
Minutes

The Audit and Compliance Committee of the Board of Trustees met on September 13, 2016 at the Virginia Retirement System located in Richmond, Virginia. The following individuals were present.

Audit and Compliance Committee Members:

William H. Leighty, Committee Chair
Diana F. Cantor, Committee and Board Vice-Chair
Robert L. Greene, Board Chair

VRS Staff:

Patricia S. Bishop, L. Farley Beaton, Cynthia W. Wilkinson, Kenneth C. Robertson, K.C. Howell, Curtis M. Mattson, John P. Alouf, Laura Pugliese, Laurie L. Nelson, Michael B. Scott, Franklin O. Berry, Jennifer B. Schreck, Judy S. Bolt, Joshua G. Fox, Krystal M. Groff, Matthew B. Priestas, and Aaron D. Yarborough

Auditor of Public Accounts: Zach L. Borgerding and Kristy M. Scott

Joint Legislative Audit and Review Commission: Mark R. Gribbin

Department of Planning and Budget (DPB): Emily M. Grimes

Mr. Leighty called the meeting to order at approximately 9:00 a.m.

Minutes

Upon motion of Mr. Greene, seconded by Ms. Cantor, the Committee approved the minutes of the Audit and Compliance Committee meeting held on June 2, 2016.

Exit with the APA on their Employer Assurances Audit

The Committee met with Zachary Borgerding, Audit Director, Auditor of Public Accounts, to receive an update on their annual examinations.

Mr. Borgerding noted that the APA has issued its audit opinions on the Schedules of Employer Allocations and related information provided by VRS and used by VRS's participating employers to reflect their pension obligations and expenses as required by GASB (Governmental Accounting Standards Board) Standard #68. APA issued unqualified audit opinions on all such data supplied to the participating employers along with an unqualified opinion on the assertions made by management with respect to the underlying census data used in arriving at such allocations.

The Committee then discussed the allocation of VRS's net pension liability as an employer. Mr. Greene and Ms. Cantor requested that Mr. Borgerding and management provide the Committee with additional information regarding the treatment of the allocation under GASB 68.

Audit Reports

Mr. Leighty then directed the Committee's attention to the presentation of the three audit reports that appeared as the next items on the agenda.

Report 364

Mr. Fox presented the first report, entitled "Investment Governance Review." He noted this examination was to determine if VRS's investment governance structures, processes and practices were aligned with the best practices of corporate governance, while identifying any areas of governance that could be improved. While the examination found VRS's governance structures, processes and practices were aligned with best practices, the review identified some relatively minor opportunities to better align these processes with the Board and management's current practices as well as more clearly articulate certain expectations of the Board to management. Additionally, the review included one recommendation for improvement, which focused on the need to consider periodic comprehensive reviews of the Board Governance Policy.

Ms. Cantor and Mr. Greene inquired regarding the scope of the engagement, confirming that the audit was primarily a document review. Then the Committee discussed additional objectives, which would assist the Committee in its oversight role. Mr. Berry indicated this was the first of two reports and that these items would be incorporated within the upcoming review of governance over VRS's administration activities.

Report 365

Next, Ms. Bolt presented the report on the "Deferred Compensation Plan, Cash Match Plan and Other Retirement Plans." She noted the examination found the Master Trusts and Plan Documents for the plans appear to conform to the requirements set forth in the Code of Virginia and the Internal Revenue Code and were sufficient to provide the third party administrator guidance to administer the plans. In addition, she reported management oversight and monitoring of the plans and related investment products were sufficient and reasonable.

Further, Ms. Bolt stated the examination found the assets of the plans were supported by underlying data as reported by the Investment Managers, and, through independent confirmation, she found such assets to be accurately recorded, in all material respects. While the report had no formal recommendations, the review did identify some issues with the adequacy of documented policies that govern the procedures performed by the Investment Accounting Department to assist with plan oversight. Management acknowledged a project has been initiated to address the scope and documentation of these procedures moving forward.

Report 367

Mr. Priestas presented the final report on "IT Client-Server General Controls." He explained VRS is moving to a client-server based operating environment and will ultimately convert all mainframe-based legacy systems to this environment once the Modernization Program is completed. He noted the examination found the overall control environment over the client-server environment was adequate; however, the examination found a few areas where controls could be improved. The report specifically identified these areas while offering opportunities for improvement for management to consider.

Mr. Berry noted management concurred with the recommendations cited in each report, while stating that planned corrective actions seemed reasonable.

Ms. Cantor requested additional information be provided to the Committee clarifying the use of document watermarks within information presented to the Committee. Mr. Greene further inquired regarding the technological safeguards for non-public electronic information reviewed as a part of audit examinations. Mr. Berry indicated additional information on both topics would be provided at a future Committee meeting.

Mr. Leighty expressed his appreciation to the staff for their reports.

Upon motion of Mr. Greene, seconded by Ms. Cantor, the Committee accepted Audit Reports 364, 365 and 367 as presented.

Audit Recommendation Follow-up System (ARFUS) – Annual Status Report

Next, Mr. Berry presented the Quarterly Audit Recommendation Follow-Up System report for the fiscal year ended June 30, 2016. Mr. Berry noted this report is prepared quarterly, but is only provided to the Committee on an annual basis due to the voluminous nature of the report. Mr. Berry observed as of June 30, 2016, there were 5 audit recommendations pending implementation, none of which presented undue risk to VRS.

It was also noted that the quarterly update for Internal Audit had been extended to July 31, 2016 to capture the closure of the one remaining finding from the Department's 2014 External Quality Assurance Review; leaving no recommendations pending implementation.

**Report #366:
Release of
Recommendations
from ARFUS**

Mr. Yarborough presented the next report entitled, "Release of Recommendations from the Audit Recommendation Follow-Up System," noting this examination is performed periodically to evaluate whether actions taken by management to implement written audit recommendations were satisfactory. Mr. Yarborough noted the examination reviewed management's implementation of six recommendations and all six were found to be sufficiently implemented to no longer warrant monitoring by Internal Audit.

Upon motion of Mr. Greene and seconded by Ms. Cantor, the Committee accepted audit report 366 as presented.

**Modernization
Quarterly Report –
Management**

Mr. Beaton presented management's report on Modernization Phase 4 through July 29, 2016. Mr. Beaton highlighted the Phase 4 Roadmap along with planned changes that will re-baseline the schedule from completion date of December 2017 to April 2018. Mr. Beaton indicated these schedule adjustments were necessary to appropriately address risk, previous lessons learned, and complexity of the areas being implemented. Mr. Beaton stated that the Phase's remaining schedule and budget contingencies will be used to address these changes.

Then the status of Release 5 through 8 was presented, along with the current budget, and staff costs. The overall schedule was presently represented as slightly behind; however, with the planned re-baselining, the overall Phase 4 Modernization scope, budget, and schedule were not represented as being at risk at this time.

**Modernization
Quarterly Report –
Internal Audit**

Mr. Priestas then presented Internal Audit's Quarterly Review of Modernization - Phase 4 as of August 1, 2016. Mr. Priestas noted that management is re-baselining the Phase 4 schedule and outstanding workstreams and indicated that the implementation of these schedule changes will fully exhaust the schedule reserves and \$4 million budgetary contingency funds. Mr. Priestas stated that nothing has come to Internal Audit's attention to indicate that Phase 4 is not on budget nor is Internal Audit aware of any significant adjustments to the scope beyond that previously reported.

Mr. Priestas also reported that Internal Audit reviewed the organizational readiness area in detail, along with VRS's plans on how the organization will function once the Phase is completed. Internal Audit expects to see more activities around this area leading into and throughout calendar year 2017.

Ms. Cantor exited the meeting at 10:20 a.m. and returned at 10:27 a.m.

**Annual Audit Plan
Results and Long
Range Plan Status–
For the Year Ended
June 30, 2016**

Mr. Berry presented the annual audit plan results for the fiscal year ended June 30, 2016, along with the long-range audit plan results for the four years ended June 30, 2016. He stated essentially all planned projects for the four years were completed, with some minor adjustments to allow for appropriate timing. The Committee congratulated the audit staff on the successful completion of the long-range audit plan.

**Future Committee
Meeting Schedule
for Calendar Year
2017**

The Committee discussed its potential meeting schedule for calendar year 2017 and asked to be polled by Ms. Schreck via email regarding their availability. The Committee will approve its 2017 meeting schedule at its December 2016 meeting.

**A Brief Recap of the
Past Year and a Look
into the Future**

Mr. Berry provided the Committee with a brief recap of the Department's accomplishments over the past year, as well as a brief look into the future regarding how the Department may need to change or shift focus in certain areas. He further recognized the contributions of both the long standing and new team members, noting he believes the Department is positioned well for the future.

Finally, Mr. Berry explicitly confirmed to the Audit and Compliance Committee that the VRS Internal Audit Department and its staff are organizationally independent of the activities they examine, and that the department is adequately staffed.

**Miscellaneous
Briefings and
Updates**

Review of Side Letters

As a follow-up to the Committee's June meeting, Mr. Yarborough presented an overview of the use of Side Letter Agreements within externally managed investments. Mr. Yarborough noted that that the letters are typically utilized to clarify matters of law such as jurisdictional venue, applicable statutes, and preference items such as most favored nation.

Review of APOs and Operating Standards

Mr. Berry reported on Internal Audit's review of the Agency Performance Outcomes and Agency Operating Standards for the fiscal year ended June 30, 2016, noting that internal audit has no reason to believe that the Agency Performance Outcomes and Agency Operating Standards were not appropriately satisfied for the fiscal year.

Confirmation of Internal Audit's Review of Investment Incentive Compensation

Mr. Berry reported on Internal Audit's review of the Investment Department's Incentive Compensation pool amounts noting the review found such amounts to be accurately computed and in accordance with the Board authorized pay plan for Investment Professionals. Mr. Berry further noted that the results of this review were provided to the Administration and Personnel Committee at their September meeting to support the Board's actions regarding Investment Professionals' compensation.

Results of the Quality Assurance and Improvement Program

Mr. Berry presented the results of the annual Internal Quality Assurance and Improvement Program Review as of June 30, 2016, noting that the Principal Auditor for Quality Assurance had completed the review and concluded there was reasonable assurance that the Internal Audit Department was performing in conformance with the International Standards for the Professional Practice of Internal Auditing.

Quarterly Report on Fraud, Waste, and Abuse Hotline Cases Ms. Bolt presented the schedule of cases received by OSIG for the period of May 1, 2016 through July 31, 2016. Ms. Bolt noted that there were two cases reported through OSIG during the period that alleged abuse of short-term disability. Neither of these cases were substantiated, and both investigations were closed.

Management's Quarterly Travel Expense and Per Diem Report The Committee reviewed the quarterly travel expense and per diem report. Mr. Fox reminded the Committee the report is a management prepared report; however, Internal Audit reviews it for reasonableness. He reported all out-of-state Board and Committee travel was within the currently approved limits.

Closed Meeting Motion Mr. Greene moved and Ms. Cantor seconded that the Audit and Compliance Committee of the Virginia Retirement System Board of Trustees convene a closed meeting under the Virginia Freedom of Information Act to discuss and consider the performance of the VRS Internal Audit Director and to discuss and consider the candidates for the position of Internal Audit Director.

Pursuant to the personnel exemption at Virginia Code § 2.2-3711(A)(1). Votes were noted as follows: Leighty – aye, Cantor – aye, Greene - aye

All attendees, except Mr. Leighty, Mr. Greene, Ms. Cantor, Ms. Wilkinson and Mr. Robertson exited the meeting at this time.

Certification Ms. Cantor seconded the following resolution:

WHEREAS, the Audit and Compliance Committee of the Virginia Retirement System Board of Trustees convened a closed meeting on this date pursuant to an affirmative recorded vote and in accordance with the provisions of The Virginia Freedom of Information Act; and

WHEREAS, § 2.2-3712 of the Code of Virginia requires a certification by this Committee that such closed meeting was conducted in conformity with Virginia law;

NOW, THEREFORE, BE IT RESOLVED, that the Committee certifies that, to the best of each member's knowledge, (i) only public business matters lawfully exempted from open meeting requirements under this chapter were discussed in the closed meeting to which this certification resolution applies, and (ii) only such public business matters as were identified in the motion by which the closed meeting was convened were heard, discussed or considered by the Committee.

Votes were noted as follows: Leighty – aye, Cantor – aye, Greene - aye

Upon exiting from the closed session, the Committee agreed to recommend to the full Board an additional five percent bonus for Mr. Berry.

Additionally, the Committee agreed to recommend Jennifer Preston Bell Schreck to the Board of Trustees for appointment to the position of Internal Audit Director, effective October 10, 2016.

There being no further business, the meeting adjourned at approximately 11:30 a.m.


Secretary


Chair