

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, MARCH 21, 2018

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

2018 AUDIT COMMITTEE MEMBERS

Vivian Gray
David Green
Shawn R. Kehoe
Joseph Kelly
Herman Santos
Michael S. Schneider

AUDIT COMMITTEE CONSULTANT

Rick Wentzel

- I. ELECTION OF OFFICERS (Election of Chair, Vice Chair, and Secretary)
- II. APPROVAL OF MINUTES
 - A. Approval of the Minutes of the Regular Meeting of November 30, 2017
- III. PUBLIC COMMENT
- IV. NON-CONSENT AGENDA
 - A. Recommendation as submitted by Richard Bendall, Chief Audit Executive: That the Committee review the Audit Committee Meeting Schedule and provide direction to staff on changes.
(Memo Dated on March 1, 2018)

IV. NON-CONSENT AGENDA (Continued)

B. Recommendation as submitted by Richard Bendall, Chief Audit Executive, Leisha Collins, Principal Internal Auditor, and Christina Logan, Senior Internal Auditor: That the Committee:

1. Provide direction to staff on the proposed updates to the Audit Committee Charter, and
2. Upon approval, recommend to the Board of Retirement and Board of Investments to adopt the revised Audit Committee Charter.
(Memo Dated on March 1, 2018)

C. Recommendation as submitted by Richard Bendall, Chief Audit Executive: That the Committee review and discuss the Retiree Healthcare Benefits Program Funding Audit engagement report and 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 on March 1, 2018)

D. Recommendation as submitted by Richard Bendall, Chief Audit Executive: That the Committee review and discuss the External Penetration Test engagement report and 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 on March 1, 2018)

E. Recommendation as submitted by Richard Bendall, Chief Audit Executive: That the Committee review and discuss the Data Backup and Retention engagement report 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,

IV. NON-CONSENT AGENDA (Continued)

3. Provide further instruction to staff.
(Memo Dated on March 1, 2018)

- F. Recommendation as submitted by Richard Bendall, Chief Audit Executive: That the Committee review and discuss the Physician Selection, Monitoring, and Compensation Audit engagement report and 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 on March 1, 2018)

V. REPORTS

- A. Internal Audit Risk Assessment Report
Richard Bendall, Chief Audit Executive
(Memo Dated on March 1, 2018)

- B. Audit Plan Status Report
Richard Bendall, Chief Audit Executive
(Report Updated on March 1, 2018)

- C. Recommendation Follow-Up Report
Quoc Nguyen, Principal Internal Auditor
(Report Updated on March 1, 2018)

- D. **Attorney-Client Privilege/Confidential Memo**
Privacy Audit Recommendation Follow-Up
Steven Rice, Chief Legal Counsel
Richard Bendall, Chief Audit Executive
(Memo Dated on March 1, 2018)

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V. REPORTS (Continued)

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 on March 1, 2018)

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

G. Internal Audit Goal Report
Richard Bendall, Chief Audit Executive
(Updated on March 1, 2018)

VI. CONSULTANT COMMENTS

Rick Wentzel, Audit Committee Consultant
(Verbal Presentation)

VII. REPORT ON STAFF ACTION ITEMS

VIII. GOOD OF THE ORDER
(For Information Purposes Only)

IX. EXECUTIVE SESSION

A. Performance Evaluation – CAE Goals Report
[Pursuant to Government Code Section 54957(b)(1)]
Title: Chief Audit Executive

X. 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

8:00 A.M., THURSDAY, NOVEMBER 30, 2017

PRESENT: Joseph Kelly, Chair

Michael S. Schneider, Vice Chair

Shawn Kehoe

David Green

ABSENT: Vivian Gray, Secretary

STAFF, ADVISORS, AND PARTICIPANTS

Richard Bendall, Chief Audit Executive

Steven Rice, Chief Legal Counsel

Rick Wentzel, Audit Committee Consultant

Quoc Nguyen, Principal Internal Auditor

Leisha Collins, Principal Internal Auditor

Christina Logan, Senior Internal Auditor

Michelle Watterworth, CPA, Managing Partner

Amanda Cronk, CPA, Senior Audit Manager

NOVEMBER 30, 2017

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I. CALL TO ORDER

The meeting was called to order at 8:00 a.m. in the Boardroom of Gateway Plaza by Mr. Kelly, Chair of the Committee.

II. PLEDGE OF ALLEGIANCE

Mr. Schneider led the Board Members and staff in reciting the Pledge of Allegiance.

III. APPROVAL OF THE MINUTES

- A. Approval of the Minutes of the Regular Audit Committee Meeting of August 16, 2017.

Mr. Schneider made a motion, Mr. Kehoe seconded, to approve the minutes of the regular Audit Committee meeting of August 16, 2017. The motion passed unanimously.

IV. REPORT ON CLOSED SESSION ITEMS

There were no items to report.

V. PUBLIC COMMENT

There were no requests from the public to speak.

VI. NON-CONSENT ITEMS

- A. Recommendation that the Audit Committee approve the proposed changes to the Audit Committee Charter as submitted by Richard Bendall, Chief Audit Executive, Leisha Collins, Principal Internal Auditor, and Christina Logan, Senior Internal Auditor. (Memo dated: November 15, 2017)

VI. NON-CONSENT ITEMS (Continued)

Mr. Kehoe made a motion, Mr. Green seconded, to approve staff's recommendation including the following revision: to add a conflict and ethics section to Board of Retirees Charter. The motion passed unanimously.

- B. Recommendation that the Audit Committee approve the proposed changes to the Internal Audit Charter as submitted by Richard Bendall, Chief Audit Executive, and Leisha Collins, Principal Internal Auditor, and Christina Logan, Senior Internal Auditor. (Memo dated: November 15, 2017)

Mr. Kehoe made a motion, Mr. Green seconded, to approve staff's recommendation including the following revisions: the March 2017 Institute of Internal Auditor's model internal audit charter updates and clarification of Internal Audit's access authority to LACERA's records. The motion passed unanimously.

- C. 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: November 15, 2017)

- a. Los Angeles County Rehired Retirees Audit
Nathan Amick, Internal Auditor
(Report dated: October 31, 2017)

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VI. NON-CONSENT ITEMS (Continued)

- b. Member Death Verification Process
Gabriel Tafoya, Senior Internal Auditor
(Report dated: October 31, 2017)

Mr. Kehoe made a motion, Mr. Green seconded, to approve the agenda item with direction to staff to separate audit reports as distinct non-consent agenda items and to forward the Member Death Verification Process report to the Operations Oversight Committee for review. The motion passed unanimously.

VII. REPORTS

These items were received and filed.

- A. Plante Moran Presentation of the Reports – June 30, 2017
Agenda and Reports from Plante Moran et. al.
 - Report on Internal Control Over Financial Reporting and on Compliance
 - Required Communications to the Audit Committee
Michelle Watterworth, CPA, Managing Partner
Amanda Cronk, CPA, Senior Audit Manager
(Memo dated: October 12, 2017)

Michelle Watterworth was present and answered questions from the Board.

- B. Pensionable Pay Code Testing
Quoc Nguyen, Principle Internal Auditor
Gabriel Tafoya, Senior Internal Auditor
(Presentation dated: November 30, 2017)

Mr. Nguyen was present and answered questions from the Board.

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

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VII. REPORTS (Continued)

- D. Audit Plan Status Report
Richard Bendall, Chief Audit Executive
(Report dated: October 31, 2017)

- E. Recommendation Follow-Up Report
Quoc Nguyen, Principal Internal Auditor
Gabriel Tafoya, Senior Internal Auditor
(Memo dated: October 31, 2017)

- F. Privacy Audit Recommendation Follow-Up
Richard Bendall, Chief Audit Executive
Darla Vidger, Internal Auditor
(Memo dated: November 14, 2017)

- G. Attorney-Client Privilege/Confidential Memo
Human Resources Compliance Audit [by Liebert Cassidy Whitmore]
Recommendation Follow-Up
Richard Bendall, Chief Audit Executive
(Memo dated: November 15, 2017)

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

VIII. CONSULTANT COMMENTS

Rick Wentzel, Audit Committee Consultant

Mr. Wentzel commended staff on the successful completion of the annual financial audit.

NOVEMBER 30, 2017

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IX. GOOD OF THE ORDER

(For information purposes only)

Mr. Schneider commended staff regarding their efficiency and asked staff to comment on the Association of Certified Fraud Examiners' most recent Report to the Nations on Occupational Fraud and Abuse at the next meeting.

X. REPORT ON STAFF ACTION ITEMS

There was nothing to report.

XI. ADJOURNMENT

There being no further business to come before the Audit Committee, the meeting was adjourned at 8:45 a.m.

VIVIAN GRAY, SECRETARY

JOSEPH KELLY, CHAIR



March 1, 2018

TO: 2018 Audit Committee
Vivian Gray
David Green
Shawn R. Kehoe
Joseph Kelly
Herman Santos
Michael S. Schneider

Audit Committee Consultant
Rick Wentzel

FROM: Richard Bendall 
Chief Audit Executive

FOR: March 21, 2018 | Audit Committee Meeting

SUBJECT: **Audit Committee Meeting Dates**

RECOMMENDATION

It is recommended that the Audit Committee review the proposed Audit Committee Meeting Schedule for the remaining two meetings of 2018 and provide direction to staff.

BACKGROUND

In December 2005, the Audit Committee adopted a Resolution to hold meetings at 9:00 am on the third Wednesday of March, July and November. In November 2011, your Committee approved rescheduling the November meeting to the first Thursday of December to accommodate Committee Member attendance at SACRS. Both the 2005 Resolutions and 2011 Committee Date Revision Memo are included for your reference.

For the 2018 calendar, some Committee members expressed that they were unable to attend some of the scheduled meetings. Staff would like your Committee to provide direction on the proposed dates for the remaining meetings this year.

Based on the survey that was sent to your Committee, the most convenient 2018 meeting dates were determined to be:

Wednesday, July 18, 2018 at 9:00 a.m.

Thursday, December 6, 2018 at 9:00 a.m.





March 1, 2018

TO: 2018 Audit Committee
Vivian Gray
David Green
Shawn R. Kehoe
Joseph Kelly
Herman Santos
Michael S. Schneider

Audit Committee Consultant
Rick Wentzel

FROM: Richard Bendall 
Chief Audit Executive

Leisha Collins 
Principal Internal Auditor

Christina Logan 
Senior Internal Auditor

FOR: March 21, 2018 | Audit Committee Meeting

SUBJECT: **Updates to Audit Committee Charter**

RECOMMENDATION:

Recommendation that the Audit Committee:

1. Provide direction to staff on the proposed updates to the Audit Committee Charter
2. Upon approval, recommend to the Board of Retirement and Board of Investments to adopt the revised Audit Committee Charter.

BACKGROUND

The Institute of Internal Auditors (IIA) recommends that Audit Committees formally define their purpose, authority, and responsibilities in a charter. In addition, the IIA recommends periodic reviews of the charter to ensure it is aligned with industry best practices and organizational changes. LACERA's Audit Committee Charter (Charter) was established in 2004, and has been updated several times, most recently in November 2017.

The IIA has not updated its model audit committee charter subsequent to the November 2017 Charter. However, staff is proposing additional wording to the Charter's "*Audit Committee Composition and Consultant*" section. Specifically, the revisions address the election of a new member when a Board Member resigns from the Audit Committee (Committee) prior to the completion of their term. This update does not change the Committee's organization, authority, or responsibilities; staff believes the update is administrative and can therefore be approved by the Committee. Refer to Attachment A for the Charter with the proposed revisions.

CONCLUSION

Staff recommends that the Audit Committee:

1. Provide direction to staff on the proposed updates to the Audit Committee Charter
2. Upon approval, recommend to the Board of Retirement and Board of Investments to adopt the revised Audit Committee Charter.

Attachments:

A: Proposed 2018 AC Charter

Audit Committee Charter

March 2018



2018



AUDIT COMMITTEE CHARTER

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 - G. OTHER RESPONSIBILITIES 6
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AUDIT COMMITTEE CHARTER

I. PURPOSE

In November 2003, the Los Angeles County Employees Retirement Association's Board of Retirement and Board of Investments established the LACERA Audit Committee.

The purpose of this "Audit Committee Charter" is to govern the Audit Committee that assists the Boards of Retirement and Investments (Boards) in fulfilling their fiduciary oversight responsibilities for the financial reporting process, the system of internal controls, the audit processes, and the organization's method for monitoring compliance with laws and regulations. The Audit Committee Charter is a living document and may be amended for procedural and administrative matters upon majority vote of the Audit Committee.

II. AUTHORITY

The Audit Committee has the authority to conduct or authorize investigations into any matters within its scope of responsibility.

It shall have the following authorities:

- A. Meet with LACERA's officers, Internal Auditors, External Auditors, or consultants as necessary.
- B. Seek any information it requires from employees, all of whom are directed to cooperate with the Committee's requests, or consultants, as necessary.
- C. Resolve any disagreements or coordinate between Management, Internal Audit, and/or External Audit.
- D. Oversee the work of Internal and External Audit, and any other consultants hired to assist the Audit Committee in fulfilling its fiduciary duties.
- E. Make recommendations to the Boards regarding:
 1. The appointment, compensation, and work of the External Auditor employed to audit LACERA's financial statements.
 2. The appointment, compensation, and work of accountants or other consultants to perform audits, reviews, or investigations related to financial or operational matters (when the cost is expected to exceed the Chief Executive Officer's discretionary allowance for such contracts).
 3. Such other matters as the Committee encounters in its work.



III. AUDIT COMMITTEE COMPOSITION AND CONSULTANT

The Audit Committee will consist of the chair and vice-chair of the Boards of Retirement and Investments, plus one additional Board member elected annually by each Board, for a total of four to six members¹. Board chairs and vice-chairs that leave Board service will be replaced automatically on the Audit Committee, when the Board replaces its missing officer while other Committee membership remains intact. If any elected Audit Committee member leaves Board service, [or resigns from the Audit Committee prior to the completion of their term](#), the Board of the departing member, will elect a new Audit Committee member at the next regularly scheduled Board meeting. If Audit Committee voting results in a tie, the Committee will forward the recommendation to the appropriate Board for consideration and final decision.

The Committee shall have the authority to approve the hiring of the audit consultant as an advisor. The audit consultant will be designated as the audit technical and financial expert, to advise the Committee on audit and financial matters. The audit consultant's contract will be for three years with the option for the Audit Committee to choose to extend the contract for an additional two-year period.

At the first Committee meeting of each calendar year, the Committee shall elect a Chairman, Vice Chair and Secretary, each to serve for a term of one year or until his or her successor is duly elected and qualified, whichever is less. In the event of a vacancy in the office of chair, the vice chair shall immediately assume the office of chair for the remainder of the term. In the event of a vacancy in the office of vice chair or secretary, the Committee shall elect one of its members to fill such vacancy for the remainder of the term, at its next regular meeting.

IV. AUDIT COMMITTEE MEETINGS

The Audit Committee will conduct regular meetings at least three times per year, with authority to convene additional meetings, as circumstances require. All Committee members are expected to attend each meeting.

Regular meeting notices and agendas will be posted at least 72 hours in advance of the regular meetings, and will be made available to the public in accordance with the Ralph M. Brown Act (Government Code Sections 54950, et seq.). Public documents referred to in the agenda will be made available for review at the office of the staff secretary to the Committee. The Committee will invite members of management, Internal Auditors, External Auditors, and/or others to attend meetings and provide pertinent information, as necessary.

¹ The number of Committee members is dependent upon the designated Chair and Vice Chair appointments to the Boards of Retirement and Investments. If both Boards were to elect the same individuals to the positions of Chair and/or Vice Chair, the Audit Committee would be comprised of four or five Board Members.



Special meetings of the Committee may be called in the manner provided by Government Code Section 54956(a). The Committee will have such other powers as provided in the Brown Act.

Robert's Rules of Order, except as otherwise provided herein, shall guide the Committee in its proceedings; however, the chair of the Committee shall have the same rights to vote and participate in discussions as any other member of the Committee without relinquishing the chair. The order of business shall be as determined by formal action of the Committee. Four members of a six-member Audit Committee or three members of a four or five-member Audit Committee, excluding the audit consultant, constitute a quorum.

The secretary of the Committee shall cause to be recorded in the minutes the time and place of each meeting of the Committee, the names of the members present, all official acts of the Committee, the votes given by members except when the action is unanimous, and when requested by a member, that member's dissent or approval with his or her reasons, and shall cause the minutes to be written forthwith and presented for approval at the next regular meeting.

V. RESPONSIBILITIES

The Audit Committee will carry out the following responsibilities to fulfill their fiduciary oversight responsibilities:

A. Internal Audit

1. Approve the Internal Audit Charter.
2. Ensure the independence of Internal Audit.
3. Approve the Annual Audit Plan and all major changes to the Plan. Review and monitor Internal Audit's activity relative to its Plan.
4. Review, with the Chief Audit Executive (CAE), Internal Audit's resource plan, activities, and organizational structure.
5. Monitor Internal Audit's recommendations to ensure Management has adequately addressed the risk(s) identified, either through implementing a new policy, procedure, or process, or accepting the associated risk.
6. Review and discuss engagement reports to take the following action(s):
 - a. accept and file report and/or,
 - b. instruct staff to forward report to Boards or Committees and/or,
 - c. provide further instruction to staff.

**B. Chief Audit Executive**

Since the CAE reports to the Chief Executive Officer (CEO) for administrative purposes, but to the Audit Committee for functional purposes, the Audit Committee will be responsible for the following:

1. Make recommendations to both Boards regarding the appointment, discipline, dismissal, and/or removal of the CAE, which will be addressed by the Boards in a joint meeting. Both Boards will make the final decisions as to the appointment, discipline, dismissal, and/or removal of the CAE. The CEO has authority to administer minor discipline, which is limited to counseling memos and written warnings, with notice of such discipline to be provided to the Committee and the Boards at their next meetings. Consideration by the Boards and the Committee concerning the appointment, discipline, dismissal, and/or removal of the CAE will be made in executive session under Government Code Section 54957(b).
2. Perform the CAE's annual assessment with qualitative input from the CAE and CEO. The Committee's discussion regarding the CAE's annual performance evaluation will be made in executive session under Government Code Section 54957(b).
3. Administer the CAE's annual salary adjustment using the Boards' established compensation structure.

C. External Audit

1. Make recommendations to the Board of Retirement regarding the appointment, compensation, and the work of the External Auditor.
2. Oversee the work of the External Auditor, including review of the External Auditor's proposed audit scope and approach, as well as coordination with Internal Audit and Management.
3. Review the findings and recommendations of the External Auditor, Management's responses, and actions taken to implement the audit recommendations.
4. Approve all non-compliance work.

D. Monitoring the Financial Reporting Process

1. Review significant accounting and reporting issues, including complex or unusual transactions and highly judgmental areas, recent professional and regulatory pronouncements, and understand their impact on the financial statements.
2. Review with Management and the External Auditors the results of the audit, including any difficulties encountered.
3. Review the annual financial statements, consider whether they are complete, consistent with information known to Committee members, and reflect appropriate accounting principles.



4. Review with Management and the External Auditors all matters required to be communicated to the Committee under *Generally Accepted Auditing Standards*.

E. Monitoring Management's System of Internal Controls

1. Consider the effectiveness of LACERA's internal control system, including information technology security and control.
2. Understand the scope of Internal and External Auditors' review of internal control over financial reporting, and obtain reports on significant findings and recommendations, together with Management's responses.

F. Monitoring Management's System of Compliance

1. Annually, review the effectiveness of Management's system of compliance with laws, regulations, policies, and procedures that are business critical.
2. As needed, review the findings of any examinations by regulatory agencies, and any auditor observations.
3. Annually, review Management's process for communicating LACERA's Code of Ethics to company personnel, and for monitoring compliance therewith.
4. Annually, review reported activity to ensure issues of fraud, noncompliance, and/or inappropriate activities are being addressed.

G. Conflicts and Ethics

Audit Committee members must comply with the BOR, BOI, and LACERA's Code of Ethics. Specific to the Audit Committee:

1. Avoid actual or potential conflict of interest or ethics issues. Members will notify the Audit Committee Chair and Vice Chair, the CEO, and Legal Counsel of such issues concerning themselves and other Audit Committee members related to the business of the Audit Committee.
2. Review reports received relating to conflict of interest and ethics issues, and if appropriate, make a recommendation to the Boards.

H. Other Responsibilities

1. Report to the Boards as needed about the Audit Committee's activities, issues, and related recommendations.
2. Provide an open avenue of communication between Internal Audit, the External Auditors, Management, and the Boards.
3. Perform other activities related to this Charter as requested by the Boards
4. Review and assess the adequacy of the Committee's Charter annually, requesting the Boards' approval for proposed changes, and ensure appropriate disclosure as may be required by law or regulation.



5. Communicates public disclosures related to the purpose, authority, function, and responsibility of the Audit Committee.

VI. APPROVAL OF PROCEDURAL AND ADMINISTRATIVE UPDATES

This Audit Committee Charter (“AC Charter”) was updated for procedural and administrative matters, and approved by the Audit Committee on March 21, 2018. This updated AC Charter is thereby effective this day and is hereby signed by the Audit Committee Chair,

Joseph Kelly

Chair, Audit Committee

Date

VII. APPROVAL OF AUDIT COMMITTEE CHARTER

This Audit Committee Charter (“AC Charter”) was reviewed by the Audit Committee on December 14, 2016, and approved by the Board of Retirement and Board of Investments on January 11, 2017 and January 12, 2017, respectively. This AC Charter is thereby effective January 12, 2017 and is hereby signed by the following persons who have authority and responsibilities under this Charter.

Shawn R. Kehoe

Chair, Board of Retirement

January 24, 2017

Date

David Green

Chair, Board of Investments

January 24, 2017

Date



March 1, 2018

TO: 2018 Audit Committee
Vivian Gray
David Green
Shawn R. Kehoe
Joseph Kelly
Herman Santos
Michael S. Schneider

Audit Committee Consultant
Rick Wentzel

FROM: Richard Bendall 
Chief Audit Executive

FOR: March 21, 2018 | Audit Committee Meeting

SUBJECT: **Retiree Healthcare Benefits Program Funding Audit Report**

RECOMMENDATION

In accordance with your current Audit Committee Charter, staff recommends that the Audit Committee review and discuss the following engagement report 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

- a. Retiree Healthcare Benefits Program Funding Audit
Kathryn Ton, Senior Internal Auditor
(Report issued: January 22, 2018)

Attachment



LACERA INTERNAL AUDIT DIVISION

RETIREE HEALTHCARE BENEFITS PROGRAM FUNDING AUDIT

January 22, 2018

AUDIT PERFORMED BY:

Kathryn Ton, CPA, CFE

Senior Internal Auditor

EXECUTIVE SUMMARY

As part of the fiscal year 2018 audit plan, we reviewed LACERA's process for administering Los Angeles County's retiree healthcare program. Specifically, we assessed LACERA's internal controls for collecting healthcare premiums from retirees and the plan sponsor ("County"), and then paying insurance carriers to fund the LACERA-administered plans. The below diagram illustrates the process flows between the parties involved.



Over \$500 million is spent on retiree healthcare, annually. The County subsidizes around \$460 million of the annual costs (92%). Collectively, members contribute the remaining \$40 million (8%). It is important for LACERA to correctly enroll and insure the 47,000+ members and their eligible dependents in the Retiree Healthcare Benefits Program, because retirees rely on their healthcare benefits for financial security and peace of mind. Properly billing members and the plan sponsor for retiree healthcare is a key aspect of ensuring LACERA produces, protects, and provides the promised benefits.

Overall, Internal Audit found management's controls and procedures to be effective and functioning as intended. Specifically, we noted that management has adequate controls in place to ensure errors are mitigated when calculating the premium balances for carriers, members, and the plan sponsor. Additionally, we noted that management has good processes for administering the Medicare Part B premium reimbursements to members. We tested the premiums collected from members and the plan sponsor, and premiums paid to the insurance carriers and did not note any exceptions.

We did identify one minor exception in the collection of administrative fees, which funds LACERA's retiree healthcare operations. This resulted in an under-allocation of \$5,700 in fees to LACERA, but the overall impact was minimal since the total annual administrative fee that LACERA collects from its members and plan sponsor is approximately \$9.5 million. We verified that management corrected this error in November 2017. The details of our findings and recommendations are addressed in the attached report. We thank the Retiree Healthcare Division, Systems Division, Investments Office, and Financial and Accounting Systems Division for their assistance and cooperation with this audit.

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INTRODUCTION

As part of the fiscal year 2018 audit plan, we reviewed LACERA’s process for administering Los Angeles County’s retiree healthcare program. Specifically, we assessed LACERA’s internal controls for collecting healthcare premiums from retirees and the plan sponsor (“County”), and then paying insurance carriers to fund the LACERA-administered plans. The below diagram illustrates the process flows between the parties involved.



Over \$500 million is spent on retiree healthcare, annually. The County subsidizes around \$460 million of the annual costs (92%). Collectively, members contribute the remaining \$40 million (8%). It is important for LACERA to correctly enroll and insure the 47,000+ members and their eligible dependents in the Retiree Healthcare Benefits Program, because retirees rely on their healthcare benefits for financial security and peace of mind. Properly billing members and the plan sponsor for retiree healthcare is a key aspect of ensuring LACERA produces, protects, and provides the promised benefits.

BACKGROUND

LACERA has been administering the Retiree Healthcare Benefits Program (“RHCBP”) for the plan sponsor since 1971. The Retiree Healthcare Division (“RHC”) manages the relationship between the insurance carriers and retirees and their eligible dependents enrolled in a LACERA-administered plan. The LACERA-administered plans include Anthem Blue Cross, Cigna, Kaiser, SCAN, and United Healthcare. LACERA and the insurance carriers, with approval from the Board of Retirement, make annual adjustments to the monthly premiums. The monthly premiums are paid one month in advance to the insurance carriers. LACERA’s Systems Division supports the program by managing the Workspace database that calculates the monthly premium balances for carriers, members, and the plan sponsor. LACERA’s Investments Office and Financial and Accounting Systems Division (“FASD”) facilitate the transfers of funds from members and the plan sponsor to the insurance carriers for the premium payments. The premium payments for members may be fully or partially covered by the plan sponsor depending on their years of service with the County.

RETIREE HEALTHCARE SUBSIDY

As a Los Angeles County employee, the plan sponsor offers eligible members Other Post-Employment Benefits (“OPEB”). OPEBs are healthcare benefits Los Angeles County employees receive at the start of their retirement, and includes medical, dental, and vision coverage. Retirees are eligible for OPEBs after 10 years of service (“vested”), and for those hired before July 1, 2014 (“Tier 1”), can also include eligible spouses and eligible dependent children under 26 years of age. For employees hired after June 30, 2014 (“Tier 2”), OPEB subsidies cover the retiree only; the retiree is responsible for paying the cost of other dependents included on his or her healthcare plan. The plan sponsor will subsidize a portion of the medical, dental, and vision premiums once vested, equal to 40 percent of the premium cost of the insurance plan or 40 percent of the benchmark plan rate, whichever is less. The benchmark plans are Anthem Blue Cross for medical, and Cigna Indemnity for dental coverage. Beyond the vesting period, the subsidy increases 4 percent each year of service, up to the maximum benefit at 25 years. Members are

responsible for premium amounts above the benchmark plan rates. Members with outstanding premium balances will have their share of the premiums deducted from their monthly pension checks. LACERA bills the plan sponsor for the remaining balance.

RETIREE ELIGIBILITY FOR MEDICARE PART B REIMBURSEMENT

In addition to the healthcare premium subsidy, the plan sponsor reimburses members with a stipend for being enrolled in a LACERA-administered Medicare plan, up to the Medicare Part B premium standard amount. This is called the Medicare Part B premium reimbursement. The County incentivizes retirees for enrolling in Medicare plans since it ultimately reduces the premiums that the plan sponsor pays (the plan sponsor subsidizes 92% of the retiree healthcare costs). The Medicare Part B Reimbursement Program requires annual approval by the Los Angeles County Board of Supervisors, and was renewed for calendar year 2017. The reimbursement rate that is applied to a member's account is based on the year the member enrolled in Medicare and submitted verification.

To qualify for the reimbursement, members must:

- (1) Be enrolled in Medicare Parts A and B,
- (2) Be enrolled in a LACERA-administered Medicare Supplement or Medicare Advantage Prescription Drug Plan,
- (3) Pay for Medicare Part B premiums out-of-pocket, and
- (4) Not be reimbursed for Medicare Part B premiums by the State or another agency

Tier 1 and 2 members have different rules that apply for the Medicare Part B reimbursement. First, Tier 1 members have the option to enroll in Medicare Parts A and B, whereas Tier 2 members are required to enroll. Second, Tier 1 members can apply the reimbursement rate to the retiree/survivor and one eligible dependent, whereas Tier 2 members can apply it to the retiree/survivor only.

RETIREE HEALTHCARE BENEFITS PROGRAM ADMINISTRATIVE FEE

LACERA adds an administrative fee to the insurance premiums to cover expenses for administering the healthcare plans. The administrative fee is included as part of the retiree healthcare premium for each member plan, per month. The administrative fee is \$8 and covers the cost of consulting services, vendor fees, staffing, and allocations to other LACERA divisions that support retiree healthcare operations. For fiscal year 2018, the budgeted cost of administering the program is \$6.2 million, and expected to grow as federal programs expand and membership and operational costs increase over time. In anticipation of future costs, the Board of Retirement approved an increase in the administrative fee from \$5 to \$8 in April 2016, effective fiscal year 2017. Any surpluses LACERA collects on the fees are expected to offset growing costs in administering the program.

AUDIT OBJECTIVES

The audit objectives were to assess the adequacy and effectiveness of the controls for paying the monthly retiree healthcare premiums to the insurance carriers as well as collecting from members and the plan sponsor for their share of the premium.

Specifically, this assessment included a review on the timeliness and accuracy of:

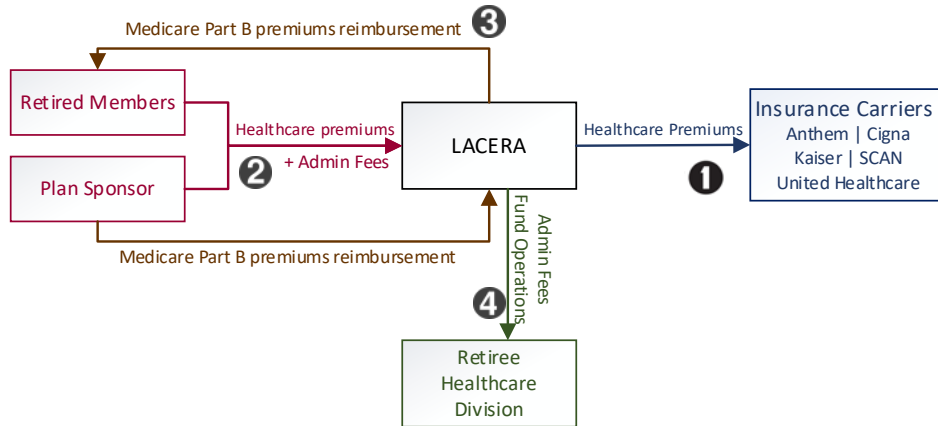
- (1) Retiree healthcare premium payments from LACERA to insurance carriers,
- (2) Healthcare premiums collected from retired members and the plan sponsor, and

(3) Medicare Part B premiums reimbursed to eligible members from the plan sponsor.

Additionally:

(4) We assessed whether the RHC administrative fees charged to each member plan per month covered LACERA's costs for administering the program.

The below diagram outlines the process flows that were reviewed as part of this audit:



AUDIT SCOPE

The audit scope covered:

- (1) Procedures and practices related to the Retiree Healthcare Benefits Program.
- (2) The following activities related to retiree healthcare:
 - Insurance premiums for the August 2017 payroll period for September 2017 coverage
 - Medicare Part B premium reimbursements for all active retirees
 - Administrative fees for fiscal year 2018.
- (3) All LACERA divisions that assist in the administration of the program:
 - RHC, Systems, Investments Office, and FASD.
- (4) Controls testing to verify all operations are performed according to established procedures.
- (5) Transactions testing to verify all actions are performed according to established procedures.

Note: We did not test wire transfer controls related to carrier payments because this will be performed in a separate audit later this fiscal year.

AUDIT METHODOLOGY

- (1) To review the timeliness and accuracy of retiree healthcare premium payments from LACERA to the insurance carriers:
 - Compared annual agreed-upon renewal rates to inputted rates in the Workspace database management system. This control test was necessary because these rates are used to calculate the premium balances for carriers, members, and the plan sponsor.
 - Reconciled healthcare premiums from system-generated reports. The Systems Division produces monthly insurance reports that RHC uses to determine the monthly premiums due to carriers. FASD uses the reports to determine the monthly premiums billed to the plan sponsor.
 - Interviewed Staff to understand controls related to enrolling retirees in LACERA-administered plans, as well as calculating monthly premiums paid to carriers and collected from the plan sponsor.

- (2) To review the timeliness and accuracy of the monthly premiums collected from retired members and the plan sponsor:
 - Recalculated the premium totals (member share plus plan sponsor share) for each member account, and compared this total to the healthcare plan total. This test allowed us to determine whether each member was billed the proper amount for the healthcare plan he or she selected. In addition, we verified that each member's healthcare subsidy was calculated correctly based on his or her years of service (i.e., 10 years of service credit = 40% subsidy and 4% for each year thereafter).
 - Reviewed program formulas used to calculate the premium balances for members and the plan sponsor.

- (3) To review the timeliness and accuracy of Medicare Part B premiums reimbursed to eligible members from the plan sponsor:
 - Performed test work on retiree population, and reviewed supporting documentation members submitted from the Social Security Administration.

- (4) To assess the adequacy of RHC administrative fees in support of the program:
 - Reviewed policies and practices to determine the appropriateness of the administrative fee.

AUDIT RESULTS

Overall, Internal Audit found the controls and procedures to be effective and functioning as intended.

Notably, we observed the following good practices with administering the program:

- RHC and Systems Division have good checks and balances with respect to inputting the new, annually approved insurance rates into Workspace and reviewing the inputs for accuracy.
- Systems Division has user authorization controls when accessing retiree healthcare accounts.
- Systems Division developed an in-house program to calculate premium balances systematically with a high degree of consistency.
- FASD has multiple reviewers involved in the reconciliation and validation of carrier payments.

- RHC established month-end deadlines to process carrier payments, timely and efficiently.
- RHC, Investments Office, and FASD have proper segregation of duties when it comes to the initiation, authorization, and release of wire transfers.

Based on our test work performed, we noted the following:

- We tested for the accuracy of the monthly premiums paid to carriers, which totaled \$46.6 million for September 2017. We tested 100% of the population, or 97,257 records (47,193 medical and 50,064 dental and vision accounts), and found no exceptions to 99.7% of the population. There was one minor exception that impacted 0.3% of the population, or 132 accounts, because the incorrect administrative fee was applied. This error resulted in a \$396 overpayment to the carriers in September 2017, or \$5,727 in total overpayments from July 2016 to September 2017. Following our review, a one-time adjustment of \$5,727 was made to correct for this mistake in November 2017. Further details on this exception are discussed in the next section.
- We tested for the accuracy of the monthly premiums collected from retired members and the plan sponsor. We tested 100% of the medical population or 47,193 accounts, and found no exceptions.
- We tested for the accuracy of members eligible for Medicare Part B and the appropriateness of the reimbursement amount, which totaled \$4.7 million for September 2017. We sampled 100 of 33,724 accounts, and found no exceptions.
- We tested for the appropriateness of the administrative fee LACERA collects from members to fund the cost of administering the Retiree Healthcare Benefits Program. We determined that the \$8 monthly administrative fee LACERA collects from each member for each plan currently covers the costs of the program. We should note that in April 2016, the Board of Retirement approved an increase in the administrative fee from \$5 to \$8 to account for incremental costs anticipated over the following four to five years.

While we observed mostly positive observations in our audit, we identified an opportunity for management to further strengthen their processes, as discussed in detail below. In addition, Internal Audit developed a cross-functional flow chart which covered the process flows between RHC, Systems Division, Investments Office, and FASD on the key controls and activities within the program. We shared this flow chart with management to use at their discretion.

Update Operating Procedures

As part of our audit, we observed that the Board of Retirement approved a fee increase for administering the Retiree Healthcare Benefits Program in fiscal year 2017. As RHC Staff applied the correct fee to the general population (99.7%), they failed to update the fee from \$5 to \$8 to the remaining population (0.03%) that had to have manual adjustments made. As a result, LACERA undercharged \$5,727 in administrative fees over a 15-month period. We noted that \$5,727 is a nominal amount relative to the \$9.5 million in fees collected to fund the program annually (0.06%). This error could have been prevented had management updated procedures to address the fee increase and trained staff on the change in procedures. Following our identification of the discrepancy, RHC Staff made a one-time adjustment for \$5,727, the total amount of the error. Internal Audit verified that this amount was corrected in November 2017.

RECOMMENDATION

1. RHC management update procedures to address future fee increases related to the program. RHC management train staff on updated procedures so that the correct amounts are charged and promptly addressed when future changes occur.

Management Response

The RHC procedure was updated to address future administrative fee increases ensuring that the correct administrative fee is applied when future changes occur. Staff received training on the new procedure.

We thank Retiree Healthcare, Systems, Investments Office, and Financial and Accounting Systems Division for their assistance and cooperation with this audit.

NOTED AND APPROVED



RICHARD BENDALL
Chief Audit Executive

Date: January 25, 2018

REPORT DISTRIBUTION

<i>2018 Audit Committee</i>	<i>Robert Hill</i>	<i>Cassandra Smith</i>	<i>Robert Santos</i>
<i>Rick Wentzel</i>	<i>James Brekk</i>	<i>Leilani Ignacio</i>	<i>Beulah Auten</i>
<i>Steve Rice</i>	<i>Bernie Buenaflor</i>	<i>Mary Phillips</i>	<i>Ted Granger</i>
<i>Internal Audit Staff</i>	<i>JJ Popowich</i>	<i>Jan Tran</i>	



March 1, 2018

TO: 2018 Audit Committee
Vivian Gray
David Green
Shawn R. Kehoe
Joseph Kelly
Herman Santos
Michael S. Schneider

Audit Committee Consultant
Rick Wentzel

FROM: Richard Bendall 
Chief Audit Executive

FOR: March 21, 2018 | Audit Committee Meeting

SUBJECT: **2017 External Penetration Test**

RECOMMENDATION

In accordance with your current Audit Committee Charter, staff recommends that the Audit Committee review and discuss the following engagement report 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

- a. 2017 External Penetration Test
George Lunde, Senior Internal Auditor
(Report issued: January 25, 2018)

Attachment



January 25, 2018

TO: 2018 Audit Committee
David Green, Chair
Hernan B. Santos
Les Robbins
Shawn Kehoe, Vice Chair
Vivian H. Gray

FROM: George Lunde
Senior Internal Auditor

Richard Bendall 
Chief Audit Executive

FOR: March 21, 2018 | Audit Committee Meeting

SUBJECT: **2017 External Penetration Test**

In October 2017, Internal Audit contracted with Tevora Business Solutions Inc. (Tevora), an information technology audit consultant specializing in both penetration testing and application assessments, to assess security over LACERA's internet perimeter and the member portal MyLACERA web application. MyLACERA is a JAVA-based internet application which interfaces to LACERA's mission critical core membership WorkSpace application.

The results of Tevora's review are summarized in their attached executive summary report. The detailed full report is highly technical and contains information that would compromise LACERA's security if made public.

Internal Audit periodically and randomly schedules these types of security tests, the last of which was performed in October 2016. We have used a number of firms over the last 20 years to perform these types of security reviews and commonly we use each firm at least twice. This is the first time that we have employed the services of Tevora.

Systems Division staff was not informed of the scheduled audit in advance of Tevora initiating their initial penetration tests. These tests are most often done on a surprise basis in order to replicate real world attacker scenarios and to measure the efficacy of operational safeguards. In this case, staff detected the suspicious internet activity generated by Tevora after Tevora began their penetration attempts. LACERA's Chief Information Officer informed Internal Audit that his staff had identified the threat. In

accordance with our usual protocols, the Systems Division then provided Tavora with authorization credentials and allowed them to continue their testing without restriction.

We are pleased to report that as indicated in the executive summary segment of Tavora's report, that with the exception of a very minor issue identified, they concluded that "Overall, LACERA was found to have a strong external security posture with no critically vulnerable exposed services and no major web application issues."

Internal Audit commends the Systems Division for their continued vigilance in ensuring network and application security is continually updated to protect LACERA's critical data from ever changing vulnerabilities.

MEMO DISTRIBUTION

<i>2018 Audit Committee</i>	<i>Bernie Buenaflor</i>	<i>James Brekk</i>
<i>Audit Committee Consultant</i>	<i>Robert Hill</i>	<i>Mary Phillips</i>
<i>Internal Audit Staff</i>	<i>JJ Popowich</i>	<i>Steven Rice</i>

REVIEWED AND APPROVED



Richard Bendall
Chief Audit Executive



LACERA
2017 Web and External
Penetration Test Report

Delivered Date: December 13, 2017



One Spectrum Pointe Drive, Suite 200 | Lake Forest, California 92630

Project Overview

Purpose

The web application penetration tests for LACERA was conducted from October 23 to October 31, 2017 to ensure that the LACERA web applications and network perimeter are secure from external threats.

Testing was initially performed in a stealthy manner, with Tevora using several remote 'VPC' proxies and only performing light testing, or testing that would appear as normal traffic on most analysis. Tevora slowly ramped up testing over the course of the week of testing, introducing more detectable enumeration traffic such as port scans, and eventually, full vulnerability scanning traffic.

The web application testing was initially performed with no credentials or special access to the application. After performing the initial black box testing, Tevora was given credentials to the member.lacera.com application to enable more comprehensive authenticated testing.

Additional objectives for this penetration test were based on industry standard guidelines as follows:

- Identification of vulnerabilities so that they can be identified and remediated prior to being exploited by an attacker
- Verification of application logic, session handling, and input validation for web application using supplied credentials
- Verification that only authorized services are exposed to the network perimeter

Scope

This report contains the summary of project scope, findings, and recommendations resulting from the web application penetration tests conducted by Tevora against the LACERA environment.

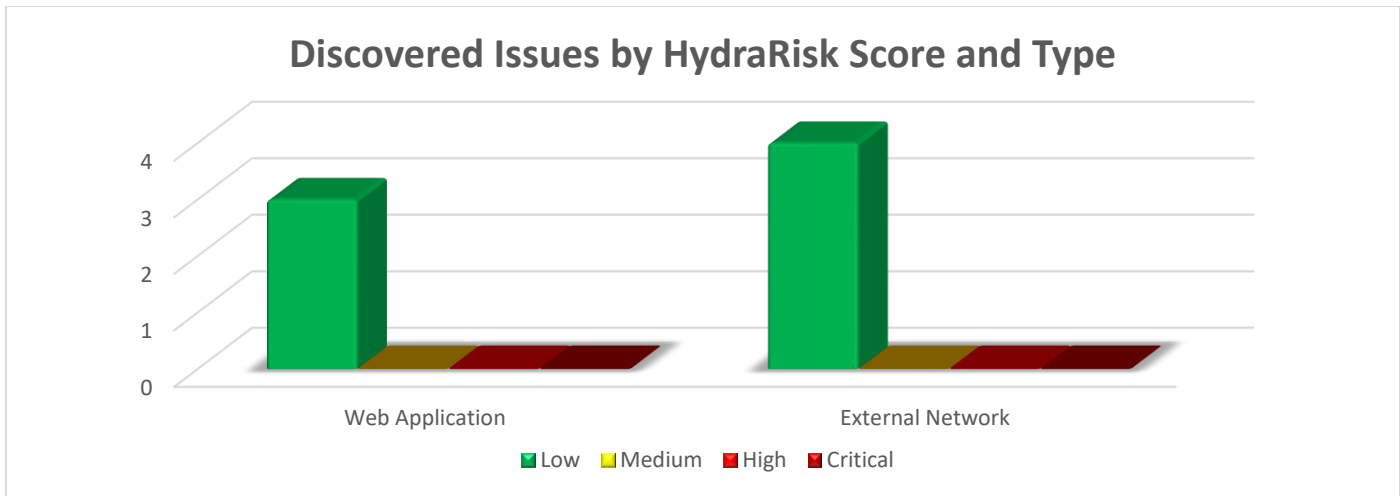
Web Application Test Comprehensive web application testing was conducted remotely out of the Tevora offices against the following applications:

- members.lacera.com

External Network Test Testing was conducted remotely out of the Tevora offices and spanned all external network locations that host the LACERA systems and services

Executive Summary

Overview



Summary of Findings

Overall, LACERA was found to have a strong external security posture with no critically vulnerable exposed services and no major web application issues.

LACERA’s web applications were either mostly static, or powered by proven third party technology stacks such as Novell and NetIQ. The static applications did not have many issues, or attack surface area in general, as they largely appear to be serving public data. The dynamic sites clearly contain sensitive internal data, but had strong access controls, no major web application flaws, and patched underlying frameworks. Additionally, many sites appeared to have web application firewall (WAF) like protections built into the application, which returned 404 errors when potential attack payloads were present in a request. There was a minor issue discovered that LACERA can remediate to harden their publicly facing applications.

LACERA’s external network did not have any major misconfigurations, vulnerable software, or vulnerable services exposed. Tevora only discovered web services and IPSec VPNs to be publicly exposed. Some of the discovered web services were running on non-standard ports, but these were established to be secure and known services. One of these services was the search functionality powering searches on LACERA sites, and another was confirmed to be a service use by IT administrators. These services are known by LACERA and do not pose a risk to the organization. There are minor improvements LACERA can make to these external endpoints, such as hardening SSL ciphers, and scrubbing metadata from publicly accessible documents, to further harden the external security posture.

Strategic Recommendations

LACERA is recommended to review the discovered issues, and implement the recommended remediation’s. LACERA has demonstrated a sufficiently hardened perimeter, and should ensure other attack avenues such as email phishing and physical intrusion are similarly difficult for an attacker to pursue.



March 1, 2018

TO: 2018 Audit Committee
Vivian Gray
David Green
Shawn R. Kehoe
Joseph Kelly
Herman Santos
Michael S. Schneider

Audit Committee Consultant
Rick Wentzel

FROM: Richard Bendall 
Chief Audit Executive

FOR: March 21, 2018 | Audit Committee Meeting

SUBJECT: **Data Backup and Retention Audit Report**

RECOMMENDATION

In accordance with your current Audit Committee Charter, staff recommends that the Audit Committee review and discuss the following engagement report 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

- a. Data Backup and Retention
George Lunde, Senior Internal Auditor
(Report issued: February 14, 2018)

Attachment



LACERA INTERNAL AUDIT DIVISION

DATA BACKUP AND RETENTION

February 14, 2018

AUDIT PERFORMED BY:

George Lunde
Senior Internal Auditor

EXECUTIVE SUMMARY

The purpose of this review was to evaluate backup management of critical LACERA information systems data and applications. In order to minimize the probability and impact of major a systems service interruption: applications, data, and documentation need to be backed-up and securely stored according to defined schedules and protocols. While not all data and applications are mission critical, many applications and data stores are critical to a division's operations. e.g., voice recordings, scanned document correspondence, analytical spreadsheets, or operational-informational databases.

This audit determined that backup and retention of mission critical enterprise data and application systems is in effect in accordance with generally accepted guidelines. The retention period for membership, accounting and investment activity as well as operational division data files and applications are sufficient to facilitate recovery of operations and comply with applicable good practice guidance.

However, two recommendations are provided that would serve to minimize the time for return-to-operations efforts in the event of a major systems interruption. The Systems Division has not conducted a disaster recovery exercise subsequent to the LACERA-wide technology upgrade in 2017. The exercise, last conducted in 2016, provides assurance that the core Membership System and data is restorable from backups and functions with current technology. A recovery exercise is required as soon as practical so staff can gain knowledge and experience as well as validate recovery plan assumptions using current upgraded technology.

Another concern pertains to the lack of procedures for the backup and offsite storage of Communications Division's Macintosh System, related software and data. This presents an unnecessary exposure to recovery delays for a portion of Communication Division operations in the event of unexpected business interruption. The Communications Division's Macintosh systems and data in the Systems Division's offsite storage and recovery process need to be included in the Systems offsite storage procedures.

DATA BACKUP AND RETENTION

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BACKGROUND

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 that backup arrangements and availability of business-critical information is effective. Annual disaster recovery exercises conducted by Systems provide assurance that the core Membership System and data is restorable from backups. However, LACERA divisions also rely on non-membership systems and information to be available or to be easily retrievable in the event of a system interruption. Data retention and recovery from vendor applications (e.g. banking, investments) not resident within LACERA's technology infrastructure are also critical in the event of a significant service disruption.

A defined schedule, which considers data types such as core membership, accounting or investment data; provides the basis for the backup of application systems and data. In addition, critical divisional end-user documents, spreadsheets, and data database applications are part of the Systems backup process. LACERA's Business Continuity Plan provides Systems with disaster recovery guidance on critical data and systems.

AUDIT OBJECTIVES

The purpose of this audit was to evaluate and determine:

- Backup and transport procedures for systems operation files are current, in effect, and updated to reflect changes in business and technology requirements;
- Contingency recovery plan documents including the priority of service provisions are current;
- Backup and storage procedures for application data and programs are current and in effect to ensure processes and systems can be effectively recovered; and
- Retention periods for audit records and logs comply with applicable good practice guidance.

AUDIT SCOPE

- This assessment covered current procedures, as of January 2018, for backup of network/mainframe/server operating systems, applications, data, and documentation to determine if data systems business requirements outlined in the LACERA business continuity plan are in effect.
- This was not a review of LACERA's Business Continuity Plan.

AUDIT METHODOLOGY

Generally, accepted audit guidelines for government information systems:

- Enquiry and validation confirmed that a set of practices achieve successful backups of mainframe, network, and server operating systems, applications, and application data;
- Inspected and reviewed the network backup control approach and tested the design for completeness, relevancy, timeliness, and measurability; and
- Selected a date range, located the relevant backup media and determined the selected media contain the expected data.

AUDIT RESULTS

Enterprise Systems

A review of procedures for backing up and transporting files indicates they are current, and effectively include recent changes to LACERA's technology infrastructure. LACERA backs up critical data in real time onsite and stores an encrypted backup offsite on a daily basis to prevent data loss and maintain data integrity. Mainframe, network and voice communication systems are included in the backup process. Due diligence visits to offsite, storage locations verified physical security and environmental controls.

Information system recovery procedures provide for recovery and reconstitution to the system's original state after a disruption or failure including; an uninterruptible power supply and a backup generator allow power for orderly shutdown; and backup hardware ensures a high level of system availability for critical applications.

Backup personnel are available, so that recovery plans are implemented independent of specific individuals. Contracts and agency agreements ensure backup processing facilities:

- Are in a state of readiness commensurate with the risks of interrupted operations;
- Include alternate network and telecommunication services;
- Have sufficient processing and storage capacity; and
- Are likely to be available for use.

A recent technology upgrade of desktop computers and server systems relied upon a live interface to the *Microsoft Government Cloud Services - Enterprise Office 365* operating and email systems. Recovery of these services at a remote processing facility in conjunction with recovery of LACERA's core membership system would be required during a major service disruption. Before the upgrade, annual disaster recovery exercises provided assurance that recovery procedures would restore operations within an acceptable period. However, the last recovery exercise was in 2016 and another is not scheduled. Without such a training exercise, there is a concern that unnecessary recovery time and effort will be required to restore systems. There should be a scheduled structured recovery test exercise to keep staff well versed and to validate recovery plan assumptions using current technology to ensure the necessary elements for a timely successful recovery will be available when needed.

AUDIT RESULTS (continued)

RECOMMENDATION

1. **Perform a recovery exercise of mission critical operations at a remote location as soon as practical to validate recovery procedures and capture learnings for potential disruptions.**

Management Response

Mission critical membership payroll, accounting and investment data processing functions will be replicated offsite in a disaster recovery scenario during the fourth calendar quarter of 2018.

Application Systems

Current schedules (January 2018) for the backup of division-specific application programs and data are in place. On a prescribed basis, backups rotate off-site to avoid disruption if current files are lost or damaged. Membership, accounting, administrative support, and member call recording application programs and data are included in backup and retention procedures.

Review of third party Service Organization Control (SOC2) audit reports for vendor applications not resident within LACERA's technology infrastructure, indicate data backup, security and access to essential recovery abilities are in place. These included banking operations, investment operations, and investigations.

LACERA's Communications Division relies upon an Apple Macintosh system and local area network for producing video presentations, website design, and originating other member communication materials in support of all LACERA divisional communication needs. However, the Macintosh system, network, related software and data are not included within Systems' backup, retention, offsite storage, nor recovery procedures. This presents an unnecessary exposure to recovery delays for Communication Division operations in the event of unexpected business interruption.

RECOMMENDATION

2. **Develop a schedule and procedure to include the Communications Division's Macintosh systems and data in the Systems Division's offsite storage and recovery process.**

Management Response

The Systems Division will set up an account with the current offsite storage vendor for the Communications Division data backup media.

AUDIT RESULTS (continued)

Management Response (continued)

Additionally, the Communications Division will establish procedures to deposit division Macintosh systems and data backup media with Systems on a scheduled basis.

Management anticipates completion by June 30, 2018.

Audit Records and Logs


Daily offsite rotation of audit record backup files serves to minimize disruption, if current files are lost or damaged. Lacera maintains audit records and transaction logs effecting changes to LACERA member accounts indefinitely. Retention of operating system logs and website presentation material provides support for after-the-fact forensic investigations and meet good practice guidelines. Warning mechanisms alert staff to take action if there is interruption or failure of audit or transaction logging processing. Review of configuration settings for monitoring and controlling storage capacity indicate the current settings ensure adequate capacity and files will be available for recovery as needed.

CONCLUSION

This audit determined mission critical enterprise data and application systems are backed-up and retained in accordance with generally accepted guidelines. The retention period for membership, accounting and investment activity is sufficient to facilitate recovery of operations and complies with applicable good practice guidance. Addressing the two recommendations noted would serve to minimize return-to-operations efforts in the event of a disaster.

Internal Audit would like to extend its appreciation to the management and staff of the Systems Division. Their helpful attitude and responsiveness contributed greatly towards the successful completion of this audit.

NOTED AND APPROVED



Richard Bendall
Chief Audit Executive

Date: February 14, 2018

REPORT DISTRIBUTION

2018 Audit Committee
Audit Committee Consultant
James Brekk

Bernie Buenaflor
Robert Hill
JJ Popowich

Steve Rice
Mary Philips
Roxana Castillo



March 1, 2018

TO: 2018 Audit Committee
Vivian Gray
David Green
Shawn R. Kehoe
Joseph Kelly
Herman Santos
Michael S. Schneider

Audit Committee Consultant
Rick Wentzel

FROM: Richard Bendall 
Chief Audit Executive

FOR: March 21, 2018 | Audit Committee Meeting

SUBJECT: **Physician Selection, Monitoring, and Compensation Audit Report**

RECOMMENDATION

In accordance with your current Audit Committee Charter, staff recommends that the Audit Committee review and discuss the following engagement report 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

- a. Physician Selection, Monitoring and Compensation Audit
Christina Logan, Senior Internal Auditor
(Report issued: February 12, 2018)

Attachment



LACERA INTERNAL AUDIT DIVISION

Physician Selection, Monitoring, and Compensation Audit

February 12, 2018

Audit Conducted By:
Christina Logan, CPA, CFE
Senior Internal Auditor

EXECUTIVE SUMMARY

As part of the fiscal year 2018 audit plan, we reviewed Disability Retirement Services' (DRS) process for overseeing LACERA's panel of physicians used for the Disability Application Process. Specifically, we assessed DRS' internal controls, policies and procedures for selecting, monitoring and approving payments for physicians.

LACERA administers a disability retirement program pursuant to the County Employees Retirement Law of 1937 (CERL). It is important that LACERA retain physicians that are qualified and competent. As part of the disability retirement program, LACERA's Board of Retirement is required to determine, based on the physician's medical evaluations, whether the applicant for a disability retirement is permanently incapacitated from performing his/her usual job duties and, if so, whether the disability is service-connected. LACERA has contracted with over 60 physicians who are Board certified in various specialties and located throughout Southern California. In fiscal year 2017, physicians provided medical evaluations to approximately 500 members with an associated cost of approximately \$1.6 million dollars.

Internal Audit found that controls related to the selection, monitoring, and compensation processes are generally effective. However, we identified the following specific areas where Management could further strengthen controls:

- 1. Improve the storage of physician's documentation**
- 2. Develop a more comprehensive quarterly log to validate physician qualifications**
- 3. Consider a more secure method of transferring members' medical records to/and from physicians**

Internal Audit would like to thank DRS management and staff for their cooperation and assistance in facilitating this audit.

Physician Selection, Monitoring, and Compensation Audit

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AUDIT RESULTS	7

BACKGROUND

LACERA administers a disability retirement program pursuant to the County Employees Retirement Law of 1937 (CERL). It is important that LACERA maintains a panel of physicians that are qualified and competent. As part of the disability retirement program, LACERA's Board of Retirement (BOR) is required to determine, based on the physician's medical evaluations, whether the applicant for a disability retirement is permanently incapacitated from performing his/her usual job duties and, if so, whether the disability is service-connected. LACERA has contracted with over 60 Los Angeles County physicians who are Board certified in various specialties. In fiscal year 2017, physicians provided medical evaluations to approximately 500 members, with an associated cost of approximately \$1.6 million dollars.

DRS is responsible for selecting qualified and competent physicians. The selection process consists of the following steps:

- **Identifying a logistical and/or a medical need for an additional physician** - Staff submits requests for physician referrals to a variety of different sources, including medical agencies, current panel physicians, other Disability Service or Workers Compensation organizations.
- **Recruiting a physician** - Staff sends potential physicians, a letter of recruitment detailing the required documents the physician must provide for further consideration.
- **Screening a physician** - After the documentation is received, staff and LACERA's medical advisor (Advisor), screens the physician to ensure the physician has a valid California medical license with no disciplinary action, is Board certified by a medical specialty board, and has the proper levels of medical liability insurance. Staff also reviews the physician's sample medical evaluations. Upon approval staff conducts an interview at the physician's office to discuss LACERA's needs and requirements, and evaluates the physician's professionalism and office logistics.
- **Approving a physician** - Staff prepares a memo for the DRS division manager (Manager) outlining the physician's qualifications, strengths, office logistics, and recommendation to either approve or deny the physician. If the Division Manager approves of the physician, the physician's selection package is then routed to the executive office and the Disability Procedures and Services Committee for approval. The BOR will grant final approval during their board meeting. Staff officially adds the physician to the panel, once there is Board approval and a fully executed contract.

After a physician is added to the panel, DRS monitors the physician's qualifications and the quality of service provided. Quarterly, staff reviews its log of physician qualifications to validate each physicians' credentials. Additionally, staff monitors the quality of care provided to members by including a quality control questionnaire with each member's Disability Retirement application. DRS supervisors review completed surveys and address any issues reported in the survey after the member's case has been concluded so as not to affect the physician's objectivity. Finally, staff reviews each medical evaluation submitted by the physician to ensure it includes all required information to assess if the member is permanently incapacitated from performing his/her usual job duties and, if so, whether the disability is service-connected.

As agreed upon in the contract, LACERA pays a flat fee for the physician's initial medical examination and report, and a fixed amount per inch of documentation for the review of the member's prior medical records. Since the physician is required to review the member's prior medical records, LACERA transfers hard copies of the member's records to the physician. Generally, the physician submits the medical evaluation and the associated invoice when he/she returns the member's medical records to LACERA. If the physician's bill is for the contracted amounts, the DRS specialist assigned to the case, reviews and approves the invoice. If the bill has additional fees or expenses that exceed contracted terms, the invoice is routed to DRS Quality Assurance for resolution and approval. Invoices are then sent to the DRS administrative assistant to process the payment request, and the manager for review and approval, and then to Financial Accounting Services Division (FASD) for a final review and payment. FASD reviews the payment request and supporting documentation to ensure it is not a duplicate expense and does not exceed the \$15,000 threshold. The BOR approved Service Provider Invoice Policy, requires Board approval for physician invoices that exceed the \$15,000 threshold for one member.

AUDIT OBJECTIVE(S)

The audit objectives were to assess the adequacy and effectiveness of the controls, policies, and procedures to ensure:

- The selection process aids staff in selecting qualified and competent physicians.
- The monitoring process validates the qualifications and competencies of LACERA's panel of physicians.
- The monitoring process validates physicians' quality of service, during the medical evaluations and when submitting medical reports.
- The compensation process ensures payments are for valid and accurate physician invoices.

AUDIT SCOPE

The audit scope included:

- **Selection process** – The 66 physicians on the LACERA's panel during fiscal year 2017.
- **Monitoring process** –
 - The quarterly log of physician qualifications for fiscal year 2017, which included the physicians' names, expiration of medical license, expiration of Board Certification, and if the physician had submitted insurance certificate.
 - Quality control questionnaires for appointments in fiscal year 2017.
 - Medical evaluations submitted by physicians during fiscal year 2017.
- **Compensation process** – Physician invoices for medical evaluations during fiscal year 2017.

AUDIT METHODOLOGY

Audit work included but was not limited to the following:

- To understand the selection, monitoring, and compensation processes and related controls:
 - Interviewed DRS staff, reviewed DRS' policy, and written procedures.
- To assess the effectiveness of the selection process to aid staff in selecting qualified and competent physicians
 - Tested ten of the 66 physicians on the panel during fiscal year 2017, which included reviewing the physicians' folders to ensure the folders include the information as required by the Selection Policy. Nine out of ten of the physician folders included all required information, however, the documentation was not well-organized, as detailed in the Audit Results section of this report
- To assess the effectiveness of staff's process for validating the qualifications and competencies of LACERA's panel of physicians:
 - Reviewed the quarterly log of physician qualifications for fiscal year 2017. The log did not include enough information to demonstrate DRS' complete review, as detailed in the Audit Results section of this report
 - Randomly selected eight of the 66 physicians to validate the information in the quarterly log against the California Medical Board's website and the American Board of Medical Specialties' website. No exceptions were noted.
- To assess the effectiveness of staff's process for ensuring physicians are providing quality service, during the member's medical evaluations and when submitting medical reports,
 - Selected five physicians' quality control questionnaire folders to review the questionnaires returned within fiscal year 2017. Reviewed 25 questionnaires and found two with complaints about excessive wait times for two different physicians. The folders for these two physicians included communication from DRS to the physicians regarding the complaints but did not require a response from them since other members had not reported a similar issue.
 - Selected a medical report to review from each of the five most frequented physicians in fiscal year 2017. Each of the five medical reports included the required information to determine the outcome of the member's disability application.
- To assess the effectiveness of the compensation process:
 - Reviewed the invoices related to the five medical evaluations tested in the monitoring process, which totaled approximately \$20,000. All invoices were properly reviewed and approved by DRS, and then routed to FASD for an additional review and payment.

- Analyzed physician invoices during fiscal year 2017 to determine if all payments over \$15,000 to a physician for a single member, were reviewed and approved by the BOR. During the fiscal year, no payments exceeded the threshold.

AUDIT RESULTS

Internal Audit found Disability Retirement Services' controls related to the selection, monitoring, and compensation processes are generally effective, provide reasonable assurance that risks are managed, and objectives are met.

Internal Audit observed the following best practices in use:

- DRS staff ensures a segregation of duties between the processes for selecting and monitoring physicians, and compensating physicians.
- DRS staff has multiple people knowledgeable and trained for the selection, monitoring, and compensation processes to ensure the disability process does not get delayed due to absences. The Division Manager and supervisors are all engaged in the processes.
- DRS thoroughly reviews the physician's medical evaluations to ensure it is a high-quality report that includes the information necessary to make a judgement regarding a member's claim.
- DRS agrees physician invoices to contracted amounts. Staff documents questions and concerns about expenses that are outside of the contract, including the physicians' responses. Staff recalculates amounts requested to ensure accuracy.

We identified opportunities to strengthen the existing Policy, procedure, and/or process in the following areas:

1. **Improve the storage of physicians' documentation**

Currently, DRS maintains physician folders that includes the physician's application, qualifications, and signed contract. Folders also include documentation of communications ranging from billing questions, to requests for additional information in medical reports, and updated required documentation. In each of the ten files reviewed, the information was not organized in any particular fashion, making it difficult to find documentation or to determine if all pertinent information was included in the file. To ensure that all required documentation is obtained and easily assessable, it is recommended DRS create a checklist of required information to retain in physician folders and establish an organized method for the retention of documentation.

RECOMMENDATIONS:

1. **Develop a checklist to include in physician folders to ensure all required documentation is included and organized in user-friendly format.**

Management Response and implementation date:

2. **Revise the quarterly log of physician qualifications**

As part of DRS' Hiring of Panel Physicians Policy, on a quarterly basis staff is required to validate that all panel physicians have current licensing, certifications, and insurance coverage. Currently, the DRS administrative assistant is responsible for this process and uses a spreadsheet that includes the expirations dates of each physician's license, certification and insurance coverage. Each quarter, the administrative assistant reviews the log to identify physicians with licenses and/or certifications that will expire within the next quarter, obtains updated documentation from the physician, and checks the certifying authority's website for additional information on the physician. Periodically, the DRS supervisor reviews the California Department of Industrial Relations' website to verify the physicians not had any disciplinary actions taken by Workers Compensation, as the physicians often also, work on Workers Compensation cases as well. However, this review is documented in the quarterly log.

As part of our testing, we verified the qualifications of eight randomly selected physicians, including the expiration dates for the physician's California medical license and Board Certifications using the related websites and documentation included in DRS' physician folders. Although our testing did not disclose issues with the physicians' qualifications, we noted that the quarterly log does not include sufficient information to demonstrate a complete review of the physicians' qualifications. Specifically, the log should have a separate tab for each quarter reviewed and should include the review date and who completed the review for accountability. In addition to the information currently on the log, the log should include the physician's California medical license number, if any disciplinary actions were reported by the state, the certifying Board's name and physician's number, and the date when the physician's insurance expires.

RECOMMENDATIONS:

Revise the quarterly log to include additional information to demonstrate a complete review of the physicians' qualifications.

Management Response and implementation date:

3. Consider a more secure method of transferring members' medical records to/and from physicians

As part of the disability process, a member must authorize DRS to obtain the member's prior medical files from the member's personal physicians and Workers Compensation doctors. DRS creates a hardcopy file of the member's medical records and then sends it to the physician's office who reviews the records and assesses the member's prior medical history into the medical evaluation.

Currently DRS sends its sole hardcopy of the member's prior medical history to the physician via FedEx. DRS also, includes in the package, a pre-paid, self-addressed FedEx label for the return of the medical records to LACERA. DRS uses FedEx since it provides tracking, and reliable and quick service. Although DRS' overall experience with this method has been satisfactory, transferring around 500 members' medical records

annually is a high risk area that our members' medical records could be lost or sent to incorrect address. DRS should work with LACERA System Division in developing a system using today's technology to safeguard member data and lessen DRS' reliability on an outside vendor.

RECOMMENDATIONS:

Consider a more secure method of transferring members' medical records to/and from physicians.

Management Response and implementation date:

NOTED AND APPROVED



Richard Bendall
Chief Audit Executive

Date:

REPORT DISTRIBUTION

2018 Audit Committee
Rick Wentzel
Internal Audit Staff

Robert Hill
James Brekk
Bernie Buenaflor


JJ Popowich
Steve Rice
Ricki Contreras



March 1, 2018

TO: 2018 Audit Committee
Vivian Gray
David Green
Shawn R. Kehoe
Joseph Kelly
Herman Santos
Michael S. Schneider

Audit Committee Consultant
Rick Wentzel

FROM: Richard Bendall 
Chief Audit Executive

FOR: March 21, 2018 | Audit Committee Meeting

SUBJECT: **Internal Audit Risk Assessment Process**

Internal Audit performs a risk assessment in accordance with the Internal Audit Charter and Institute of Internal Auditors (IIA) Professional Standards to use in the development of the Annual Audit Plan. Our risk assessment approach begins with you, the Audit Committee at this meeting. The intent of the following presentation is to explain our approach and share with you the criteria and process we plan to use in evaluating risk.

We look forward to your feedback and input regarding risk at LACERA and our risk assessment process.

We will bring our completed risk assessment along with our Audit Plan for the fiscal year ending June 30, 2019 to your Committee for approval at your next meeting.

RB:dv
Attachment

Risk Assessment Process

FYE 2018

March 21, 2018 | Audit Committee Meeting

Audit Plan

Audit Plan Status Report

June 30, 2018

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	
• New Payee Validation	Audit	Periodic	
• Over 90 Payee Testing	Audit	Periodic	
2. Contract Compliance Program	Audit	Planned	
3. Internal Controls Training	Consulting	Planned	
4. Privacy Training	Consulting	Planned	
5. Los Angeles County Rehired Retirees Audit (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. RHC Benefits Program Funding Audit	Audit	Planned	
14. Internal Audit Consulting Pool – RFP	RFP	Planned	
15. Compliance Committee	Consulting	Planned	
16. Privacy Audit Recommendation Monitoring	Consulting	Planned	
BENEFITS ADMINISTRATION		EST. HOURS: 2,000	
17. Benefits' Process Management Group	Consulting	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 Account Settlement Collection Process	Audit	Planned	
23. Physician Selection, Monitoring, and Compensation	Audit	Planned	
INFORMATION SYSTEMS		EST. HOURS: 2,000	
24. Business Continuity Planning	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 Consultant – RFP	External Audit	Planned	
FINANCIAL & INVESTMENT OPERATIONS		EST. HOURS: 2,800	
29. External Financial Audit - Oversight	External Audit	Annual	
30. Actuarial Audit - Oversight	External Audit	Annual	
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 Compliance Review	Audit	Planned	
36. Real Estate Debt Program Review	External Audit	Planned	
37. Custodial Bank Review	Audit	Planned	
ADDITIONAL/UNPLANNED PROJECTS			
38. THC Financial Audit Oversight	External Audit	Unplanned	

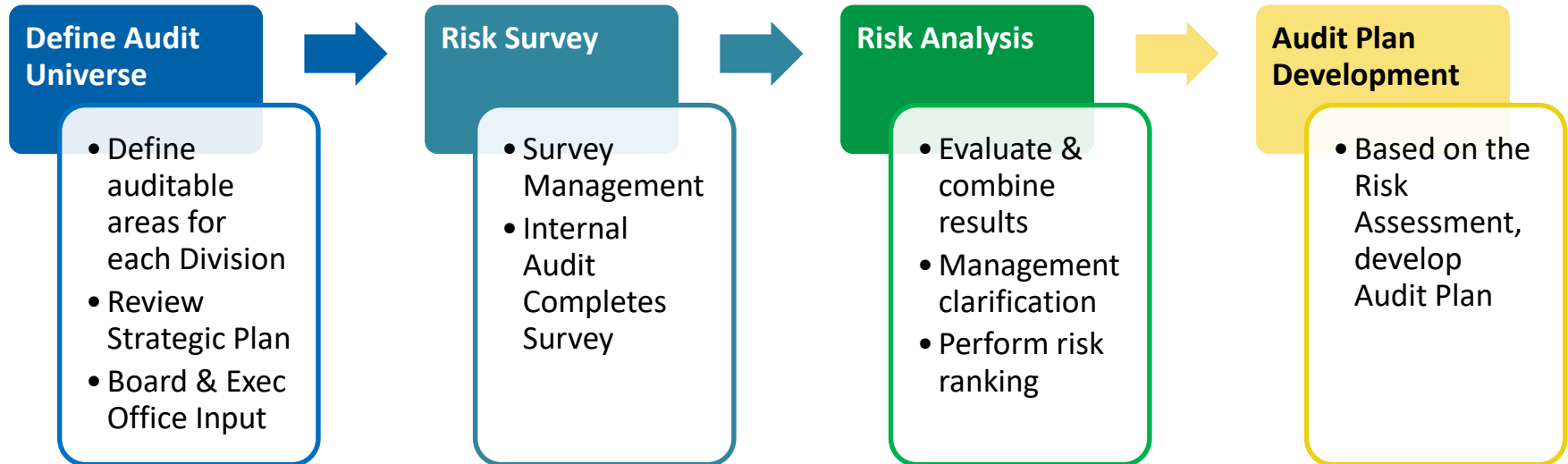
In Progress Completed

Risk Perspectives

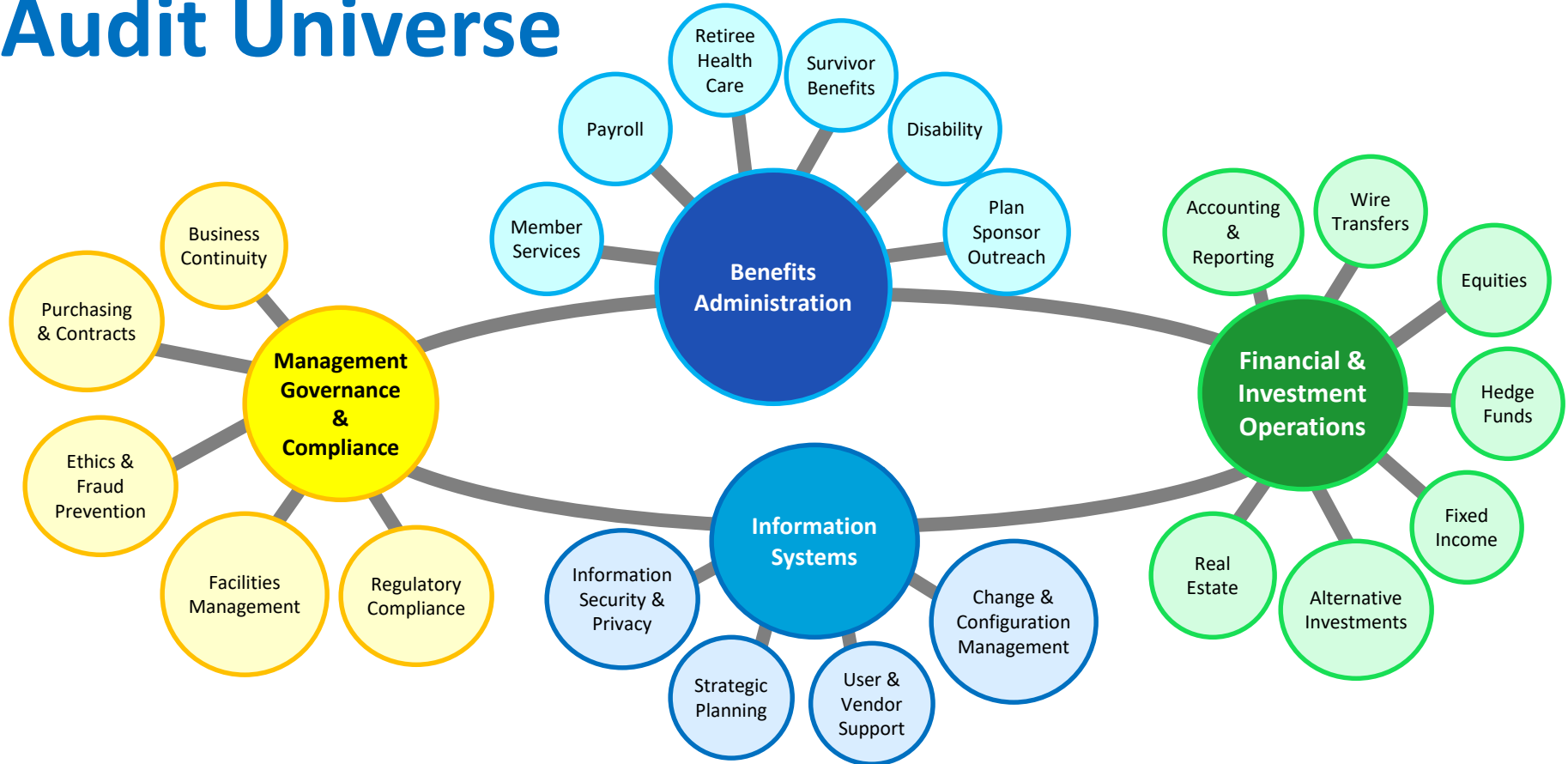


Risk Assessment Process

The diagram here represents our Risk Assessment Process to be discussed in detail in the following section.



Audit Universe



Risk Assessment Survey

Internal Audit Risk Assessment Survey |



Division: Survey Completed By: Date:

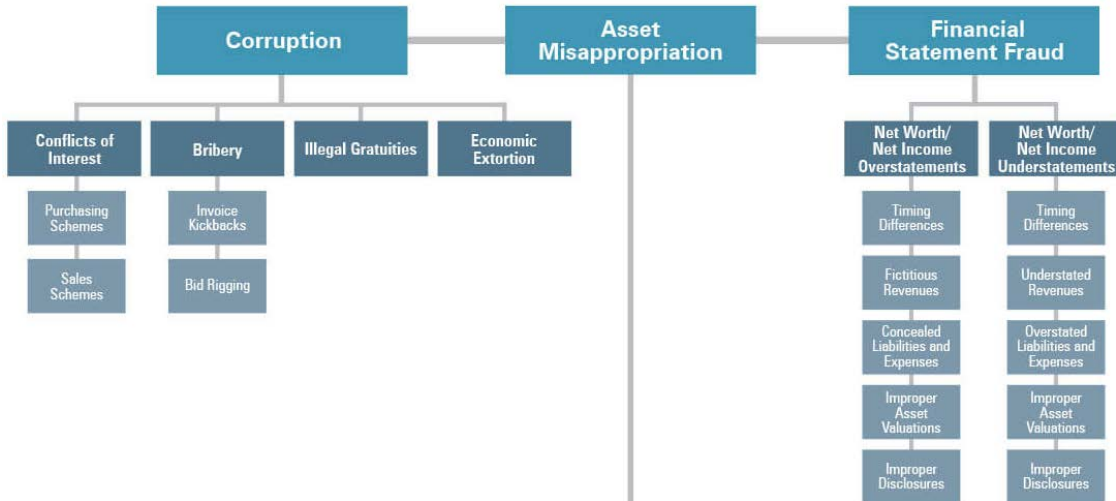
Instructions: Please answer the following questions to the best of your ability. You may use a separate sheet of paper if you require additional space for your answers. Thank you!

- | | |
|-------------------------------------------------------------------------------------------------------------------------------------|--|
| 1. What are the key objectives/goals of your division? | |
| 2. What are the most significant hurdles that will prevent your division from accomplishing goals? <i>Describe at a high level.</i> | |
| 3. Have there been any significant staffing changes in the | |

Fraud Risk Assessment

THE FRAUD TREE

OCCUPATIONAL FRAUD AND ABUSE CLASSIFICATION SYSTEM



Fraud Risk Mitigation

Current

- Continuous Fraud Testing
 - New Member Payroll
- Fraud Risk Considered in Every Audit
- Fraud Hotline

Planned

- Fraud Risk Workshops
- Fraud Prevention Training
- Fraud Hotline Campaign

Questions?

2018

Audit Plan Status Report

FYE 2018 Plan Status as of February 28, 2018

Submitted to the Audit Committee
March 21, 2018

In This Report

WORK COMPLETED & IN PROGRESS.....	3
ONGOING TESTING, MONITORING & CONSULTING	10

AUDIT COMMITTEE

of the Board of Retirement & Board of Investments

Vivian Gray

David Green

Shawn R. Kehoe

Joseph Kelly

Herman Santos

Michael S. Schneider

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, CFE Internal Auditor

Perla Gonzalez Senior Secretary

AUDIT COMMITTEE CONSULTANT

Rick Wentzel, CPA

EXECUTIVE SUMMARY

On behalf of the Internal Audit team, I am pleased to submit the **Internal Audit Work-In-Progress Report (Report)** of the Los Angeles County Employees Retirement Association (*LACERA*) for the period of November 1, 2017 to February 28, 2018. This Report provides information on the FYE 2018 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.

During the period, there were 3,808 staff hours available. A total of 3,240 staff hours (85 percent) were applied to audit projects, while 568 staff hours (15 percent) were applied to administrative projects. As of July 1, 2017, the FYE 2018 Audit Plan consisted of thirty-seven (37) projects. As the year progressed one (1) additional/unplanned projects was added to the Audit Plan, for a total of thirty-eight (38) audit projects for the FYE 2018 Audit Plan. Of the thirty-eight (38) total projects on the current Audit Plan, twenty-four (24) projects have been initiated during the year with eight (8) completed and sixteen (16) in various stages of progress toward completion.

The attached report contains the status on all projects undertaken this fiscal year including the objective of the project, the rationale for the work, and a brief synopsis on the "progress" or "conclusion" of each project. We also include the justification for initiating each of the unplanned projects. Any reports issued during the period since your last Audit Committee meeting are provided to your Committee under separate cover.

I would like to thank the Committee for your continued support of Internal Audit.

Sincerely,


A handwritten signature in blue ink, appearing to read 'Richard Bendall', written in a cursive style.

Richard Bendall, CPA, CISA
Chief Audit Executive

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	
• New Payee Validation	Audit	Periodic	
• Over 90 Payee Testing	Audit	Periodic	
2. Contract Compliance Program	Audit	Planned	
3. Internal Controls Training	Consulting	Planned	
4. Privacy Training	Consulting	Planned	
5. Los Angeles County Rehired Retirees Audit (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. RHC Benefits Program Funding Audit	Audit	Planned	
14. Internal Audit Consulting Pool – RFP	RFP	Planned	
15. Compliance Committee	Consulting	Planned	
16. Privacy Audit Recommendation Monitoring	Consulting	Planned	
BENEFITS ADMINISTRATION		EST. HOURS: 2,000	
17. Benefits' Process Management Group	Consulting	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 Account Settlement Collection Process	Audit	Planned	
23. Physician Selection, Monitoring, and Compensation	Audit	Planned	
INFORMATION SYSTEMS		EST. HOURS: 2,000	
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26. Member Applications Change Control	Audit	Planned	
27. Systems Penetration Testing	External Audit	Periodic	
28. IT Risk Assessment Consultant – RFP	External Audit	Planned	
FINANCIAL & INVESTMENT OPERATIONS		EST. HOURS: 2,800	
29. External Financial Audit - Oversight	External Audit	Annual	
30. Actuarial Audit - Oversight	External Audit	Annual	
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 Compliance Review	Audit	Planned	
36. Real Estate Debt Program Review	External Audit	Planned	
37. Custodial Bank Review	Audit	Planned	
ADDITIONAL/UNPLANNED PROJECTS			
38. THC Financial Audit Oversight	External Audit	Unplanned	

 In Progress  Completed

The following provides a more detailed narrative of both the planned and unplanned Internal Audit projects completed or in progress for the period of November 1, 2017 to February 28, 2018. 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 February 28, 2018.

ADMINISTRATIVE SERVICES

Business Continuity Planning

DIVISION(S)	ADMINISTRATIVE SERVICES	REPORT DATE	TBD
OBJECTIVE	<p>Provide consulting to Administrative Services management in their revision and upgrade of LACERA’s business continuity plan including:</p> <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	<p>Internal Audit is required to review the effectiveness of management's system of compliance with laws, regulations, policies and procedures that are business critical.</p> <p>The Business Continuity Plan is critical to the continuation of LACERA in the event of a disaster. Rather than perform an audit of the current plan, we determined together with the Executive Office and Administrative Services Management that it would be more appropriate for Administrative Services to engage a consultant to evaluate and possibly upgrade the current Business Continuity platform. This will include improving board and staff awareness of the plan as well as training LACERA staff on the plan and its deployment in the event of a disaster.</p>		
PROGRESS	<p>Internal Audit is participating in a cross-functional oversight committee. A Business Continuity Planning vendor has been selected and the scope of work contract is in final review stages.</p>		

Contract Compliance Program

DIVISION(S)	ADMINISTRATIVE SERVICES	REPORT DATE	TBD
OBJECTIVE	<p>The purpose of this memo is to update the Audit Committee on management’s existing plans and areas in need of management’s attention.</p>		
RATIONALE	<p>Internal Audit staff reviewed LACERA’s contract compliance program as part of the fiscal year 2018 audit plan. This was in response to a prior audit finding in which Internal Audit recommended that management implement a formal contract monitoring program. Management addressed the audit finding in a January 2016 memo to the Operations Oversight Committee (“OCC”), and committed to building a robust contract monitoring process.</p> <p>Contract monitoring is an important area of compliance, because an effective contract management system can help manage financial and operational risks when working with third-party vendors. Third-party vendors are contractually obligated to perform the services within the agreed-upon terms, and LACERA is contractually obligated to remit payment for those services. The inability to do either is a financial and operational risk on LACERA, and opens the door for litigation and other regulatory issues.</p>		
PROGRESS	<p>Staff is reviewing the program, and anticipates finalizing the memo by March 15, 2018.</p>		

BENEFITS

Benefits' Process Management Group

DIVISION(S)	BENEFITS	REPORT DATE	N/A
OBJECTIVE	Assess the internal control structure and process design of the policy and procedure development process.		
RATIONALE	The purpose of the Program Management Group (PMG) audit was to assess the administration of policies and procedures within the Benefits Division to see if this was transferable to all LACERA divisions.		
CONCLUSION	Internal Audit has decided not to perform this audit for fiscal year 2018. LACERA recently established a cross-divisional team to create organization-wide policies and procedures. The Policy on Policies Committee (POP) was created in response to one of Alston & Bird's recommendations in the 2016 Privacy Audit. Led by LACERA's Chief Counsel and Executive Office, the committee will present their policies and procedures to the Operational Oversight Committee (OOC) for their review and approval. With the development of the POP Committee, we believe Management has strong oversight over the process for developing policies and procedures. As a result, Internal Audit decided not to perform this audit for fiscal year 2018.		

Member Account Settlement Collections Process

DIVISION(S)	BENEFITS	REPORT DATE	TBD
OBJECTIVE	The purpose of the Member Account Settlement Collections Process audit is to assess internal controls and design of the process of recovering payments that members owe to the LACERA fund resulting from members underpaying their contributions to LACERA or LACERA overpaying benefits to members.		
RATIONALE	As part of our fiscal year 2017-18 Audit Plan and based on a request from Management to follow-up on a previous review, Internal Audit is performing a review of LACERA's Member Account Settlements Process (to ensure that collections are initiated from members within the statute of limitations).		
PROGRESS	The fieldwork for this audit is currently underway. We estimate completing the audit and issuing a report to your Committee by April 30, 2018.		

DISABILITY RETIREMENT SERVICES

Physician Selection, Monitoring, & Compensation Audit

DIVISION(S)	Disability Retirement Services (DRS)	REPORT DATED	FEB 12, 2018
OBJECTIVE	To assess DRS’ internal controls, policies and procedures for selecting, monitoring and approving payments for LACERA’s panel of physicians.		
RATIONALE	The audit is part of our fiscal year 2017-2018 audit plan, added as a result of the annual risk assessment. In fiscal year 2016-2017, approximately 500 members were provided medical evaluations from one of LACERA’s 66 panel of physicians, with an associated cost of approximately \$1.6 million dollars.		
CONCLUSION	<p>COMPLETED: Internal Audit concluded fieldwork and issued the audit report February 12, 2018.</p> <p>We found DRS’ controls related to the selection, monitoring, and compensation processes are generally effective, provide reasonable assurance risks are managed, and objectives are being met. We found DRS’ processes use many best practices, including ensuring segregation of duties between the selecting and compensating physicians, knowledgeable cross-trained staff, thorough reviews of the physician’s medical evaluations to ensure high-quality reports are received, and staff completes a detailed review of physician invoices before a payment is issued. To strengthen the processes, Internal Audit recommended DRS improve the storage of physicians’ documentation, revise the format of its quarterly log of physician qualifications, and consider a more secure method of transferring member records to/from the physicians.</p>		

EXECUTIVE OFFICE

Compliance Committee

DIVISION(S)	EXECUTIVE OFFICE	REPORT DATE	N/A
OBJECTIVE	Provide consulting to the Executive Office and participate in the Compliance Committee in their development of a framework for a formal compliance program at LACERA.		
RATIONALE	Internal Audit has been requested by the Executive Office to assist with the development of a framework managements system of compliance. As part of the updates to the Audit Committee Charter, the Audit Committee will have responsibility for monitoring managements system of compliance.		
PROGRESS	Internal Audit is continuing to meet and consult with Management and participate with the Compliance Committee on the development of the formal compliance program.		

FINANCIAL AND ACCOUNTING SERVICES

FYE 2018 Actuarial Audit - Oversight

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.		
PROGRESS	Milliman and Segal have completed 2017 actuarial services. This is an ongoing project that will conclude June 30, 2018.		

INTERNAL AUDIT

Internal Audit Consultant Pool RFP *(Real Estate Advisor Audits & Real Estate Debt Program Review)*

DIVISION(S)	INTERNAL AUDIT	MEMO DATE	TBD
OBJECTIVE	Internal Audit will issue an RFP to hire a pool of audit consultants to perform audits of LACERA Real Estate Advisors and LACERA's Real Estate Debt Program.		
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	In January 2018, staff selected four firms for the audit pool and are in the process of finalizing Audit Services Agreements. Audit projects will begin in March 2018.		

LACERA Annual Risk Assessment – FYE 2019

DIVISION(S)	INTERNAL AUDIT	MEMO DATE	TBD
OBJECTIVE	Internal Audit will assess the organization's risks, risk controls in place and areas of unmitigated risk.		
RATIONALE	In accordance with LACERA's Internal Audit Charter and the Institute of Internal Auditors – International Professional Practices Framework, Internal Audit is accountable to LACERA's Management and the Audit Committee to provide an annual assessment on the adequacy and effectiveness of LACERA's processes for controlling its activities and managing its risks. Internal Audit's audit plans are derived from the annual risk assessment.		
PROGRESS	The organizational risk assessment is in progress and we will requesting feedback from your Audit Committee at the March meeting regarding the Committee's risk perspective. The majority of Internal Audit's project areas are identified through the risk assessment process, so the Committee's risk insight is key.		

INVESTMENTS

Foreign Tax Reclamation RFP & Audit Oversight

DIVISION(S)	INVESTMENTS DIVISION	REPORT DATE	N/A
OBJECTIVE	Issue an RFP for foreign tax reclamation audit services.		
RATIONALE	The Board of Investments directed Staff to issue a Request for Proposals (RFP) for a firm to audit LACERA’s tax reclaim process, which is managed by State Street Bank, LACERA’s custodian. The firm that is selected will determine whether LACERA has reclaimed all foreign tax withholdings to which it is entitled.		
PROGRESS	The Board of Investments selected VAT IT (known as wTAX) at the December 2017 meeting.		

Securities Lending Compliance Review

DIVISION(S)	INVESTMENTS	REPORT DATE	TBD
OBJECTIVE	The audit objectives are to assess whether LACERA and its lending agents, State Street Bank and Goldman Sachs Agency Lending, are in compliance with key provisions of the Securities Lending Agency Agreements.		
RATIONALE	The Securities Lending Program is an important area to review, because members and their beneficiaries rely on LACERA for the safe management and care of their retirement benefits. A Securities Lending Program is a low-risk program that offers incremental income to the total portfolio if managed and monitored properly. It is prudent for State Street Bank and Goldman Sachs Agency Lending to implement the program within the compliance guidelines set by LACERA to ensure that the funds are not exposed to more or less risk than desired.		
PROGRESS	Staff is performing fieldwork, and anticipates finalizing the report by March 2018.		

THC Financial Audit Oversight

DIVISION(S)	INVESTMENTS	REPORT DATE	N/A
ADDITIONAL PROJECT JUSTIFICATION	The audit project was initially included on the FY 2018 Audit Plan in the External Financial Oversight project, however, the CAE decided to track separately this project due to the significance of the project and extensive work that will be done by staff.		
OBJECTIVE	The objectives of this project are to hire firms to perform audit and tax services associated with LACERA’s wholly owned THCs. Staff will also oversee the THC audits to ensure that audits and financial reports are provided within established guidelines.		
RATIONALE	The purpose of the THC audit is to ensure that real estate advisors are providing accurate and appropriate financial reports to LACERA. IA serves as liaison between the audit firms and the key stakeholders: FASD, the Investment Office and the Legal Division to ensure that the audits comply with established procedures and financial reports are provided within established periods.		
PROGRESS	Staff plan to issue the RFP for the selection of audit firms by March 2018. The audits and oversight of the audits will begin in May 2018.		

RETIREE HEALTH CARE

RHC Benefits Program Funding Audit

DIVISION(S)	RETIREE HEALTH CARE	REPORT DATE	JAN 22, 2018
OBJECTIVE	The audit objectives were to assess the adequacy and effectiveness of the controls for paying the monthly retiree healthcare premiums to the insurance carriers as well as collecting from members and the plan sponsor for their share of the premium.		
RATIONALE	<p>This area has not previously been reviewed by Internal Audit, and was included in the audit plan for fiscal year 2018.</p> <p>It is important for LACERA to correctly enroll and insure the 47,000+ members and their eligible dependents in the Retiree Healthcare Benefits Program, because retirees rely on their healthcare benefits for financial security and peace of mind. Properly billing members and the plan sponsor for retiree healthcare is a key aspect of ensuring LACERA produces, protects, and provides the promised benefits.</p>		
CONCLUSION	<p>COMPLETED: Internal Audit concluded fieldwork and issued the audit report January 22, 2018. Overall, Internal Audit found management’s controls and procedures to be effective and functioning as intended. We did identify one minor exception in the collection of administrative fees, which funds LACERA’s retiree healthcare operations. This resulted in an under-allocation of \$5,700 to LACERA, but the overall impact was minimal since the total annual administrative fee that LACERA collects from members and the plan sponsor is approximately \$9.5 million. We verified that management corrected this error in November 2017, and updated operating procedures to address future fee increases related to the program.</p>		

SYSTEMS

Data Backup & Retention

DIVISION(S)	SYSTEMS	REPORT DATE	FEB 12, 2018
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. Further, to review the contingency plan including the priority of service provisions.		
RATIONALE	Internal Audit has identified this as a key risk area. 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.		
CONCLUSION	<p>COMPLETED: Internal Audit concluded fieldwork and issued the audit report February 12, 2018. Two recommendations were provided that would serve to minimize the time for return-to-operations efforts in the event of a major systems interruption.</p>		

SYSTEMS

Systems Penetration Testing

DIVISION(S)	SYSTEMS	REPORT DATE	JAN 25, 2018
OBJECTIVE	To evaluate the controls preventing vulnerabilities on the internet accessible Web Portal that 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, to ensure the protection of access to LACERA and member data, best practice is to perform periodic IT security and penetration testing.		
CONCLUSION	<p><u>COMPLETED:</u> Internal Audit issued the audit report January 25, 2018.</p> <p>With the exception of one minor issue identified, LACERA was found to have a strong external security posture with no critically vulnerable exposed services and no major web application issues.</p>		

Information Technology Risk Assessment Consultant RFP

DIVISION(S)	SYSTEMS	REPORT DATE	TBD
OBJECTIVE	Internal Audit will issue a Request-For-Proposal (RFP) to select firm to conduct a Risk Assessment of the entire information technology operations area consisting of policy review, data security, and risk exposure in order to establish a baseline of opportunities for improvement.		
RATIONALE	Best Practice to address IT risk.		
PROGRESS	Internal Audit is pursuing participation in a Regional Cooperative Agreement (RCA) originating from another large Southern California county. The Security Risk Analysis Services provided in the RCA align with LACERA’s needs. The RCA process is being reviewed to ensure it addresses the vendor selection guidelines contained in LACERA’s purchasing policy.		

ONGOING TESTING, MONITORING & CONSULTING

The following provides a brief narrative of ongoing Internal Audit projects for the period of July 1, 2017 to October 31, 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.

BENEFITS

New Payee Validation Continued Process Test (CPT)

DIVISION(S)	BENEFITS
OBJECTIVE	<p>To assess validity of new payees added to the retirement payroll, Internal Audit performs an independent monthly continuous process test of scheduled benefit payments to new service and disability retirees and new survivor payees.</p> <ul style="list-style-type: none"> Internal Audit staff confirm by reviewing supporting file documentation that new payments added to the retiree payroll are only to eligible former Los Angeles County employees or their beneficiaries. Internal Audit examines 100% of the new benefit payees using computer assisted audit techniques.
RATIONALE	Internal Audit performs this monthly fraud test due to our independence from the operations.
PROGRESS	Internal Audit has tested 100 percent of all new benefit payees from July 2017 through October 2017. This an ongoing monitoring that will conclude June 30, 2018. No exceptions have been noted to date in our testing this year.

Over 90 High Risk Payees Continued Process Test (CPT)

DIVISION(S)	BENEFITS
OBJECTIVE	<p>To assess validity of “Over 90 High Risk Payees,” Internal Audit performs an independent continuous process test using Data Analytics against LACERA’s Workspace member data. The intention of testing is designed to identify payees over 90 that have met the following fraud scenarios:</p> <ul style="list-style-type: none"> Someone may be concealing the death in order to receive the continued payment, Member is alive but due to their current condition (mental, physical, old age) someone is misappropriating the members benefit, Identification of trends, patterns, anomalies, and exceptions in data to identify fraud or deceased members still being paid. <p>All test results are provided to the Benefit Protection Unit (BPU) for their review and follow-up.</p>
RATIONALE	Internal Audit performs this test on a periodic basis as part of our Continuous Audit Program (CAP).
PROGRESS	Internal Audit has started testing for the Over 90 High Risk Payees.

EXECUTIVE OFFICE

Pensionable Paycode Testing

DIVISION(S)	INTERNAL AUDIT, QUALITY ASSURANCE, BENEFITS, SYSTEMS DIVISION	REPORT DATE	N/A
OBJECTIVES	<ul style="list-style-type: none"> • Verify that the pay codes used by the Plan Sponsor are codes that have been approved by the Board of Retirement. The Plan Sponsor should not be using a code that has not been determined by the Board of Retirement as either pensionable or non-pensionable. • Verify that each pay code used is coded correctly by the Plan Sponsor (e.g., either “yes” as pensionable or “no” as non-pensionable) • Verify, on a sample basis, that pay codes used by the County are applied to the correct group and/or sub-group of employees (e.g., pay codes intended for Sheriff’s deputies should only be used for Sheriff’s deputies) 		
RATIONALE	<p>In accordance with the Public Employees’ Pension Reform Act of 2013 (“PEPRA”), LACERA’s Board of Retirement (“BOR”) became responsible for determining whether the components of a member’s compensation are pensionable or non-pensionable while working as an active employee after 1/1/13. To date, the BOR has made a determination on over 800 County pay codes. Once these earnings pay codes are approved by the BOR, they are implemented by the Auditor-Controller and paid accordingly for eligible employees.</p> <p>It is critical that the County correctly implements each pay code according to the BOR’s determination to ensure compliance with PEPRA, employee and employer contributions are accurate, and census data is accurate.</p> <p>LACERA has developed a testing process for verifying that the pay codes used by the County Auditor-Controller are valid pay codes and coded correctly based on the determination of LACERA’s Board of Retirement.</p>		
PROGRESS	<p>Internal Audit (IA) is currently testing pay codes and will provide any errors to QA for analysis and follow-up. IA will continue to test pay codes on a quarterly and annual interval.</p>		

EXECUTIVE OFFICE

Privacy Audit Recommendation Monitoring

DIVISION(S)	EXECUTIVE OFFICE
OBJECTIVE	Internal Audit will participate in the cross-functional management oversight team and record the status of the implementation of recommendations in the external Privacy Audit final report.
RATIONALE	Internal Audit has an independent oversight role in validating the implementation of audit recommendations. Due to the attorney-client privilege manner in which the audit was performed and reported to the Audit Committee, Internal Audit performs this role and reports on the status of implementation to your Committee separately.
PROGRESS	<p>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.</p> <p>Internal Audit as a part of the team is working on those recommendations for which we have primary ownership. Internal Audit also records the status update of all recommendations and we are 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. We will be reporting the status of the Privacy Audit recommendation follow-up to your Committee at your March 21, 2018 meeting, under separate cover.</p>

Privacy Training

DIVISION(S)	EXECUTIVE OFFICE
OBJECTIVE	Internal Audit will review and revise LACERA’s Privacy Training to include new sections on Security and the Clean Desk Policy.
RATIONALE	Due to recent changes in policies and procedures related to security and privacy, LACERA will be updating its Privacy Training for all staff and new hires.
PROGRESS	Internal Audit is currently updating the Privacy Training. Once the new security and privacy policies are approved, Internal Audit will finalize the training to be delivered to staff in 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.
PROGRESS	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 November 1, 2017 through February 28, 2018. This project will continue through the fiscal year ending June 30, 2018.

Board and Committee Monitoring

DIVISION(S)	INTERNAL AUDIT
OBJECTIVE	To monitor all LACERA board and committee meetings, to stay abreast of board concerns and or identify emerging risks.
RATIONALE	Internal Audit's scope of work includes the monitoring of LACERA's network of risk management, control, and governance processes.
PROGRESS	Ongoing

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.
PROGRESS	Internal Audit maintains an open door policy for general consulting purposes. This is ongoing consulting that will conclude June 30, 2018.

SYSTEMS

Member Applications Change Control


DIVISION(S)	SYSTEMS	REPORT DATE	TBD
OBJECTIVES	<p>To review the change management process over LACERA’s Member Applications (Workspace and the Member On-Line Web Portal), to assess whether the process is controlled, monitored and is in compliance with Control Objectives. Specifically, the objectives of this audit are to determine if:</p> <ul style="list-style-type: none"> • Policies, standards, and procedures that cover key activities and controls are established, properly approved, and followed. • Monitoring and management of change activities is in place. • Adequate segregation of duties exists over key control activities. • Changes to Member Applications, including emergency changes, are properly documented, tested, and approved prior to implementation to production. • Personnel have well-defined, documented instructions to implement changes to production and to rollback if problems are encountered. • Access to development, QA, and production environments is restricted to only authorized personnel, including enforcement of proper segregation of duties. 		
RATIONALE	<p>As part of our fiscal year 2017-18 Audit Plan, Internal Audit is reviewing the Member Applications Change Control Process to ensure that only authorized and tested changes to member applications are implemented.</p>		
PROGRESS	<p>Internal Audit is currently performing the fieldwork for this audit. We anticipate the final report will be issued by April 30, 2018.</p>		



March 1, 2018

TO: 2018 Audit Committee
Vivian Gray
David Green
Shawn R. Kehoe
Joseph Kelly
Herman Santos
Michael S. Schneider

Audit Committee Consultant
Rick Wentzel

FROM: Quoc Nguyen 
Principal Internal Auditor

Gabriel Tafoya 
Senior Internal Auditor

FOR: March 21, 2018 | Audit Committee Meeting

SUBJECT: **Recommendation Follow-Up Report**

AUDIT RECOMMENDATION IMPLEMENTATION SUMMARY

From November 1, 2017 through February 28, 2018, the following audit recommendation activity occurred:

- Six (6) new recommendations were made during this reporting period. These recommendations resulted from the Data Backup/Retention, Physician Selection Compensation Monitoring and Systems Penetration audits.
- Ten (10) recommendations were implemented.
 - Two (2) were implemented by the Benefits Division.
 - Seven (7) were implemented by Investments.
 - One (1) was implemented by Retiree Health Care

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

AUDIT RECOMMENDATIONS STATUS
 November 1, 2017 – February 28, 2018

Division	New Recommendations	Implemented/ Closed	Management Accepts Risk	Pending
Administrative Services:				6
Benefits Division:		2		10
Communications:				
Disability Litigation:				
Disability Retirement:	3			
Executive-Org. level:				
FASD:				
Human Resources:				
Internal Audit:				
Investments:		7		1
Legal:				
Member Services:				
Quality Assurance:				
Retiree Health Care:		1		
Systems:	3			
Actuary:				
Total:	6	10	0	17

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.

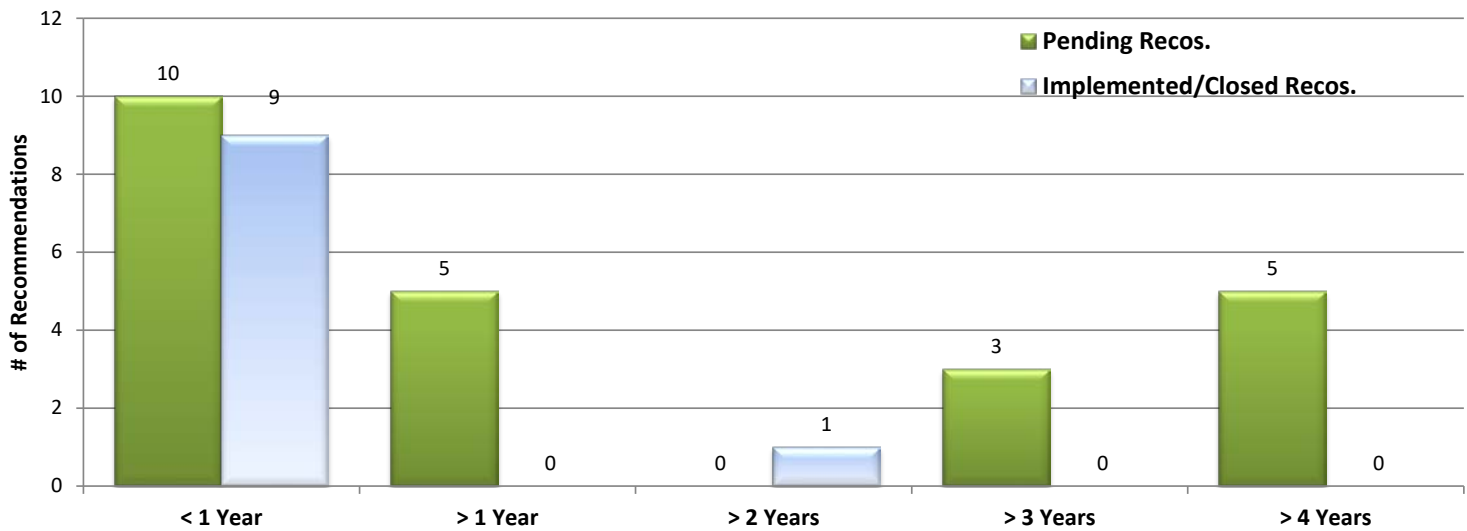
It is not the responsibility of the Chief Audit Executive to resolve the risks identified during audit work. However, in accordance with IIA Performance Standard #2600, it is Internal Audit's responsibility to communicate the acceptance of risks when the Chief Audit Executive concludes that Management 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

Attachments

Audit Recommendation Aged Report

November 1, 2017 through February 28, 2018



Pending Recos.	< 1 Year	> 1 Year	> 2 Years	> 3 Years	> 4 Years
Administrative Services	4	3			3
Benefits Division		1		3	2
Communications					
Disability Retirement	3				
FASD					
Human Resources					
Internal Audit					
Investments		1			
Legal					
Systems Division	3				
Retiree Healthcare					
Pending Total:	10	5	0	3	5

Implemented/Closed Recos	< 1 Year	> 1 Year	> 2 Years	> 3 Years	> 4 Years
Administrative Services					
Benefits Division	2				
Communications					
Benefits Division					
Disability Retirement					
FASD					
Human Resources					
Internal Audit					
Investments	6		1		
Legal					
Systems Division					
Retiree Healthcare	1				
Implemented/Closed Total:	9	0	1	0	0

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	6/30/2018	A policy draft was completed/updated and presented to the Executive Office and key managers for review. Upon approval of the updated Policy, the Purchasing Manual will be updated to include all applicable procedures and controls. Once the manual is finalized, the Administrative Services Division will roll-out the manual and provide staff training.
	Daily operating procedures ("desk procedures") need enhancement re control procedures	Procurement Unit should update & expand its written, daily operating procedures	5	6/30/2018	The daily operating procedures will be revised once the Board has adopted the new Procurement Policy. We estimate the development of the daily operating procedures will take an additional 90 -120 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. The procedures will be in compliance with all policy directives and will include all necessary controls.
	"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	6/30/2018	After the updated Procurement Policy is approved by the Retirement Board, the bidding requirements and sole-source requirements will be formally communicated to appropriate staff. Estimated Completion date. Procurement Unit procedures have been updated to include exception to the buying process such as "piggy-back" purchases that utilize pricing published by organizations such as NASPO and the State of California. Completed 10/17/2014. Procurement met with FASD and has established a process for scanning and retaining copies of purchase orders and supporting documentation on the LACERA network for retention purposes. The Procurement Unit procedures have been updated and this policy is in place. Completed 10/17/2014. Updates to the daily operating procedures will be made upon Retirement Board approval of the Purchasing Policy. The procedures will be in compliance with all policy directives and include necessary controls.
Benefits	1st Payment - Separation of Duties	Implement secondary review	5	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.
	Potential for input errors	Develop field for logging first payment and monthly payment data	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.
	Need to review non-CIB transactions	Forward non-CIB cases to QA for review	4	6/30/2018	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

Attachment A

Administrative Services

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	6/30/2018
Inconsistent levels of participation from key stakeholders	Improve Planning and communication of Office Renovation projects		12/31/2016	6/30/2018
Change Orders are not adequately documented or addressed in written procedures	Develop and codify process for managing Change Orders		12/31/2016	6/30/2018

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	6/30/2018
Daily operating procedures ("desk procedures") need enhancement re control procedures	Procurement Unit should update & expand its written, daily operating procedures		12/31/2011	6/30/2018
"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	6/30/2018

Audit Recommendation Follow Up

Benefits

Status: **Implemented**

Audit Project: **Member Verification (June 30, 2017)**

Issue:	Recommendation	Actual	Estimated	Revised
Insufficient HRV Policy and Procedure	Executive Office require that appropriate authentication steps	2/23/2018	12/31/2017	
No HRV	Management develop Of Procedures	2/23/2018	12/31/2017	

Status: **Pending**

Audit Project: **Certificate Processing (June 28, 2017)**

Issue:	Recommendation	Actual	Estimated	Revised
Birth Certificate Missing for Options Retirees	Certificate Requirements Review		6/29/2018	

Audit Project: **Certificate Processing (June 28, 2017)**

Issue:	Recommendation	Actual	Estimated	Revised
Controls over Certificates Processing	Organization-wide Certificates Policy		6/29/2018	

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

Issue:	Recommendation	Actual	Estimated	Revised
1st Payment - Separation of Duties	Implement secondary review		12/31/2012	6/30/2018

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	6/30/2018

Audit Recommendation Follow Up

Benefits

Status: **Pending**

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

Issue:	Recommendation	Actual	Estimated	Revised
Need to review non-CIB transactions	Forward non-CIB cases to QA for review		12/31/2013	6/30/2018

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

Issue:	Recommendation	Actual	Estimated	Revised
Expand the Automation of Special Payment Approvals	Expand the Automation of Special Payment Approvals		12/31/2017	12/31/2018

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	6/30/2018

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
No Documented Procedures	Need for Documented Procedures		6/30/2016	6/30/2018
Two Different Disability Databases	Eliminate Double Entry and Continue Reconciling Disability Status		6/30/2014	6/30/2018

Audit Recommendation Follow Up

Disability Retirement

Status: **New**

Audit Project: **Physician Selection, Compensation, and Monitoring (February 23, 2018)**

Issue:	Recommendation	Actual	Estimated	Revised
Quarterly log of physician qualifications does not document DRS' complete review	Revise the quarterly log of physician qualifications		3/30/2018	
Method of transferring members' medical records to/and from physicians may not be the most efficient and does not use today's current technology	Consider a more secure method of transferring members' medical records to/and from physicians		6/29/2018	
Documentation of physicians' qualifications is not organized	Improve the storage of physicians' documentation		5/31/2018	

Audit Recommendation Follow Up

Investments

Status: **Implemented**

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

Issue:	Recommendation	Actual	Estimated	Revised
Commingled Real Estate Fund Fees	Validate Commingled Real Estate Fund Fees	1/31/2018	12/31/2017	3/31/2018
Public Market Commingled Fund Fees	Validate fees for the fixed income commingled fund and fund-of-one.	1/31/2018	9/30/2017	3/31/2018
Actual Hedge Fund Performance Fee Data	Request for Actual Performance Fee Data Rather Than Accrued Performance Fee Data	12/31/2017	12/31/2017	
No Procedures for Fee Validation and Fee Disclosure	Develop Fee Validation and Disclosure Procedures	2/28/2018	12/31/2017	3/31/2018
Underlying Hedge Fund Fees	Request GSAM to Validate Underlying Hedge Fund Fees	3/31/2018	12/31/2017	
Public Market Commingled Fund Fees	Communicate and Cordinate Fee Validation Roles	12/31/2017	9/30/2017	

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

Issue:	Recommendation	Actual	Estimated	Revised
Due Diligence Checklists	Include guidelines for checklists and sign-off on checklists	12/28/2017	12/31/2015	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

Audit Recommendation Follow Up

Retiree Healthcare

Status: **Implemented**

Audit Project: Retiree Healthcare Benefits Program Funding (January 22, 2018)				
Issue:	Recommendation	Actual	Estimated	Revised
Underpayment of Administrative Fees	Update Fee Increase Procedures	2/1/2018	2/8/2018	

Audit Recommendation Follow Up

Systems

Status: **New**

Audit Project: Data Backup/Retention Testing (February 14, 2018)		Actual	Estimated	Revised
Issue:	Recommendation			
Disaster Recovery Test Exercise Needed	Schedule System Recovery Exercise		12/31/2018	
Macintosh System Backup Process	Macintosh Offsite Storage		6/30/2018	

Audit Project: Systems Penetration Testing 2017 (January 25, 2018)		Actual	Estimated	Revised
Issue:	Recommendation			
Document Metadata Internal Information Disclosure	Removing Metadata		1/31/2018	4/1/2018



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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300 N. Lake Ave., Suite 620
Pasadena, CA 91101**



March 1, 2018

TO: 2018 Audit Committee
Vivian Gray
David Green
Shawn R. Kehoe
Joseph Kelly
Herman Santos
Michael S. Schneider

Audit Committee Consultant
Rick Wentzel

FROM: Richard Bendall 
Chief Audit Executive

FOR: March 21, 2018 | Audit Committee Meeting

SUBJECT: **Internal Audit Goal Report – FYE 2018**

The attached report provides a status on the Internal Audit Divisional Goals for the fiscal year ending June 30, 2018. Internal Audit first presented these goals to the Audit Committee at the August 16, 2017 meeting.

RB: dv
Attachment

Internal Audit Goals | FYE 2018

The following is the status of Internal Audit 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:

- *Internal Audit will report on the completion of the FYE 18 Audit Plan to the Audit Committee*
- *Internal Audit will provide the FYE 19 Audit Plan to the Audit Committee for approval at the fiscal year end meeting.*

Current Status:

- *Internal Audit reported on the status of the FYE 18 Audit Plan to the Audit Committee as of February 28, 2018 under separate cover.*
- *Internal Audit is initiating the risk assessment to be used in developing the FYE 19 Audit Plan which will be presented to the Audit Committee for approval at the July meeting.*

2. Complete 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.

Current Status:

The QAIP is included on the FYE 18 Audit Plan and will be completed and reported to the Audit Committee at the July 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.

Current Status:

The plan is current and up to date.

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.

Current Status:

Internal Audit is working with a communications consultant to assist in the development of the standards. All staff will be trained on the performance and report writing standards by the end of the fiscal year.



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