

AGENDA

A REGULAR MEETING OF THE AUDIT COMMITTEE

AND/OR BOARD OF RETIREMENT AND/OR BOARD OF INVESTMENTS*

LOS ANGELES COUNTY EMPLOYEES RETIREMENT ASSOCIATION

300 N. LAKE AVENUE, SUITE 810, PASADENA, CALIFORNIA 91101

9:00 A.M., WEDNESDAY, AUGUST 16, 2017

*The Committee may take action on any item on the agenda,
and agenda items may be taken out of order.*

2017 COMMITTEE MEMBERS

Joseph Kelly – *Chair*

Michael S. Schneider – *Vice Chair*

Vivian Gray – *Secretary*

David Green

Shawn R. Kehoe

AUDIT COMMITTEE CONSULTANT

Rick Wentzel

I. CALL TO ORDER

II. APPROVAL OF MINUTES

- A. Approval of the Minutes of the Regular Audit Committee Meeting of March 22, 2017

III. REPORT ON CLOSED SESSION ITEMS

IV. PUBLIC COMMENT

V. NON-CONSENT ITEMS

- A. Recommendation, as submitted by Richard Bendall, Chief Audit Executive, that the Audit Committee review and discuss the following engagement reports to take the following action(s):
1. accept and file report and/or,
 2. instruct staff to forward report to Boards or Committees and/or,
 3. provide further instruction to staff.
(Memo dated July 31, 2017)
 - a. Retiree Healthcare Member Verification
Nathan Amick, Internal Auditor
(Report issued June 30, 2017)
 - b. Certificates Processing Review
Darla Vidger, Internal Auditor
(Report issued June 29, 2017)
 - c. Investment Fees Audit
Quoc Nguyen, Principal Internal Auditor
(Report issued June 28, 2017)
 - d. Duplicate Special Payments
Gabriel Tafoya, Senior Internal Auditor
(Report issued January 19, 2017)
- B. Recommendation that the Audit Committee review and approve the Audit Plan for Fiscal Year End 2018 as submitted by Richard Bendall, Chief Audit Executive, and Quoc Nguyen, Principal Internal Auditor
(Memo dated July 31, 2017)

VI. REPORTS

- A. Internal Audit Staffing Report
Richard Bendall, Chief Internal Auditor
(Verbal presentation only)

VI. REPORTS (continued)

- B. Internal Audit Annual Report – Fiscal Year End 2017
Richard Bendall, Chief Audit Executive
(Report dated June 30, 2017)
- C. Recommendation Follow-Up Report
Quoc Nguyen, Principal Internal Auditor
(Memo dated June 30, 2017)
- D. Privacy Audit Recommendation Follow-Up
Richard Bendall, Chief Audit Executive
Darla Vidger, Internal Auditor
(Memo dated July 31, 2017)
- E. **Attorney-Client Privilege/Confidential Memo**
Human Resources Compliance Audit [by Liebert Cassidy Whitmore]
Recommendation Follow-Up
Richard Bendall, Chief Audit Executive
(Memo dated July 31, 2017)
- F. Status of Other External Audits Not Conducted at the Discretion of
Internal Audit
Richard Bendall, Chief Audit Executive (Verbal Presentation)
 - 1. **Attorney-Client Privilege/Confidential Memo**
Audit Report of LACERA's Pay Practices [by Liebert Cassidy
Whitmore]
Johanna Fontenot, Senior Staff Counsel
John Nogales, Human Resources Director
(Memo dated August 3, 2017)
- G. Quality Assurance & Improvement Program Report
Richard Bendall, Chief Audit Executive
(Memo dated July 31, 2017)
- H. Internal Audit Goal Report
Richard Bendall, Chief Audit Executive
(Memo dated July 31, 2017)

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VII. CONSULTANT COMMENTS

Rick Wentzel, Audit Committee Consultant
(Verbal Presentation)

VIII. REPORT ON STAFF ACTION ITEMS

IX. GOOD OF THE ORDER

(For information purposes only)

X. CLOSED SESSION

- A. Performance Evaluation – 2017 CAE Fiscal Year End Report
[Pursuant to Government Code Section 54957(b)(1)]

Title: Chief Audit Executive

- B. Performance Evaluation – 2018 CAE Goals & Expectations
[Pursuant to Government Code Section 54957(b)(1)]

Title: Chief Audit Executive

XI. ADJOURNMENT

**The Board of Retirement and Board of Investments have adopted a policy permitting any member of the Boards to attend a standing committee meeting open to the public. In the event five (5) or more members of either the Board of Retirement and/or the Board of Investments (including members appointed to the Committee) are in attendance, the meeting shall constitute a joint meeting of the Committee and the Board of Retirement and/or Board of Investments. Members of the Board of Retirement and Board of Investments who are not members of the Committee may attend and participate in a meeting of a Board Committee but may not vote on any matter discussed at the meeting. Except as set forth in the Committee's Charter, the only action the Committee may take at the meeting is approval of a recommendation to take further action at a subsequent meeting of the Board.*

Documents subject to public disclosure that relate to an agenda item for an open session of the Board and/or Committee that are distributed less than 72 hours prior to the meeting will be available for public inspection at the time they are distributed to a majority of the members of any such Board and/or Committee at LACERA's offices at 300 N. Lake Avenue, Suite 820, Pasadena, CA 91101 during normal business hours [e.g., 8:00 a.m. to 5:00 p.m. Monday through Friday].

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MINUTES OF THE REGULAR MEETING OF THE AUDIT COMMITTEE
AND BOARD OF RETIREMENT AND/OR BOARD OF INVESTMENTS*
LOS ANGELES COUNTY EMPLOYEES RETIREMENT ASSOCIATION
300 N. LAKE AVENUE, SUITE 810, PASADENA, CALIFORNIA 91101

9:00 A.M., WEDNESDAY, MARCH 22, 2017

PRESENT: Shawn R. Kehoe
Joseph Kelly
Michael S. Schneider

ABSENT: Vivian Gray
David Green

STAFF, ADVISORS, AND PARTICIPANTS

Gregg Rademacher, Chief Executive Officer

Richard Bendall, Chief Audit Executive

Steven Rice, Chief Legal Counsel

Rick Wentzel, Audit Committee Consultant

Leisha Collins, Principal Internal Auditor

Quoc Nguyen, Principal Internal Auditor

I. ELECTION OF OFFICERS (Election of Chair, Vice Chair, Secretary)

The election of officers was conducted by Chair Kelly:

A. Chair of the Audit Committee

Mr. Kelly was nominated for the position of Chair by Mr. Schneider of the 2017 Audit Committee. Hearing no other nominations, Mr. Kelly was unanimously elected Chair of the Committee.

B. Vice-Chair of the Audit Committee

Mr. Schneider was nominated for the position of Vice Chair of the 2017 Audit Committee by Mr. Kelly. Hearing no other nominations, Mr. Schneider was unanimously elected Vice Chair of the Committee.

C. Secretary of the Audit Committee

Ms. Gray was nominated for the position of Secretary of the 2017 Audit Committee by Mr. Kelly. Hearing no other nominations, Ms. Gray was unanimously elected Secretary of the Committee.

II. APPROVAL OF THE MINUTES

A. Approval of the Minutes of the Regular Audit Committee Meeting Of December 14, 2016.

Mr. Schneider made a motion, and Mr. Kehoe seconded to approve the minutes of the regular Audit Committee meeting of December 14, 2016. The motion passed unanimously.

III. PUBLIC COMMENT

No items to report.

IV. NON-CONSENT AGENDA (FORMERLY “ACTION ITEMS”)

- A. Recommendation, as submitted by Richard Bendall, Chief Audit Executive, that the Audit Committee review the Audit Committee Meeting Schedule and provide direction to staff on changes. (Memo dated March 8, 2017)

Mr. Kehoe made a motion, Mr. Schneider seconded, to approve the agenda item. The motion passed unanimously.

- B. Recommendation, as submitted by Richard Bendall, Chief Audit Executive, that the Audit Committee review and discuss the following engagement reports to take the following action(s):

- (1) accept and file report and/or,
- (2) instruct staff to forward report to Boards or Committees and/or,
- (3) provide further instruction to staff.

(Memo dated March 8, 2017)

- a. Duplicate Special Payments
Gabriel Tafoya, Senior Internal Auditor
(Report issued January 19, 2017)
- b. External Penetration Test
George Lunde, Senior Internal Auditor
(Report issued February 28, 2017)
- c. Tuition Reimbursement Audit
Christina Logan, Senior Internal Auditor
(Report issued March 8, 2017)

Mr. Schneider made a motion, Mr. Kehoe seconded, to accept and file the External Penetration Test and Tuition Reimbursement Audit reports (items b. and c.) and to hold the Duplicate

IV. NON-CONSENT AGENDA (FORMERLY “ACTION ITEMS”) (continued)

Special Payments Report (item a.) until the next meeting. The motion passed unanimously.

V. REPORTS (FORMERLY “ADMINISTRATIVE REPORTS”)

- A. Internal Audit Risk Assessment Report
Richard Bendall, Chief Audit Executive
(Memo dated March 8, 2017)

Mr. Bendall, Ms. Collins and Mr. Nguyen provided an overview of the Internal Audit Risk Assessment Process and its purpose including proposed changes to the process.

- B. Audit Plan Status Report
Richard Bendall, Chief Audit Executive
(Report dated March 8, 2017)

Mr. Bendall described the Audit Plan cycle and gave a high-level recap of work performed since the last Audit Committee meeting.

- C. Recommendation Follow-Up Report
Richard Bendall, Chief Audit Executive
(Report dated March 8, 2017)

Mr. Bendall described the nature and schedule of the Recommendation Follow-Up Report and how it provides the status of management’s progress toward audit recommendations. Mr. Bendall then gave an overview of the Recommendation Aging Report and progress on any outstanding recommendations.

V. REPORTS (FORMERLY “ADMINISTRATIVE REPORTS”) (continued)

- D. Privacy Audit Recommendation Follow-Up
Steven Rice, Chief Legal Counsel
Richard Bendall, Chief Audit Executive
(Memo dated March 8, 2017)

Mr. Bendall acknowledged the Executive Office taking ownership and expressed satisfaction in the level of priority given.

- E. **Attorney-Client Privilege/Confidential Memo**
Human Resources Compliance Audit [by Liebert Cassidy Whitmore]
Recommendation Follow-Up
Steven Rice, Chief Legal Counsel
Richard Bendall, Chief Audit Executive
(Memo dated March 8, 2017)

There were no comments.

- F. Status of Other External Audits Not Conducted at the Discretion of Internal Audit
Richard Bendall, Chief Audit Executive (Verbal Presentation)

There were no comments.

- G. Internal Audit Goal Report
Richard Bendall, Chief Audit Executive
(Report dated March 8, 2017)

Mr. Bendall provided an overview of the Internal Audit Goal Report and the planned goals for the 2017 Calendar Year.

V. CONSULTANT COMMENTS
Rick Wentzel, Audit Committee Consultant

There were no comments.

MARCH 22, 2017

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VI. GOOD OF THE ORDER

(For information purposes only)

Mr. Wentzel commented that he looks forward to seeing the Internal Audit Risk Assessment at the next meeting.

Mr. Schneider stated a concern regarding high-dollar amount transactions at LACERA. Mr. Nguyen responded Internal Audit periodically audits the controls around payments and high-risk transactions. Mr. Nguyen also stated that in the recent Duplicate Special Payments Audit staff found that Management had strong controls for mitigating the occurrence of duplicate special payments.

Mr. Kelly applauded the Tuition Reimbursement Audit.

Mr. Kehoe commended the External Penetration Test report.

Mr. Bendall noted that Mr. Redman was retiring and thanked Mr. Redman for his service.

VII. CLOSED SESSION (formerly "EXECUTIVE SESSION")

- A. Performance Evaluation – 2016 Goals & Expectations
[Pursuant to Government Code Section 54957(b)(1)]

Title: Chief Audit Executive

VIII. ADJOURNMENT

There being no further business to come before the Audit Committee, the meeting was adjourned at 9:40 a.m.

VIVIAN GRAY, SECRETARY

JOSEPH KELLY, CHAIR



July 31, 2017

TO: Each Member
2017 Audit Committee

Audit Committee Consultant
Rick Wentzel

FROM: Richard Bendall 
Chief Audit Executive

FOR: August 16, 2017 | Audit Committee Meeting

SUBJECT: **AUDIT REPORTS**

RECOMMENDATION

In accordance with your current Audit Committee Charter, staff recommends that the Audit Committee review and discuss the current engagement reports, listed below and attached, to take the following action(s):

- 1. accept and file report and/or,**
- 2. instruct staff to forward report to Boards or Committees and/or,**
- 3. provide further instruction to staff.**

ENGAGEMENT REPORTS

Please note: Attached to the first three audit reports are the questions and comments staff received from your Audit Committee as well as Internal Audit's responses.

- a. Retiree Healthcare Member Verification
Nathan Amick, Internal Auditor
(Report issued June 30, 2017)

- b. Certificates Processing Review
Darla Vidger, Internal Auditor
(Report issued June 29, 2017)

- c. Investment Fees Audit
Quoc Nguyen, Principal Internal Auditor
(Report issued June 28, 2017)

- d. Duplicate Special Payments
Gabriel Tafoya, Senior Internal Auditor
(Report issued January 19, 2017)

Attachments



LACERA INTERNAL AUDIT DIVISION

Retiree Healthcare Member Verification

June 30, 2017

Audit Performed By:

Nathan Amick

Internal Auditor

EXECUTIVE SUMMARY

Internal Audit became aware of a potential risk that Retiree Healthcare's call center staff may be giving out member personal information (PI) and/or personal health information (PHI) without properly authenticating the caller as required by LACERA policy. We determined that this was a critical risk and conducted a limited scope audit of Retiree Healthcare's call center member verification process.

LACERA has two call centers, the Member Services call center and Retiree Healthcare call center. Members can reach both using LACERA's 1-800 number. Retiree Healthcare handles healthcare questions while Member Services handles all other inquiries. Staff in the two call centers may transfer calls between each other when necessary.

LACERA created two levels of authentication for members wishing to communicate over the phone. The first level, called the Basic Verification process, is simply used to identify the member calling. The second level, called the High Risk Verification process, is designed to authenticate (i.e., provide a much higher level of assurance) that the caller is in fact the member.

The scope of our audit was limited to reviewing LACERA's policies and procedures for taking calls from members over the phone and testing calls taken by the Retiree Healthcare call center. Our audit objective was to determine whether appropriate controls exist in the Retiree Healthcare call center to ensure that the High Risk Verification process is appropriately performed prior to PI and PHI being discussed with callers over the phone.

Based on our audit and test work, we confirmed that Retiree Healthcare does not always high risk verify callers appropriately prior to providing them with PI and/or PHI.

Retiree Healthcare Management agreed with our finding and immediately developed a written procedure manual, and implemented procedures that require staff to perform the High Risk Verification process prior to discussing member's PI and/or PHI. Additional details regarding our finding and recommendations are included in the attached report.

Retiree Healthcare Member Verification

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INTRODUCTION

During our facilitation of the external Privacy Audit recommendation follow-up, Internal Audit became aware of a potential risk that Retiree Healthcare call center staff may be giving (PI) and/or personal health information (PHI) without performing the appropriate high risk member verification over the phone to authenticate that they are speaking to the actual member or an authorized person prior to providing the information. We determined that this was a critical risk and conducted a limited scope audit of Retiree Healthcare's call center member verification process.

BACKGROUND

LACERA has two call centers. The Member Services call center and the Retiree Healthcare call center, both which can be reached using LACERA's 1-800 number. Callers press "0" to reach the Member Services call center or press "1" to reach Retiree Healthcare call center. Member Services call center staff and Retiree Healthcare call center staff may transfer calls between each other when necessary.

LACERA created two levels of authentication for members wishing to communicate over the phone. The first called the Basic Verification process, is simply used to identify the member calling. Both call centers have a script they use to ask the member's name, address, date of birth and their social security number (SSN) or employee ID. This allows the call center staff to access the member's account, and without further verification to answer any general questions the member may have (i.e., general retirement plan or health plan information, or any other general LACERA information that does not require the call center staff providing answers specific to the members account).

The second level of verification, the High Risk Verification, is designed to authenticate (i.e., provide a much higher level of assurance) that the caller is in fact the member. While the High Risk Verification process is accessible in Workspace for use by both call centers, each call center has their own procedure for when to use it. The Member Services call center High Risk Verification procedure is very clear about when and how to perform the High Risk Verification. Any request by the caller for information about, or an action related to the members account, requires that staff first perform the High Risk Verification. Retiree Health Care has its own High Risk Verification procedure document, but it is less detailed and less instructional than Member Service's procedure.

AUDIT OBJECTIVE(S)

Determine whether appropriate controls exist in the Retiree Healthcare call center to ensure that the High Risk Verification process is appropriately performed when necessary.

AUDIT SCOPE

We reviewed:

- Call center operating procedures for both Member Services and Retiree Healthcare

AUDIT SCOPE *(continued)*

- Retiree Healthcare recorded phone calls - our test work population included all Retiree Healthcare recorded calls for calendar year 2016

AUDIT METHODOLOGY

We interviewed Member Services and Retiree Healthcare management and staff and reviewed their respective procedures for performing the High Risk Verification.

We performed very limited tests of calls to ascertain whether or not PI and/or PHI were provided by Retiree Healthcare call center staff to callers.

AUDIT RESULTS

According to LACERA's "Privacy and Confidentiality Policy", reasonable safeguards are to be implemented to ensure the privacy of PI and PHI. As defined in LACERA's policy, PI is any non-public information that is identifiable to an individual which includes member records. PHI is individually identifiable health information including, but not limited to, carrier health plan information (i.e., the name of the member's health plan or the member's health plan premium amounts).

We selected a sample of 18 calls received by Retiree Healthcare call center staff during the 2016 calendar year, three calls from each of the six Retiree Healthcare call center staff. We confirmed based on listening to the calls that the RHC call center does provide the callers with PI and PHI without a High Risk Verification.

While Retiree Healthcare call center staff did perform a Basic Verification for each call, the Basic Verification is designed to only identify the member so that staff could pull up the member's account, and is not intended to authenticate the member's identity. Retiree Healthcare should be performing the High risk Verification process to authenticate callers prior to disclosing PI and PHI.

We also found that Retiree Healthcare's procedures are not clear and do not specify when, and how staff should use the Basic Verification versus the High Risk Verification. In comparison, Member Services written procedures are very specific and provide instructions to staff on when and how to perform the High Risk Verification.

RECOMMENDATIONS

- 1. Retiree Healthcare Management develop and implement appropriate High Risk Verification procedures.**
- 2. The Executive Office require that appropriate authentication steps, including high risk verification, are performed consistently in all areas of the organization that accept phone calls prior to sharing members' personal identifiable and/or personal health information.**

AUDIT RESULTS *(continued)*

RETIREE HEALTHCARE MANAGEMENT RESPONSE

Retiree Healthcare Management agrees with the audit recommendation. As a result Retiree Healthcare has developed a written procedure manual for the High Risk Verification process. Retiree Healthcare call center staff have been educated and trained on the procedure manual and are now executing the required High Risk Verification process.


EXECUTIVE OFFICE MANAGEMENT RESPONSE

The Executive Office agrees with the recommendation there should be a uniform member identification and verification procedure for all staff who call members, receive calls from members, or meet personally with members. The uniform procedures will be based on the established Member Services procedures. Member Services and Quality Assurance will develop and coordinate a member identification training program for all appropriate staff. Training for staff will be completed by December 31, 2017.

ACKNOWLEDGEMENT

We would like to thank the Executive Office, Retiree Healthcare, and Member Services Division Management and Staff for their cooperation with our audit.

NOTED AND APPROVED



Richard Bendall
Chief Audit Executive

Date: June 30, 2017

REPORT DISTRIBUTION

2017 Audit Committee
Rick Wentzel
Gregg Rademacher
Internal Audit Staff

Robert Hill
JJ Popowich
Allan Cochran

Steve Rice
Cassandra Smith
Leilani Ignacio



Retiree Healthcare Member Verification

June 30, 2017

Audit Performed By:

Nathan Amick
Internal Auditor

EXECUTIVE SUMMARY

Internal Audit became aware of a potential risk that Retiree Healthcare's call center staff may be giving out member personal information (PI) and/or personal health information (PHI) without properly authenticating the caller as required by LACERA policy. We determined that this was a critical risk and conducted a limited scope audit of Retiree Healthcare's call center member verification process.

AC QUESTION: There is no discussion from Legal about whether or not this violated law and if it did what the corrective action plan might be. We need to know that Legal reviewed this.

RESPONSE: We met with Legal counsel and confirmed that no violation took place. We have not been notified nor are we aware any cases where we provided member data to anyone but the member.

LACERA has two call centers, the Member Services call center and Retiree Healthcare call center. Members can reach both using LACERA's 1-800 number. Retiree Healthcare handles healthcare questions while Member Services handles all other inquiries. Staff in the two call centers may transfer calls between each other when necessary.

LACERA created two levels of authentication for members wishing to communicate over the phone. The first level, called the Basic Verification process, is simply used to identify the member calling. The second level, called the High Risk Verification process, is designed to authenticate (i.e., provide a much higher level of assurance) that the caller is in fact the member.

The scope of our audit was limited to reviewing LACERA's policies and procedures for taking calls from members over the phone and testing calls taken by the Retiree Healthcare call center. Our audit objective was to determine whether appropriate controls exist in the Retiree Healthcare call center to ensure that the High Risk Verification process is appropriately performed prior to PI and PHI being discussed with callers over the phone.

Based on our audit and test work, we confirmed that Retiree Healthcare does not always high risk verify callers appropriately prior to providing them with PI and/or PHI.

AC QUESTION: You mean apply the High Risk Verification process?

RESPONSE: Yes. Retiree Healthcare does not always apply the High Risk Verification process prior to providing callers with PI and/or PHI.

Retiree Healthcare Management agreed with our finding and immediately developed a written procedure manual, and implemented procedures that require staff to perform the High Risk Verification process prior to discussing member's PI and/or PHI. Additional details regarding our finding and recommendations are included in the attached report.

Retiree Healthcare Member Verification

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INTRODUCTION

During our facilitation of the external Privacy Audit recommendation follow-up, Internal Audit became aware of a potential risk that Retiree Healthcare call center staff may be giving (PI) and/or personal health information (PHI) without performing the appropriate high risk member verification over the phone to authenticate that they are speaking to the actual member or an authorized person prior to providing the information. We determined that this was a critical risk and conducted a limited scope audit of Retiree Healthcare's call center member verification process.

BACKGROUND

LACERA has two call centers. The Member Services call center and the Retiree Healthcare call center, both which can be reached using LACERA's 1-800 number. Callers press "0" to reach the Member Services call center or press "1" to reach Retiree Healthcare call center. Member Services call center staff and Retiree Healthcare call center staff may transfer calls between each other when necessary.

AC QUESTION: You don't state this, but I assume staff are assigned to one call center, but not both.

RESPONSE: Yes, staff is assigned to only one call center.

LACERA created two levels of authentication for members wishing to communicate over the phone. The first called the Basic Verification process, is simply used to identify the member calling. Both call centers have a script they use to ask the member's name, address, date of birth and their social security number (SSN) or employee ID. This allows the call center staff to access the member's account, and without further verification to answer any general questions the member may have (i.e., general retirement plan or health plan information, or any other general LACERA information that does not require the call center staff providing answers specific to the members account).

AC QUESTION: If someone does a google search on me, they will find all this information with the exception of my employee number. I don't have my ID card handy but I think the number is on its face.

RESPONSE: The primary use of the "basic verification" is to allow call center staff to access the members account and pull it up on their screen. Receiving just the member's name, address, date of birth and/or their social security number (SSN) or employee ID does not result in an authentication of identity.

The second level of verification, the High Risk Verification, is designed to authenticate (i.e., provide a much higher level of assurance) that the caller is in fact the member. While the High Risk Verification process is accessible in Workspace for use by both call centers, each call center has their own procedure for when to use it. The Member Services call center High Risk Verification procedure is very clear about when and how to perform the High Risk Verification. Any request by the caller for information about, or an action related to the members account, requires that staff first perform the High Risk Verification. Retiree Health Care has their own High Risk Verification procedure document, but it is less detailed and less instructional than Member Service's procedure.

AC QUESTION: I assume procedures were signed off on as "official" procedures by management, correct? Were both developed in the recent past, or one more old than the other?

RESPONSE: The Member Services procedure was created in 2005, but the documents change log shows 35 revisions throughout the years with the last revision on 6/8/17. RHC procedures were created in January 2017. RHC procedures were subsequently revised in May 2017.

AUDIT OBJECTIVE(S)

Determine whether appropriate controls exist in the Retiree Healthcare call center to ensure that the High Risk Verification process is appropriately performed when necessary.

AC COMMENT: There is no need to include a characterization of appropriate.

RESPONSE: Comment noted.

AUDIT SCOPE

We reviewed:

- Call center operating procedures for both Member Services and Retiree Healthcare
- Retiree Healthcare recorded phone calls - our test work population included all Retiree Healthcare recorded calls for calendar year 2016

AUDIT METHODOLOGY

We interviewed Member Services and Retiree Healthcare management and staff and reviewed their respective procedures for performing the High Risk Verification.

We performed very limited tests of calls to ascertain whether or not PI and/or PHI were provided by Retiree Healthcare call center staff to callers.

AUDIT RESULTS

According to LACERA's "Privacy and Confidentiality Policy", reasonable safeguards are to be implemented to ensure the privacy of PI and PHI. As defined in LACERA's policy, PI is any non-public information that is identifiable to an individual which includes member records. PHI is individually identifiable health information including, but not limited to, carrier health plan information (i.e., the name of the member's health plan or the member's health plan premium amounts).

We selected a sample of 18 calls received by Retiree Healthcare call center staff during the 2016 calendar year, three calls from each of the six Retiree Healthcare call center staff.

AC QUESTION: So staff did not apply the HRV process to all 18, or 100% of the calls tested. How many calls were included in the "Retiree Healthcare recorded phone calls" at the top of this page?

RESPONSE: We identified 7 calls with no issues and 11 calls with instances where Retiree Health Care staff provided unsolicited confidential information. RHC took 32,451 calls in calendar year 2016.

AC QUESTION: Are all six long-term employees? I ask because my recollection is that staff graduate into these positions from the training academy. New staff should have reviewed the procedures, noted they weren't clear or sufficient and inquired. Did none of that occur?

RESPONSE: Member Identification Procedures are not currently part of the Core Benefits Training. MS staff are trained on this process when they come to the MS Call Center or when they go to the Member Services Center in Outreach. QA is developing training to be included in the Core Benefits Program since the procedures are to be made applicable to the entire organization. Management will hold separate training for existing staff in Benefits, DRS, and other divisions that are serving members directly. RHC also provides training to staff on this process.

We confirmed based on listening to the calls that the RHC call center does provide the callers with PI and PHI without a High Risk Verification.

While Retiree Healthcare call center staff did perform a Basic Verification for each call, the Basic Verification is designed to only identify the member so that staff could pull up the member's account, and is not intended to authenticate the member's identity. Retiree Healthcare should be performing the High risk Verification process to authenticate callers prior to disclosing PI and PHI.

We also found that Retiree Healthcare's procedures are not clear and do not specify when, and how staff should use the Basic Verification versus the High Risk Verification. In comparison, Member Services written procedures are very specific and provide instructions to staff on when and how to perform the High Risk Verification.

RECOMMENDATIONS

- 1. Retiree Healthcare Management develop and implement appropriate High Risk Verification procedures.**
- 2. The Executive Office require that appropriate authentication steps, including high risk verification, are performed consistently in all areas of the organization that accept phone calls prior to sharing members' personal identifiable and/or personal health information**

AC QUESTION: I concur but how about an additional control which is to inform the caller, during hold periods, to expect such questions, and incorporating into the post call survey (which is done at the completion of the call, no?) whether staff asked such questions?

RESPONSE: Member Services Division supervisors conduct High Risk Verification audits through sampling of call monitoring. Your recommendation to incorporate additional controls into the work process is reasonable and this report could be forwarded to the Operations Oversight Committee for review and further action. Additionally, you may provide staff specific direction to include a specific area or topic on a Board or Committee agenda for discussion.

Retiree Healthcare Management Response

Retiree Healthcare Management agrees with the audit recommendation. As a result Retiree Healthcare has developed a written procedure manual for the High Risk Verification process. Retiree Healthcare call center staff have been educated and trained on the procedure manual and are now executing the required High Risk Verification process.

Executive Office Management Response

The Executive Office agrees with the recommendation there should be a uniform member identification and verification procedure for all staff who call members, receive calls from members, or meet personally with members. The uniform procedures will be based on the established Member Services procedures. Member Services and Quality Assurance will develop and coordinate a member identification training program for all appropriate staff. Training for staff will be completed by December 31, 2017.

AC QUESTION: I would suggest that this doesn't go far enough. I think we need to de-link questions from the caller's purported work experience and link the questions to a security profile that members establish on mylacera.

IA RESPONSE: Although not all members establish a security profile through mylacera, your recommendation to incorporate this de-linked security approach could improve data security for the members who do so. This report could be forwarded by the Audit Committee to the Operations Oversight Committee for review and further action. Additionally, you may provide staff specific direction to include a specific area or topic on a Board or Committee agenda for discussion.

We would like to thank the Executive Office, Retiree Healthcare, and Member Services Division Management and Staff for their cooperation with our audit.

NOTED AND APPROVED

Date: June 30, 2017

Richard Bendall
Chief Audit Executive

REPORT DISTRIBUTION

2017 Audit Committee

Rick Wentzel

Gregg Rademacher

Robert Hill

JJ Popowich

Allan Cochran

Steve Rice

Cassandra Smith

Leilani Ignacio



Certificates Processing Review

June 28, 2017

Audit Conducted By:
Darla Vidger, MPA, CIA
Internal Auditor

EXECUTIVE SUMMARY

As a part of our fiscal year 2016-17 Audit Plan, Internal Audit completed a review of LACERA's controls for accepting and processing member certificates that validate birth, marriage, and death information.

In many circumstances, documents such as marriage, birth, and death certificates must be provided by members or their beneficiaries to verify data necessary to determine eligibility. The following divisions are involved in the process of requesting, receiving, and validating the certificates used by LACERA:

- Benefits and Retiree Healthcare staff send requests to members to provide certificates.
- Administrative Services staff receive, validate, and distribute the certificates.
- Member Services staff authenticate certificates received and enter the certificate data into Workspace.
- Benefits and Retiree Healthcare staff use the certificate data in Workspace to verify eligibility and ensure that the benefits provided are correct.

It is critical that Management has good controls over the processing of certificates to ensure that staff verifies benefit eligibility and calculations using the most accurate and reliable information.

Based on our review of certificate processing throughout LACERA, discussions with Management, and testwork performed; we can conclude generally that Management has developed adequate controls over the request, receipt, validation, and use of certificates.

However, we determined there to be an opportunity for management to strengthen the consistency of practices related to certificate processing throughout LACERA if it were to establish an organization-wide certificates policy. As mentioned, multiple LACERA divisions handle and process certificates. We noted that many of the adopted practices regarding certificates have been developed locally within each division which has caused inconsistencies between the divisions that process certificates. In one example, the Member Services Division requires that members provide original birth certificates as a form of verification, while the Benefits Division accepts copies of birth certificates in some situations. A unified organizational certificates policy would serve to strengthen and improve processes and best practices on when certificates are requested, how they are provided, how best to validate them, and would strengthen the system of controls over their use.

Internal Audit would like to express our gratitude to LACERA Management and staff for their cooperation, assistance, and time during this course of this review.

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INTRODUCTION

As a part of our fiscal year 2016-17 Audit Plan, Internal Audit completed a review of LACERA's controls for accepting and processing member certificates such as birth, marriage, and death certificates. Certificates submitted to LACERA serve as supporting documentation to verify benefit eligibility and help ensure the accuracy of benefit calculations.

BACKGROUND

LACERA provides a menu of benefits to its members and their beneficiaries. These benefits include life-time annuities to the member upon retirement and continuances to a surviving spouse, domestic partner, or minor children. Members may also customize an annuity for themselves and their designated beneficiaries through various "Retirement Options."

The County Employees Retirement Law ("CERL") and LACERA's Board of Retirement plan documents stipulate member and beneficiary benefit eligibility requirements and prescribe how benefits are calculated. Before paying benefits, staff must ensure benefit eligibility by reviewing the member's account to ensure that the requirements of CERL and the Board of Retirement are met. In many circumstances, documents such as marriage, birth, and death certificates must be provided by members or their beneficiaries to verify data necessary to determine eligibility.

Some examples include:

- Optional retirement elections where the benefit calculation is actuarially dependent on the respective ages of any named beneficiary.
- Death payouts to beneficiaries where the member's date and cause of death must be verified.
- Survivor continuances where the surviving spouse's marriage date must be validated to ensure that the spouse was married to the member at least one year and one day prior to the member's retirement.
- Minor child continuances where it must be verified that the child is legally associated with the member and under the age of 18 or enrolled in an accredited educational institution full-time, through the age of 21.

There are many other documents that may be necessary in the processing of member transactions such as divorce documents, documents supporting purchase contracts, power of attorney documents, etc. However, our scope was limited to reviewing the request for, receipt of, and processing of birth, marriage, and death certificates.

The following divisions are involved in the process of requesting, receiving, and validating the certificates used by LACERA:

- Benefits and Retiree Healthcare staff send requests to members to provide certificates.
- Administrative Services staff receive, validate, and distribute the certificates.
- Member Services staff authenticate certificates received and enter the certificate data into Workspace.
- Benefits and Retiree Healthcare staff use the certificate data in Workspace to verify eligibility and ensure that the benefits provided are correct.

BACKGROUND *(continued)*

LACERA members have the ability to add, delete, or change their beneficiary information throughout the course of their County career and later in retirement. To authenticate any beneficiary changes, staff request that members provide verification such as birth or marriage certificates. It is critical that Management has good controls over the processing of certificates to ensure that staff update member accounts properly and verify benefit eligibility and calculations using the most accurate and reliable information.

OBJECTIVES

The objectives of our review were to:

- Assess management's controls for determining which certificates are required to verify benefit eligibility
- Assess management's controls for authenticating certificates
- Determine whether Member Services staff accurately enter certificate information into Workspace

SCOPE

The scope of the review included:

- Policies and procedures that staff use to determine whether members and their beneficiaries are eligible for benefits
- Policies and procedures for authenticating certificates
- Examining transactions where benefits were initially paid to members or their beneficiaries in 2016

METHODOLOGY

- Conducted interviews with staff in Administrative Services, Member Services, Benefits, Retiree Healthcare, and the Legal Office
- Reviewed documented policies and procedures
- Directly observed how staff processed certificates
- Tested a sample of 25 benefit payments initiated in calendar year 2016 where a certificate was required to verify eligibility.

We then verified the following:

- Staff collected the necessary certificate(s) to verify the member's eligibility
- Staff entered the member's information from the certificate accurately into Workspace
- The certificate submitted was authentic based on LACERA's criteria for acceptable certificates

Note: *Not all benefit payments we tested required the same certificate. Some benefits only required a birth, marriage, domestic partnership, or death certificate. Some required a combination of the certificates.*

AUDIT RESULTS

Based on our review of certificate processing throughout LACERA, discussions with Management, and testwork performed, Internal Audit concluded that staff has developed adequate controls over the request, receipt, validation, and use of certificates. We did not note any exceptions with the accuracy of certificate information entered into Workspace or the authenticity of certificates that staff used to verify benefit eligibility.

However, we identified areas where LACERA's policies and procedures need to be strengthened to improve the consistency and efficiency of processing certificates. The following are our findings and recommendations.

Use of Certificates as a Control

As mentioned, multiple LACERA divisions handle and process certificates such as birth, marriage or death certificates provided by members. However, we noted that many of the adopted practices regarding certificates have been developed locally within each division which has caused some inconsistencies.

For example, below are some of the inconsistencies we noted:

- The Member Services Division requires members to provide original birth certificates, while the Benefits Division accepts copies.
- For verification of certain benefits, members are able to provide "in lieu of documents" in place of the required certificate; however, this practice is not consistently applied for the verification of other benefits that require the same certificate for verification.
- Staff in different areas of the organization have developed and adopted their own means of validating certificates. For example, in Administrative Services staff review examples of State Department birth certificates on-line to validate foreign birth certificates received, however, this practice is not consistently performed in other divisions

To ensure consistency and strengthen practices related to certificates processing, Management should establish an organization-wide policy over the request, receipt, validation, and use of certificates along with other sources of information used to validate key member or beneficiary information. As part of establishing an organization-wide policy, Management should evaluate and document the criteria for each benefit type to confirm that LACERA is requesting and obtaining the appropriate certificate or document to verify benefit eligibility.

RECOMMENDATION

- 1. LACERA should establish an organization-wide policy over the request, receipt, validation and use of certificates along with other sources of information to validate member or beneficiary information.**

MANAGEMENT RESPONSE

The Benefits Division concurs with the recommendation and has an ongoing project to standardize procedures governing the validation and use of various government-issued documents.

AUDIT RESULTS *(continued)*

MANAGEMENT RESPONSE *(continued)*

This project was initiated by the Process Management Group in collaboration with partners in Member Services, Administrative Services, the Legal Office and Internal Audit. The new Benefits Protection Unit has joined in this effort as well. It is anticipated that this project will be completed by June 30, 2018.

Certificates Processing Testwork

We tested 25 benefit payments that staff initiated in 2016. Each benefit that we tested required staff to request, authenticate, and correctly enter the member's information into Workspace for, at least one certificate from the member before the payment was made. The 25 transactions in our sample fell under one of three benefit types described below, each having specific certificate verification requirements. We noted the following:

- We tested eight (8) **Survivor Continuance** first payments. For this benefit type tested, LACERA required the member's surviving spouse to provide a valid death certificate as well as a marriage certificate to demonstrate evidence that the survivor was married to the member at least one year and one day prior to the deceased member's retirement date. We found no exceptions.
- We tested five (5) **Lump Sum Death Benefit** payments which required the member's death certificate and each beneficiary's birth certificate to verify the named beneficiaries. We found no exceptions.
- We tested twelve (12) **Option 2, 3, 4 or 7** first retirement payments. Since the member's retirement benefit and the survivor's continuance in these Option Retirements uses the named beneficiary's age as a component of the calculation, LACERA procedures require that staff validate the named beneficiary's birth certificate. We noted here that, although staff requested birth certificates in each of the twelve cases, they did not obtain the birth certificates in three (3) instances.

However, in all three instances, staff processed the retirements anyway and used the beneficiaries' ages provided by the members over the phone. Based on discussions with staff, these exceptions were a result of a misunderstanding of current procedures and whether or not staff could hold-up the retirement process based on a missing birth certificate as an actual business practice.

RECOMMENDATION

- 2. Management should review and update the procedures regarding "Retirement Options" and related certificate requirements prior to retirement and ensure that staff are provided with any necessary clarification and/or training.**

AUDIT RESULTS *(continued)*

MANAGEMENT RESPONSE

The Benefits Division concurs with the recommendation and has an ongoing project to standardize procedures governing the validation and use of various government-issued documents. This project was initiated by the Process Management Group in collaboration with partners in Member Services, Administrative Services, the Legal Office and Internal Audit. The new Benefits Protection Unit has joined in this effort as well.

Within the scope of this project, existing procedures regarding the use of government-issued documents in the processing of retirement options will be reviewed, updated and disseminated among all appropriate staff. It is anticipated that this project will be completed by June 30, 2018.

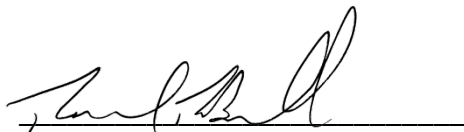
Accuracy of Certificate Data Entry

In our test work of the previously mentioned 25 member accounts where a certificate was used to verify benefit eligibility, we confirmed the member or beneficiary information on each certificate submitted matched the information entered by staff in Workspace. We did not find any errors or omissions.

ACKNOWLEDGEMENT

Internal Audit would like to express our gratitude to LACERA Management and staff for their cooperation, assistance, and time during this course of this review.

NOTED AND APPROVED



Richard Bendall
Chief Audit Executive

Date: **June 28, 2017**

REPORT DISTRIBUTION

2017 Audit Committee	Steve Rice	Sylvia Botros	Roberta Van Nortrick
Rick Wentzel	Fern Billingsy	Louis Gittens	Robert Morgan
Gregg Rademacher	James Pu	Allan Cochran	Elsy Gutierrez
Robert Hill	Mary Phillips	Carlos Barrios	
JJ Popowich	Cassandra Smith	Kelly Puga	
Internal Audit Staff	Bernie Buenaflor	Kimberly Hines	



Certificates Processing Review

June 29, 2017

Audit Conducted By:
Darla Vidger, MPA, CIA
Internal Auditor

EXECUTIVE SUMMARY

As a part of our fiscal year 2016-17 Audit Plan, Internal Audit completed a review of LACERA's controls for accepting and processing member certificates that validate birth, marriage, and death information.

In many circumstances, documents such as marriage, birth, and death certificates must be provided by members or their beneficiaries to verify data necessary to determine eligibility. The following divisions are involved in the process of requesting, receiving, and validating the certificates used by LACERA:

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- Benefits and Retiree Healthcare staff use the certificate data in Workspace to verify eligibility and ensure that the benefits provided are correct.

It is critical that Management has good controls over the processing of certificates to ensure that staff verifies benefit eligibility and calculations using the most accurate and reliable information.

Based on our review of certificate processing throughout LACERA, discussions with Management, and testwork performed; we can conclude generally that Management has developed adequate controls over the request, receipt, validation, and use of certificates.

However, we determined there to be an opportunity for management to strengthen the consistency of practices related to certificate processing throughout LACERA if it were to establish an organization-wide certificates policy. As mentioned, multiple LACERA divisions handle and process certificates. We noted that many of the adopted practices regarding certificates have been developed locally within each division which has caused inconsistencies between the divisions that process certificates. In one example, the Member Services Division requires that members provide original birth certificates as a form of verification, while the Benefits Division accepts copies of birth certificates in some situations. A unified organizational certificates policy would serve to strengthen and improve processes and best practices on when certificates are requested, how they are provided, how best to validate them, and would strengthen the system of controls over their use.

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INTRODUCTION

As a part of our fiscal year 2016-17 Audit Plan, Internal Audit completed a review of LACERA's controls for accepting and processing member certificates such as birth, marriage, and death certificates. Certificates submitted to LACERA serve as supporting documentation to verify benefit eligibility and help ensure the accuracy of benefit calculations.

BACKGROUND

LACERA provides a menu of benefits to its members and their beneficiaries. These benefits include life-time annuities to the member upon retirement and continuances to a surviving spouse, domestic partner, or minor children. Members may also customize an annuity for themselves and their designated beneficiaries through various "Retirement Options."

The County Employees Retirement Law ("CERL") and LACERA's Board of Retirement plan documents stipulate member and beneficiary benefit eligibility requirements and prescribe how benefits are calculated. Before paying benefits, staff must ensure benefit eligibility by reviewing the member's account to ensure that the requirements of CERL and the Board of Retirement are met. In many circumstances, documents such as marriage, birth, and death certificates must be provided by members or their beneficiaries to verify data necessary to determine eligibility.

Some examples include:

- Optional retirement elections where the benefit calculation is actuarially dependent on the respective ages of any named beneficiary.
- Death payouts to beneficiaries where the member's date and cause of death must be verified.
- Survivor continuances where the surviving spouse's marriage date must be validated to ensure that the spouse was married to the member at least one year and one day prior to the member's retirement.
- Minor child continuances where it must be verified that the child is legally associated with the member and under the age of 18 or enrolled in an accredited educational institution full-time, through the age of 21.

There are many other documents that may be necessary in the processing of member transactions such as divorce documents, documents supporting purchase contracts, power of attorney documents, etc. However, our scope was limited to reviewing the request for, receipt of, and processing of birth, marriage, and death certificates.

The following divisions are involved in the process of requesting, receiving, and validating the certificates used by LACERA:

- Benefits and Retiree Healthcare staff send requests to members to provide certificates.
- Administrative Services staff receive, validate, and distribute the certificates.
- Member Services staff authenticate certificates received and enter the certificate data into Workspace.
- Benefits and Retiree Healthcare staff use the certificate data in Workspace to verify eligibility and ensure that the benefits provided are correct.

BACKGROUND *(continued)*

LACERA members have the ability to add, delete, or change their beneficiary information throughout the course of their County career and later in retirement. To authenticate any beneficiary changes, staff request that members provide verification such as birth or marriage certificates. It is critical that Management has good controls over the processing of certificates to ensure that staff update member accounts properly and verify benefit eligibility and calculations using the most accurate and reliable information.

AC QUESTION: Courts are now considered State, no? Aren't Court employees LACERA members?

RESPONSE: The Courts are consolidated under the State of California and the Court employees are LACERA members by MOU Agreement and by California statute.

OBJECTIVES

The objectives of our review were to:

- Assess management's controls for determining which certificates are required to verify benefit eligibility
- Assess management's controls for authenticating certificates
- Determine whether Member Services staff accurately enter certificate information into Workspace

AC QUESTION: So you stopped in essence at the point at which staff would have made a determination based on the certificate being true and accurate?

RESPONSE: That is correct. The full determination of benefit eligibility may include other factors outside of the data in certificates which was outside the scope of our audit.

SCOPE

The scope of the review included:

- Policies and procedures that staff use to determine whether members and their beneficiaries are eligible for benefits
- Policies and procedures for authenticating certificates
- Examining transactions where benefits were initially paid to members or their beneficiaries in 2016

METHODOLOGY

- Conducted interviews with staff in Administrative Services, Member Services, Benefits, Retiree Healthcare, and the Legal Office
- Reviewed documented policies and procedures
- Directly observed how staff processed certificates
- Tested a sample of 25 benefit payments initiated in calendar year 2016 where a certificate was required to verify eligibility.

We then verified the following:

- Staff collected the necessary certificate(s) to verify the member's eligibility
- Staff entered the member's information from the certificate accurately into Workspace

METHODOLOGY *(continued)*

- The certificate submitted was authentic based on LACERA's criteria for acceptable certificates

Note: *Not all benefit payments we tested required the same certificate. Some benefits only required a birth, marriage, domestic partnership, or death certificate. Some required a combination of the certificates.*

AUDIT RESULTS

Based on our review of certificate processing throughout LACERA, discussions with Management, and testwork performed, Internal Audit concluded that staff has developed adequate controls over the request, receipt, validation, and use of certificates. We did not note any exceptions with the accuracy of certificate information entered into Workspace or the authenticity of certificates that staff used to verify benefit eligibility.

AC QUESTION: I am interpreting this to mean that staff performs certain steps to determine a physical certificate is true and accurate. Then staff input a confirmation statement of that into Workspace. Does staff not also image and attach the certificate?

RESPONSE: When LACERA receives certificates, the physical certificate is validated, then scanned into Workspace. Data entry staff perform another validation prior to entering the data from the scanned certificate into the respective fields in the member's Workspace account. However, confirmation of the verification procedure is not recorded in Workspace. Rather, the certificate is either accepted or rejected based on staff's determination.

However, we identified areas where LACERA's policies and procedures need to be strengthened to improve the consistency and efficiency of processing certificates. The following are our findings and recommendations.

Use of Certificates as a Control

As mentioned, multiple LACERA divisions handle and process certificates such as birth, marriage or death certificates provided by members. However, we noted that many of the adopted practices regarding certificates have been developed locally within each division which has caused some inconsistencies.

For example, below are some of the inconsistencies we noted:

- The Member Services Division requires members to provide original birth certificates, while the Benefits Division accepts copies.
- For verification of certain benefits, members are able to provide "in lieu of documents" in place of the required certificate; however, this practice is not consistently applied for the verification of other benefits that require the same certificate for verification.

AC QUESTION: What are in lieu of options for birth or death?

RESPONSE: It varies by Division. For example, passports are acceptable in lieu of birth certificates and "information only" death certificates are acceptable in lieu of an official death certificates.

AUDIT RESULTS *(continued)*

- Staff in different areas of the organization have developed and adopted their own means of validating certificates. For example, in Administrative Services staff review examples of State Department birth certificates on-line to validate foreign birth certificates received, however, this practice is not consistently performed in other divisions

To ensure consistency and strengthen practices related to certificates processing, Management should establish an organization-wide policy over the request, receipt, validation, and use of certificates along with other sources of information used to validate key member or beneficiary information. As part of establishing an organization-wide policy, Management should evaluate and document the criteria for each benefit type to confirm that LACERA is requesting and obtaining the appropriate certificate or document to verify benefit eligibility.

AC QUESTION: I agree, but the standard needs to be the best practice.

MANAGEMENT RESPONSE: In the development of the standardized procedures, LACERA will research best practices followed by other agencies.

RECOMMENDATION

- 1. LACERA should establish an organization-wide policy over the request, receipt, validation and use of certificates along with other sources of information to validate member or beneficiary information.**

MANAGEMENT RESPONSE

The Benefits Division concurs with the recommendation and has an ongoing project to standardize procedures governing the validation and use of various government-issued documents. This project was initiated by the Process Management Group in collaboration with partners in Member Services, Administrative Services, the Legal Office and Internal Audit. The new Benefits Protection Unit has joined in this effort as well. It is anticipated that this project will be completed by June 30, 2018.

AC QUESTION: I would also encourage management to reach out to the Registrar Recorder County Clerk on best practice.

MANAGEMENT RESPONSE: In the development of the standardized procedures, LACERA will research best practices followed by other agencies

Certificates Processing Testwork

We tested 25 benefit payments that staff initiated in 2016. Each benefit that we tested required staff to request, authenticate, and correctly enter the member's information into Workspace for, at least one certificate from the member before the payment was made. The 25 transactions in our sample fell under one of three benefit types described below, each having specific certificate verification requirements. We noted the following:

- We tested eight (8) **Survivor Continuance** first payments. For this benefit type tested, LACERA required the member's surviving spouse to provide a valid death certificate as well as a marriage certificate to demonstrate evidence that the survivor was married to the member at least one year and one day prior to the deceased member's retirement date. We found no exceptions.

- We tested five (5) **Lump Sum Death Benefit** payments which required the member's death certificate and each beneficiary's birth certificate to verify the named beneficiaries. We found no exceptions.

AUDIT RESULTS *(continued)*

- We tested twelve (12) **Option 2, 3, 4 or 7** first retirement payments. Since the member's retirement benefit and the survivor's continuance in these Option Retirements uses the named beneficiary's age as a component of the calculation, LACERA procedures require that staff validate the named beneficiary's birth certificate. We noted here that, although staff requested birth certificates in each of the twelve cases, they did not obtain the birth certificates in three (3) instances.

However, in all three instances, staff processed the retirements anyway and used the beneficiaries' ages provided by the members over the phone. Based on discussions with staff, these exceptions were a result of a misunderstanding of current procedures and whether or not staff could hold-up the retirement process based on a missing birth certificate as an actual business practice.

RECOMMENDATION

- 2. Management should review and update the procedures regarding "Retirement Options" and related certificate requirements prior to retirement and ensure that staff are provided with any necessary clarification and/or training.**

MANAGEMENT RESPONSE

The Benefits Division concurs with the recommendation and has an ongoing project to standardize procedures governing the validation and use of various government-issued documents. This project was initiated by the Process Management Group in collaboration with partners in Member Services, Administrative Services, the Legal Office and Internal Audit. The new Benefits Protection Unit has joined in this effort as well.

Within the scope of this project, existing procedures regarding the use of government-issued documents in the processing of retirement options will be reviewed, updated and disseminated among all appropriate staff. It is anticipated that this project will be completed by June 30, 2018.

Accuracy of Certificate Data Entry

In our test work of the previously mentioned 25 member accounts where a certificate was used to verify benefit eligibility, we confirmed the member or beneficiary information on each certificate submitted matched the information entered by staff in Workspace. We did not find any errors or omissions.

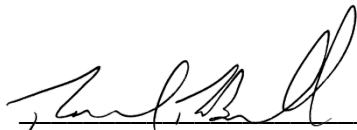
ACKNOWLEDGEMENT

Internal Audit would like to express our gratitude to LACERA Management and staff for their cooperation, assistance, and time during this course of this review.

AC COMMENT: Well done.

RESPONSE: Thank you!

NOTED AND APPROVED



Richard Bendall
Chief Audit Executive

Date: June 29, 2017

REPORT DISTRIBUTION

2017 Audit Committee
Rick Wentzel
Gregg Rademacher
Robert Hill
JJ Popowich
Internal Audit Staff

Steve Rice
Fern Billingsy
James Pu
Mary Phillips
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Carlos Barrios
Kelly Puga
Kimberly Hines

Roberta Van Nortrick
Robert Morgan
Elsy Gutierrez



LACERA INTERNAL AUDIT DIVISION

Investment Fees Audit

June 28, 2017

Audit Conducted by:

Quoc Nguyen, CPA, CFA

Principal Internal Auditor

EXECUTIVE SUMMARY

As part of our fiscal year 2016-2017 audit plan, we completed an audit of investment fees paid to investment managers. LACERA retains investment managers that directly invest in stocks, bonds, real estate, private equity, hedge funds, and other assets on LACERA's behalf. In fiscal years ending June 30, 2016, June 30, 2015, and June 30, 2014, LACERA disclosed investment fees totaling \$184 million, \$161 million, and \$155 million, respectively, in the supplemental sections of its Comprehensive Annual Financial Report ("CAFR").

Our audit assessed management's process for validating investment fees (i.e., verifying that the fees paid are in compliance with the contract terms) and disclosing complete and accurate investment fees in the CAFR. As a part of our audit, we tested a sample of quarterly investment fees. We excluded private equity fees from our testing since LACERA engaged an outside third-party to audit private equity fees.

LACERA's portfolio consists of 105 different investments (excluding private equity). Of the 105 investments, 59 (56%) are structured as "separately managed accounts" where the holdings are directly owned by LACERA and managed by an investment manager, while 46 (44%) are structured as "commingled funds" where LACERA is one of multiple investors in a pooled fund managed by an investment manager. Commingled funds (with the exception of indexed commingled funds) generally have more complex fee structures than separately managed accounts.

Overall, we noted that staff has good controls for validating investment fees of separately managed accounts, and staff comprehensively discloses *management fees* and *acquisition fees* in the CAFR. However, management needs to strengthen the process for 1) validating fees of commingled funds and 2) accounting for and disclosing *performance fees*, *carried interest*, and *expenses* in the CAFR. Our observations are discussed below.

Validating Investment Fees

The Financial and Accounting Services Division (FASD) validates the fees of public market investments (e.g., public equities, fixed income, commodities) for both separately managed accounts and commingled funds. The Investments Office validates the fees of private market investments (e.g., private equity, real estate, hedge funds) for both separately managed accounts and commingled funds. The responsibilities for validating fees in the Investments Office are decentralized by asset class.

We tested the quarterly fees of 38 investments (21 separately managed accounts and 17 commingled funds) totaling \$19.2 million paid in fiscal year ending June 30, 2015. We noted that the FASD and Investments Office routinely validate the fees of separately managed accounts. However, staff did not have a process to review and validate the fees for 14 (83%) of the 17 commingled funds we tested,

EXECUTIVE SUMMARY

which included eight commingled real estate funds, four commingled public equity funds, and two commingled fixed income funds. In all cases the reason cited for not validating these fees was the complexity of doing so. For the three commingled funds that were validated, they were indexed commingled funds and the fees were relatively easy to recalculate.

Beyond our review of what the Investments Office and FASD did to validate investment manager fees, for each of the 38 investments, we selected one quarter of fees paid in fiscal year ending June 30, 2015 and verified that the fees paid were in accordance to the contract terms. For some of the more complex commingled funds, we worked with staff and/or communicated with the investment manager to assist us in validating the fees. We believe that we were able to reasonably validate the fees for all 38 investments for the quarters we tested, without exception.

Disclosing Investment Fees

LACERA pays a variety of investment fees, including management fees, performance fees, carried interest, acquisition fees, and expenses. Management fees make up a majority of investment related fees and are paid to all firms in every asset class. The other types of fees (like performance fees, carried interest and acquisition fees) are charged primarily by private equity, real estate, and hedge fund managers.

We noted that staff comprehensively accounts for and discloses management fees and acquisition fees in the CAFR. However, there are inconsistencies with the accounting for and disclosing of performance fees, carried interest, and expenses. For example, staff captures the performance fees, carried interest, and expenses paid to some firms but not all. Only some of the performance fees, carried interest, and expenses that are captured are disclosed in the CAFR.

Disclosing performance fees, carried interest, and expenses in the CAFR is a matter related to improving transparency rather than of compliance. LACERA's external auditors have opined that LACERA's annual financial statements are in compliance with regulatory reporting standards. In recent years, however, there has been increased public interest into the transparency of investment fees paid by public pension funds. We note also that fee transparency can enhance LACERA's ability to measure and manage its investment costs. Absent specific regulatory requirements on fee disclosure in the CAFR, we believe management should determine, and document in their procedures, which fees should be accounted for and disclosed.

These and other observations are detailed in the attached report. We also include other recommendations that we believe will improve management's processes related to validating and disclosing investment fees. Management agreed with our observations and recommendations, and has developed action plans to implement the recommendations. We would like to thank the Investments Office and FASD Staff for their cooperation and assistance in this audit.

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<i>Details of Findings, Other Observations, Recommendations And Management Responses</i>	

INTRODUCTION

As part of our fiscal year 2016-2017 audit plan, we completed an audit of investment fees paid to investment managers. LACERA retains investment managers to directly invest one hundred percent of LACERA's trust assets which on June 30, 2016 was valued at \$47.7 billion. The purpose of our audit was to assess LACERA's system of controls for validating the accuracy of fees paid to investment managers and disclosing those fees in LACERA's Comprehensive Annual Financial Report ("CAFR"). As part of our audit, we also performed test work to verify the accuracy of fees paid and disclosed in fiscal year ending June 30, 2015.

We excluded private equity fees from our testing since LACERA engaged an external auditor, Kreischer Miller, to perform a retrospective fee audit on a sample of private equity funds which is expected to be completed by August 2017. Additionally, LACERA engaged a consultant in August 2016, the Pavilion Group, to assist the Investments Office with collecting and validating private equity fees on a prospective basis.

BACKGROUND

LACERA pays a variety of investment fees such as management fees, performance fees, carried interest, real estate acquisition fees, and reimbursed expenses. Investment managers of all asset classes charge a "management fee" which is commonly assessed as an annual percentage of assets under management. Typically, private market managers (private equity, real estate, hedge funds) charge other fees on top of management fees. Hedge fund managers charge "performance fees" if the investment returns exceed a specific rate of return within a specific period (e.g., quarterly, annually). Private equity and real estate fund managers include provisions in their agreements for "carried interest", which if earned, is a type of performance fee or profit sharing. Real estate managers may charge an "acquisition fee" when they acquire property on LACERA's behalf.

LACERA's ownership structure in an investment can impact the way fees are paid. LACERA's investments are structured in either a separately managed account ("SMA") or commingled fund¹. In a SMA structure, holdings are directly owned by LACERA and managed by an investment manager. In a commingled fund structure, LACERA is one of multiple investors in a pooled fund managed by a general partner or portfolio manager. In general, SMA investment managers request payment for their fees by sending quarterly invoices whereas commingled fund managers pay themselves by withdrawing funds directly from LACERA's capital account within the investment².

¹ We use the term commingled funds in this report to also describe investments also set-up in a "fund-of-one" structure. LACERA invests in a few fund-of-one vehicles which are similar to commingled funds in that the investment managers are paid by withdrawing fees from LACERA's capital account or capital calls.

² LACERA's BlackRock public market indexed commingled funds send quarterly invoices for payment of fees.

In the table below, we list the total number of investment managers and investments by asset class as of June 2017. We also indicate whether each investment is a SMA or commingled fund structure.

Asset Class	Total Investment Managers*	Total Investments	Separately managed accounts (SMAs)	Commingled Funds
Private Equity	107	220	7	213
Public Equity	19	31	14	17
Real Estate	21	34	13	21
Fixed Income	22	29	22	7***
Hedge Funds**	2	4	4	-
Commodities	4	4	4	-
Cash	1	2	2	-
Total	176	324	66	258

*Some investment managers have more than one mandate and manage more than one SMA and/or commingled fund.

** LACERA is invested in four hedge fund-of-funds (HFOF). Three are managed by Grosvenor Capital Management, held in a limited partner fund-of-one structure. One is managed by Goldman Sachs Asset Management with 28 underlying hedge funds that LACERA directly holds under its own name. Each of the four HFOF holds underlying investments in commingled hedge funds.

***One of these seven fixed income funds is structured in a fund-of-one structure.

As indicated above, LACERA allocates capital to 176 different investment managers. For investment fees, both the types and rates can vary widely depending on the asset class being managed and terms negotiated. Certain contracts allow for lower fees when LACERA allocates additional capital to the investment manager or when an investment period changes (e.g., when a fund's life changes from an investment period to a distribution period). It is important that LACERA has strong controls for ensuring that investment managers correctly charge LACERA based on the terms in the contracts.

Validating Investment Fees

The Investments Office and Financial and Accounting Services Division ("FASD") currently share the function of validating investment fees but their duties vary depending on the asset class. FASD staff validates fees of public market investments (public equities, fixed income, and commodities). Public market managers typically charge management fees which have relatively simple fee calculations. Investments Office staff oversees the process for validating fees of private market investments (real estate, hedge funds, and private equity). Private market managers tend to have more complex fee structures, especially in commingled funds.

Disclosing Investment Fees

LACERA's annual investment fees are disclosed in the supplemental sections of LACERA's CAFR. FASD collects data for public market fees and works with the Investments Office, LACERA's consultants, and State Street Bank (LACERA's custodian) to collect data for private market fees. FASD then aggregates fees for all asset classes and discloses the fees in the CAFR.

In fiscal years ending June 30, 2016, June 30, 2015, and June 30, 2014, LACERA disclosed investment fees totaling \$184 million, \$161 million, and \$155 million, respectively, and in basis points (bps) of the Trust's total net asset value, the total fees equaled 38.6 bps, 33.3 bps, and 31.7 bps, respectively. The fees in these totals include management fees and generally do not include other fees such as performance fees, carried interest, and fund expenses. Historically, LACERA, like other public pension funds, has only disclosed management fees in the CAFR.

Disclosing fees such as performance fees, carried interest, and expenses is a matter of improving transparency rather than of compliance. LACERA has always received clean opinions on its financial statements from its external auditors. In recent years, however, there has been increased public and stakeholder interest in the transparency of investment fees paid by public pension funds. Furthermore, the State of California passed Assembly Bill 2833 in 2016 which requires California public pension funds, including LACERA, to collect and publicly disclose details of fees paid to alternative investment vehicles, managers, and related parties, including private equity funds, venture funds, hedge funds, and absolute return funds as well as, based on LACERA's interpretation, real estate, for new contracts signed on or after January 2017, and must undertake reasonable efforts to obtain that fee information for existing contracts. In LACERA's view, the law applies to alternative investment structures across all asset classes. Staff is working with the Legal Office to implement the new law.

AUDIT OBJECTIVES

- Review and evaluate the system of controls for ***validating*** and ***disclosing*** investment fees paid to investment managers
- Perform test work on a sample of quarterly investment fees (excluding private equity) to determine if the investment fees paid were:
 1. Properly reviewed and approved by staff
 2. Accurately charged by the investment manager based on the contract terms
 3. Accurately disclosed in the supplemental sections of LACERA's CAFR

AUDIT SCOPE

We reviewed:

- Staff's process for validating investment fees
- Staff's process for disclosing investment fees in the CAFR
- A sample of 38 quarterly investment fees paid from July 1, 2014 to June 30, 2015 (each quarterly fee tested was from a different investment)

AUDIT METHODOLOGY

To evaluate the system of controls related to validating and disclosing investment fees, we:

- Interviewed Investments Office and FASD staff
- Performed walkthroughs of staff's processes
- Reviewed internal policies and procedures
- Contacted investment managers when additional information was needed

To perform our test work, we judgmentally sampled 38 investments in LACERA's portfolio where a quarterly fee was paid from July 1, 2014 to June 30, 2015. For each investment, we compared the fee in the quarterly invoice or statement provided by the investment manager to the terms of the contract³. We also verified that the fees paid rolled up accurately into the supplemental sections of LACERA's CAFR.

The number of investments selected for each asset class was proportionate to the asset class' pro-rata share of total investment management fees disclosed in the fiscal year 2014-2015 CAFR after subtracting out private equity fees. See table below:

Asset Class	Management fees disclosed in FYE 2014-2015 CAFR	Pro-rata share of total fees**	Investments tested	Dollar amount tested
Private Equity	\$44,542,272	-	-	-
Public Equity	\$38,841,471	33%	13	\$7,035,029
Real Estate	\$38,372,299	33%	13	\$6,779,520
Fixed Income	\$23,502,491	20%	8	\$3,616,700
Hedge Funds	\$11,265,657	10%	3	\$1,420,817
Commodities	\$3,847,848	3%	1	\$378,603
Cash	\$951,023	1%	-	-
Mortgage Servicers	\$171,487	0%	-	-
Total*	\$116,952,282	100%	38	\$19,230,669

*The totals exclude private equity.

**The pro-rata percentages are rounded to the nearest percent.

³ In commingled funds, investment managers generally withdraw quarterly fees directly from LACERA's capital account or capital calls. For commingled funds, we did not verify the actual cash withdrawal transaction. We relied on information in the quarterly invoices or statements provided by the investment manager. We also did not test expenses (i.e., some contracts allow for fund expenses to be reimbursed to the manager) since the amounts were small relative to other types of fees.

AUDIT RESULTS

OVERALL RESULTS

For all 38 investments tested, we did not note any instances where an investment manager incorrectly charged LACERA. Overall, staff has good internal controls for validating fees of separately managed accounts ("SMAs"). We also verified that staff accurately disclosed management fees for public equity, fixed income, commodities, and hedge fund investments in the fiscal year ending June 30, 2015 CAFR.

However, we identified areas where management could improve internal controls. Specifically, we noted that staff did not validate fees for some commingled fund investments in real estate, public equities, and fixed income. Additionally, we noted inconsistencies in staff's process of accounting for and disclosing, in the supplemental sections of the CAFR, performance fees, carried interest, and expenses paid to private market managers. We believe that developing formal procedures for capturing and accounting for investment fees would strengthen management's overall controls for disclosing, measuring, and managing investment fees. Our observations and recommendations, as well as management's responses, are discussed in detail below.

INVESTMENT FEE GOVERNANCE

The Board of Investments', Statement of Investment Beliefs indicates that investment fees should be actively monitored. In current practice, the Investments Office and FASD are both involved with validating and disclosing investment fees. However, there is no LACERA policy or procedure governing which business unit has ultimate responsibility for overseeing that investment fees are appropriately captured, validated, and disclosed in the CAFR. We believe that having a formal fee validation procedure which identified the business unit(s) accountable for overseeing the administration of investment fees may have prevented the process gaps noted in our report below. In one example, there was miscommunication between staff as to whether FASD or the Investments Office was responsible for validating fees for public market commingled funds and, as a result, the fees for six funds were not reviewed and validated.

We also noted that staff does not have clear direction on which fees need to be accounted for and disclosed. As a result, we found inconsistencies in the types of fees that LACERA accounts for and discloses in the supplemental sections of the CAFR. Specifically, based on our test work, we noted:

- Management fees and acquisition fees are accounted for and disclosed in the CAFR.
- Some performance fees, carried interest, and expenses paid to private market managers are accounted for and disclosed in the CAFR but a majority of these fees are not.

As mentioned, LACERA has received clean opinions on its audited financial statements. LACERA's private market investment income is reported net of performance fees and carried interest, which is consistent with regulatory reporting standards. However, regulatory reporting standards are rather vague with regard to investment fee reporting and disclosure. Specifically, Statement No. 67 of the Governmental Accounting Standards Board which governs financial reporting for U.S. public pension funds states that -- "*Investment-related costs should be reported as investment expense if they are separable from (a) investment income and (b) the administrative expense of the pension plan.*" Statement No. 67 leaves it up to U.S. public pension funds to interpret what costs are separable. This ambiguity has allowed for material costs (i.e., fees and expenses) to be netted from investment returns to arrive at a net income figure, which may be practical for financial reporting purposes, but provides for less transparency since there is no requirement for the explicit disclosure of these netted costs in the CAFR.

We believe that in the absence of specific regulatory requirements defining the accounting, validation, and disclosure of investment fees, a best practice is for management to develop investment fee validation and disclosure procedures. Procedures would clarify which types of fees need to be accounted for, validated, and disclosed, and the business unit(s) responsible for overseeing those functions. It would also allow management to evaluate whether existing resources are sufficient to account for and validate the fees.

If procedures are developed for fee validation and disclosure, management should also consider including the provisions of California Assembly Bill (AB) 2833 in the procedures. AB 2833 requires California public pension funds to obtain detailed information of fees paid to alternative investment vehicles, managers, and related parties, including private equity funds, venture funds, hedge funds, and absolute return funds as well as real estate, made on or after January 1, 2017, and make reasonable efforts to obtain detailed fee information for these investments where LACERA had an existing contract prior to January 1, 2017. LACERA has applied the law to alternative investment structures in all asset classes. AB 2833 also requires LACERA to publicly report, on an annual basis, fees paid to firms that manage these investments.

RECOMMENDATION

The Investments Office and Financial and Accounting Services Division:

- 1. Develop procedures that:**
 - a. Define which investment fees should be captured, validated, and disclosed in the supplemental sections of the CAFR.**
 - b. Define the business unit(s) responsible for capturing, validating, and disclosing investment fees.**
- 2. Work with the Legal Office to incorporate the requirements of AB 2833 in the procedures mentioned in recommendation #1.**

Management Response

Investments Office and FASD Management agrees with the recommendations. Investments Office and FASD staff will work together to develop documented procedures defining the investments fees that should be captured, validated, and disclosed in the CAFR. The procedures will also identify the business units responsible for performing these functions. LACERA staff will work with the Legal Office to incorporate the requirements of AB 2833 into the documented procedures. These procedures will be developed by December 31, 2017.

REAL ESTATE

LACERA's real estate investments are structured in both SMAs and commingled funds. Investment managers of real estate SMAs have relatively simple fee structures and send quarterly invoices to LACERA for payment. Investment managers of commingled real estate funds tend to have complex fee structures and pay themselves by withdrawing quarterly fees directly from LACERA's capital account in the fund. Of the \$38 million in real estate management fees disclosed in the fiscal year 2014-2015 CAFR, approximately \$28 million (74%) was paid to SMA managers and nearly \$10 million (26%) was paid to commingled fund managers. The Investments Office's real estate team is responsible for validating all real estate fees. FASD works with the real estate team to aggregate and reconcile annual real estate fees to be disclosed in the CAFR.

We tested the quarterly fees of 13 real estate investments which consisted of five SMAs and eight commingled funds, and noted the following:

Real Estate – Separately Managed Accounts

For the five real estate SMAs tested, we did not note any exceptions with the quarterly fee amount paid to the investment manager. We also noted that real estate staff reviews and validates fees for all real estate SMAs.

Real Estate – Commingled Funds

For the eight commingled real estate funds tested, we noted that staff did not validate the quarterly fees. In November 2015, Investments Office management informed the Board of Investments' Real Estate Committee that staff did not have a process to validate commingled real estate fund fees and that staff was working on a solution. LACERA is currently invested in 21 commingled real estate funds, which have similar fee structures and complexity to private equity funds.

While our test work did not note exceptions with a fee amount paid to any of the eight commingled real estate fund manager, we identified an error with a fee amount disclosed in the supplemental sections of the CAFR for one commingled real estate fund. Specifically, LACERA disclosed a quarterly management fee of \$1.16 million in the fiscal year ending 2014-2015 CAFR when the fee was

approximately \$170,000. This error stemmed from the investment manager providing an erroneous quarterly statement to LACERA which reported an incorrect management fee. Had a review process been in place to validate commingled real estate fund fees, this reporting error would likely have been identified and prevented.

Internal Audit followed-up with the investment manager and noted that their reporting error was due to the investment manager reporting a "plug" number, which allowed the investment manager's books to reconcile, instead of the actual quarterly management fee. This reporting error applied to all quarterly statements provided to LACERA since the fund's inception in 2012. Due to this discrepancy, Internal Audit requested from the investment manager a detailed summary of all management fees charged since the fund's inception. Based on the information provided, we verified that the management fees charged since inception reflected the terms of the contract. Therefore, this issue appeared only to be a misreporting issue. Investments Office management should ensure that commingled real estate fund fees are reviewed and validated to prevent these types of reporting errors and ensure that investment managers charge LACERA correctly based on the contract.

RECOMMENDATIONS

Investments Office Management:

- 3. Develop a process to review and validate commingled real estate fund fees to ensure that the fees are accurately charged to LACERA and disclosed in the Comprehensive Annual Financial Report.**

Management Response

Investments Office Management agrees with the recommendation. Management will develop a process for reviewing and validating investment fees of commingled real estate funds and expects to implement the process by December 31, 2017.

PUBLIC MARKETS

(Public Equity, Fixed Income, and Commodities)

FASD currently validates fees for public market investments. FASD also aggregates public market fees to be disclosed in the CAFR. Of the \$66 million in public market management fees disclosed in the fiscal year 2014-2015 CAFR, approximately \$49 million (74%) was paid to SMA managers and nearly \$17 million (26%) was paid to commingled fund managers. Most of LACERA's public market fees, for both SMAs and commingled funds, consist of management fees which are relatively simple to calculate. Only a few public market commingled funds charge performance fees which have more complex fee structures.

We tested quarterly fees of 22 public market funds which consisted of 13 SMAs and nine commingled funds, and noted the following:

Public Market – Separately Managed Accounts

For all 13 public market SMAs tested, we did not note any exceptions. We also noted that FASD has a strong process to validate fees for public market SMAs.

Public Market – Commingled Funds

For the nine public market commingled funds tested, we noted staff did not review and validate investment fees for six commingled public market funds, which included four public equity commingled funds, one fixed income commingled fund, and one fixed income fund-of-one.

FASD staff indicated that since there were no invoices to review before the six public market commingled fund fees were paid (i.e., the investment managers paid themselves) and the fees were relatively more complex than other funds, staff did not validate those fees. There was also an apparent miscommunication between Investments Office and FASD staff with respect to which party had responsibility for validating the fees of public market commingled funds.

We discussed our observations with the public equity team and FASD staff who immediately worked together to develop a process to validate the fees of three commingled public equity funds. There was no need to develop a process to validate fees for the fourth commingled public equity fund since LACERA terminated the investment manager in 2016. With regards to the two fixed income funds, the fixed income team is working with FASD to develop a validation process for the fund-of-one since the fee structure is straight forward; for the commingled fund, since the fee structure is more complex, the fixed income team is evaluating the best solution for validation. Nonetheless, the fixed income team provided documentation showing that they perform reasonableness checks on the quarterly fees charged by these two fixed income managers, which we believe reduces the risk of LACERA being incorrectly charged.

RECOMMENDATION

- 4. Investments Office and FASD clearly communicate and coordinate roles to ensure that fees of all public market commingled funds are validated.**
- 5. Investments Office management develop a fee validation process for the fixed income commingled fund and fund-of-one.**
- 6. To ensure accountability, Investments Office and FASD document the business unit(s) responsible for validating public market fees, as suggested in recommendations #1 & #2.**

Management Response

The Investment Office will work with FASD to develop procedures for validating all public market manager fees (commingled funds and separate accounts). The procedures will document the roles and responsibilities for the respective business units. Furthermore, investment staff will propose establishing a quarterly meeting with FASD to ensure that fees for all public market managers are reviewed and validated. We anticipate that the new procedures will be implemented in time for a review of fees paid in the quarter ending September 30, 2017.

HEDGE FUNDS

At the time of our test work, LACERA's hedge fund portfolio consisted of three hedge fund-of-funds ("HFOF")⁴. Two HFOFs are managed by Grosvenor Capital Management ("Grosvenor") and one is managed by Goldman Sachs Asset Management ("GSAM"). Each HFOF has between 14-35 underlying hedge fund investments.

LACERA pays two layers of fees. The first layer is paid to Grosvenor and GSAM who only charge management fees. The second layer is paid to the underlying hedge fund managers who charge management and performance fees. LACERA's hedge fund team validates the first layer of fees and relies on Grosvenor and GSAM to validate the second layer of fees. Grosvenor and GSAM provide LACERA an annual report totaling all fees of the underlying managers. LACERA's hedge fund team then forwards all hedge fund fees to FASD to be reported in the CAFR.

We tested quarterly fees paid to all three HFOFs. We also reviewed Grosvenor's and GSAM's process for validating and reporting hedge fund fees by interviewing their operations teams. We did not test fees of the underlying hedge fund managers.

Fee Validation

Based on our test work, there were no exceptions with the quarterly fees charged by Grosvenor or GSAM. Additionally, we noted that Grosvenor has a robust process to validate management fees charged and performance fees accrued by the underlying hedge fund managers. However, we noted that GSAM's fee validation process may not be adequate for ensuring that the fees charged by the underlying managers are accurate. Specifically, GSAM's operations team mitigates the risk that managers incorrectly charge LACERA by performing pre and post-investment operational due diligence of the underlying managers in the HFOF. GSAM's due diligence includes verifying that the underlying managers have good back-office controls to correctly calculate and charge investment fees. GSAM also performs reasonableness checks but only for management fees. While this may

⁴ LACERA invested in a fourth hedge fund-of-funds since we began our test work, which is managed by Grosvenor Capital Management.

reduce the risk, Investments Office management should request that GSAM develop a more robust process to validate the fees charged by the underlying managers.

RECOMMENDATIONS

- 7. Investments Office Management request that Goldman Sachs Asset Management enhance the process for validating the fees that LACERA pays to the underlying hedge fund managers.**

Management Response

Investments Office Management agrees with the recommendation. We are currently working with Goldman Sachs Asset Management to enhance the fee validation process for the fees paid by LACERA to the underlying hedge fund managers. The improved fee validation process will be in place by December 31, 2017.

Fee Reporting

Grosvenor and GSAM provide detailed information to LACERA of the management fees paid to the underlying managers. However, we noted the performance fees that Grosvenor and GSAM provide are accrued performance fees rather than paid performance fees. Accrued performance fees are cumulative unpaid performance fees of the underlying hedge fund managers that are only paid if/when the underlying fund's investment return exceeds a specified rate of return during the period specified in the contract (e.g., quarter, year, end of fund). While these accrued performance fees are netted from the underlying hedge funds' investments returns and net asset values, if/when these payouts occur, Grosvenor and GSAM do not capture the timing of when the performance fees are paid. As a result, the actual performance fees paid are not captured and reported to LACERA.

As of January 2017, LACERA must publicly report performance fees "paid" to hedge funds as required in California Assembly Bill 2833. LACERA may also decide to disclose performance fees in the supplemental sections of the CAFR as part of our recommendation #1. For fee disclosure purposes, it would be impractical to report accrued performance fees since the actual payout amounts are contingent on future hedge fund returns, which can fluctuate from quarter to quarter. Investments Office management should work with Grosvenor and GSAM to capture and report the actual performance fees paid to the underlying managers.

RECOMMENDATIONS

- 8. Investments Office management request that Grosvenor Capital Management and Goldman Sachs Asset Management collect and report the actual performance fees LACERA pays to the underlying hedge fund managers.**

Management Response

Investments Office Management agrees with the recommendation. We have historically collected accrued performance fees. We will request that, in addition to accrued fees, Grosvenor and GSAM provide actual performance fees by December 31, 2017.

We thank the Investments Office and Financial and Accounting Services Division Management and Staff for their cooperation with our Audit.

NOTED AND APPROVED:



Richard Bendall
Chief Audit Executive

Date: June 28, 2017

c: Audit Committee
Gregg Rademacher
Robert Hill
JJ Popowich
Jon Gabel

Vache Mahseredjian
John McClelland
Ted Wright
Christopher Wagner
Jim Rice

Steven Rice
Christine Roseland
Beulah Auten
Ted Granger



Investment Fees Audit

June 28, 2017

Audit Conducted by:
Quoc Nguyen, CPA, CFA
Principal Internal Auditor

EXECUTIVE SUMMARY

AC QUESTION: What is the policy related to posting audit reports on LACERA's website?

IA Response: Currently there is no official policy. In practice, LACERA Internal Audit Reports, unless deemed confidential, are posted on LACERA's website at the time of the Audit Committee meeting for those reports issued to the Audit Committee prior to that Audit Committee meeting.

As part of our fiscal year 2016-2017 audit plan, we completed an audit of investment fees paid to investment managers. LACERA retains investment managers that directly invest in stocks, bonds, real estate, private equity, hedge funds, and other assets on LACERA's behalf. In fiscal years ending June 30, 2016, June 30, 2015, and June 30, 2014, LACERA disclosed investment fees totaling \$184 million, \$161 million, and \$155 million, respectively, in the supplemental sections of its Comprehensive Annual Financial Report ("CAFR").

AC QUESTION: Is there any reason a fee that LACERA "disclosed" would not be "paid" - paid fees are the subject of audit.

IA Response: There shouldn't be a reason that disclosed fees would not be paid fees. Disclosed fees would be paid fees – LACERA either paid the fee through a manager invoice or knows about the fee from the manager's quarterly statements, and thus the fee was disclosed. However, LACERA "paid" fees wouldn't necessarily mean that the fees were disclosed. For example, most paid performance fees, carried interest, and/or expenses, are not disclosed in the CAFR.

Our audit assessed management's process for validating investment fees (i.e., verifying that the fees paid are in compliance with the contract terms) and disclosing complete and accurate investment fees in the CAFR. As a part of our audit, we tested a sample of quarterly investment fees. We excluded private equity fees from our testing since LACERA engaged an outside third-party to audit private equity fees.

LACERA's portfolio consists of 105 different investments (excluding private equity). Of the 105 investments, 59 (56%) are structured as "separately managed accounts" where the holdings are directly owned by LACERA and managed by an investment manager, while 46 (44%) are structured as "commingled funds" where LACERA is one of multiple investors in a pooled fund managed by an investment manager. Commingled funds (with the exception of indexed commingled funds) generally have more complex fee structures than separately managed accounts.

Overall, we noted that staff has good controls for validating investment fees of separately managed accounts, and staff comprehensively discloses *management fees* and *acquisition fees* in the CAFR. However, management needs to strengthen the process for 1) validating fees of commingled funds and 2) accounting for and disclosing *performance fees*, *carried interest*, and *expenses* in the CAFR. Our observations are discussed below.

EXECUTIVE SUMMARY

Validating Investment Fees

The Financial and Accounting Services Division (FASD) validates the fees of public market investments (e.g., public equities, fixed income, commodities) for both separately managed accounts and commingled funds. The Investments Office validates the fees of private market investments (e.g., private equity, real estate, hedge funds) for both separately managed accounts and commingled funds. The responsibilities for validating fees in the Investments Office are decentralized by asset class.

AC COMMENT: Some background on this separation exists would be informative to the reader.

IA Response: Comment noted.

We tested the quarterly fees of 38 investments (21 separately managed accounts and 17 commingled funds) totaling \$19.2 million paid in fiscal year ending June 30, 2015. We noted that the FASD and Investments Office routinely validate the fees of separately managed accounts. However, staff did not have a process to review and validate the fees for 14 (83%) of the 17 commingled funds we tested, which included eight commingled real estate funds, four commingled public equity funds, and two commingled fixed income funds. In all cases the reason cited for not validating these fees was the complexity of doing so. For the three commingled funds that were validated, they were indexed commingled funds and the fees were relatively easy to recalculate.

AC COMMENT: I think staff need to stay on point with the language they choose to state the results of the testwork. The practice, as characterized does not tell me if the fees for the 21 accounts staff selected reconciled without exception.

IA Response: Staff reconciled the 21 separately managed accounts without exception. We noted this in the blanket statement that "...FASD and Investments Office routinely validate the fees of separately managed accounts". In the executive summary, we could have referred specifically to the 21 separately managed accounts.

AC QUESTION: On the next page we learn of varying fee types. What specifically are "quarterly fees" when one refers to the fee types on the next page?

IA Response: All types of fees, if charged, are charged on a quarterly basis. We noted this is the background section of the report but not in the executive summary.

Beyond our review of what the Investments Office and FASD did to validate investment manager fees, for each of the 38 investments, we selected one quarter of fees paid in fiscal year ending June 30, 2015 and verified that the fees paid were in accordance to the contract terms. For some of the more complex commingled funds, we worked with staff and/or communicated with the investment manager to assist us in validating the fees. We believe that we were able to reasonably validate the fees for all 38 investments for the quarters we tested, without exception.

AC QUESTION: Prior to this, you hadn't characterized the fund as complex, you stated the investment staff stated they didn't reconcile because it was a complex reconciliation. Are you now agreeing with investment staff? If so the characterization is of the calculation, not of the fund.

EXECUTIVE SUMMARY

IA Response: On page one, paragraph three of the executive summary, we noted “Commingled funds (with the exception of indexed commingled funds) generally have more complex fee structures than separately managed accounts.” We do not agree or disagree with investment staff. We are stating our observation as to the reason why those commingled fund fees in our test work were not validated.

Disclosing Investment Fees

LACERA pays a variety of investment fees, including management fees, performance fees, carried interest, acquisition fees, and expenses. Management fees make up a majority of investment related fees and are paid to all firms in every asset class. The other types of fees (like performance fees, carried interest and acquisition fees) are charged primarily by private equity, real estate, and hedge fund managers.

We noted that staff comprehensively accounts for and discloses management fees and acquisition fees in the CAFR. However, there are inconsistencies with the accounting for and disclosing of performance fees, carried interest, and expenses. For example, staff captures the performance fees, carried interest, and expenses paid to some firms but not all. Only some of the performance fees, carried interest, and expenses that are captured are disclosed in the CAFR.

AC QUESTION: One would think a "comprehensive accounting" would include a reconciliation. If you agree with that, how can you then make this statement given the findings?

IA Response: In the context of this observation/section, comprehensive accounting would be collecting the “management fee” and “acquisition fee” data from the manager and disclosing those fees in the CAFR. While this was the case for management and acquisition fees, this was not the case for performance fees, carried interest, and expenses.

Disclosing performance fees, carried interest, and expenses in the CAFR is a matter related to improving transparency rather than of compliance. LACERA's external auditors have opined that LACERA's annual financial statements are in compliance with regulatory reporting standards. In recent years, however, there has been increased public interest into the transparency of investment fees paid by public pension funds. We note also that fee transparency can enhance LACERA's ability to measure and manage its investment costs. Absent specific regulatory requirements on fee disclosure in the CAFR, we believe management should determine, and document in their procedures, which fees should be accounted for and disclosed.

AC QUESTION: Really? LACERA is required to comply with California law and the legislature amended that law in the last year to include private equity fee reporting requirements.

IA Response: AB 2833 does not require any fee disclosure in the CAFR. AB 2833 requires that LACERA disclose the fees covered under the provision at least once annually in a public meeting.

EXECUTIVE SUMMARY

AC QUESTION: Why do you not consider California law to be a regulatory requirement?

IA Response: We do consider AB 2833 as a regulatory requirement, but not for CAFR disclosure.

These and other observations are detailed in the attached report. We also include other recommendations that we believe will improve management's processes related to validating and disclosing investment fees. Management agreed with our observations and recommendations, and has developed action plans to implement the recommendations. We would like to thank the Investments Office and FASD Staff for their cooperation and assistance in this audit.

Investment Fees Audit

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INTRODUCTION

As part of our fiscal year 2016-2017 audit plan, we completed an audit of investment fees paid to investment managers. LACERA retains investment managers to directly invest one hundred percent of LACERA's trust assets which on June 30, 2016 was valued at \$47.7 billion. The purpose of our audit was to assess LACERA's system of controls for validating the accuracy of fees paid to investment managers and disclosing those fees in LACERA's Comprehensive Annual Financial Report ("CAFR"). As part of our audit, we also performed test work to verify the accuracy of fees paid and disclosed in fiscal year ending June 30, 2015.

We excluded private equity fees from our testing since LACERA engaged an external auditor, Kreischer Miller, to perform a retrospective fee audit on a sample of private equity funds which is expected to be completed by August 2017. Additionally, LACERA engaged a consultant in August 2016, the Pavilion Group, to assist the Investments Office with collecting and validating private equity fees on a prospective basis.

BACKGROUND

LACERA pays a variety of investment fees such as management fees, performance fees, carried interest, real estate acquisition fees, and reimbursed expenses. Investment managers of all asset classes charge a "management fee" which is commonly assessed as an annual percentage of assets under management. Typically, private market managers (private equity, real estate, hedge funds) charge other fees on top of management fees. Hedge fund managers charge "performance fees" if the investment returns exceed a specific rate of return within a specific period (e.g., quarterly, annually). Private equity and real estate fund managers include provisions in their agreements for "carried interest", which if earned, is a type of performance fee or profit sharing. Real estate managers may charge an "acquisition fee" when they acquire property on LACERA's behalf.

LACERA's ownership structure in an investment can impact the way fees are paid. LACERA's investments are structured in either a separately managed account ("SMA") or commingled fund¹. In a SMA structure, holdings are directly owned by LACERA and managed by an investment manager. In a commingled fund structure, LACERA is one of multiple investors in a pooled fund managed by a general partner or portfolio manager. In general, SMA investment managers request payment for their fees by sending quarterly invoices whereas commingled fund managers pay themselves by withdrawing funds directly from LACERA's capital account within the investment².

¹ We use the term commingled funds in this report to also describe investments also set-up in a "fund-of-one" structure. LACERA invests in a few fund-of-one vehicles which are similar to commingled funds in that the investment managers are paid by withdrawing fees from LACERA's capital account or capital calls.

² LACERA's BlackRock public market indexed commingled funds send quarterly invoices for payment of fees.

In the table below, we list the total number of investment managers and investments by asset class as of June 2017. We also indicate whether each investment is a SMA or commingled fund structure.

Asset Class	Total Investment Managers*	Total Investments	Separately managed accounts (SMAs)	Commingled Funds
Private Equity	107	220	7	213
Public Equity	19	31	14	17
Real Estate	21	34	13	21
Fixed Income	22	29	22	7***
Hedge Funds**	2	4	4	-
Commodities	4	4	4	-
Cash	1	2	2	-
Total	176	324	66	258

*Some investment managers have more than one mandate and manage more than one SMA and/or commingled fund.

** LACERA is invested in four hedge fund-of-funds (HFOF). Three are managed by Grosvenor Capital Management, held in a limited partner fund-of-one structure. One is managed by Goldman Sachs Asset Management with 28 underlying hedge funds that LACERA directly holds under its own name. Each of the four HFOF holds underlying investments in commingled hedge funds.

***One of these seven fixed income funds is structured in a fund-of-one structure.

As indicated above, LACERA allocates capital to 176 different investment managers. For investment fees, both the types and rates can vary widely depending on the asset class being managed and terms negotiated. Certain contracts allow for lower fees when LACERA allocates additional capital to the investment manager or when an investment period changes (e.g., when a fund's life changes from an investment period to a distribution period). It is important that LACERA has strong controls for ensuring that investment managers correctly charge LACERA based on the terms in the contracts.

Validating Investment Fees

The Investments Office and Financial and Accounting Services Division ("FASD") currently share the function of validating investment fees but their duties vary depending on the asset class. FASD staff validates fees of public market investments (public equities, fixed income, and commodities). Public market managers typically charge management fees which have relatively simple fee calculations. Investments Office staff oversees the process for validating fees of private market investments (real estate, hedge funds, and private equity). Private market managers tend to have more complex fee structures, especially in commingled funds.

Disclosing Investment Fees

LACERA's annual investment fees are disclosed in the supplemental sections of LACERA's CAFR. FASD collects data for public market fees and works with the Investments Office, LACERA's consultants, and State Street Bank (LACERA's custodian) to collect data for private market fees. FASD then aggregates fees for all asset classes and discloses the fees in the CAFR.

In fiscal years ending June 30, 2016, June 30, 2015, and June 30, 2014, LACERA disclosed investment fees totaling \$184 million, \$161 million, and \$155 million, respectively, and in basis points (bps) of the Trust's total net asset value, the total fees equaled 38.6 bps, 33.3 bps, and 31.7 bps, respectively. The fees in these totals include management fees and generally do not include other fees such as performance fees, carried interest, and fund expenses. Historically, LACERA, like other public pension funds, has only disclosed management fees in the CAFR.

Disclosing fees such as performance fees, carried interest, and expenses is a matter of improving transparency rather than of compliance. LACERA has always received clean opinions on its financial statements from its external auditors. In recent years, however, there has been increased public and stakeholder interest in the transparency of investment fees paid by public pension funds. Furthermore, the State of California passed Assembly Bill 2833 in 2016 which requires California public pension funds, including LACERA, to collect and publicly disclose details of fees paid to alternative investment vehicles, managers, and related parties, including private equity funds, venture funds, hedge funds, and absolute return funds as well as, based on LACERA's interpretation, real estate, for new contracts signed on or after January 2017, and must undertake reasonable efforts to obtain that fee information for existing contracts. In LACERA's view, the law applies to alternative investment structures across all asset classes. Staff is working with the Legal Office to implement the new law.

AC COMMENT: I am relieved to see you acknowledge the legislation, but the first sentence is not appropriate given the requirement in the legislation.

IA Response: In the context of compliance, we intended to relate the matter of compliance to financial statement and CAFR reporting/disclosure.

AUDIT OBJECTIVES

- Review and evaluate the system of controls for **validating** and **disclosing** investment fees paid to investment managers
- Perform test work on a sample of quarterly investment fees (excluding private equity) to determine if the investment fees paid were:
 1. Properly reviewed and approved by staff
 2. Accurately charged by the investment manager based on the contract terms
 3. Accurately disclosed in the supplemental sections of LACERA's CAFR

AUDIT SCOPE

We reviewed:

- Staff's process for validating investment fees
- Staff's process for disclosing investment fees in the CAFR
- A sample of 38 quarterly investment fees paid from July 1, 2014 to June 30, 2015 (each quarterly fee tested was from a different investment)

AUDIT METHODOLOGY

To evaluate the system of controls related to validating and disclosing investment fees, we:

- Interviewed Investments Office and FASD staff
- Performed walkthroughs of staff's processes
- Reviewed internal policies and procedures
- Contacted investment managers when additional information was needed

To perform our test work, we judgmentally sampled 38 investments in LACERA's portfolio where a quarterly fee was paid from July 1, 2014 to June 30, 2015. For each investment, we compared the fee in the quarterly invoice or statement provided by the investment manager to the terms of the contract³. We also verified that the fees paid rolled up accurately into the supplemental sections of LACERA's CAFR.

³ In commingled funds, investment managers generally withdraw quarterly fees directly from LACERA's capital account or capital calls. For commingled funds, we did not verify the actual cash withdrawal transaction. We relied on information in the quarterly invoices or statements provided by the investment manager. We also did not test expenses (i.e., some contracts allow for fund expenses to be reimbursed to the manager) since the amounts were small relative to other types of fees.

The number of investments selected for each asset class was proportionate to the asset class' pro-rata share of total investment management fees disclosed in the fiscal year 2014-2015 CAFR after subtracting out private equity fees. See table below:

Asset Class	Management fees disclosed in FYE 2014-2015 CAFR	Pro-rata share of total fees**	Investments tested	Dollar amount tested
Private Equity	\$44,542,272	-	-	-
Public Equity	\$38,841,471	33%	13	\$7,035,029
Real Estate	\$38,372,299	33%	13	\$6,779,520
Fixed Income	\$23,502,491	20%	8	\$3,616,700
Hedge Funds	\$11,265,657	10%	3	\$1,420,817
Commodities	\$3,847,848	3%	1	\$378,603
Cash	\$951,023	1%	-	-
Mortgage Servicers	\$171,487	0%	-	-
Total*	\$116,952,282	100%	38	\$19,230,669

*The totals exclude private equity.

**The pro-rata percentages are rounded to the nearest percent.

AUDIT RESULTS

OVERALL RESULTS

For all 38 investments tested, we did not note any instances where an investment manager incorrectly charged LACERA. Overall, staff has good internal controls for validating fees of separately managed accounts ("SMAs"). We also verified that staff accurately disclosed management fees for public equity, fixed income, commodities, and hedge fund investments in the fiscal year ending June 30, 2015 CAFR.

However, we identified areas where management could improve internal controls. Specifically, we noted that staff did not validate fees for some commingled fund investments in real estate, public equities, and fixed income. Additionally, we noted inconsistencies in staff's process of accounting for and disclosing, in the supplemental sections of the CAFR, performance fees, carried interest, and expenses paid to private market managers. We believe that developing formal procedures for capturing and accounting for investment fees would strengthen management's overall controls for disclosing, measuring, and managing investment fees. Our observations and recommendations, as well as management's responses, are discussed in detail below.

INVESTMENT FEE GOVERNANCE

The Board of Investments', Statement of Investment Beliefs indicates that investment fees should be actively monitored. In current practice, the Investments Office and FASD are both involved with validating and disclosing investment fees. However, there is no LACERA policy or procedure governing which business unit has ultimate responsibility for overseeing that investment fees are appropriately captured, validated, and disclosed in the CAFR. Decentralized processes require centralized controls. Period. We believe that having a formal fee validation procedure which identified the business unit(s) accountable for overseeing the administration of investment fees may have prevented the process gaps noted in our report below. In one example, there was miscommunication between staff as to whether FASD or the Investments Office was responsible for validating fees for public market commingled funds and, as a result, the fees for six funds were not reviewed and validated.

AC COMMENT: At an organizational level, there are so many similarities between this report and the certificates report.

IA Response: Comment noted.

We also noted that staff does not have clear direction on which fees need to be accounted for and disclosed. As a result, we found inconsistencies in the types of fees that LACERA accounts for and discloses in the supplemental sections of the CAFR. Specifically, based on our test work, we noted:

- Management fees and acquisition fees are accounted for and disclosed in the CAFR.
- Some performance fees, carried interest, and expenses paid to private market managers are accounted for and disclosed in the CAFR but a majority of these fees are not.

AC COMMENT: I would like the CIO's opinion as these matters come up to take a fresh look at these issues and decide if fee reconciliation responsibilities belong in the Investment Office. This report assumes the status quo.

IA Response: The Chief Investment Officer, Investments Office Management, and the Financial and Accounting Services Division Management will evaluate the strengths and weaknesses of the various groups involved in fee oversight and other aspects of the CAFR that require inter-divisional cooperation during LACERA's next audit cycle to determine appropriate roles and responsibilities.

As mentioned, LACERA has received clean opinions on its audited financial statements. LACERA's private market investment income is reported net of performance fees and carried interest, which is consistent with regulatory reporting standards. However, regulatory reporting standards are rather vague with regard to investment fee reporting and disclosure. Specifically, Statement No. 67 of the Governmental Accounting Standards Board which governs financial reporting for U.S. public pension funds states that -- "*Investment-related costs should be reported as investment expense if they are separable from (a) investment income and (b) the administrative expense of the pension plan.*" Statement No. 67 leaves it up to U.S. public pension funds to interpret what costs are separable. This ambiguity has allowed for material costs (i.e., fees and expenses) to be netted from investment

returns to arrive at a net income figure, which may be practical for financial reporting purposes, but provides for less transparency since there is no requirement for the explicit disclosure of these netted costs in the CAFR.

We believe that in the absence of specific regulatory requirements defining the accounting, validation, and disclosure of investment fees, a best practice is for management to develop investment fee validation and disclosure procedures. Procedures would clarify which types of fees need to be accounted for, validated, and disclosed, and the business unit(s) responsible for overseeing those functions. It would also allow management to evaluate whether existing resources are sufficient to account for and validate the fees.

If procedures are developed for fee validation and disclosure, management should also consider including the provisions of California Assembly Bill (AB) 2833 in the procedures. AB 2833 requires California public pension funds to obtain detailed information of fees paid to alternative investment vehicles, managers, and related parties, including private equity funds, venture funds, hedge funds, and absolute return funds as well as real estate, made on or after January 1, 2017, and make reasonable efforts to obtain detailed fee information for these investments where LACERA had an existing contract prior to January 1, 2017. LACERA has applied the law to alternative investment structures in all asset classes. AB 2833 also requires LACERA to publicly report, on an annual basis, fees paid to firms that manage these investments.

RECOMMENDATION

The Investments Office and Financial and Accounting Services Division:

1. **Develop procedures that:**
 - a. **Define which investment fees should be captured, validated, and disclosed in the supplemental sections of the CAFR.**

AC COMMENT: If the recommendation is to not capture, validate, and disclose, the procedures need to include that determination and the reasons for it.

IA Response: Your recommendation for documenting the reasons for deciding not to capture, validate, and disclose a fee appears to be reasonable practice. This report could be forwarded by the Audit Committee to the Portfolio Risk Committee for review and further action. Additionally, you may provide staff specific directions to include a specific area or topic on a Board or Committee agenda for discussion.
 - b. **Define the business unit(s) responsible for capturing, validating, and disclosing investment fees.**
2. **Work with the Legal Office to incorporate the requirements of AB 2833 in the procedures mentioned in recommendation #1.**

Management Response

Investments Office and FASD Management agrees with the recommendations. Investments Office and FASD staff will work together to develop documented procedures defining the investments fees that should be captured, validated, and disclosed in the CAFR. The procedures will also identify the business units responsible for performing these functions. LACERA staff will work with the Legal Office to incorporate the requirements of AB 2833 into the documented procedures. These procedures will be developed by December 31, 2017.

REAL ESTATE

LACERA's real estate investments are structured in both SMAs and commingled funds. Investment managers of real estate SMAs have relatively simple fee structures and send quarterly invoices to LACERA for payment. Investment managers of commingled real estate funds tend to have complex fee structures and pay themselves by withdrawing quarterly fees directly from LACERA's capital account in the fund. Of the \$38 million in real estate management fees disclosed in the fiscal year 2014-2015 CAFR, approximately \$28 million (74%) was paid to SMA managers and nearly \$10 million (26%) was paid to commingled fund managers. The Investments Office's real estate team is responsible for validating all real estate fees. FASD works with the real estate team to aggregate and reconcile annual real estate fees to be disclosed in the CAFR.

We tested the quarterly fees of 13 real estate investments which consisted of five SMAs and eight commingled funds, and noted the following:

Real Estate – Separately Managed Accounts

For the five real estate SMAs tested, we did not note any exceptions with the quarterly fee amount paid to the investment manager. We also noted that real estate staff reviews and validates fees for all real estate SMAs.

Real Estate – Commingled Funds

For the eight commingled real estate funds tested, we noted that staff did not validate the quarterly fees. In November 2015, Investments Office management informed the Board of Investments' Real Estate Committee that staff did not have a process to validate commingled real estate fund fees and that staff was working on a solution. LACERA is currently invested in 21 commingled real estate funds, which have similar fee structures and complexity to private equity funds.

While our test work did not note exceptions with a fee amount paid to any of the eight commingled real estate fund manager, we identified an error with a fee amount disclosed in the supplemental sections of the CAFR for one commingled real estate fund. Specifically, LACERA disclosed a quarterly

management fee of \$1.16 million in the fiscal year ending 2014-2015 CAFR when the fee was approximately \$170,000. This error stemmed from the investment manager providing an erroneous quarterly statement to LACERA which reported an incorrect management fee. Had a review process been in place to validate commingled real estate fund fees, this reporting error would likely have been identified and prevented.

Internal Audit followed-up with the investment manager and noted that their reporting error was due to the investment manager reporting a "plug" number, which allowed the investment manager's books to reconcile, instead of the actual quarterly management fee.

AC QUESTION: Isn't that a reportable action under SEC rules and regulations?

IA Response: The quarterly statements staff receive from the managers are part of an internal process that staff use to obtain fee information from real estate commingled fund managers. This is not part of a SEC regulatory reporting or disclosure process. However, staff obtain the information from these quarterly statements to disclose the real estate commingled fund management fees paid as part the supplemental disclosures in the CAFR. Supplemental disclosure of investment fees in the CAFR, as we understand it, is not mandated by the SEC or GASB. Nonetheless, we will verify this with our external auditors.

This reporting error applied to all quarterly statements provided to LACERA since the fund's inception in 2012. Due to this discrepancy, Internal Audit requested from the investment manager a detailed summary of all management fees charged since the fund's inception. Based on the information provided, we verified that the management fees charged since inception reflected the terms of the contract. Therefore, this issue appeared only to be a misreporting issue. Investments Office management should ensure that commingled real estate fund fees are reviewed and validated to prevent these types of reporting errors and ensure that investment managers charge LACERA correctly based on the contract.

AC COMMENT: Misreporting issues get solved; this has been outstanding for five years.

IA Response: This misreporting issue has since been corrected by Staff as a result of the finding.

RECOMMENDATIONS

Investments Office Management:

- 3. Develop a process to review and validate commingled real estate fund fees to ensure that the fees are accurately charged to LACERA and disclosed in the Comprehensive Annual Financial Report.**

Management Response

Investments Office Management agrees with the recommendation. Management will develop a process for reviewing and validating investment fees of commingled real estate funds and expects to implement the process by December 31, 2017.

PUBLIC MARKETS
(Public Equity, Fixed Income, and Commodities)

FASD currently validates fees for public market investments. FASD also aggregates public market fees to be disclosed in the CAFR. Of the \$66 million in public market management fees disclosed in the fiscal year 2014-2015 CAFR, approximately \$49 million (74%) was paid to SMA managers and nearly \$17 million (26%) was paid to commingled fund managers. Most of LACERA's public market fees, for both SMAs and commingled funds, consist of management fees which are relatively simple to calculate. Only a few public market commingled funds charge performance fees which have more complex fee structures.

We tested quarterly fees of 22 public market funds which consisted of 13 SMAs and nine commingled funds, and noted the following:

Public Market – Separately Managed Accounts

For all 13 public market SMAs tested, we did not note any exceptions. We also noted that FASD has a strong process to validate fees for public market SMAs.

Public Market – Commingled Funds

For the nine public market commingled funds tested, we noted staff did not review and validate investment fees for six commingled public market funds, which included four public equity commingled funds, one fixed income commingled fund, and one fixed income fund-of-one.

FASD staff indicated that since there were no invoices to review before the six public market commingled fund fees were paid (i.e., the investment managers paid themselves) and the fees were relatively more complex than other funds, staff did not validate those fees. There was also an apparent miscommunication between Investments Office and FASD staff with respect to which party had responsibility for validating the fees of public market commingled funds.

We discussed our observations with the public equity team and FASD staff who immediately worked together to develop a process to validate the fees of three commingled public equity funds. There was no need to develop a process to validate fees for the fourth commingled public equity fund since LACERA terminated the investment manager in 2016. With regards to the two fixed income funds, the fixed income team is working with FASD to develop a validation process for the fund-of-one since the fee structure is straight forward; for the commingled fund, since the fee structure is more complex, the fixed income team is evaluating the best solution for validation. Nonetheless, the fixed income team provided documentation showing that they perform reasonableness checks on the quarterly fees charged by these two fixed income managers, which we believe reduces the risk of LACERA being incorrectly charged.

AC QUESTION: Is that the right benchmark?

IA Response: Regardless of staff performing reasonableness checks, we recommend (in Reco. #5) that staff develop a process to validate the fees for these two fixed income funds. Here, we wanted to give staff credit for performing reasonableness checks on the fees which we believe does reduce some risk of LACERA being overcharged.

RECOMMENDATION

4. Investments Office and FASD clearly communicate and coordinate roles to ensure that fees of all public market commingled funds are validated.
5. Investments Office management develop a fee validation process for the fixed income commingled fund and fund-of-one.
6. To ensure accountability, Investments Office and FASD document the business unit(s) responsible for validating public market fees, as suggested in recommendations #1 & #2.

Management Response

The Investment Office will work with FASD to develop procedures for validating all public market manager fees (commingled funds and separate accounts). The procedures will document the roles and responsibilities for the respective business units. Furthermore, investment staff will propose establishing a quarterly meeting with FASD to ensure that fees for all public market managers are reviewed and validated. We anticipate that the new procedures will be implemented in time for a review of fees paid in the quarter ending September 30, 2017.

HEDGE FUNDS

At the time of our test work, LACERA's hedge fund portfolio consisted of three hedge fund-of-funds ("HFOF")⁴. Two HFOFs are managed by Grosvenor Capital Management ("Grosvenor") and one is managed by Goldman Sachs Asset Management ("GSAM"). Each HFOF has between 14-35 underlying hedge fund investments.

LACERA pays two layers of fees. The first layer is paid to Grosvenor and GSAM who only charge management fees. The second layer is paid to the underlying hedge fund managers who charge management and performance fees. LACERA's hedge fund team validates the first layer of fees and relies on Grosvenor and GSAM to validate the second layer of fees. Grosvenor and GSAM provide LACERA an annual report totaling all fees of the underlying managers. LACERA's hedge fund team then forwards all hedge fund fees to FASD to be reported in the CAFR.

⁴ LACERA invested in a fourth hedge fund-of-funds since we began our test work, which is managed by Grosvenor Capital Management.

We tested quarterly fees paid to all three HFOFs. We also reviewed Grosvenor's and GSAM's process for validating and reporting hedge fund fees by interviewing their operations teams. We did not test fees of the underlying hedge fund managers.

Fee Validation

Based on our test work, there were no exceptions with the quarterly fees charged by Grosvenor or GSAM. Additionally, we noted that Grosvenor has a robust process to validate management fees charged and performance fees accrued by the underlying hedge fund managers.

AC QUESTION: This suggests that the thoroughness or completeness of the LACERA fee reconciliation is compromised because Grosvenor does it well. Is that true?

IA Response: Staff and Grosvenor perform fee reconciliations on different fees. Staff reconcile the fees that Grosvenor charges to LACERA, the first layer of the fund-of-funds fees. Grosvenor reconciles the fees charged by the various underlying hedge fund managers that are part of the fund-of-funds separate account, the second layer of fees. Staff do not validate the second layer of fees.

However, we noted that GSAM's fee validation process may not be adequate for ensuring that the fees charged by the underlying managers are accurate. Specifically, GSAM's operations team mitigates the risk that managers incorrectly charge LACERA by performing pre and post-investment operational due diligence of the underlying managers in the HFOF. GSAM's due diligence includes verifying that the underlying managers have good back-office controls to correctly calculate and charge investment fees. GSAM also performs reasonableness checks but only for management fees. While this may reduce the risk, Investments Office management should request that GSAM develop a more robust process to validate the fees charged by the underlying managers.

RECOMMENDATIONS

- 7. Investments Office Management request that Goldman Sachs Asset Management enhance the process for validating the fees that LACERA pays to the underlying hedge fund managers.**

Management Response

Investments Office Management agrees with the recommendation. We are currently working with Goldman Sachs Asset Management to enhance the fee validation process for the fees paid by LACERA to the underlying hedge fund managers. The improved fee validation process will be in place by December 31, 2017.

Fee Reporting

Grosvenor and GSAM provide detailed information to LACERA of the management fees paid to the underlying managers. However, we noted the performance fees that Grosvenor and GSAM provide are accrued performance fees rather than paid performance fees. Accrued performance fees are cumulative unpaid performance fees of the underlying hedge fund managers that are only paid if/when the underlying fund's investment return exceeds a specified rate of return during the period

specified in the contract (e.g., quarter, year, end of fund). While these accrued performance fees are netted from the underlying hedge funds' investments returns and net asset values, if/when these payouts occur, Grosvenor and GSAM do not capture the timing of when the performance fees are paid. As a result, the actual performance fees paid are not captured and reported to LACERA.

AC COMMENT: This answers one of my questions.

As of January 2017, LACERA must publicly report performance fees "paid" to hedge funds as required in California Assembly Bill 2833. LACERA may also decide to disclose performance fees in the supplemental sections of the CAFR as part of our recommendation #1. For fee disclosure purposes, it would be impractical to report accrued performance fees since the actual payout amounts are contingent on future hedge fund returns, which can fluctuate from quarter to quarter. Investments Office management should work with Grosvenor and GSAM to capture and report the actual performance fees paid to the underlying managers.

AC COMMENT: And really on an ongoing basis, LACERA should require each manager in respective contracts report fees paid.

IA Response: It is management's intent to request that Grosvenor and Goldman capture and report to LACERA the actual performance fees of the underlying hedge fund managers on an on-going basis.

RECOMMENDATIONS

- 8. Investments Office management request that Grosvenor Capital Management and Goldman Sachs Asset Management collect and report the actual performance fees LACERA pays to the underlying hedge fund managers.**

Management Response

Investments Office Management agrees with the recommendation. We have historically collected accrued performance fees. We will request that, in addition to accrued fees, Grosvenor and GSAM provide actual performance fees by December 31, 2017.

We thank the Investments Office and Financial and Accounting Services Division Management and Staff for their cooperation with our Audit.

NOTED AND APPROVED:



Richard Bendall
Chief Audit Executive

Date: **June 28, 2017**

c: Audit Committee
Gregg Rademacher
Robert Hill
JJ Popowich
Jon Grabel

Vache Mahseredjian
John McClelland
Ted Wright
Christopher Wagner
Jim Rice

Steven Rice
Christine Roseland
Beulah Auten
Ted Granger



LACERA INTERNAL AUDIT DIVISION

Duplicate Special Payments

January 19, 2017

AUDIT PERFORMED BY:

Gabriel Tafoya, CISA
Senior Internal Auditor

EXECUTIVE SUMMARY

As part of our fiscal year 2016-2017 audit plan, we performed data analytics testing on "special payments". This type of audit test is a component our Continuous Auditing Program which leverages technology such as Audit Command Language (or "ACL") software to perform our testing. ACL allows us to analyze large sets of data relatively quickly using algorithmic formulas.

Our testing was limited in scope, specifically designed to identify duplicate payments issued within the "special payments" process. Special payments are initiated by the Benefits Division and are one-time payments issued to members and beneficiaries outside of the normal monthly payroll process. Examples of special payments are:

- (1) payouts for terminated employees who withdraw their funds before retirement
- (2) payouts of death and retro-active benefits
- (3) re-issuance of monthly benefit checks that had been cancelled through stop payments, outlaw checks, or voids

LACERA could be at risk of issuing duplicate payments or other types of payment errors if proper controls are not in place. Although our testing was primarily data-driven, we also performed a limited review of the internal controls related to issuing special payments. We have two recommendations for management related to the special payments process as discussed further below.

To perform our data testing, we used ACL to conduct analytics on the 6,677 (100%) special payments initiated in calendar year 2015 which totaled \$45,289,095. Using our analytics, we identified 1,154 (17%) potential duplicate payments. We then performed detailed testing on a sample of the potential duplicates. Our testing did not result in any exceptions. We found that the special payments in our sample were generally void and re-issued payments, where only one legitimate payment was actually made. Additionally, each payment tested was accompanied by the required supporting documentation and approvals. Based on our testing, the Benefits Division had adequate controls to prevent duplicate payments within the special payments process.

However, in our limited process review, we identified two opportunities for improving the current system of controls related to issuing special payments. First, Benefits Management should update their written procedures to require staff to check for duplicate payments at each stage of the review and approval process.

Secondly, the Benefits Division should work with the Systems Division to automate "payment approvals" for all disbursements paid through the special payments process. Currently, approximately 90 percent of disbursements issued through the special payment process are approved manually, meaning that the review and approval sign-offs are paper-based versus an automated electronic workflow. Manual approvals increase the risk of duplicate payments, payment errors, or fraudulent payments. While we commend the Systems Division for automating "member contribution withdrawals", which makes up approximately 10 percent of special payment transactions, we believe continuing the automation efforts for all special payments will greatly improve processing efficiencies and internal controls.

Overall, Benefits Management and staff are to be congratulated on the effectiveness and consistency of their procedures. Internal Audit thanks the Benefits and Systems Division Management and staff for their assistance in this review.

Duplicate Member Payments

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INTRODUCTION

As part of our fiscal year 2016-2017 audit plan, we performed data analytics testing on "special payments". This type of audit test is a component our Continuous Auditing Program which leverages technology such as Audit Command Language (or "ACL") software to perform our testing. ACL allows us to analyze large sets of data relatively quickly using algorithmic formulas.

This was a limited scope set of data tests, specifically designed to identify duplicate payments issued within the "special payments" process. Special payments are one-time payments issued to members and beneficiaries and are issued outside of the normal monthly payroll process. Without proper controls in place, LACERA could be at risk of issuing duplicate payments or other types of payment errors. The primary purpose of this test was to determine whether duplicate special payments exist. However, we also performed a limited review of the internal controls related to issuing special payments.

BACKGROUND

Special Payments

The Benefits Division issues approximately 6,700 special payments annually totaling over \$45 million. The payment amounts have ranged from less than two dollars to over \$500,000 per member payment. The reasons for issuing special payments include, but are not limited to:

- (1) retirees non-receipt of regular monthly payments;
- (2) the re-issuance of monthly benefit checks that had been cancelled through stop payments, outlaw checks or voids;
- (3) first payments to new retirees;
- (4) terminated employees who withdrew their funds before retirement;
- (5) payouts of member death benefits;
- (6) payouts of retro-active disability benefits; and
- (7) non-routine distributions of funds, such as divorce-related legal splits.

Initiating and processing a special payment is performed within Workspace (LACERA's member application and database) and requires Benefits staff to perform multiple level reviews and approvals to ensure that supporting documentation, calculations, and required approvals, are appropriate. A Special Payment Control Form (paper-based) is used to formally document the above process through each level of review and approval. The number of required approval levels depends on the dollar amount of the payment. Additionally, a Benefits staff-person independent of the review and approval processes must verify that the required approvals exist prior to releasing each payment.

AUDIT OBJECTIVE(S)

- Determine if duplicate special payments exist.
- Perform a limited review of the internal controls related to the special payments process.

AUDIT SCOPE

- Our test work population **included** all special payments initiated through LACERA's special payment system for calendar year 2015.
- Our test work **excluded** testing payments to members that were part of the regular monthly payroll process.

AUDIT METHODOLOGY

Objective 1:

Our data analytics testing was performed by extracting all special payments transactions for calendar year 2015 from the special payments system. This amounted to 6,677 payment transactions valued at \$45,289,095. We then analyzed 100% of the transactions using Audit Command Language (ACL) to identify potential duplicate special payments to members. To accomplish our test objectives, we used ACL to perform the six tests listed below.

Provide results for member/beneficiary special payments that have the:

1. Same SSN numbers, check dates, check amounts.
2. Same SSN numbers, check dates.
3. Same SSN numbers, check amounts.
4. Same SSN numbers, member names, check dates, payment types, check amounts.
5. Same SSN numbers, member names, check dates, payment types.
6. Same SSN numbers, member names, payment types, check amounts.

The six tests described above are typical data analytics practices for identifying potential duplicate payments and are also published within Information Systems Audit and Control Association (ISACA) White Paper that address duplicate payment testing.

Once we obtained our potential duplicates population using ACL, we performed detailed testing on a sample of the potential duplicates to determine whether the transactions were actual exceptions or false positives. False positives would be reported exceptions that are not true duplicates but end up in our testing results for various reasons.

Objective 2:

In our limited process review, we interviewed the Benefits Division and Systems Division Management and staff to obtain an understanding of the existing controls related to preventing duplicate payments, payment errors, and/or fraudulent payments.

AUDIT RESULTS

Overall, Internal Audit's data analytics and testing uncovered no duplicate special payments. We found that Benefits Management had adequate controls to prevent duplicate special payments. However, based on our limited review of special payment process controls, we identified two opportunities for Management to further improve the controls related to preventing duplicate payments and other possible payment errors. Detailed results of our review are discussed below.

SPECIAL PAYMENTS DATA TESTING

The six data analytics tests we performed, as mentioned in the audit methodology section, resulted in 1,154 potential duplicate special payment records. To determine whether the 1,154 records we identified were false positives or in-fact duplicate special payments, we performed additional test work by sampling and testing 40 records (and planned to increase the sample size if we found any true duplicates or control exceptions). The 40 records (valued at \$1,823,235 in total) were selected on a judgmental basis consisting of high dollar values within the payment types and transactions that represented a higher risk. We then obtained supporting documentation from Workspace to determine whether each of the 40 payment transactions were legitimate.

Based on our testing, each of the 40 records turned out to be a false positive and was the result of a voided payment that had to be re-issued at a later date. We worked with Benefits staff to confirm the reasons for each voided payment and noted that they were due to normal business activities. Specifically, the reasons were:

- The member did not supply their correct address when the original check was issued.
- The member changed their payout request (cash-out versus rollover into a tax-deferred account) which resulted in LACERA needing to include or exclude taxes from the original check.
- The member never cashed the original check before the cashing period expired.

We found that each payment was legitimate and accompanied by the required staff and/or manager review and approval. Further, staff documented in Workspace the need for voiding the original payment before reissuing the replacement check.

Since the records in our targeted sample were all voided and reissued checks, we performed additional testing to verify whether staff actually voided all original checks before reissuing

replacement checks. We did this by comparing all checks in LACERA's member payment system labeled as "void" to LACERA's custodian bank's voided payment records (State Street Bank). We confirmed that all these checks were in fact voided through State Street Bank.

We did not identify duplicate payments or control exceptions in our test work and also verified that the voided checks in LACERA's records were voided at State Street Bank. As a result, we gained comfort that the existing controls related to preventing duplicate special payments were functioning as intended and therefore we limited our test work to 40 transactions.

LIMITED REVIEW OF SPECIAL PAYMENT CONTROLS

In our limited review of the internal controls related to the special payment process, we identified two opportunities for management to improve their existing controls which are discussed below.

Update Special Payment Procedures

We noted in our interviews that staff, during their payment review process, verifies that each special payment is not a duplicate of a previous payment already made to a member. However, we noted this verification step is not documented in staff's written procedures. The special payment procedures should be updated to include this requirement. This will reinforce management's existing controls of preventing duplicate special payments.

RECOMMENDATION

- 1. Update the existing special payment procedures to include additional instructions that require staff to verify that there are no duplicate requests in process by reviewing the special payment log and the Events Comments.**

Management Response

Benefits Management agreed and has updated the existing "Special Payment Request Form" to include additional instructions that require the initiator and releaser of payments to verify that there are no duplicate payment requests in process or previously paid based on their review of the special payments log and the Workspace events comments. Benefits Management completed the addition of instructions to the Special Payment Request Form on October 31, 2016.

Expand the Automation of Special Payment Approvals

A long-term goal of the Systems Division has been to automate the special payment approval process, where each required approval electronically work-flows from one approver to the next to certify the validity of the payment. Automation adds efficiency to the review and approval process and also enhances internal controls to ensure that appropriate segregation of duties exists, business rules are strictly followed, and sufficient data trails are left behind for the use of management, exception, and audit reports.

We commend the Systems Division for automating the payment approvals for the "member contribution withdrawal" process; this is when members withdraw contributions from their account. However, we noted the member withdrawal process accounts for approximately 10% and 28% of all annual special payment transactions and dollars issued, respectively. The remaining special payment transaction types are approved manually which requires staff to pass along a "Special Payment Control Form" (paper-based) from one approver to the next, depending on the required number of approvers for each payment. While we did not identify any payment errors or control break-downs in our test work from payments that were approved manually, there is still a higher risk of payment errors with a manual approval versus an automated process, especially given the sheer volume of special payments issued annually.

To enhance the efficiency and effectiveness of the special payment approval process, we recommend that the Benefits Division work with the Systems Division to automate the remaining special payments processes that are currently approved manually. We also recommend that the Benefits and Systems Divisions work with Internal Audit during its development to help ensure that proper internal controls are designed into the automation process and that necessary data points are captured that will assist with post-transaction analytics and reporting.

RECOMMENDATION

- 2. Benefits Division work with the Systems Division to automate the approval of those special payments processes where approvals are currently performed manually.**
- 3. Benefits and Systems Divisions work with Internal Audit during its development to help ensure proper controls are designed into the automation process and that proper data points are captured that will assist with post-transaction analytics and reporting.**

Management Response

Automating the approval process for special payments is feasible; however, special payments are initiated from multiple sources in Workspace. Each source will need to be analyzed and then specifications developed and tailored to each individual source. As such, the approval process would need to be implemented in a phased approach. Internal Audit will be included in the implementation process to ensure proper controls

and reporting. There are some significant organizational goals that need to be completed before this modification can be addressed. It is estimated that determining the requirements and the level of effort can begin in the next fiscal year, July, 2017. The results of the requirement gathering will be reported to management by December 31, 2017, so that the project can be prioritized.

We would like to thank both the Benefits Division and the Systems Division for their assistance in completing this audit.

In designing this test, we set-up the test scripts in ACL so we could easily test for duplicate special payments in the future. We will continue to assess the effectiveness of Benefits Division's duplicate special payment controls on a periodic basis as part of the Continuous Auditing Program.

NOTED AND APPROVED



Richard Bendall
Chief Audit Executive

Date: January 19, 2017

REPORT DISTRIBUTION

2017 Audit Committee
Audit Committee Consultant
Internal Audit Staff

Gregg Rademacher
Robert Hill
JJ Popowich


Bernie Buenaflor
Mary Phillips
James Pu
Steven Rice



July 31, 2017

TO: Each Member
2017 Audit Committee

Audit Committee Consultant
Rick Wentzel

FROM: Richard Bendall 
Chief Audit Executive

FOR: August 16, 2017 | Audit Committee Meeting

SUBJECT INTERNAL AUDIT PLAN - FISCAL YEAR END 2018

RECOMMENDATION

Approve the proposed Internal Audit Plan for Fiscal Year End 2018.

BACKGROUND

According to the Institute of Internal Auditor's (IIA's) *International Standards for the Professional practice of Internal Auditing (Standards)*, the Chief Audit Executive (CAE) must establish risk based plans to determine the priorities of the internal audit activity, consistent with the organization's goals. To remain in compliance with the *Standards*, as well as the Audit Committee Charter, Internal Audit has developed the attached Internal Audit Plan (*Audit Plan*) for Fiscal Year End (FYE) 2018.

The Audit Plan is designed to ensure audit resources are appropriately allocated to address identified top priorities and key risk areas. The Audit Plan is color coded with a reference key to indicate projects currently in progress as well as those projects that are ongoing. The Audit Plan is also broken out by category as follows: Management Governance, Information Systems, Benefits Administration, or Financial & Investment Operations.

In considering the Audit Plan for FYE 2018, we remind your Committee that the Audit Plan is intended as a living document to allow changes to its content and schedule as a result of ongoing changes to risk factors, organizational needs, or resource limitations. Changes to the Audit Plan will be approved by the CAE for expediency. Information regarding changes to the Audit Plan will be provided to your Committee at each Committee Meeting during the fiscal year.

PURPOSE

The purpose of the Audit Plan is to justify support for audit resources and a means to engage Management in establishing priorities and identifying areas of risk and control for review. The Audit Plan provides a basis for measuring Internal Audit's accomplishments and supplies a guide to external auditors and others of the planned internal audit coverage. Most importantly, the Audit Plan helps to ensure audit resources are allocated to address identified top priorities.

RISK ASSESSMENT AND AUDIT PLANNING

The projects included in our Audit Plan are primarily identified through our on-going risk assessment process which includes keeping abreast of the concerns of the Audit Committee and Boards throughout the year, discussions with Executive Management, reviewing of LACERA's Strategic Plan, and having risk meetings with division managers and staff. As a component of our risk assessment process we request that division managers fill out a survey with questions that challenge their existing controls. We also had division managers fill out risk rating worksheets that allowed them to rate the risks in their respective areas. This relatively new enhancement allows us to have a better idea of Management's perception of their existing risks and controls. We then reconcile and combine Management's risk assessment results with our independent risk assessment to determine which audit projects to add to the Audit Plan.

This year, we continue to allocate resources towards consulting and auditing in those areas determined to be a higher risk and focus area of the organization such as compliance and privacy. For example, included are two projects where Internal Audit will provide training to staff throughout LACERA. The training is pro-active measure designed to enhance staff's awareness of good internal controls and privacy practices. We also included an audit of the Process Management Group (a unit within the Benefits Division) whose core function is to develop policies and procedures. Executive Management intends to scale the Process Management Group's policy and procedure operations to other parts of the organization, as part of the development of LACERA's formal compliance program. We believe that assessing the Process Managements Group's operations for soundness is a prudent step before the program is scaled to other parts of the organization. These are a few examples of the projects added. Below summarizes our proposed FYE 2018 Audit Plan.

AUDIT PARTICIPATION AREAS

As our proposed FYE 2018 Audit Plan below indicates, we included 37 total projects:

- 17 projects were rolled over from the FYE 2017 Audit Plan
- 18 are new audits or consulting projects added based on our annual risk assessment
- One is an administrative project designed to improve our audit operation's efficiency and effectiveness
- One is an on-going administrative project that is performed annually

As a whole, the projects in our proposed Audit Plan are those we believe best support LACERA's mission *to produce, protect, and provide the promised benefit*, and promote LACERA's strategic initiatives to improve service quality, information technology, and data accuracy.

AUDIT PARTICIPATION AREAS *(continued)*

As organizational needs, conditions, resources, and priorities change, Internal Audit Management will use its professional judgment as to the order in which audit projects are addressed. Staff will focus on efficiency and effectiveness in performing work to make every effort to complete the 37 projects included in this aggressive Audit Plan. Actual hours for each project will be determined at the start of each project based on the final scope and audit approach.

Internal Audit will be available at the August 16, 2017 Audit Committee meeting to discuss any questions you may have about the attached Audit Plan.

RECOMMENDATION

Should your Committee agree with staff's recommendation, appropriate action would be to:

1. Approve the proposed Internal Audit Plan for Fiscal Year End 2018


Attachments


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INTERNAL AUDIT PLAN FYE 2018

The following table provides a list of the planned Internal Audit projects for the **Fiscal Year End 2018**.

INTERNAL AUDIT PLAN FYE 2018		TOTAL HOURS: 10,600	
MANAGEMENT, GOVERNANCE & COMPLIANCE		EST. HOURS: 3,800	
PROJECT	TYPE	FREQUENCY	
1. Continuous Auditing Program	Audit	Ongoing	
2. Contract Compliance Program - Administration	Audit	Planned	
3. Internal Controls Training	Consulting	Planned	
4. Privacy Training	Consulting	Planned	
5. 960 Hours Testing	Audit	Periodic	
6. Pensionable Paycode Testing	Audit	Periodic	
7. Felony Convictions Plan Sponsor Reporting*	Audit	Periodic	
8. Corporate Credit Card Audit	Audit	Planned	
9. Board and Staff Travel	Audit	Planned	
10. Inventory Controls	Audit	Planned	
11. Quality Assurance Improvement Program FYE 2018	Admin	Periodic	
12. Risk Assessment – FYE 2019	Admin	Annual	
13. County Medical Reimbursements*	Audit	Planned	
14. Internal Audit Contractor Pool – RFP*	RFP	Planned	
15. Compliance Committee	Consulting	Planned	
16. Privacy Audit Reco. Coordination*	Consulting	Planned	
BENEFITS ADMINISTRATION		EST. HOURS: 2,000	
17. Benefits' Process Management Group	Audit	Planned	
18. Benefits' Exception Report Review Process	Audit	Planned	
19. Active Death Process*	Audit	Planned	
20. Member Death Verification Process*	Audit	Planned	
21. New Benefits Tier Plan*	Audit	Planned	
22. Member Accounts Settlement Process*	Audit	Planned	
23. Physician Selection and Compensation*	Audit	Planned	
INFORMATION SYSTEMS		EST. HOURS: 2,000	
24. Business Continuity/Disaster Recovery*	Consulting	Planned	
25. Data Backup/Retention Testing*	Audit	Planned	
26. Member Applications Change Control*	Audit	Planned	
27. Systems Penetration Testing	External Audit	Periodic	
28. IT Risk Assessment*	External Audit	Planned	
FINANCIAL & INVESTMENT OPERATIONS		EST. HOURS: 2,800	
29. FYE 2018 External Financial Audit - Oversight	External Audit	Planned	
30. FYE 2018 Actuarial Audit - Oversight	External Audit	Planned	
31. Foreign Tax Reclamation - Oversight	External Audit	Planned	
32. Wire Transfers Audit	Audit	Planned	
33. Real Estate Investment Operations*	External Audit	Planned	
34. Real Estate Advisor Audits*	External Audit	Periodic	
35. Securities Lending*	Audit	Planned	
36. Real Estate Debt Program Review*	External Audit	Planned	
37. Custodial Bank Review	Audit	Planned	

 In Process

 Ongoing

*FYE 2017 Project Rolled Over to Current Year

Internal Audit Plan

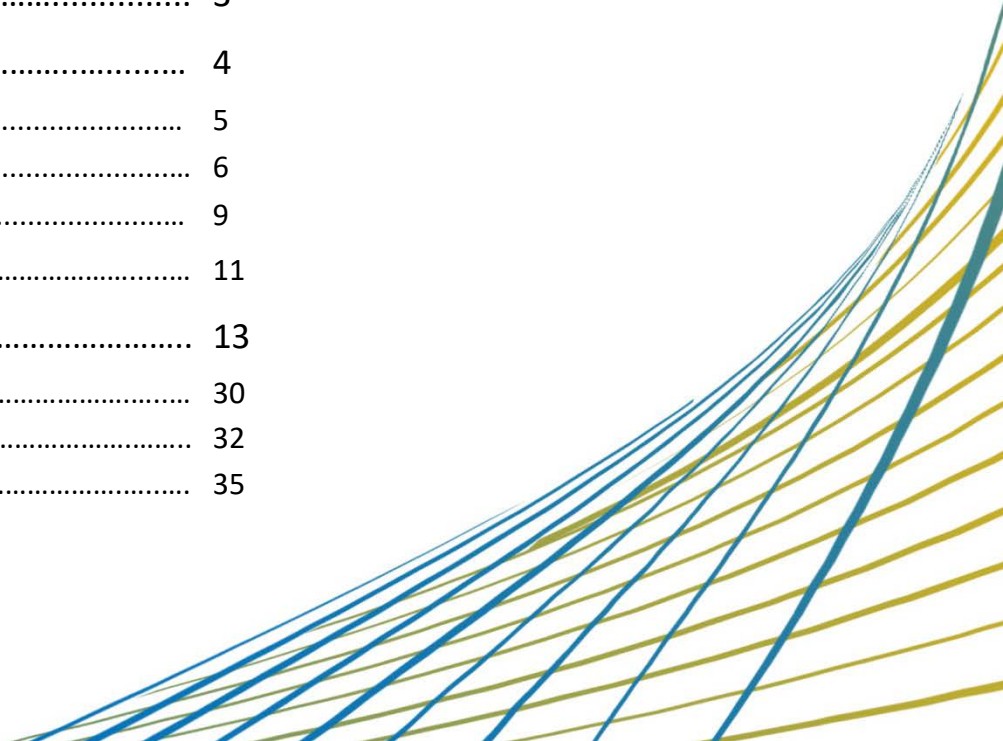
FYE 2018

Submission to the Audit Committee

August 16, 2017

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Executive Summary

Purpose

This document provides LACERA's proposed Internal Audit Plan ("Audit Plan") for the Fiscal Year Ending 2018 for the Audit Committee's review and approval as required by professional auditing standards and our Internal Audit Charter.

The purpose of the Audit Plan is to ensure audit resources are allocated to address identified top priorities.

Audit Plan Development & Scope

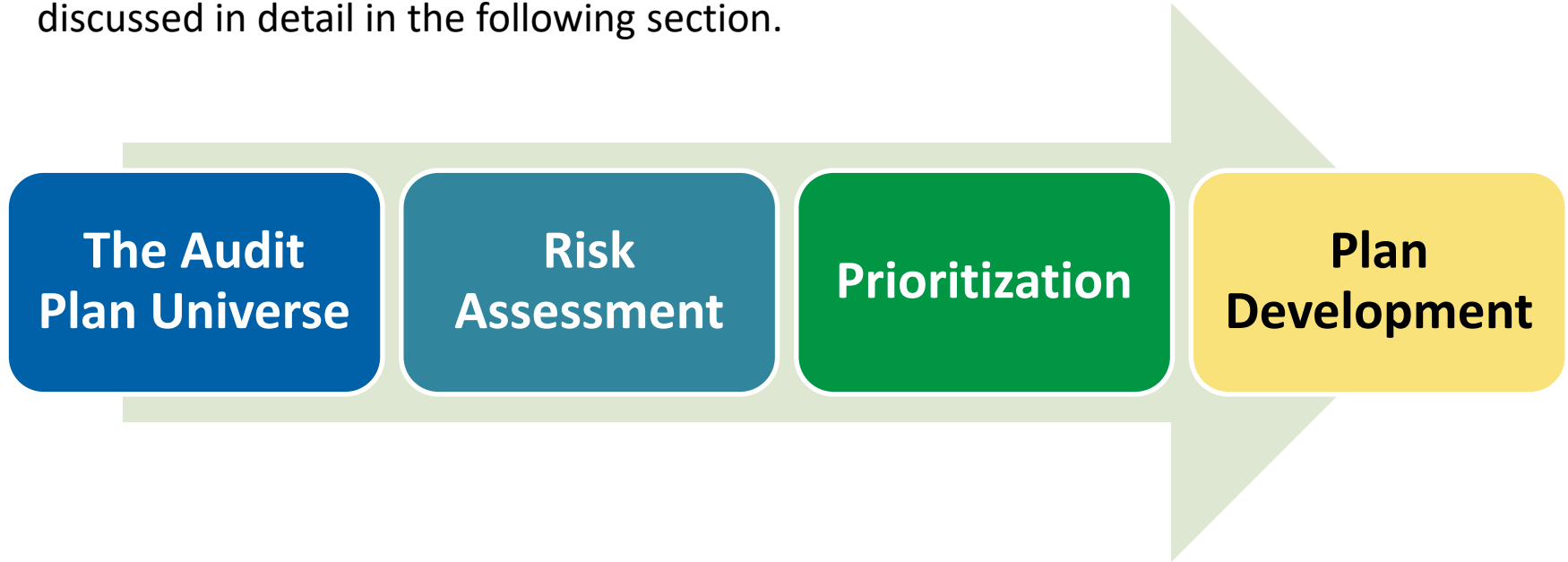
Our Audit Plan is designed to provide coverage of key risks, given the existing staff and approved budget. See the Appendices for information regarding the Internal Audit Budget, Performance Measures, and LACERA Audit Universe.

Changes Subsequent to Approval

Interim adjustments to the Audit Plan will occur periodically due to changes in business risks, timing of LACERA initiatives, and staff availability. We will report any Audit Plan adjustments to Management and the Audit Committee as appropriate.

Audit Plan Process

The diagram here represents our Audit Plan Process to be discussed in detail in the following section.



The Audit Plan Universe

What is the Audit Plan Universe?

The Audit Universe is a list of all possible audits that could be performed. They may be identified by division or by process.

Internal Audit applies a host of resources and knowledge including, but not limited to: LACERA's Strategic Plan, CAFR, budgets, organization charts, job descriptions, policies, the Internal Audit Risk Assessment, as well as general knowledge of LACERA and business processes in defining the Audit Universe. (See Appendix C) The Audit Plan Universe is **dynamic** as it is subject to change as additional auditable units are identified or circumstances change.



Risk Assessment

Understanding Risk

Risk assessment is the systematic process for identifying and evaluating events including possible risks and opportunities that could affect the achievement of objectives, positively or negatively.

Such events can be identified in the external environment (*e.g., new laws or regulations such as PEPPRA*) and within an organization's internal environment (*e.g., personnel, infrastructure, or process changes*). When these events intersect with an organization's objectives, (*or can be predicted to do so*), they become risks. ***Risk*** is therefore defined as, **"the possibility that an event will occur and adversely affect the achievement of objectives."**

Risk Assessment

Risk Assessment Process

In accordance with Internal Audit's Charter and the Institute of Internal Auditors (IIA), our Audit Plan is developed using an appropriate risk-based methodology, including the consideration of any risks or control concerns identified by management.

Planning for LACERA's overall audit needs requires a macro view of the organizations objective and related risks. Internal Audit continually assess all information relating to risk, potential or existing, along with special requests for audits and identified areas of concern.

Internal Audit gathers information regarding current and potential risks to the organization through the following:

- Discussions with LACERA Executive Management and review of LACERA's Strategic Plan,
- Risk meetings with Division Managers and Staff
- Risk Assessment Surveys and Risk Tables received from each Division Manager.
- Attendance at LACERA Board and Committee meetings
- Meetings with the LACERA Plan Sponsors and business partners
- Past participation in audits, reviews, and specific management concerns.

Risk Assessment


Risk Assessment Survey

Our risk assessment process is evolving as we find new and innovative ways to identify and assess risk throughout the organization. Specifically, we included a higher level of Management participation with respect to assessing the risks in their divisions by having managers fill out the survey shown here. In this survey, managers were asked to answer questions that challenged their existing controls.

The four key areas included in the survey are:

1. Operational Objectives
2. Significant Changes
3. Privacy
4. Compliance

Internal Audit
Risk Assessment Survey | FYE 2016


Los Angeles County Employees Retirement Association

Division: _____ Survey Completed By: _____ Date: _____

Instructions: Please answer the following questions to the best of your ability. When answering the questions, you should consider risks associated with work processed within your division and controls implemented to address those risks. Feel free to add additional pages or documents as needed. Thank you!

OPERATIONAL OBJECTIVES	
1. What are the key objectives/goals of your division?	
2. What are the most significant operational limitations that will prevent your division from accomplishing your divisional objectives? <i>Describe at a high level.</i>	
3. Are there any delays or backlogs in processes performed in your division? Why have they occurred?	
4. Are there any 2016-2017 strategic goals tied to work processes within your division?	
5. List significant processes or procedures in your division that are not documented with written procedures.	
6. Are there any specific control weaknesses or areas where controls could be further enhanced through additional segregation of duties or levels of approval, etc? If so please describe at a high level.	
SIGNIFICANT CHANGES	
7. Have there been any significant staffing changes in the past year? How did these staffing changes impact your division?	
8. List new legislative mandates that have or will impact your division.	
9. List new (or significant changes to) processes or work functions established in your division within the past year. How has this impacted your division? Do you anticipate any significant changes in fiscal year 2016-2017?	
PRIVACY	
10. Do you have divisional privacy policies or procedures?	
11. Describe processes in your division where member data is sent outside of the organization.	
12. Describe processes in your division where member data is sent to other divisions within the organization, include the method (e.g., via email, hard copy, etc.) the information is sent.	

Risk Assessment

Risk Assessment Worksheet

We also had division managers fill out a Risk Rating Worksheet shown here that allowed them to rate the risks in their respective areas.

This enhancement allowed us to have a better idea of Management's perception of their existing risks and controls. We then reconciled and combined Management's risk assessment results with our independent risk assessment to determine which audit projects to add to the Audit Plan.

Risk Assessment Table - Division A

Auditable Area/Function	Base Score	Materiality	Privacy	Change	Focus	Headline	Total	Explanation
		(-2 to +2)	(-2 to +2)	(-2 to +2)	(-2 to +2)	(-2 to +2)	(-7 to +13)	Justification for (+ or -) in this category
	3	1	1	0	2	-1	6	
1 Audit Area 1	3	1	0	2	-2	1	5	
2 Audit Area 2	3	-1	1	-2	1	1	3	
3 Audit Area 3	3	0	0	-2	1	0	2	
4 Audit Area 4	3	0	0	-1	-1	-2	-1	
5 Audit Area 5	3	1	1	0	0	1	6	
6 Audit Area 6	3	2	1	2	1	0	9	
7 Audit Area 7	3	1	1	0	1	1	7	
8 Audit Area 8	3	-1	-2	0	-2	0	-2	
9 Audit Area 9	3	1	1	0	0	0	5	
10 Audit Area 10	3	0	0	1	-1	1	4	

Steps to completing the Risk Assessment Table:

- Review the list of Auditable Areas, also referred to as functions. These are independent functions or processes performed within your division. You can add, change or delete functions so that the list clearly reflects key areas of work done within your division.
- For each function listed on the table rate the associated risks based on the 5 risk factors: materiality, privacy, change, focus, and headline (top row of table). Refer to Risk Criteria Definitions on Worksheet #2
- Assign points based on the risk methodology parameters defined on page 2. For each risk criteria, you can increase the score up to a maximum 2 points, or decrease the score down by a maximum of 2 points.
- Calculate the total (if working on file, the total will automatically calculate). The total score will consist of the base score of 3 plus or minus the points assigned to each of the 5 criteria. The minimum total is -7 and the maximum total is +13. See Example Area 1 and 2 included in the risk table above.
- The explanation column can be used to further explain any high risk scores or provide information or details significant to that function. relating to the function.
- Email completed table back to Internal Audit - address to Richard Bendall, cc to Leisha Collins and Quoc Nguyen

Prioritization

Overview

Internal Audit helps the organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of governance, risk management, and control processes. The primary responsibility of Internal Audit is assess if control processes as designed and represented by Management, is adequate and functioning in a manner to ensure the following:

- Risks are appropriately identified and managed.
- Significant financial, managerial, and operating information is accurate, reliable, and timely.
- Employees' actions are in compliance with policies, standards, procedures, and applicable laws and regulations.
- Resources are acquired economically, used efficiently, and protected adequately.
- Programs, plans and objectives are achieved.
- Quality and continuous improvement are fostered in LACERA's control process.
- Significant legislative or regulatory issues impacting LACERA are recognized and addressed appropriately.

Prioritization

A Balancing Act

It is important for Internal Audit to strike a balance in all aspects of our operations especially with regard to how we focus our attention on key risks and allocate our resources to address those risks.

If we are able to strike the right balance, we can effectively provide assurance to stakeholders on the effectiveness of LACERA's internal controls without compromising the efficiency of business unit operations.



Plan Development

Oversight

Our Audit Plan reflects the results of our continuous Risk Assessment Process as of the end of the LACERA fiscal year. Each year's updated Audit Plan is presented for your approval at the regularly scheduled July meeting and is implemented immediately upon approval.

Key Areas of Focus

Our Assessment focuses on exposures relating to LACERA's governance, operations, and information systems regarding the:

- reliability and integrity of financial and operational information
- effectiveness and efficiency of operations
- safeguarding of assets
- compliance with LACERA policy
- compliance with legal, privacy, regulatory, and contractual obligations
- detection and prevention of fraud

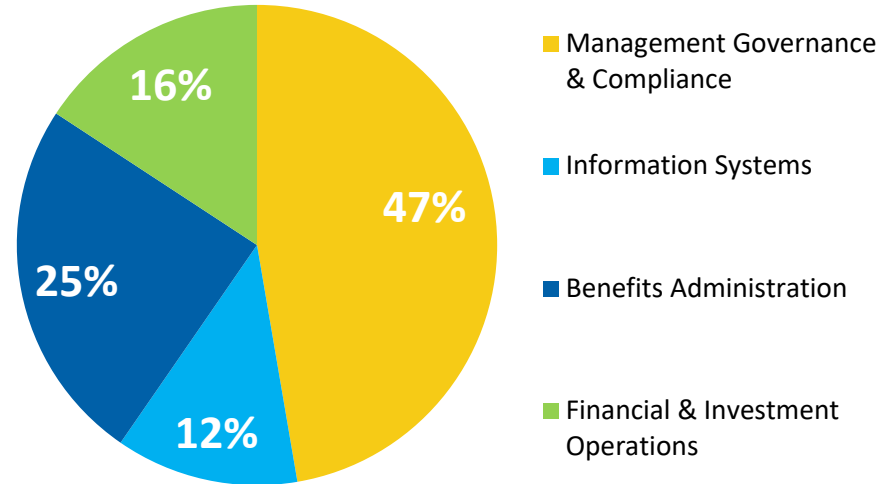
Plan Development

Resource Allocation FYE 2018

Our Audit Plan is based on 10,600 hours of available work hours.

The chart shown here indicates the distribution of our resources by **Project Type**.

Projects by Type



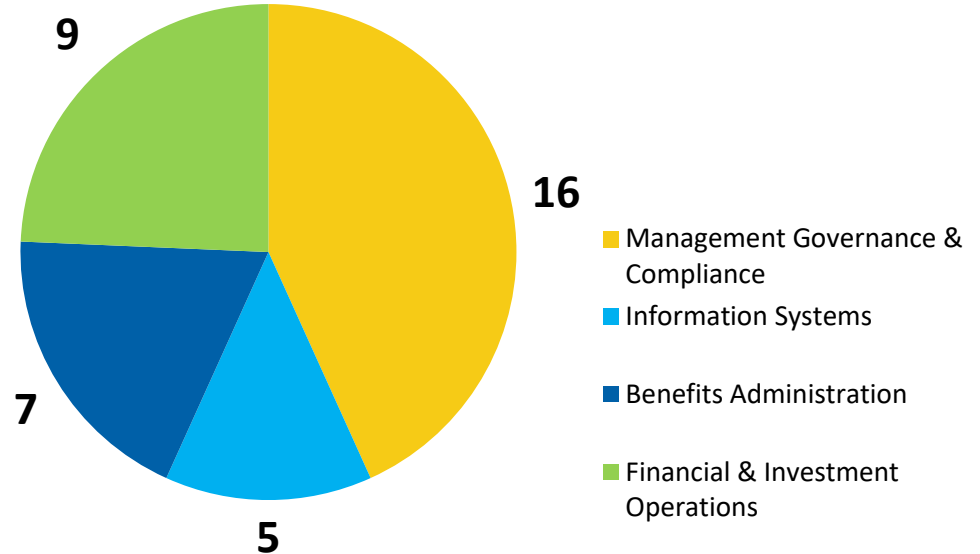
Internal Audit Plan

FYE 2018

Big Picture Snapshot | FYE 2018

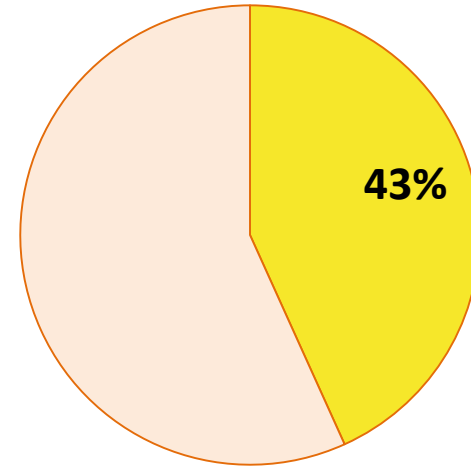
37 Projects

Projects by Type



Management, Governance & Compliance

16 Projects



Management, Governance & Compliance

No.	Project	Preliminary Scope
1	Continuous Auditing Program	In general, Internal Audit performs continuous, automated testing of LACERA transactions and information systems. This testing is performed to provide assurance that LACERA is in compliance with applicable laws and regulations as well as internal policies and procedures.
2	Contract Compliance Program - Administration	Review management's centralized contract compliance program.
3	Internal Controls Training	As a pro-active measure to enhance awareness on internal control fundamentals, we will provide LACERA staff with internal controls training.
4	Privacy Training	As a pro-active measure to enhance awareness regarding the privacy policy and good practices, we will provide LACERA staff with privacy training.



In Process



Ongoing

Management, Governance & Compliance

No.	Project	Preliminary Scope
5	960 Hours Testing	A periodic test to determine whether all retirees were temporarily rehired in compliance with legal requirements and LACERA policies.
6	Pensionable Paycode Testing	A periodic test to verify that the plan sponsors' pay codes are in compliance with the Board of Retirement's determination on pensionability.
7	Felony Convictions Plan Sponsor Reporting*	This is a compliance review of the LACERA Plan Sponsor's requirements for reporting certain felony convictions as required by PEPRA.
8	Corporate Credit Card Audit	Review of staff's credit card usage to verify compliance with LACERA's credit card and purchasing policies.

*FYE 2017 Project Rolled Over to Current Year



In Process



Ongoing

Management, Governance & Compliance

No.	Project	Preliminary Scope
9	Board and Staff Travel	Review of Board and staff travel to ensure that expenses are in compliance with the LACERA Travel Policy.
10	Inventory Controls	Review management's inventorying process for IT hardware.
11	Quality Assurance Improvement Program FYE 2018	The Quality Assurance and Improvement Program (QAIP) is part of an annual internal review process designed to help Internal Audit add value for its clients, improve the organization's operations, and ensure that audit activities are conducted in conformance with The IIA's Standards, the Definition, and the Code of Ethics.
12	Risk Assessment – FYE 2019	In compliance with the Internal Audit Charter and Institute of Internal Auditors Professional Practices Framework, Internal Audit will assess risks and controls throughout the organization to plan for LACERA's overall audit needs and to develop the Audit Plan.



In Process



Ongoing

Management, Governance & Compliance

No.	Project	Preliminary Scope
13	County Medical Reimbursements*	Review of medical reimbursement process from the County and reconciliation for accuracy, timeliness and appropriateness.
14	Internal Audit Contractor Pool – RFP*	Internal Audit will prepare an RFP, conduct a search, and complete contracts to establish a pool of qualified internal audit service providers that may be sourced for future audit projects as appropriate and necessary.
15	Compliance Committee	Serve on the Compliance Program Steering Committee in developing a framework for LACERA's formal compliance program.
16	Privacy Audit Reco. Coordination*	Internal Audit will oversee and actively coordinate the implementation of the recommendations as stated in the external Privacy Audit final report.

*FYE 2017 Project Rolled Over to Current Year



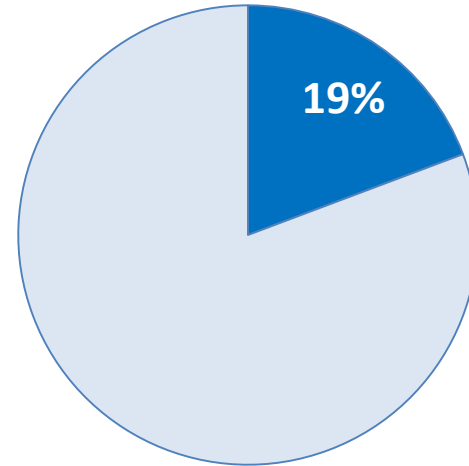
In Process



Ongoing

Benefits Administration

7 Projects



Benefits Administration

No.	Project	Preliminary Scope
17	Benefits' Process Management Group	Assess the internal control structure and process design of the Policy and Procedure Development Process within the Benefits' Process Management Group.
18	Benefits' Exception Report Review Process	Review LACERA's process for reviewing and managing exception reports related to Benefits data and transactions.
19	Active Death Process*	Review of Active Death case management in Benefits and Member Services. Also, follow-up of previous recommendations relating to this Process.
20	Member Death Verification Process*	Review LACERA's processes for verifying member deaths not reported to LACERA through the standard death reporting process.

*FYE 2017 Project Rolled Over to Current Year



In Process



Ongoing

Benefits Administration

No.	Project	Preliminary Scope
21	New Benefits Tier Plan*	Verify that Benefits and Retiree Health Care are placing members in the correct Retiree Health Care plan tier based on PEPR.
22	Member Accounts Settlement Process*	A review of the cross-functional Member Account Settlements Process administered by Benefits and Financial & Accounting Services Division to provide assurance that controls are functioning as intended.
23	Physician Selection and Compensation*	Review Disability Retirement Services' process for selecting physicians and monitoring their eligibility.

*FYE 2017 Project Rolled Over to Current Year



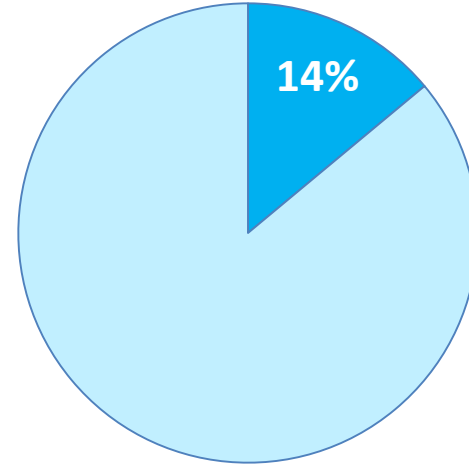
In Process



Ongoing

Information Systems

5 Projects



Information Systems

No.	Project	Preliminary Scope
24	Business Continuity/Disaster Recovery*	Internal Audit will provide consulting to management for enhancements to LACERA's Business Continuity/Disaster Recovery Program.
25	Data Backup/Retention Testing*	Internal Audit will test current operating procedures and processes for data back-up and retention.
26	Member Applications Change Control*	Internal Audit will test current operating procedures and processes for changing or creating new membership application programs.
27	Systems Penetration Testing	External Network Penetration testing is performed annually to assess the security of the internet accessible Member Portal.
28	IT Risk Assessment*	Internal Audit will engage an external auditor to perform a governance, risk, and control assessment of LACERA's Information Technology.

*FYE 2017 Project Rolled Over to Current Year



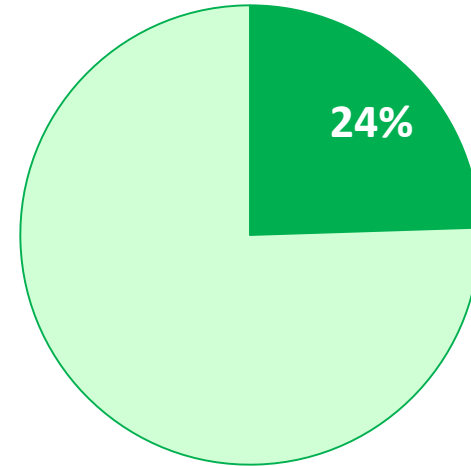
In Process



Ongoing

Financial & Investment Operations

9 Projects



Financial & Investment Operations

No.	Project	Preliminary Scope
29	FYE 2018 External Financial Audit - Oversight	Internal Audit manages the relationship with the LACERA Annual Financial Auditors to facilitate the annual financial statement audit.
30	FYE 2018 Actuarial Audit - Oversight	Internal Audit manages the relationship with the Actuarial Auditor for any services relating to work performed by LACERA's Actuarial Consultant.
31	Foreign Tax Reclamation – Oversight	Oversee the external audit of LACERA's foreign tax withholding reclaim process.
32	Wire Transfers Audit	Assess LACERA's internal controls for setting up and transacting wire transfers to outside parties
33	Real Estate Investment Operations*	Review the Real Estate Investment Program to assess whether adequate controls exist and are functioning as intended.

*FYE 2017 Project Rolled Over to Current Year



In Process



Ongoing

Financial & Investment Operations

No.	Project	Preliminary Scope
34	Real Estate Advisor Audits*	Contract compliance and operational review of LACERA's Real Estate Advisor, Emmes.
35	Securities Lending*	Audit of LACERA's Securities Lending Program(s) at Goldman Sachs and State Street.
36	Real Estate Debt Program Review*	Contract compliance and operational review of LACERA's Real Estate Debt Program.
37	Custodial Bank Risk Assessment	Contract compliance and operational review of LACERA's Real Estate Debt Program.

*FYE 2017 Project Rolled Over to Current Year



In Process



Ongoing

Appendix A

Operating Budget | FYE 2018



Operating Budget

Categories	Budget FYE 2017	Budget FYE 2018
Salaries & Employee Benefits	\$1,662,211	\$1,897,534
Professional & Specialized Services	\$525,000	\$540,000
Educational Expenses	\$49,200	\$32,000
Transportation & Travel	\$23,800	\$30,000
Office Supplies & Equipment	\$1,000	\$2,000
Miscellaneous	\$1,000	\$1,000
Total Operating Budget <i>(excluding indirect costs such as computers, office space, and utilities)</i>	\$2,262,211	\$2,502,534
Full Time Equivalent (FTE) Positions	10.0	10.0

Appendix B

Performance Measures | FYE 2018



The following are Internal Audit's proposed Goals and Performance Measures for the FYE 2018:

GOAL 1:

Manage the completion of the FYE 18 Audit Plan and develop a realistic risk-based Audit Plan for FYE 19.

Performance Measures:

- *Execute 80%* of audit and agreed-upon procedures projects for the FYE 18 Audit Plan by the fiscal year end. (*Note: 80% allows for flexibility due to changes in LACERA business practices and special requests.)*
- *Internal Audit will provide the FYE 19 Audit Plan to the Audit Committee for approval at the fiscal year end meeting.*

GOAL 2:

Monitor and measure Internal Audit efficiency using the Quality Assurance and Improvement Program (QAIP) internal evaluation and report results of the QAIP to the Audit Committee.

Performance Measure:

Internal Audit complete its internal QAIP assessment and report the results to the Audit Committee at the fiscal year end meeting.

GOAL 3:

Update the LACERA Disaster Recovery Plan.

Performance Measure:

Internal Audit will ensure that the Division section of the current LACERA Disaster Recovery Plan is updated and current.

GOAL 4:

Develop and implement audit performance and report writing standards along with Internal Audit staff training on the standards.

Performance Measures:

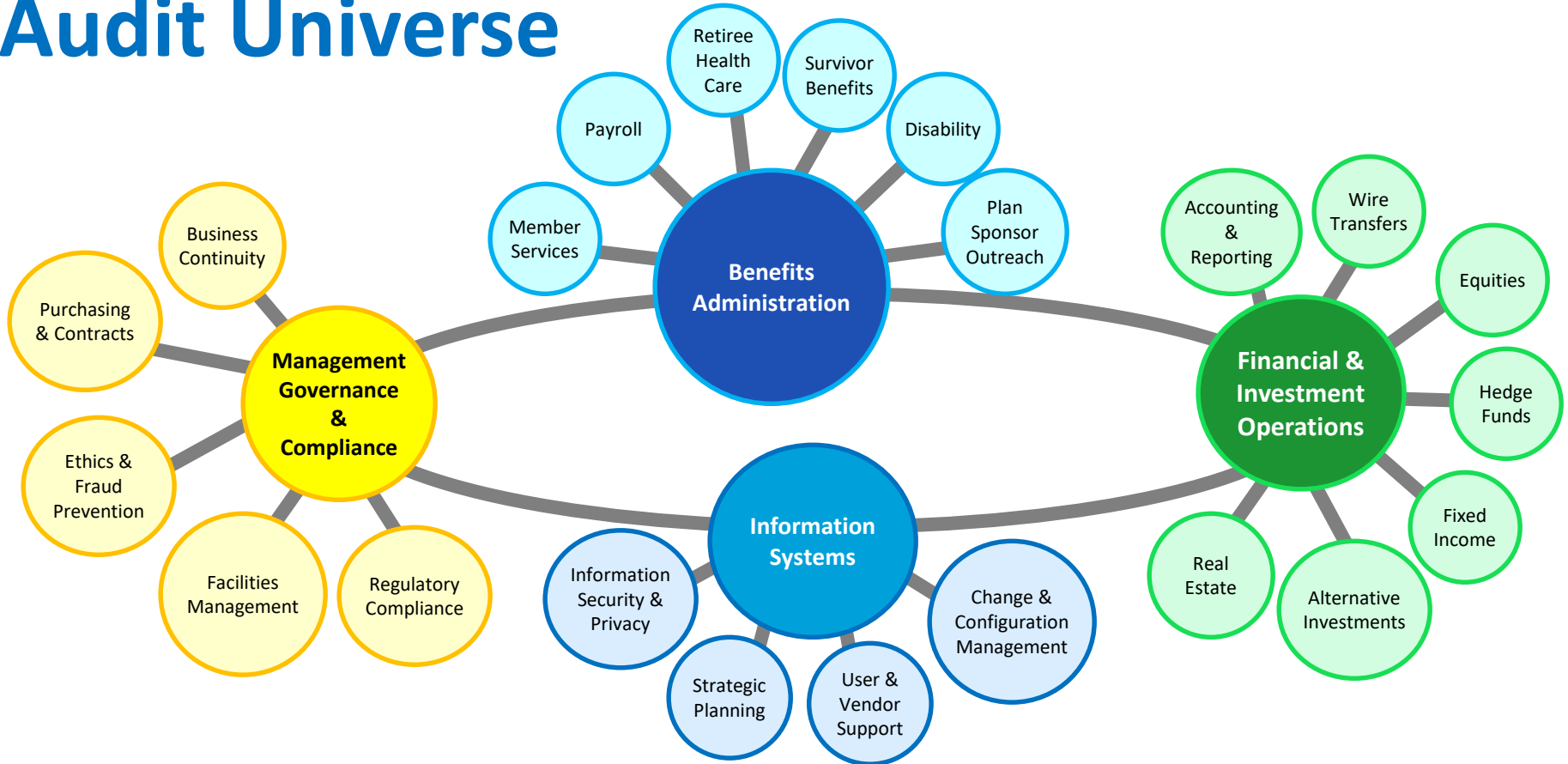
Ensure that all Internal Audit staff are trained on the new audit performance and report writing standards by the end of the fiscal year.

Appendix C

Audit Universe



Audit Universe



2017

LACERA

Los Angeles County Employees Retirement Association

Audit Plan Status Report

FYE 2017 Plan Status as of June 30, 2017

Submitted to the Audit Committee
August 16, 2017

In This Report

WORK COMPLETED & IN PROGRESS.....	5
ONGOING TESTING, MONITORING & CONSULTING.....	21



Los Angeles County Employees Retirement Association

AUDIT COMMITTEE

of the Board of Retirement & Board of Investments

Joseph Kelly – Chair

Michael S. Schneider – Vice Chair

Vivian Gray – Secretary

David Green

Shawn R. Kehoe

INTERNAL AUDIT DIVISION

Richard Bendall, CPA, CISA Chief Audit Executive

Leisha Collins, CPA Principal Internal Auditor

Quoc Nguyen, CPA, CFA Principal Internal Auditor

Christina Logan, CPA, CFE Senior Internal Auditor

George Lunde, CIA, CISA Senior Internal Auditor

Kathryn Ton, CPA, CFE Senior Internal Auditor

Gabriel Tafoya, CISA, ACDA Senior Internal Auditor

Nathan Amick Internal Auditor

Darla Vidger, MPA, CIA Internal Auditor

AUDIT COMMITTEE CONSULTANT

Rick Wentzel, CPA

EXECUTIVE SUMMARY

On behalf of my entire Internal Audit team, I am pleased to submit the **Internal Audit Annual Report** (*Report*) of the Los Angeles County Employees Retirement Association (*LACERA*) for the Fiscal Year Ended June 30, 2017. This Report provides information on the FYE 2017 Audit Plan, the assurance, consulting, and advisory projects completed as well as other Internal Audit activities.

The work performed by LACERA Internal Audit contributes toward accountability, integrity, and good management practices throughout LACERA's business units.

As of July 1, 2016; the FYE 2017 Audit Plan consisted of thirty-eight (38) projects. As the year progressed six (6) unplanned projects were added to the Audit Plan, for a total of forty-four (44) audit projects for the FYE 2017 Audit Plan. During the fiscal year, Internal Audit tackled thirty-four (34) projects -- completing twenty-eight (28) projects with six (6) projects still in progress.

During the period from July 1, 2016 to June 30, 2017; there were 11,438 staff hours available. A total of 9,097 staff hours (80%) were applied to audit projects, while 2,341 staff hours (20%) were applied to administrative projects.

This Report contains the status on all projects undertaken this fiscal year. Also provided in this report are details on each project including the objective of the project, the rationale for the work, and a brief synopsis on the "progress" or "conclusion" of the project. Recently completed projects with corresponding audit reports are provided in the "Non-Consent Items" portion of your Audit Committee Meeting packet.

I would like to thank the Audit Committee and Executive Office for their continuing support. Your ongoing perspective and guidance continues to be invaluable. I would also like to acknowledge my Internal Audit staff for all their hard work and dedication to our practice throughout the year. Their resilience and unwavering professionalism has made me proud.

Sincerely,



Richard Bendall, CPA, CISA
Chief Audit Executive

INTERNAL AUDIT PLAN FYE 2017

The following table provides the status of both the planned and unplanned Internal Audit projects for the fiscal year ended June 30, 2017. Total estimated hours for fiscal year ending 2017 was 13,000 hours.

MANAGEMENT, GOVERNANCE & COMPLIANCE				
PROJECT	TYPE	FREQUENCY	EST. HOURS	ACTUAL HOURS
1. Actuarial Experience Study – RFP	RFP	Periodic	300	214
2. Actuarial Audit – RFP	RFP	Periodic	300	215
3. Internal Audit Operations Manual Update <i>(formerly known as IA Guidebook)</i>	Admin	Planned	600	140
4. Compliance Monitoring – Administration	Consulting	Planned	400	132
5. Continuous Auditing Program	Audit	Ongoing	750	99
• Fraud Testing – Duplicate Member Payments	Audit	Periodic	-	366
• High Risk Payees	Audit	Periodic		120
6. New Payees Testing	Audit	Ongoing	300	269
7. County Medical Reimbursements*	Audit	Planned	400	-
8. Felony Convictions Plan Sponsor Reporting	Audit	Periodic	300	-
9. Internal Audit Contractor Pool – RFP	RFP	Planned	200	453
10. Internal Audit Websites Update	Admin	Planned	200	-
11. PEPRA Employer Compliance Testing	Audit	Periodic	600	
• Program Administration	Admin	Periodic	-	74
• 960 Hours Testing	Audit	Periodic	-	145
• Pensionable Cap Compliance	Audit	Periodic	-	313
12. Privacy Audit Reco. Coordination	Consulting	Planned	500	1113
13. Quality Assurance Improvement Program	Admin	Planned	550	20
14. Risk Assessment – FYE 2018	Admin	Annual	550	-
15. Travel & Education Policy Compliance	Audit	Planned	200	163
BENEFITS ADMINISTRATION				
16. Active Death Process*	Audit	Planned	500	-
17. Certificates Processing Audit	Audit	Planned	500	662
18. Member Death Verification Process	Audit	Planned	450	662
19. Member High Risk Verification	Audit	Planned	450	317
20. New Benefits Tier Plan*	Audit	Planned	400	-
21. Member Accounts Settlement Process	Audit	Planned	500	-
22. Physician Selection and Compensation*	Audit	Planned	400	-
INFORMATION SYSTEMS				
23. Business Continuity/Disaster Recovery	Consulting	Planned	300	207
24. Data Backup/Retention Testing	Audit	Planned	200	304
25. Member Applications Change Control*	Audit	Planned	600	-
26. Systems Penetration Testing	External Audit	Periodic	200	235
27. IT Risk Assessment*	External Audit	Planned	300	-

FINANCIAL & INVESTMENT OPERATIONS				
PROJECT	TYPE	FREQUENCY	EST. HOURS	ACTUAL HOURS
28. FYE 2017 – External Financial Audit Facilitation & RFP	External Audit	Annual	300	805
29. Audit of Actuarial Consulting Services	External Audit	Periodic	200	
30. Compliance Monitoring (Investments)	Consulting	Planned	400	90
31. Investment Fee Reporting & Validation	Audit	Planned	200	328
32. Princeville THC Audit & Tax Service – RFP	RFP	Periodic	300	74
33. Real Estate Financial Audit & Tax Service	External Audit	Annual	250	177
34. Real Estate Investment Operations*	External Audit	Planned	100	
35. Real Estate Advisor Review (EMMES)*	External Audit	Periodic	100	
36. Real Estate Advisor Review (Cornerstone)*	External Audit	Periodic	100	
37. Securities Lending*	External Audit	Planned	50	
38. Real Estate Debt Program Review*	External Audit	Planned	50	
UNPLANNED PROJECTS				
39. Tuition Reimbursement	Audit	Unplanned	-	214
40. APPFA Fall Conference 2016	Admin	Unplanned	-	171
41. Retiree Health Care Consultant - RFP	Consult	Unplanned	-	170
42. Private Equity Audit Monitoring	Consult	Unplanned	-	277
43. 401(a) Salary Contributions Limit**	Audit	Unplanned	-	102
44. Foreign Tax Reclamation RFP	RFP	Unplanned	-	40

****This item will rollover to the fiscal year ending June 30, 2018 Audit Plan.***

*****Due to a lower level of risk, this item will not be rolled over to the new audit plan.***

WORK COMPLETED & IN PROGRESS

The following provides a more detailed narrative of both the planned and unplanned Internal Audit projects completed for the **fiscal year ended June 30, 2017**. The projects are ordered by Division. Project detail includes the objective, rationale, and a brief synopsis of the project’s conclusion or status as of June 30, 2017.

ADMINISTRATIVE SERVICES

Business Continuity Planning

DIVISION(S)	Administrative Services	REPORT DATE	TBD
OBJECTIVE	Provide consulting to Administrative Services management in their revision and upgrade of LACERA’s business continuity plan including: <ol style="list-style-type: none"> 1. Business impact analysis <ol style="list-style-type: none"> a. processes that are critical and order of importance b. recovery time objectives c. recovery point objectives 2. Develop crisis management plan roles and responsibilities 		
RATIONALE	Internal Audit is required to review the effectiveness of management's system of compliance with laws, regulations, policies and procedures that are business critical. While the LACERA Systems Division continues to pursue and strengthen LACERA Disaster Recovery (DR) capabilities and technology infrastructure resilience, there is a recognized need for LACERA to ensure that a holistic functional operational plan is in place to address all aspects of Business Continuity (BC) in the event of a disruption.		
PROGRESS	Internal Audit is continuing to meet and consult with Administrative Services management and evaluating options with respect to Business Continuity Planning, Consulting and Assessment requirements. Negotiations are underway with LACERA's current BCP software vendor in anticipation that consulting services would benefit and facilitate upgrading to vendor's current software release in the upcoming fiscal year.		

BENEFITS

Duplicate Member Payments

DIVISION(S)	BENEFITS	REPORT DATE	JAN 19, 2017
OBJECTIVE	To determine whether the Benefits Division was paying duplicate special payments and to assess the effectiveness of its internal controls to detect duplicate member payments and avoid unnecessary member payments.		
RATIONALE	This audit is a component of our fraud and compliance testing program which leverages data analytics using audit software such as Audit Command Language (ACL). ACL allows us to analyze large sets of data relatively quickly using algorithmic formulas. As such, we determined this type of analytical testing would be appropriate to apply to an audit area such as duplicate member payments.		
CONCLUSION	Internal Audit has completed all fieldwork and has issued the report dated January 19, 2017. It is included in the materials for the March 22, 2017 Audit Committee meeting for action. However, the Audit Committee deferred action on this report to the August 16, 2017 Audit Committee meeting.		

Certificates Processing Audit

DIVISION(S)	BENEFITS, MEMBER SERVICES, RHC, & ADMIN SERVICES	REPORT DATE	June 29, 2017
OBJECTIVE	To assess the adequacy and effectiveness of the governance, risk management and controls for inputting and validating member certificate information. This assessment included a review of: <ol style="list-style-type: none"> 1. The accuracy of certificate data entry in LACERA’s information systems, and 2. The process for authenticating and updating members' certificates received by LACERA. 3. Additionally, we assessed whether the certificates used to validate members' eligibility for benefits are adequate based on established criteria. 		
RATIONALE	Based on Executive Office concerns regarding the accuracy of LACERA data derived from members’ certificates, as well as our risk assessment, we included this audit in our Audit Plan.		
CONCLUSION	The audit was placed on hold last year pending updates that were made by management to the certificates processing function. We re-initiated the fieldwork portion of the audit in January 2017 and performed significant follow-up fieldwork and testing. The final audit report was issued to the Audit Committee on June 29, 2017.		

BENEFITS

Member Death Verification Process

DIVISION(S)	Benefits - Benefits Protection Unit (BPU)	REPORT DATE	July 31, 2017
OBJECTIVE	<p>To review the member death verification process and assess the following:</p> <ul style="list-style-type: none"> • The adequacy of the process's design • Internal controls related to the member death verification process • If any other process and/or technology is available but is not being used by staff that would improve the process of proactively detecting deceased members • Whether staff properly follows-up on weekly death reconciliation reports from the “death verification vendor” (DVC) 		
RATIONALE	<p>The audit is part of our fiscal year 2016-2017 Audit Plan. The BPU process has not been reviewed since its inception.</p> <p>The Member Death Verification Process is where LACERA works with a third party vendor to assist with detecting member deaths as timely as possible. This process is important for preventing benefit overpayments. Without timely notifications, payments to deceased members can potentially go on for months or years before being detected. The member death verification process is managed by the Benefits Protection Unit (BPU), a unit within the Benefits Division.</p>		
CONCLUSION	<p>Internal Audit has currently completed all fieldwork and is anticipating finalizing the report by August 31, 2017.</p>		

Member Account Settlements

DIVISION(S)	BENEFITS	REPORT DATE	TBD
OBJECTIVE	<p>Assess the internal controls and process design of the Member Account Settlements Process, which is the process related recovering payments that members owe to the LACERA fund as a result of LACERA members underpaying their contributions or overpaid benefits made by LACERA to members.</p>		
RATIONALE	<p>There are also occasions where LACERA, through internal quality audits, identify that a member has underpaid required contributions to LACERA or LACERA has overpaid benefits to a member, the recovery of those funds from the member are required. It is important that LACERA has good controls over documenting and tracking the payments that must be recovered and recovering those payments.</p>		
PROGRESS	<p>Internal Audit is currently performing the initial planning for this Audit. We estimate completing the audit and issuing a report to your committee by October 31, 2017.</p>		

EXECUTIVE OFFICE

PEPRA 960 Hours Testing FYE 2016

DIVISION(S)	EXECUTIVE OFFICE	REPORT DATE	NOV 2, 2016
OBJECTIVE	To determine whether all retirees were temporarily rehired in compliance with legal requirements and LACERA policies.		
RATIONALE	The State of California’s County Employees Retirement Law provides that Los Angeles County has the option to re-employ retirees for up to 120 days (960 hours) per fiscal year, on a strictly temporary basis, without affecting their retirement status or benefits. Additionally, the Public Employees’ Pension Reform Act of 2013 and LACERA policy requires a bona fide break in service prior to the retiree being rehired by the County. Compliance with State law and LACERA policy helps ensure that LACERA retains its “qualified” tax deferred status. LACERA’s Internal Audit Division performs this audit on an annual basis.		
CONCLUSION	Internal Audit identified minor issues of non-compliance with legal requirements and LACERA policies. These issues were reported to the County's Chief Executive Office - Benefits, Compensation Policy, and Employee Relations Division and they are in the process of implementing workable solutions to mitigate these issues in the future. This report was finalized and issued November 2, 2016.		

Privacy Audit Coordination and Oversight

DIVISION(S)	EXECUTIVE OFFICE	REPORT DATE	NOV 9, 2016
OBJECTIVE	<p>The purpose of the Information Privacy Audit is to have a qualified third party perform a comprehensive study of LACERA’s business operations with the following objectives:</p> <ol style="list-style-type: none"> 1) To determine whether LACERA’s data privacy policies and practices are adequate and conform to the requirements of all applicable data protection laws and regulations, both domestic and international, as well as best practices; 2) To determine whether LACERA is actually abiding by the policies and procedures identified during the audit. This will require an investigation of and test work to verify how personal data is handled in practice within the various business units, across divisions, and when dealing with third parties; and 3) A legal opinion on LACERA’s compliance obligations as they relate to the Health Insurance Portability and Accountability Act (HIPAA) and recommendations for changes in privacy policies and practices as necessary to further comply with relevant privacy legislation and best practices. 		
RATIONALE	At the March 18, 2015 Audit Committee meeting, staff discussed hiring a privacy consultant to review LACERA’s current privacy policy and practices. Following the Committee meeting and prompted by two key incidents involving privacy, a cross-functional team comprised of staff from the Executive Office, Legal, Systems, and Internal Audit determined that, rather than hire a consultant with limited scope, it would be prudent to contract for a full independent audit of LACERA’s privacy policies and practices.		
CONCLUSION	A final report for this review was presented to the Board of Investments on November 9, 2016 and the Board of Retirement on November 10, 2016. Internal Audit in conjunction with the Executive Office is overseeing the implementation of audit recommendations and will be providing the Audit Committee with regular updates.		

EXECUTIVE OFFICE**401(a) Salary Contributions Limit**

DIVISION(S)	EXECUTIVE OFFICE	REPORT DATE	N/A
OBJECTIVE	Verify that LACERA and the plan sponsor applied the limit to all 401(a) salary contributions members whose annual earnings exceed the IRS limit.		
RATIONALE	Retirement allowances are subject to final compensation limits under IRC 401(a)(17). The calculation of each 12-month period shall be subject to the annual compensation limit in effect for the calendar year in which the 12-month period begins. If final compensation exceeds 12-months, each 12-month period is calculated based on the applicable annual compensation limit for that 12-month period		
CONCLUSION	Staff completed a Pensionable Cap Compliance audit and issued a report to the Audit Committee on November 3, 2016. Staff concluded that the plan sponsor (LA County) had good controls for administering the pensionable caps for PEPRAs members. Since the plan sponsor administers the 401(a) compensation limits for legacy members the same way as it administers the pensionable cap limits for PEPRAs members, we were comfortable with the plan sponsor's controls for applying the 401(a) compensation limits. As a result, we did not perform this audit and will not be rolling this audit over to the following fiscal year.		

PEPRA Pensionable Cap Compliance

DIVISION(S)	EXECUTIVE OFFICE	REPORT DATE	NOV 3, 2016
OBJECTIVE	<ul style="list-style-type: none"> Verify that LACERA and the plan sponsor applied the PEPRA limit to all PEPRA members whose annual earnings exceed the PEPRA limit. Verify that all PEPRA members' employee contributions did not exceed the capped contribution amount for calendar year 2015. 		
RATIONALE	This particular audit focused on LACERA's compliance with California Government Code Section 7522.10 which put a specified compensation cap (or "PEPRA limit") on the pensionable salaries that can be used when calculating: 1) a member's pension benefit, and 2) the annual pension contributions paid by the employee and employer to fund the pension benefit. Only members hired on or after January 1, 2013 are subject to the PEPRA limit.		
CONCLUSION	Based on our review and audit objectives, we did not note any instances of non-compliance. Of the 12,533 PEPRA members identified we noted 162 individuals whose pensionable salary exceed the PEPRA limit of \$140,424. Our test results verified that all 162 individuals had their pensionable salaries capped at the PEPRA limit of \$140,424 and that their contributions did not exceed the capped annual contribution amount for calendar year 2015. Final report was completed and issues to your Committee on November 3, 2016.		

EXECUTIVE OFFICE

Compliance Monitoring (Administration)

DIVISION(S)	EXECUTIVE OFFICE	REPORT DATE	N/A
OBJECTIVE	Provide consulting to the Executive Office in their development of a framework for a formal compliance program at LACERA.		
RATIONALE	<p>As part of the updates to the Audit Committee Charter, the Audit Committee will have responsibility for monitoring managements system of compliance. Additionally, Internal Audit will be required to annually review the effectiveness of management's system of compliance with laws, regulations, and policies and procedures that are business critical.</p> <p>In order for the Audit Committee and Internal Audit to perform these activities, management must first formalize their compliance program. Currently, Management has a decentralized compliance program and does not have a formal framework in place. Internal Audit has been requested to assist with the development of a framework.</p>		
PROGRESS	Internal Audit is continuing to meet and consult with Management on the development of the formal compliance program.		

PEPRA Employer Compliance Testing

DIVISION(S)	EXECUTIVE OFFICE	REPORT DATE	TBD
OBJECTIVE	Determine the full effect of LACERA responsibility for compliance with the employer audit provisions (audit of the County) included in the Public Employees’ Pension Reform Act (PEPRA) which became effective January 1, 2013. In addition, develop Employer Audit procedures based on LACERA's new audit authority and responsibility.		
RATIONALE	PEPRA provisions allow retirement systems (LACERA) to audit the employer (County) and assess fees to recover the cost of the audit if the retirement system determines that the employer failed to comply with specific reporting requirements included in PEPRA. PEPRA requires the employer to properly identify the pay period in which compensation was earned, to report compensation that does not exceed earnable compensation defined by PEPRA, and to report all instances of convicted felonies arising out of or in the performance of the employees' official duties.		
PROGRESS	<p>Internal Audit has contacted several 37 Act Counties to obtain information on their audit procedures. Internal Audit is working with the Executive Office and Systems Division to obtain an understanding of how compensation is reported to LACERA. Internal Audit has worked with County and LACERA executives to establish a felony conviction reporting process which is now in place. Internal Audit has attended a CalPERS Employer Audit Seminar and will work with Management to develop a process for auditing the County.</p> <p>Currently, Internal Audit is working with each LACERA division responsible for performing certain components of verifying the County’s PEPRA compliance. Internal Audit will gather the procedures from each division related to their individual PEPRA compliance process. Ultimately, these procedures will be compiled into a centralized procedures document. There have been delays to this project due to resource constraints and other higher priority projects. However, we anticipate completing the audit by October 31, 2017.</p>		

EXECUTIVE OFFICE

Actuarial Audit and Experience Study - RFP

DIVISION(S)	EXECUTIVE OFFICE	REPORT DATE	N/A
OBJECTIVE	Internal Audit will issue an RFP for LACERA Actuarial Consulting and Auditing Services for fiscal years ending 2017 – 2021.		
RATIONALE	LACERA has retained Milliman and Segal for actuarial consulting and auditing services for the past 12 years. At the approval of the BOI, Internal Audit has issued an RFP to hire two firms to perform these services. As the RFP project coordinator, IA staff will oversee the issuance of the RFP, hiring of the firms and act as liaison between the firms and the Legal Office in finalizing the contract.		
PROGRESS	The RFP was issued on November 7, 2016 and bids received by December 7, 2016. Interviews were held at the June Board of Investment meeting. The Board of Investments made their selection of Milliman as the consulting actuary and Cavanaugh as the audit actuary.		

FINANCIAL AND ACCOUNTING SERVICES

Education & Travel Policy Compliance Review

DIVISION(S)	FASD & BOARD TRAVEL COMMITTEE	REPORT DATE	SEP 20, 2016
OBJECTIVE	To determine if LACERA’s Education and Travel Policy, procedures, and process are in line with industry standards and designed in line with LACERA’s objectives, and if Board and staff are in compliance with the policy.		
RATIONALE	Internal Audit last audited Board and staff travel in 2010, and in general, this is an expense highly scrutinized by the media and public. For the fiscal year ended June 30, 2016, staff’s education and travel expenses were \$995,017 while the Boards’ expenses were \$279,337.		
CONCLUSION	The Final Report was issued on September 20, 2016. Based on our audit work, we concluded the Policy and related processes are generally effective. We identified the following areas to be strengthened: ensure travel expenses are adequately documented and reviewed before accepted for payment, update the Policy to require written justification of meal reimbursement when pre-paid meals are provided, and provide regular reinforcement of the guidance and procedures contained in the Education and Travel Policy.		

Audit of Actuarial Consulting Services

DIVISION(S)	FASD	REPORT DATE	N/A
OBJECTIVE	Facilitate LACERA's ongoing, external, audit of actuarial services .		
RATIONALE	External auditors require information data and documentation; also advice, direction, assistance; and with regard to inquiries, timely responsiveness from LACERA staff and management in order to complete their work satisfactorily in a suitable fashion.		
CONCLUSION	The Segal Company (Segal), LACERA’s Audit Actuary, is engaged to audit the work performed by LACERA’s Consulting Actuary, Milliman. Segal has recently completed, and presented reports to the BOR, both the Actuarial Review of 2016 Investigation of Experience, and the Audit of June		

	30, 2016 Actuarial Valuation. Segal has also completed the OPEB Actuarial Audit 2016 Investigation of experience and is currently finalizing the OPEB Actuarial Valuation audit report.
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HUMAN RESOURCES

LACERA Annual Financial Audit Facilitation – FYE 2017

DIVISION(S)	FASD	MEMO DATE	TBD
OBJECTIVE	Facilitate LACERA’s annual external financial statement audit for FYE 2017.		
RATIONALE	External auditors require assistance with coordinating meetings with the Divisions, facilitating information, data, and documentation exchanges, and ensuring timely responsiveness from LACERA management and staff to complete their work within the determined timeframe.		
PROGRESS	<p>Plante Moran, LACERA’s new external auditor, completed its on-site fieldwork, which focused primarily on gaining an understanding of and assessing LACERA’s processes, procedures, and controls.</p> <p>Since this is PM’s first year auditing LACERA’s financial statements, Internal Audit spent a considerable amount of time coordinating and reviewing PM’s internal control questionnaires, coordinating, facilitating, and attending meetings with PM and the Divisions, and coordinating the information requested.</p> <p>Plante Moran will return in September 2017 to commence its on-site final fieldwork. The audit will be completed by October 10, 2017, and Plante Moran will attend your December Audit Committee meeting to discuss the audit results.</p>		

Tuition Reimbursement

DIVISION(S)	HUMAN RESOURCES	REPORT DATE	MAR 8, 2017
UNPLANNED PROJECT JUSTIFICATION	The Executive Office and Human Resources (“HR”) management requested Internal Audit (“IA”) to review the Tuition Reimbursement Program (Program) due to concerns over reimbursement claims submitted during fiscal year 2016-2017. Internal Audit determined that an audit of the Program was necessary to ensure that adequate controls have been established to address risks associated with this program.		
OBJECTIVE	To determine if LACERA’s Tuition Reimbursement Policy, procedures, and process are aligned with industry standards and best practices, effective, and efficient. To determine if staff is in compliance with the Policy.		

RATIONALE	The Executive Office and Human Resources management requested Internal Audit (“IA”) review the Tuition Reimbursement Program due to concerns over reimbursement claims submitted during fiscal year 2016-2017.
CONCLUSION	We completed the audit and issued the report on March 8, 2017. It was included with the materials for the March 22, 2017 Audit Committee Meeting for action. The Audit Committee accepted and filed the report.

INTERNAL AUDIT

APPFA Fall Conference 2016

DIVISION(S)	INTERNAL AUDIT	REPORT DATE	N/A
UNPLANNED PROJECT JUSTIFICATION	Time spent to plan and coordinate the conference was necessary since LACERA became the local organization hosting the conference.		
OBJECTIVE	LACERA Internal Audit was responsible for the coordination of most of the details of the conference, from the location, facilities, and attendee accommodations to the agenda, speakers, topics and conference material preparation and distribution.		
RATIONALE	The Association of Public Pension Fund Auditors (APPFA) provides a Professional Development Conference for its members twice a year during the spring and fall. Each Conference is hosted by a local organization and we are proud to have hosted the Fall 2016 Conference in Redondo Beach on November 6-9.		
CONCLUSION	The Conference provided a wide range of learning opportunities designed to enhance the knowledge and skills of all who attended including the best ways to measure internal audit value, internal audit strategic planning, and mitigating fraud risk. In addition, external speakers provided insight into a wide array of topics including, but not limited to: Cybersecurity, Fee Transparency in Public Pensions, Business Intelligence and Data Analytics. This Conference was well-attended with over 85 participants from public pensions systems throughout North America.		

Internal Audit Intranet Site

DIVISION(S)	INTERNAL AUDIT	REPORT DATE	N/A
OBJECTIVE	Internal Audit will establish more online resources for Board members, management and staff in order to: <ul style="list-style-type: none"> ▪ achieve greater consistency, reliability and internal quality control; ▪ support LACERA’s values focusing on open communication and transparency; ▪ strengthen understanding of internal control and risk management roles and responsibilities; and ▪ build and nurture better working relationships both internally and with our external business partners. 		
RATIONALE	As a result of an external, quality assurance review of LACERA’s Internal Audit practices, Internal Audit found there was a need to increase its interaction with organizational management and personnel, discussing roles and responsibilities and how Internal Audit may better support its business partners. To achieve this objective, Internal Audit will work with LACERA’s Communications and Systems Divisions to establish more robust online resources and educational tools. Implementation will be ongoing.		
CONCLUSION	Staff has prepared revisions to update the format and content of the websites. Communications has developed the new intranet site, which will be deployed following the Systems update.		

INTERNAL AUDIT

Quality Assurance and Improvement Program (QAIP)

DIVISION(S)	INTERNAL AUDIT	IMPLEMENTATION DATE	DEC 1, 2016
OBJECTIVE	Internal Audit develop a Quality Assurance and Improvement Program as required by the Institute of Internal Auditing (IIA) Standards.		
RATIONALE	In our 2015 Quality Assurance Review (QAR), our consultant recommended that LACERA Internal Audit develop a formal QAIP program to be in compliance with IIA standards. Internal Audit, while always implemented some form of the QAIP program, did not have a formalized program that fully complied with standards. Internal Audit believes that a formal QAIP is important with the on-going administration of Internal Audit and will add value to the work performed by staff. Development of the QAIP is also part of Internal Audit's 2016 divisional goals.		
CONCLUSION	Internal Audit provided the Audit Committee with the formal framework for the QAIP at the December 2016 meeting. Staff will update and implement the QAIP checklist by July 31, 2017 and present a status update to the Audit Committee at the August meeting.		

Internal Audit Operations Manual

DIVISION(S)	INTERNAL AUDIT	REPORT DATE	June 30, 2017
OBJECTIVE	To review and update the Internal Audit Manual (Manual).		
RATIONALE	The Institute of Internal Auditors (IIA) advises the Manual be reviewed and updated on a regular basis. The Manual defines the policies and procedures that guide LACERA’s Internal Audit division with regard to its operations, and the planning, performing, and reporting of internal audit engagements. The manual contributes to consistency and the quality of work Internal Audit does, and supports its Quality Assurance and Improvement program.		
CONCLUSION	Staff completed an update of the Manual on June 30, 2017.		

Internal Audit Consultant Pool RFP

DIVISION(S)	INTERNAL AUDIT	MEMO DATE	TBD
OBJECTIVE	Internal Audit will issue an RFP to hire a pool of audit consultants to perform audit services on an on-going basis.		
RATIONALE	Internal Audit will use the consultants on an as needed basis to ensure appropriate resources are available to complete audits and projects included in the Audit Plan.		
PROGRESS	Staff is in the process of completing the RFP and anticipates issuing the RFP by September 30, 2017.		

INTERNAL AUDIT

Request for Proposal – External Financial Auditor

DIVISION(S)	INTERNAL AUDIT	MEMO DATE	N/A
OBJECTIVE	Solicit bids from qualified firms to perform the annual financial audit of LACERA's financial statements, which include the OPEB Trust and the OPEB Agency Fund. The final objective is to have an auditor under contract by January 1, 2017.		
RATIONALE	The current financial external auditor contract with Brown Armstrong expires with the completion of LACERA's June 30, 2016, financial statements. LACERA must hire an external financial statement auditor for 2017 and the immediately subsequent years.		
CONCLUSION	At the Audit Committee Meeting of July 2016, the Committee interviewed 3 finalist CPA firms and selected Plante & Moran PLLC alone to be recommended for hire by the Board of Retirement. At the Board of Retirement Meeting of August 11, 2016, the Board unanimously accepted the recommendation and directed staff to commence negotiations with Plante Moran. A contract has been completed and signed and Plant Moran has begun work as LACERA's external audit firm.		

INVESTMENTS

Foreign Tax Reclamation RFP

DIVISION(S)	INVESTMENTS DIVISION	REPORT DATE	N/A
UNPLANNED PROJECT JUSTIFICATION	The Executive Office requested that Internal Audit issue an RFP for foreign tax reclamation audit services, as directed by the Board of Investments.		
OBJECTIVE	Issue an RFP for foreign tax reclamation audit services.		
RATIONALE	<p>The Board of Investments directed Staff to issue a Request for Proposals (RFP) for a firm to audit LACERA's tax reclaim process, managed by State Street Bank, LACERA's custodian, to verify that LACERA has reclaimed all foreign tax withholdings to which it is entitled.</p> <p>State Street Bank only reclaims foreign withholding taxes from income assets custodied with State Street Bank. LACERA also receives income from foreign assets custodied outside of State Street Bank (e.g., commingled funds). Internal Audit worked in conjunction with the Executive Office and Investments Office to develop the scope of work for the RFP, which has two mandates:</p> <ol style="list-style-type: none"> 1) Verify whether State Street Bank has reclaimed all foreign tax withholdings to which LACERA is entitled. 2) Analyze LACERA's assets custodied outside of State Street Bank and an assess of whether LACERA has exposure to unclaimed foreign tax withholdings from assets custodied outside of State Street Bank. 		
CONCLUSION	Internal Audit issued the RFP on July 5, 2017. Proposals from firms are due August 23, 2017. Internal Audit expects to review all RFP proposals and recommend firms for the Board of Investments' selection at the October 2017 Board of Investments' meeting.		

INVESTMENTS

Princeville THC Audit& Tax Services - RFP

DIVISION(S)	INVESTMENTS	REPORT DATE	N/A
OBJECTIVE	Obtain firm to perform audit and tax services for LACERA’s Princeville Hotel .		
RATIONALE	The Los Angeles County Employees Retirement Association (LACERA) is Requested proposals, from qualified firms of certified public accountants, for the annual financial audits and tax preparation services for its wholly-owned Princeville Hotel		
CONCLUSION	LACERA’s Princeville Hotel and its Makai Golf Course properties, engaged with RSM, to complete the financial statement assurance audit and tax services For fiscal year ending June 30, 2017, 2018, and 2019.		

Private Equity Audit Monitoring

DIVISION(S)	INVESTMENTS DIVISION	REPORT DATE	TBD
UNPLANNED PROJECT JUSTIFICATION	When LACERA retained Kreischer Miller (KM) to perform the private equity fee audit engagement, the Board of Investments and Internal Audit determined it would be appropriate that IA oversee the engagement to help maintain independence over audit process.		
OBJECTIVE	Oversee the contract signed with Kreischer Miller (KM) on August 22, 2016 to retrospectively audit private equity fees for a sample of funds within LACERA's private equity portfolio.		
RATIONALE	<p>The Board of Investments directed Staff to hire a firm(s) to provide LACERA with private equity fee verification services. In September 2015, Staff issued a Request for Proposals ("RFP") for two separate engagements:</p> <ol style="list-style-type: none"> 1) A retrospective audit of private equity management fees and carried interest, and 2) On-going private equity management fees and carried interest verification services <p>Subsequently, KM was hired to perform the retrospective audit. Internal Audit, being an independent body of LACERA, will be overseeing the engagement to help maintain independence of the audit. Investments office and FASD are monitoring and overseeing the on-going engagement.</p>		
PROGRESS	KM is approximately 95% complete. We expect that KM will provide the final report and presentation to the Board of Investments during the September BOI meeting.		

INVESTMENTS

Compliance Monitoring (Investments)

DIVISION(S)	Investments	REPORT DATE	TBD
OBJECTIVE	Consult and assist the Investments Office with enhancing their investment compliance program		
RATIONALE	<p>As part of the updates to the Audit Committee Charter, the Audit Committee will have responsibility for monitoring Managements system of compliance. Additionally, Internal Audit will be required to annually review the effectiveness of Management's system of compliance with laws, regulations, policies, and procedures that are business critical.</p> <p>In order for the Audit Committee and Internal Audit to perform these activities, Management must first formalize their compliance program. Currently, Management's compliance program is decentralized and does not have a formal framework. Internal Audit has been requested to assist with the development of a framework for the compliance program.</p>		
PROGRESS	Internal Audit is continuing to meet and consult with Investment Office on the establishment of a formal investment compliance program.		

Investment Fee Reporting and Validation

DIVISION(S)	INVESTMENTS DIVISION	REPORT DATE	June 28, 2017
OBJECTIVE	Assess LACERA's controls over reporting and validating investment fees paid to investment managers. Perform test work to verify that LACERA is accurately paying investment fees in accordance with the investment managers' contracts.		
RATIONALE	As part of Internal Audit's FY 2016-17 approved audit plan, Internal Audit will be performing an audit of LACERA's investment fees. According the LACERA's fiscal year 2014-15 Comprehensive Annual Financial Report, LACERA reported approximately \$161 million in investment management fees. This audit was added to our audit plan to verify that LACERA has adequate controls to report and validate investment management fees paid to the investment managers of all asset classes except for private equity. LACERA has already hired a third party to audit private equity investment fees.		
CONCLUSION	Internal Audit completed the audit. The report is included in the August 16, 2017 Audit Committee package.		

RETIREE HEALTHCARE

Retiree Healthcare Consultant-RFP

DIVISION(S)	RETIREE HEALTHCARE	MEMO DATE	N/A
UNPLANNED PROJECT JUSTIFICATION	The Retiree Healthcare Division (RHC) requested Internal Audit’s participation in their search for the RHC consultant due to Internal Audit staffs’ extensive years of experience consulting RHC and background in the RFP process.		
OBJECTIVE	To support the Retiree Healthcare Division in its solicitation to obtain and evaluate proposals from qualified firms to provide comprehensive benefit consulting services related to the administration of the Retiree Healthcare Benefits (OPEB) Program. The current consultant's contract with LACERA expires June 30, 2017.		
RATIONALE	Retiree Healthcare Benefits (OPEB) is an extremely complicated, sensitive & dynamic area. LACERA administers the County's OPEB program, which includes audits of retiree healthcare claims adjudicated by the insurance carriers. Neither the County nor LACERA has the resources or the expertise to fully administer the program either. As a result they need a qualified consultant to assure that LACERA and County receive the best possible service from the carriers.		
CONCLUSION	The IBL Committee approved the RFP for issue at its August 2016 Meeting. A staff Proposal Evaluation Committee subsequently reviewed all proposals received; and the bidders made presentations to the Evaluation Committee in late October 2016. The IBL Committee had the finalist bidders' presentations made to it on December 15, 2016, and recommended to the Board of Retirement that Segal Consulting be selected. The Board concurred unanimously with that recommendation at its January 12, 2017 meeting. Contract negotiations between RHC and Segal are currently underway. Internal Audit's role has concluded.		

Member High Risk Verification

DIVISION(S)	RETIREE HEALTHCARE	REPORT DATE	June 30, 2017
OBJECTIVE	Review the internal controls for Retiree Healthcare's member verification process for both directly incoming and transferred member calls. Verify that member calls taken by Retiree Health Care are properly verified using the LACERA’s High Risk Verification procedures.		
RATIONALE	During our facilitation of the external Privacy Audit recommendation follow-up, Internal Audit became aware of a potential risk that Retiree Healthcare call center staff may be giving (PI) and/or personal health information (PHI) without performing the appropriate high risk member verification over the phone to authenticate that they are speaking to the actual member or an authorized person prior to providing the information. We determined that this was a critical risk and conducted a limited scope audit of Retiree Healthcare's call center member verification process.		
CONCLUSION	Internal Audit has completed its project and issued the final report June 30, 2017. The final report includes all issues identified, recommendations, and management action plans.		

SYSTEMS

Data Backup & Retention

DIVISION(S)	SYSTEMS	REPORT DATE	TBD
OBJECTIVE	To determine whether the retention period for audit records and logs complies with applicable good practice guidance and to assess written policies and procedures for backing up and transporting files. Review the contingency plan including the priority of service provisions		
RATIONALE	In order to minimize the probability and impact on key business functions and processes of a major Systems service interruption there is a need to ensure Systems management of backup arrangements and availability of business-critical information are adequately in effect. Systems, applications, data, and documentation all need to be backed up according to a defined schedule, considering Data types (e.g., voice, optical), Critical end-user computing data (e.g., spreadsheets), Physical and logical location of data sources, Security and access rights, and Encryption.		
PROGRESS	Deferred pending completion of Systems upgrade project.		

Systems Penetration Testing

DIVISION(S)	SYSTEMS	REPORT DATE	FEB 28, 2017
OBJECTIVE	To evaluate the controls preventing vulnerabilities on the internet accessible Web Portal which could be used to gain access to the LACERA internal network, view sensitive LACERA data, or potentially corrupt data that legitimate users may access. To determine if good practice standards and program code conventions are in effect for portal access authentication and authorization code.		
RATIONALE	Prior reviews have found network and application environments exhibit many strong security practices that provided a very robust security framework. However, gaps were noted that could impact the security of the systems and member data maintained by LACERA. Systems Division Management welcomes independent assessment and acknowledges the potential risk significance of vulnerable internet member services due to ever changing technologies.		
CONCLUSION	A technology consultant specializing in both penetration testing and application assessments was retained. A Statement-Of-Work agreement addressing the objectives noted above was executed and incorporated with a recently completed Master Service Agreement. Fieldwork and testing was completed in December, 2016. The consultant completed their audit and reported the state of security from outside penetration for LACERA was excellent. The final report was completed and issued to your Committee on February 28, 2017.		

ONGOING TESTING, MONITORING & CONSULTING

The following provides a brief narrative of ongoing Internal Audit projects for the **Fiscal Year Ended 2017**. These recurring projects include testing, monitoring, and consulting assignments performed on an ongoing basis to prevent fraud and ensure compliance throughout LACERA’s business units. Project detail includes the objective, rationale, and a brief synopsis of the project’s status. All ongoing Internal Audit projects will be concluded, as of June 30, 2017, for Fiscal Year End 2017. All projects will resume July 1, 2017 for Fiscal Year End 2018.

BENEFITS

New Payee Validation Continued Process Test (CPT)

DIVISION(S)	BENEFITS
OBJECTIVE	To confirm by reviewing supporting file documentation that benefits were only paid to eligible former Los Angeles County employees or their beneficiaries. Internal Audit examines 100% of the new benefit payees using computer assisted audit techniques. Internal Audit tests all new payees on a monthly basis.
RATIONALE	In some instances, Internal Audit performs process-monitoring activities for LACERA. One of these monitoring activities is the continuous process testing of scheduled benefit payments to new service and disability retirees and also new survivor payees.
CONCLUSION	Internal Audit has tested 100 percent of all new benefit payees from July 2016 through June 2017. Internal Audit found no exceptions to the scheduled new benefit payees. This project was completed June 30, 2017 for Fiscal Year ended June 30, 2017 and will resume July 1, 2017 for Fiscal Year ending June 30, 2018.

INTERNAL AUDIT

Recommendation Follow-up

DIVISION(S)	INTERNAL AUDIT
OBJECTIVE	In compliance with the Institute of Internal Auditors' <i>International Professional Practices Framework</i> , the Chief Audit Executive must establish and maintain a system to monitor the disposition of audit results communicated to management.
RATIONALE	Internal Audit monitors the implementation status of prior audit recommendations made to LACERA Management to ensure that Management action plans have been effectively implemented

	or that Senior and Executive Management have accepted the risk of not taking action.
CONCLUSION	The status of all, audit recommendation related, management action plans are reported to the Audit Committee regularly. The most recent review cycle was completed from March 1, 2017 through June 30, 2017. This project was completed June 30, 2017 for Fiscal Year ended June 30, 2017 and will resume July 1, 2017 for Fiscal Year ending June 30, 2018.

INTERNAL AUDIT

Board and Committee Monitoring

DIVISION(S)	INTERNAL AUDIT
OBJECTIVE	To monitor all LACERA board and committee meetings, to ensure interaction and reporting is accurate and adequate.
RATIONALE	Internal Audit’s scope of work includes the monitoring of LACERA’s network of risk management, control, and governance processes, as designed and represented by Management. Monitoring is done to ensure the various LACERA governance groups/management are communicating and to ensure information is accurately and adequately conveyed to the necessary parties.
CONCLUSION	This project was completed June 30, 2017 for Fiscal Year ended June 30, 2017 and will resume July 1, 2017 for Fiscal Year ending June 30, 2018.

General Consulting (< 2 hours)

DIVISION(S)	INTERNAL AUDIT
OBJECTIVE	Assist LACERA Management with advice and/or resources.
RATIONALE	Internal Audit is often consulted for advice or additional information on organizational processes, projects, and issues. Any consulting project requiring two hours or less of an auditor’s time is placed in this category. Consulting projects requiring an excess of two hours are typically documented and reported as individual projects. The 289 hours spent this fiscal year to date, represents auditors providing consulting/advice in many different areas on various topics.
CONCLUSION	Internal Audit maintains an open door policy for general consulting purposes. This project was completed June 30, 2017 for Fiscal Year ended June 30, 2017 and will resume July 1, 2017 for Fiscal Year ending June 30, 2018.

INVESTMENTS

Real Estate External Financial Audit and Tax Services – FYE 2017


DIVISION(S)	INVESTMENTS
OBJECTIVE	<ul style="list-style-type: none"> ▪ To ensure annual audited financial statements are completed for each of LACERA’s wholly-owned real estate entities and are provided to LACERA Financial Accounting and Services Division for inclusion in LACERA’s Annual Audited Financial Statement. ▪ In conjunction with the Legal Office, to contract and monitor tax services for wholly owned real estate properties. ▪ Review and coordinate real estate audit and tax invoice payments with the Investment Office.
RATIONALE	<p>It is common industry practice that external financial audit firms are selected and contractually managed by the real estate investment advisers who manage wholly owned real estate assets on behalf of clients. However, LACERA believes an inherent conflict of interest exists when an investment adviser selects the auditors and administers the external, real estate audits of the assets the adviser manages for its clients. Internal Audit acts as the contract manager and primary point of contact for the audits of LACERA’s wholly owned real estate assets. Internal Audit selects the external financial auditors and administers the associated audit contracts for all wholly owned real property investments.</p>
PROGRESS	<p>Financial statement audits for Fiscal Year ended June 30, 2017 will be completed by September 15, 2017.</p>




July 31, 2017

TO: Each Member
2017 Audit Committee Members

Audit Committee Consultant
Rick Wentzel

FROM: Quoc Nguyen 
Principal Internal Auditor

Gabriel Tafoya 
Senior Internal Auditor

FOR: August 16, 2017 | Audit Committee Meeting

SUBJECT: **RECOMMENDATION FOLLOW-UP REPORT**

AUDIT RECOMMENDATION IMPLEMENTATION SUMMARY

From March 1, 2017 through June 30, 2017, the following audit recommendation activity occurred:

- Ten (10) new recommendations were made during this reporting period. These recommendations resulted from the Certificates' Processing, Investment Fees, and Retiree Healthcare Member Verification audits.
- Twelve (12) recommendations were implemented:
 - Four (4) were implemented by Admin Services.
 - Four (4) were implemented by the Benefits Division.
 - Three (3) were implemented by FASD.
 - One (1) was implemented by Internal Audit.

A summary report containing the relevant audit recommendations for each Division can be found in **Attachment A**.

AUDIT RECOMMENDATIONS STATUS
 March 1, 2017 – June 30, 2017

Division	New Recommendations	Implemented/ Closed	Management Accepts Risk	Pending
Administrative Services:		4		6
Benefits Division:	2	4		8
Communications:				
Disability Litigation:				
Disability Retirement:				
Executive-Org. level:				
FASD:		3		
Human Resources:				
Internal Audit:		1		
Investments:	6			2
Legal:				
Member Services:				
Quality Assurance:				
Retiree Health Care:	2			
Systems:				
Actuary:				
Total:	10	12	0	16

AUDIT RECOMMENDATIONS AGING REPORT

Internal Audit included an aging report to provide additional transparency into the amount of time it takes LACERA to fully implement audit recommendations. Audit recommendations made to address higher risk issues are most often implemented immediately or certainly within the first year whenever possible. As requested by the Audit Committee, Internal Audit has also included a status from Management for those recommendations that have been outstanding for longer than two years (see page 5).

To better understand any particular number, please refer to **Attachment A** and review the **Implemented** and **Pending** recommendations. Significantly more detail can be made available on each recommendation. Should you require such additional information, please contact me (qnguyen@lacera.com) or Mr. Bendall (rbendall@lacera.com) and we will be pleased to assist you.

BACKGROUND

The Institute of Internal Auditors' (IIA) Performance Standard #2500 pertains to monitoring the implementation progress of Internal Audit's recommendations made to Management. To be in compliance with the IIA Performance Standards, the Chief Audit Executive is required to establish and maintain a system to monitor the disposition of Management's corrective results and communicate those results to Executive Management.

During the audit process, Internal Audit, as well as external auditors (financial, fiduciary, actuarial, and IT), regularly identify areas where LACERA Management may implement changes to improve risk controls in its processes and Management provides action plans indicating how and when planned improvements will be made. These recommendations and action plans are included in each formal audit report. Additionally, Internal Audit makes recommendations and management identifies improvement plans during Internal Audit consulting assignments. All recommendations and management action plans are documented in Internal Audit's *Recommendation Follow-Up* database for tracking, monitoring, and follow-up reporting.

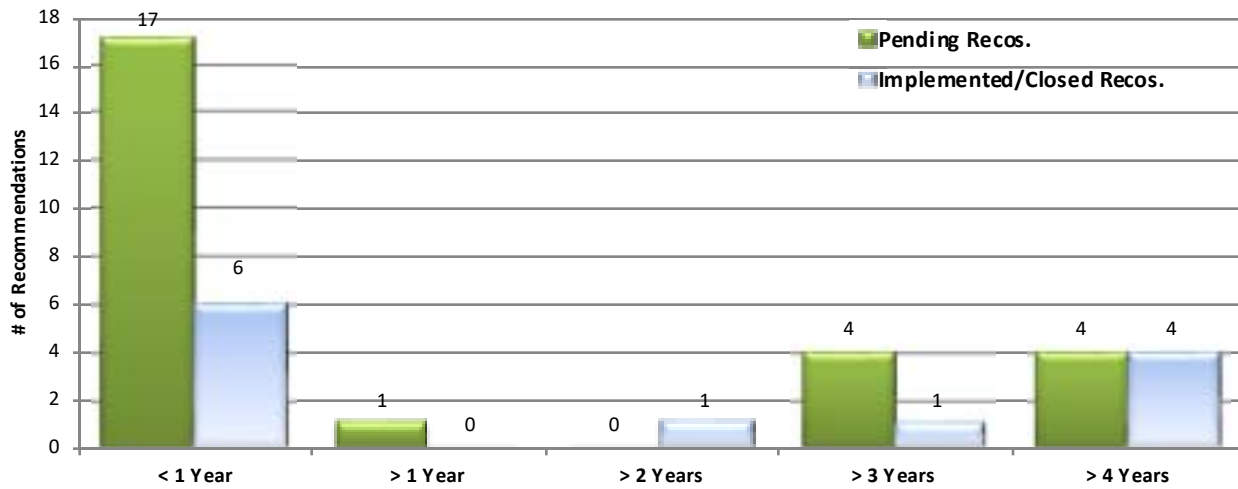
It is Internal Audit's responsibility to ensure that Management's action plans have been effectively implemented, or in the case of action plans that have yet to be implemented, to ensure that Management remains aware of the risks it has accepted by not taking action. In certain situations, if reported observations and recommendations are significant enough to require immediate action by Management, Internal Audit persistently monitors actions taken by Management until the observed risk is corrected and the recommendation implemented.

It is not the responsibility of the Chief Audit Executive to resolve the risks identified during audit work. However, in accordance with IIA Performance Standard #2600, it is Internal Audit's responsibility to communicate the acceptance of risks when the Chief Audit Executive concludes that Management has accepted a level of risk that may be unacceptable to the organization. As a result of this responsibility, Internal Audit communicates all pending *Management Action Plans* to LACERA's Executive Management for resolution. In this manner, Internal Audit escalates unsatisfactory responses or lack of Management actions - including the assumption of risk - to the appropriate levels of Executive Management.

QN/gt

Audit Recommendation Aged Report

March 1, 2017 through June 30, 2017



Pending Recos.	< 1 Year	> 1 Year	> 2 Years	> 3 Years	> 4 Years
Administrative Services	3				3
Benefits Division	5			4	1
FASD					
Human Resources					
Internal Audit					
Investments	7	1			
Legal					
Systems Division					
Retiree Healthcare	2				
Pending Total:	17	1	0	4	4

Implemented/Closed Recos.	< 1 Year	> 1 Year	> 2 Years	> 3 Years	> 4 Years
Administrative Services				1	3
Benefits Division	3		1		
FASD	3				
Human Resources					
Internal Audit					1
Investments					
Legal					
Systems Division					
Retiree Healthcare					
Implemented/Closed Total:	6	0	1	1	4

Status of Recommendations Outstanding For More Than Two Years

Division	Issue	Recommendation	Aging (years)	Revised Est. Implementation	Current status of implementation (Management's response)
Admin Services	Greater clarity & expansion needed in Purchasing Policy & the related Admin Manual	Admin Services Division should modify & expand both the Purchasing Policy and the related Admin Manual	5	1/5/2018	A policy draft was completed and presented to the Executive Office and key managers for review. The policy was not accepted and returned to staff for additional work. The additional development work was delayed due to staff being on approved leave. However, the recent appointment of an interim Division Manager will allow Admin Services to complete a revised draft for presentation to the Executive Office and key management staff within the next 90 days.
	Daily operating procedures ("desk procedures") need enhancement re control procedures	Procurement Unit should update & expand its written, daily operating procedures	5	1/5/2018	The desk procedure manual will be revised once the Board has adopted the new policy. We estimate the development of desk procedures will take an additional 90-180 days from the date the policy is approved. This includes development of the desk procedures, appropriate training for procurement staff, and training for management staff.
	"Sole-source" or bidding documentation not found	(1) Promulgate requirements to other Divisions (2) Update desk procedures & (3) Contact FASD & agree upon document retention	5	1/5/2018	The sole-sourcing documentation and process was completed and the requirements provided to other divisions via the LACERA Intranet. The documents are retained in Administrative Services Procurement by scanning all purchasing packages and housed on network.
Benefits	1st Payment - Separation of Duties	Implement secondary review	4	12/31/2017	The action plan for this recommendation is still in progress. In the meantime, independent audits of Agenda cases by QA and close monitoring of cases by Supervisors throughout the first payment process help mitigate this risk.
	Potential for input errors	Develop field for logging first payment and monthly payment data	3	12/31/2017	The action plan for this recommendation is still in progress. In the meantime, independent audits of Agenda cases by QA and close monitoring of cases by Supervisors throughout the first payment process help mitigate this risk.
	Need to review non-CIB transactions	Forward non-CIB cases to QA for review	3	12/31/2017	Until a Systems solution is available, Benefits Staff continue to work with QA to manually review selected non -CIB transactions.
	Recreating Timelines	Certify Member Timelines	3	6/30/2018	The ACE training program is currently being developed by a team made up of QA, Benefits, and the former QA Division Manager.
	Two Different Disability Databases	Eliminate Double Entry and Continue Reconciling Disability Status	3	6/30/2018	The action plan for this recommendation is still in progress. In the meantime, independent audits of Agenda cases by QA and close monitoring of cases by Supervisors throughout the first payment process help mitigate this risk.

Audit Recommendation Follow Up

Administrative Services

Status: **Implemented**

Audit Project: **Privacy Review (July 7, 2011)**

Issue:	Recommendation	Actual	Estimated	Revised
All LACERA staff have access to the DPC	#5 - DPC should be physically seperated.	5/1/2017	12/31/2011	3/31/2017
Employees must pass through the mail room to gain access to the copy center	#7 Secure Mail Room	5/1/2017	12/31/2011	3/31/2017
Reception area in Administrative Services is not keycard controlled	# 8 - Install barrier to entry.	5/1/2017	12/31/2011	3/31/2017

Audit Project: **Records Retention Guidelines (July 26, 2013)**

Issue:	Recommendation	Actual	Estimated	Revised
Record Retention Training - Division Manager Education	Management Education	3/1/2017	6/30/2014	6/30/2017

Status: **Pending**

Audit Project: **Office Renovation Projects (April 24, 2016)**

Issue:	Recommendation	Actual	Estimated	Revised
Vendor Justification Not Included in Master Project File or Addressed in Written Procedures	Update written procedures and process to include documenting vendor selection		12/31/2016	1/5/2018
Change Orders are not adequately documented or addressed in written procedures	Develop and codify process for managing Change Orders		12/31/2016	1/5/2018
Inconsistent levels of participation from key stakeholders	Improve Planning and communication of Office Renovation projects		12/31/2016	1/5/2018

Audit Recommendation Follow Up

Administrative Services

Status: **Pending**

Audit Project: **Purchasing/Procurement (May 8, 2011)**

Issue:	Recommendation	Actual	Estimated	Revised
Greater clarity & expansion needed in Purchasing Policy & the related Admin Manual	Admin Services Division should modify & expand both the Purchasing Policy and the related Admin Manual		12/30/2011	1/5/2018
Daily operating procedures ("desk procedures") need enhancement re control procedures	Procurement Unit should update & expand its written, daily operating procedures		12/31/2011	1/5/2018
"Sole-source" or bidding documentation not found	(1) Promulgate requirements to other Divisions (2) Update desk procedures & (3) Contact FASD & agree upon document retention		12/31/2011	1/5/2018

Audit Recommendation Follow Up

Benefits

Status: **Implemented**

Audit Project: **Member Minor Survivor Compliance (June 29, 2016)**

Issue:	Recommendation	Actual	Estimated	Revised
Potential Unclaimed Minor Survivor Benefits	Develop Procedure for Unclaimed Minor Survivor Benefits	7/26/2017	6/30/2017	

Audit Project: **Retired Death Benefit Audit (October 28, 2014)**

Issue:	Recommendation	Actual	Estimated	Revised
Survivor Direct Deposit Set-up	Direct Deposit Confirmation	6/30/2017	12/31/2014	6/30/2017

Audit Project: **Returned ADR Process Review (November 24, 2015)**

Issue:	Recommendation	Actual	Estimated	Revised
ADR Open Holds	ADR Open Holds - Health Care Benefits Reinstatement	1/7/2016	6/30/2017	6/30/2017
ADR Open Holds	ADR Open Holds - Member Verification	1/7/2016	6/30/2017	6/30/2017

Status: **New**

Audit Project: **Certificate Processing (June 29, 2017)**

Issue:	Recommendation	Actual	Estimated	Revised
Birth Certificate Missing for Options Retirees	Certificate Requirements Review		6/29/2018	
Controls over Certificates Processing	Organization-wide Certificates Policy		6/29/2018	

Status: **Pending**

Audit Recommendation Follow Up

Benefits

Status: **Pending**

Audit Project: **Claims - Process Objectives, Risks, Controls, Process Flows, and Procedural Gaps (April 12, 2012)**

Issue:	Recommendation	Actual	Estimated	Revised
1st Payment - Separation of Duties	Implement secondary review		12/31/2012	12/31/2017

Audit Project: **Claims Payroll Supervisor Policies/Procedures (July 2, 2013)**

Issue:	Recommendation	Actual	Estimated	Revised
Potential for input errors	Develop field for logging first payment and monthly payment data		6/30/2014	12/31/2017
Need to review non-CIB transactions	Forward non-CIB cases to QA for review		12/31/2013	12/31/2017

Audit Project: **Duplicate Special Payments (January 19, 2017)**

Issue:	Recommendation	Actual	Estimated	Revised
Expand the Automation of Special Payment Approvals	Automate the approval of those special payments processes where approvals are currently performed manually		12/31/2017	

Audit Project: **Member Minor Survivor Compliance (June 29, 2016)**

Issue:	Recommendation	Actual	Estimated	Revised
Incomplete Documentation	Develop Procedures manual and Improve Review process		6/30/2017	12/31/2017

Audit Project: **Previous service to contracts (QC/QA/CP) (February 26, 2014)**

Issue:	Recommendation	Actual	Estimated	Revised
Recreating Timelines	Certify Member Timelines		6/30/2014	6/30/2018

Audit Project: **Returned ADR Process Review (November 24, 2015)**

Issue:	Recommendation	Actual	Estimated	Revised

Audit Recommendation Follow Up

Benefits

Status: **Pending**

Audit Project: **Returned ADR Process Review (November 24, 2015)**

Issue:	Recommendation	Actual	Estimated	Revised
Documented Procedures	Need for Documented Procedures		6/30/2016	12/31/2017

Audit Project: **SCD Tax Indicator (July 3, 2012)**

Issue:	Recommendation	Actual	Estimated	Revised
Two Different Disability Databases	Eliminate Double Entry and Continue Reconciling Disability Status		6/30/2014	6/30/2018

Audit Recommendation Follow Up

FASD

Status: **Implemented**

Audit Project: **Education and Travel Compliance Audit (September 20, 2016)**

Issue:	Recommendation	Actual	Estimated	Revised
Training on Policy	Reinforce Policies and Procedures	7/13/2017	1/30/2017	4/15/2017
Written Justification of Meal Requests if Pre-Paid Meal Was Available	Update the Policy to Require Written Justification of Meal Reimbursement If a Pre-Paid Meal Was Available	3/3/2017	12/31/2016	3/31/2017
Ensure Travel Expenses and Supporting Documentation Are Adequately Reviewed	Ensure Travel Expenses and Supporting Documentation Are Adequately Reviewed	3/3/2017	12/31/2016	4/1/2017

Audit Recommendation Follow Up

Internal Audit

Status: **Implemented**

Audit Project: **External QAR of Internal Audit (October 10, 2010)**

Issue:	Recommendation	Actual	Estimated	Revised
Quality assurance and improvement programs are required	#4 - Improve quality assurance program	6/30/2017	6/30/2011	12/31/2016

Audit Recommendation Follow Up

Investments

Status: **New**

Audit Project: **Investment Fee Reporting and Validation (June 28, 2017)**

Issue:	Recommendation	Actual	Estimated	Revised
Public Market Commingled Fund Fees	Validate fees for the fixed income commingled fund and fund-of-one.		9/30/2017	
Public Market Commingled Fund Fees	Communicate and Cordinate Fee Validation Roles		9/30/2017	
Commingled Real Estate Fund Fees	Validate Commingled Real Estate Fund Fees		12/31/2017	
No Procedures for Fee Validation and Fee Disclosure	Develop Fee Validation and Disclosure Procedures		12/31/2017	
Underlying Hedge Fund Fees	Request GSAM to Validate Underlying Hedge Fund Fees		12/31/2017	
Actual Hedge Fund Performance Fee Data	Request for Actual Performance Fee Data Rather Than Accrued Performance Fee Data		12/31/2017	

Status: **Pending**

Audit Project: **Investment Private Equity Operations (June 25, 2015)**

Issue:	Recommendation	Actual	Estimated	Revised
No formal Information Management System or CRM System to manage information	Consider implementing CRM System		6/30/2016	6/30/2018
Due Diligence Checklists	Include guidelines for checklists and sign-off on checklists		12/31/2015	9/30/2017

Audit Recommendation Follow Up

Retiree Healthcare

Status: **New**

Audit Project: Member Verification (June 30, 2017)				
Issue:	Recommendation	Actual	Estimated	Revised

Insufficient HRV Policy and Procedure	Executive Office require that appropriate authentication steps		12/31/2017	
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No HRV	Management develop Of Procedures		12/31/2017	
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July 31, 2017

TO: Each Member
2017 Audit Committee

Audit Committee Consultant
Rick Wentzel

FROM: Richard Bendall 
Chief Audit Executive

FOR: August 16, 2017 | Audit Committee Meeting

SUBJECT: 2016 PRIVACY AUDIT (BY ALSTON & BIRD) - FOLLOW-UP

At the October 2016 Board of Investments and Board of Retirement meetings, your Boards were presented with the results of the 2016 Privacy Audit performed by Alston & Bird and their subcontractor, Stroz Friedberg. The final audit report, findings and conclusions presented at these meetings provided an overview of privacy practices at LACERA as well as recommendations.

While Alston & Bird found that LACERA generally conforms to the applicable privacy laws, regulations, and best practices in the areas identified through the audit, they provided a number of recommendations and advice to enhance prudent privacy practices.

Executive Management has established a cross-functional team to address the implementation of the Privacy Audit recommendations, many of which will simultaneously assist in the formalization of the compliance function at LACERA. The team will coordinate the implementation and the standardization of policies and procedures and the establishment of a compliance framework. The team has identified specific divisions as the primary owners of the Privacy Audit recommendations.

Internal Audit will both oversee the status of all recommendations and verify implementation as well complete the recommendations over which Internal Audit has primary ownership.

This table provides the statuses of the Privacy Audit recommendations as of July 31, 2017:

Beginning Balance of Recommendations	65
Disagree	5
Completed	10
Remaining Recommendations in Progress	50

As an overall comment, Internal Audit is comfortable that Management is taking the recommendations and the implementation very seriously and has developed a good plan and a reasonable timeline in which to do so.

Due to the confidential nature of the report, Internal Audit will report the status of these recommendations separately from the standard Recommendation Follow-Up Report in future Audit Committee Meetings.

Staff will be available to address questions at your August Audit Committee meeting, but please remember that due to the privileged nature of the 2016 Privacy Audit Report, the specific recommendations should not be the subject of detailed discussion at the meeting.



Documents not attached are exempt from disclosure under the California Public Records Act and other legal authority.

**For further information, contact:
LACERA
Attention: Public Records Act Requests
300 N. Lake Ave., Suite 620
Pasadena, CA 91101**



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July 31, 2017

TO: Each Member
2017 Audit Committee

Audit Committee Consultant
Rick Wentzel

FROM: Richard Bendall 
Chief Audit Executive

FOR: August 16, 2017 | Audit Committee Meeting

SUBJECT: **QUALITY ASSURANCE & IMPROVEMENT PROGRAM (QAIP) REPORT**

The Institute of Internal Auditors' International Standards for the Professional Practice of Internal Auditing (Standards) requires that the director of internal audit develop and maintain a quality assurance and improvement program (QAIP) that includes both internal and external assessments of the internal audit activity. The objective of the internal and external assessments is to evaluate the internal audit activity's conformance with the Institute of Internal Auditors' definition of Internal Auditing, the Standards and the Code of Ethics.

Internal assessments must include ongoing monitoring of the performance of the internal audit activity as well as periodic reviews performed through self-assessment. The Standards require that the results of these periodic assessments be communicated to the Audit Committee at least annually.

LACERA Internal Audit maintains an ongoing QAIP and performs ongoing monitoring as required. In addition, Internal Audit recently completed a self-assessment. The scope of this comprehensive self-assessment included a review of how well Internal Audit conforms with the Institute of Internal Auditors' (IIA's) *Standards*, *Code of Ethics*, and the *Definition of Internal Auditing* as well as a review of the audit projects with reports released in fiscal year ended 2017. We found that the division "generally conforms" which is the highest of the three possible ratings – "generally conforms," "partially conforms," and "does not conform."


To satisfy the Standards, the QAIP must also include external assessments. The LACERA Internal Audit Charter requires that an external peer review be performed once every three years. The last external peer review of Internal Audit was completed January 15, 2016. The overall opinion of the external peer reviewer was that Internal Audit is in compliance with Standards and granted the division a rating of "generally conforms." This opinion means that policies, procedures, and practices are in place to implement the *Standards* and the requirements necessary for ensuring the independence, objectivity, and proficiency of the internal audit function were met.



July 31, 2017

TO: Each Member
2017 Audit Committee Members

Audit Committee Consultant
Rick Wentzel

FROM: Richard Bendall 
Chief Audit Executive

FOR: August 16, 2017 | Audit Committee Meeting

SUBJECT: INTERNAL AUDIT GOAL REPORT

In past years, Internal Audit has provided the Committee with new calendar year goals at the first meeting of the year and a final goal report during the last meeting of the year. However, beginning this year, the LACERA Internal Audit Goals will now coincide with the fiscal year and the LACERA Strategic Plan Goals. Hence, the 2016 Internal Audit Goals will conclude on June 30, 2017 and will be presented to the Audit Committee at the fiscal year-end meeting.

The following Internal Audit Goal Report includes a status update on the completion of these goals, as well as the Internal Audit Goals proposed for the fiscal year ending June 30, 2018.

Following the brief presentation of our past and proposed goals, we welcome the opportunity for any discussion, clarification, or feedback from your Committee.

RB: dv
Attachment

Internal Audit Goals | FYE 2017

The following details the statuses of Internal Audit's goals for the six-month period ending June 30, 2017:

Goal 1: Manage the completion of the FYE 17 Audit Plan and develop a realistic risk-based Audit Plan for FYE 18.

Performance Measures:

- *Internal Audit will present the fiscal year ended (FYE) June 30, 2017 Audit Plan final status to the Audit Committee at the August 16, 2017 meeting.*
- *Internal Audit will provide the FYE 2018 Audit Plan to the Audit Committee for approval at the August 16, 2017 meeting.*

Status: **Complete.**

Staff will present the fiscal year ended (FYE) 17 Audit Plan year-end report to the Audit Committee at the August 16, 2017 meeting. Staff will also provide the Audit Committee with a risk presentation initiating the risk assessment and Audit Plan development process for the FYE 18 Plan at the same August meeting.

Goal 2: Develop & Implement a Formal Quality Assurance and Improvement Program (QAIP)

Performance Measure:

- *Internal Audit will provide the Audit Committee with the formal framework for the QAIP by the December Audit Committee Meeting.*
- *Internal Audit will update the QAIP checklist and present a status update to the Audit Committee at the August meeting.*

Goal 2: Develop & Implement a Formal Quality Assurance and Improvement Program (QAIP)

Status: **Complete.**

Internal Audit provided the Audit Committee with the formal framework for the QAIP at the December 2016 meeting. Staff will update and implement the QAIP checklist by July 31, 2017 and present a status update to the Audit Committee at the August meeting.

Goal 3: Develop & Implement an Internal Audit Operations Guide

Performance Measure:

Internal Audit will complete a comprehensive update of the Internal Audit Operations Manual by June 30, 2017.

Status: **Complete.**

Staff has completed the update of the Internal Audit Operations Manual.

Goal 4: Update Internal Audit Websites

Performance Measure:

Internal Audit will complete a comprehensive update of the Internal Audit Internet and Intranet website Guide by June 30, 2017.

Status: Complete.

Staff has prepared revisions to update the format and content of the websites. Communications has developed the new intranet site, which will be deployed following the Systems update.

Goal 5: Update the Internal Audit Divisions Disaster Recovery Plan (New annual goal)

Performance Measures:

Internal Audit will ensure that the Division section of the LACERA Disaster Recovery Plan is updated and current.

Status: Ongoing.

Staff revises and updates the Division section of the LACERA Disaster Recovery Plan when presented with our section of the plan for updates by the Administrative Services Division. The plan is current as of March 22, 2017.

Internal Audit Goals | FYE 2018

The following are the proposed goals for the fiscal year ending June 30, 2018:

- 1. Manage the completion of the FYE 18 Audit Plan and develop a realistic risk-based Audit Plan for FYE 19.**

Performance Measures:

- *Execute 80%* of audit and agreed-upon procedures projects for the FYE 18 Audit Plan by the fiscal year end.*

*(*Note: 80% allows for flexibility due to changes in LACERA business practices and special requests.)*

- *Internal Audit will provide the FYE 19 Audit Plan to the Audit Committee for approval at the fiscal year end meeting.*

- 2. Monitor and measure Internal Audit efficiency using the Quality Assurance and Improvement Program (QAIP) internal evaluation and report results of the QAIP to the Audit Committee.**

Performance Measure:

Internal Audit complete its internal QAIP assessment and report the results to the Audit Committee at the fiscal year end meeting.

- 3. Update the LACERA Disaster Recovery Plan.**

Performance Measure:

Internal Audit will ensure that the Division section of the current LACERA Disaster Recovery Plan is updated and current.

- 4. Develop and implement audit performance and report writing standards along with Internal Audit staff training on the standards.**

Performance Measure:

Ensure that all Internal Audit staff are trained on the new audit performance and report writing standards by the end of the fiscal year.



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