could be performed. Alternatively, OCERS can review the Investments Division's processes and supporting documentation for the annual fee report presented to the Investment Committee.

Submitted by:

 ORANGE COUNTY
OCERS D.J. - Approved
EMPLOYEES RETIREMENT SYSTEM

David James, CPA
Director of Internal Audit

E

Memorandum

DATE: March 22, 2017
TO: Members of the Audit Committee
FROM: David James, CPA, Director of Internal Audit
SUBJECT: STATUS OF INTERNAL AUDIT AND AUDIT PROJECTS

Recommendation

Receive and file.

Background/Discussion

Following is a brief description of in-progress internal audits and audit projects:

Actuarial Audit: At the February 28, 2017 Audit Committee meeting, the Committee approved the RFP for an actuarial firm to perform an audit of OCERS' consulting actuary. On March 1, the RFP was released on OCERS' website. Questions were received from several vendors by March 15. Responses to questions were posted on March 22. The RFP submission deadline is April 3 by 5 p.m.

According to the RFP, OCERS will convene a review panel consisting of Audit Committee members, the Chief Executive Officer, and the Director of Internal Audit to evaluate all proposals and develop recommendations. One or more of the respondents may be requested to make an oral presentation to the committee. Should the Committee wish to receive one or more oral presentations by finalists, the Committee should consider scheduling a meeting for that purpose.

OCERS' review of RFP submissions is scheduled to be completed by April 14, with vendor interviews and selection completed by May 1. The goal is to complete the audit by October 12, 2017.

Finance and Investments Transfers Review: The fieldwork phase of this audit is in progress, with multiple interviews being done of OCERS' Investments' staff, consultants, fund managers, and staff of other public retirement systems to gain an understanding of their processes and controls. The purpose of this audit is to review the role of OCERS' staff in assessing and approving investments fundings, balancings, transactions, and valuations.

Reciprocity Claims Audit: The fieldwork phase of this audit is in progress. Internal Audit will be attending the CALAPRS Reciprocity Round Table, with other California county pension funds, on April 25 for further education about the current issues pension systems encounter with reciprocity. The purpose of the audit is to review reciprocity claims for accuracy and completeness, and adequate supporting documentation.

V3 Data Conversion Audit: A draft report with the audit findings was sent to management on August 29, 2016, and Internal Audit has been intermittently working with management to confirm and obtain responses to the findings. Additional testing on the actuarial reports was also performed after the December 2016 release of V3 version 8.3. Our plan is to revise the draft report based on the management responses to all of the findings, present the report to management for comment, and then bring the final report to the Audit Committee. The purpose was to audit the data migration from PensionGold to V3, and compare the outputs of six key reports from Pension Gold and V3 for possible discrepancies.

Submitted by:



David James, CPA
Director of Internal Audit

**Orange County Employees Retirement System
Internal Audit Division
2017 Internal Audit Plan**

Audit Activity	Description	Priority (A, B, or C)	Planned Hours - Original Budget	Actual Hours as of 3/17/17	Hours Estimated to Complete	Comments
Internal Audits						
Plan Sponsor Review	Report and presentation of plan sponsors' financial status.	A	50	45	0	Completed in February.
CIO Position Review	Review responsibilities of CIO Position.	A	200	189	0	Completed in February.
San Juan Capistrano Payroll Transmittal	Review payroll transmittals and employee data.	B	50	48	0	Completed in March.
Reciprocity Claims Audit	Review reciprocity claims for accuracy and completeness, and adequate supporting documentation.	A	250	180	70	Fieldwork in progress.
V3 Data Conversion Audit	Review data used in system conversion from PensionGold to V3.	A	50	0	50	Awaiting management response.
Finance Investments Transfers Review	Role of Investments' staff in assessing and approving investments fundings, balancings, transactions, valuations.	A	300	148	152	Fieldwork in progress.
Investments Rebalancing Review	Review rebalancing processes.	A	300	0		
Payroll Transmittal - Sheriff's Dept.	Review payroll transmittals and employee data.	A	300	0		
OCFA Payroll Transmittal	Review payroll transmittals and employee data.	B	300	0		
	Internal Audits Subtotal		1,800	610		

**Orange County Employees Retirement System
Internal Audit Division
2017 Internal Audit Plan**

Audit Activity	Description	Priority (A, B, or C)	Planned Hours - Original Budget	Actual Hours as of 3/17/17	Hours Estimated to Complete	Comments
Non-Audit Projects						
Actuarial Audit	RFP - Audit of Segal's 2015 valuation.	A	60	10		
Miscellaneous Investigations	Use of hotline reporting system.	B	50			
Risk and Control Matrix	Review and update Risk and Control Matrix.	A	50			
Risk Assessment and Audit Plan	Annual preparation of the Audit Plan, updates to the current Audit Plan.	A	50	37	0	Completed in January.
	Non-Audit Projects Subtotal		210	47		
Administration						
Board and Committee Meetings	Board meetings, Audit Committee, Investment Committee, Governance Committee.	A	300	33	267	Includes preparation time for meetings.
General Administration	Attending staff and other meetings, administrative duties.	B	1,250	85	1,165	Includes various ad hoc projects.
	Administration Subtotal		1,550	118		
	Total Hours		3,560	775		

**Orange County Employees Retirement System
Internal Audit Division
2017 Internal Audit Plan**

Audit Activity	Description	Priority (A, B, or C)	Planned Hours - Original Budget	Actual Hours as of 3/17/17	Hours Estimated to Complete	Comments
Other						
Miscellaneous Leave	Holidays, Sick Leave, Time off, etc.		432	62		
Training / Conferences	Required to maintain CPA certification. SACRS, APPFA.		168	54		
Total Hours off			600	116		
	Total Hours Available for Two Auditors		4,160	891		