

AGENDA

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

9:00 A.M., WEDNESDAY, JULY 18, 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

Michael S. Schneider, Chair
Vivian Gray, Vice Chair
Herman Santos, Secretary
David Green
Shawn R. Kehoe
Joseph Kelly

AUDIT COMMITTEE CONSULTANT

Rick Wentzel

I. CALL TO ORDER

II. APPROVAL OF MINUTES

- A. Approval of the Minutes of the Regular Audit Committee Meeting of March 21, 2018

III. PUBLIC COMMENT

IV. NON-CONSENT ITEMS

A. Recommendation as submitted by Leisha Collins, Principal Internal Auditor and Quoc Nguyen, Principal Internal Auditor: That the Committee approve the Audit Plan for Fiscal Year End 2019.
(Memo dated July 5, 2018)

B. Recommendation as submitted by Quoc Nguyen, Principal Internal Auditor: That the Committee review and discuss the Securities Lending Program 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 July 5, 2018)

C. Recommendation as submitted by Quoc Nguyen, Principal Internal Auditor: That the Committee review and discuss the Tier II Retiree Healthcare Program 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 July 5, 2018)

D. Recommendation as submitted by Quoc Nguyen, Principal Internal Auditor: That the Committee review and discuss the Contract Monitoring Program Status Update 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 July 5, 2018)

July 18, 2018

Page 3 of 4

V. REPORTS

- A. Internal Audit Staffing Report
Leisha Collins, Principal Internal Auditor
Quoc Nguyen, Principal Internal Auditor
(Discussion)
- B. Status of Other External Audits Not Conducted at the Discretion of Internal Audit
Leisha Collins, Principal Internal Auditor
Quoc Nguyen, Principal Internal Auditor
(For Information Only) (Discussion)
- C. Internal Audit Annual Report – Fiscal Year End 2018
Leisha Collins, Principal Internal Auditor
Quoc Nguyen, Principal Internal Auditor
(For Information Only) (Memo dated June 30, 2018)
- D. Internal Audit Goal Report
Leisha Collins, Principal Internal Auditor
Quoc Nguyen, Principal Internal Auditor
(For Information Only) (Memo dated July 02, 2018)
- E. Recommendation Follow-Up Report
Quoc Nguyen, Principal Internal Auditor
Gabriel Tafoya, Senior Internal Auditor
(For Information Only) (Memo dated July 05, 2018)
- F. Privacy Audit Recommendation Follow-Up
Leisha Collins, Principal Internal Auditor
Christina Logan, Senior Internal Auditor
(For Information Only) (Memo dated July 10, 2018)
- G. Human Resources Compliance Audit [by Liebert Cassidy Whitmore]
Recommendation Follow-Up
Leisha Collins, Principal Internal Auditor
Quoc Nguyen, Principal Internal Auditor
(For Information Only) (Memo dated June 29, 2018)

July 18, 2018

Page 4 of 4

VI. CONSULTANT COMMENTS

VII. REPORT ON STAFF ACTION ITEMS

VIII. GOOD OF THE ORDER
(For information purposes only)

IX. 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].

Persons requiring an alternative format of this agenda pursuant to Section 202 of the Americans with Disabilities Act of 1990 may request one by calling Cynthia Guider at (626)-564-6000 extension 3327, from 8:00 a.m. to 5:00 p.m. Monday through Friday, but no later than 48 hours prior to the time the meeting is to commence. Assistive Listening Devices are available upon request. American Sign Language (ASL) Interpreters are available with at least three (3) business days notice before the meeting date.

MINUTES OF THE MEETING OF THE AUDIT COMMITTEE OF THE
BOARD OF RETIREMENT AND BOARD OF INVESTMENTS*
LOS ANGELES COUNTY EMPLOYEES RETIREMENT ASSOCIATION

300 N. LAKE AVENUE, SUITE 810, PASADENA, CA

9:00 A.M., WEDNESDAY, MARCH 21, 2018

PRESENT: Michael S. Schneider, Chair

Vivian Gray, Vice Chair

Herman Santos, Secretary

David Green

ABSENT: Joseph Kelly

Shawn R. Kehoe

STAFF, ADVISORS, PARTICIPANTS

Richard Bendall, Chief Audit Executive

Steven P. Rice, Chief Legal Counsel

Rick Wentzel, Audit Committee Consultant

Quoc Nguyen, Principal Internal Auditor

Christina Logan, Senior Internal Auditor

Gabriel Tafoya, Senior Internal Auditor

Kathryn Ton, Senior Internal Auditor

Tamara Caldwell, Disability Retirement Specialist Supervisor

James Brekk, Interim Chief Deputy

I. CALL TO ORDER

The meeting was called to order at 9:06 a.m., in the Board Room of Gateway Plaza.

II. APPROVAL OF THE MINUTES

A. Approval of the Minutes of the Regular Meeting of November 30, 2017

Mr. Green made a motion, Mr. Santos seconded, to approve the minutes of the regular meeting of November 30, 2017. The motion passed unanimously.

III. PUBLIC COMMENT

There were no requests from the public to speak.

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)

Mr. Santos made a motion, Ms. Gray seconded, to approve staff's recommendation. The motion passed unanimously.

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)

IV. NON-CONSENT AGENDA (Continued)

Mr. Santos made a motion, Ms. Gray seconded, to adopt the revised Audit Committee Charter recommendation. The motion passed unanimously.

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)

Kathryn Ton was present to answered questions from the Committee.

Mr. Santos made a motion, Mr. Green seconded, to accept and file the report. The motion passed unanimously.

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)

Mr. Santos made a motion, Mr. Green seconded, to accept and file the report. The motion passed unanimously.

IV. NON-CONSENT AGENDA (Continued)

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

Mr. Santos made a motion, Mr. Green seconded, to accept and file the report. The motion passed unanimously.

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)

Christina Logan, Tamara Caldwell, and James Brekk were present to answer

questions from the Committee.

Mr. Santos made a motion, Mr. Green seconded, to accept and file report. The motion passed unanimously.

V. REPORT

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

Mr. Bendall was present and answered questions from the Committee. This report was received and filed.

V. REPORT (Continued)

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

Mr. Bendall was present and answered questions from the Committee. This report was received and filed.

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

Messrs. Nguyen and Tafoya were present and answered questions from the Committee. This report was received and filed.

- 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)

Messrs. Bendall and Rice were present and answered questions from the Committee.

- E. Attorney-Client Privilege/Confidential Memo
Human Resources Compliance Audit [by Liebert Cassidy Whitmore]
Steven Rice, Chief Legal Counsel
Richard Bendall, Chief Audit Executive
(Memo Dated on March 1, 2018)

Mr. Bendall was present and answered questions from the Committee.

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

Mr. Bendall was present and answered questions from the Committee.

March 21, 2018

Page 6

V. REPORT (Continued)

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

Mr. Bendall was present and answered questions from the Committee.

VI. REPORT ON STAFF ACTION ITEMS

There was nothing to report.

- VII. GOOD OF THE ORDER
(For information purposes only)

Committee members thanked staff for their hard work.

VIII. ADJOURNMENT

There being no further business to come before the Committee, the meeting was adjourned at 10:50 a.m.



July 5, 2018

TO: Each Member
2018 Audit Committee

Audit Committee Consultant
Rick Wentzel

FROM: Leisha Collins 
Principal Internal Auditor

Quoc Nguyen 
Principal Internal Auditor

FOR: July 18, 2018 Audit Committee Meeting

SUBJECT INTERNAL AUDIT PLAN - FISCAL YEAR END 2019

RECOMMENDATION

Approve the proposed Internal Audit Plan for Fiscal Year End 2019.

BACKGROUND

According to the Institute of Internal Auditor's (IIA's) *International Standards for the Professional practice of Internal Auditing (Standards)*, the Chief Audit Executive (CAE) must establish risk based plans to determine the priorities of the internal audit activity, consistent with the organization's goals. To remain in compliance with the *Standards*, as well as the Audit Committee Charter, Internal Audit has developed the attached Internal Audit Plan (*Audit Plan*) for Fiscal Year End (FYE) 2019.

The Audit Plan is designed to ensure audit resources are appropriately allocated to address identified top priorities and key risk areas. The Audit Plan is also broken out by category as follows: Management Governance, Information Systems, Benefits Administration, or Financial & Investment Operations.

In considering the Audit Plan for FYE 2019, we remind your Committee that the Audit Plan is intended as a living document to allow changes to its content and schedule as a result of ongoing changes to risk factors, organizational needs, or resource limitations. For expediency, the CAE will approve changes to the Audit Plan, and provide information regarding changes to the Audit Plan at each Committee Meeting during the fiscal year.

July 05, 2018

PURPOSE

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

RISK ASSESSMENT AND AUDIT PLANNING

The projects included in our Audit Plan are primarily identified through our on-going risk assessment process. This process includes keeping abreast of the concerns of the Audit Committee and Boards throughout the year, discussions with Executive Management, review of LACERA's Strategic Plan, and risk meetings with division managers and staff. We also evaluated projects on our FYE 2018 Audit Plan that were either in-progress or did not begin prior to June 30, 2018.

We continue to allocate resources towards internal administration projects such as updating our Internal Audit Guide Book. We believe that this will help streamline our audit processes and ultimately result in higher quality audits and the completion of more projects. A big project on our plan this year is to spearhead the organization-wide Fiduciary Audit, which will be a comprehensive assessment by an independent third party of how well LACERA is meeting its governance and oversight responsibilities as well the effectiveness of its operations. Below summarizes our proposed FYE 2019 Audit Plan.

AUDIT PARTICIPATION AREAS:

As indicated on our proposed FYE 2019 Audit Plan below, we've included 33 total projects:

- 9 – Projects rolled-over from the FYE 2018 Audit Plan that are near completion
- 5 – Projects rolled-over from the FYE 2018 Audit Plan that will begin in FYE 2019
- 16 – New and ongoing (including periodic and annual) projects
- 3 – Administrative projects designed to improve audit operations

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

As organizational needs, conditions, resources, and priorities change, Internal Audit Management will use its professional judgment as to the order in which audit projects are addressed. Staff will focus on efficiency and effectiveness in performing work to make every effort to complete the 33 projects included in this Audit Plan. Estimated hours for each section of the audit plan is included; actual hours for each project will be determined at the start of each project based on the final scope and audit approach.

A brief description of each audit area is included in Attachment A. Internal Audit will be available at the July 18, 2018 Audit Committee meeting to provide an overview of the audit plan process and discuss any questions you may have about the attached Audit Plan.

Internal Audit Plan – Fiscal Year End 2019
July 05, 2018

RECOMMENDATION

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

1. Approve the proposed Internal Audit Plan for Fiscal Year End 2019

Attachments

INTERNAL AUDIT PLAN FYE 2019

The following table provides a list of the planned Internal Audit projects for the **Fiscal Year End 2019**.

PROJECT	STATUS	TYPE	FREQUENCY
MANAGEMENT, GOVERNANCE & COMPLIANCE			Est. Hours: 3500
1. Fiduciary Review		Ext. Audit	Planned
2. Privacy Audit Recommendation Coordination		Consulting	Planned
3. Compliance Committee		Consulting	Ongoing
4. Business Continuity/Disaster Recovery	In Progress	Consulting	Planned
5. Continuous Auditing Program		Audit	Ongoing
6. 960 Hours Testing		Audit	Periodic
7. Pensionable Pay code Testing		Audit	Periodic
8. Timecard Review		Audit	Planned
9. Corporate Credit Card Audit*		Audit	Planned
10. Board and Staff Travel*		Audit	Planned
11. Inventory Controls	In Progress	Audit	Planned
12. Risk Assessment – FYE 2020		Admin	Annual
13. Update Internal Audit Guide Book		Admin	Planned
14. Internal Audit Fraud Hotline		Admin	Planned
BENEFITS ADMINISTRATION			Est. Hours: 1200
15. Benefits' Exception Report Review Process	In Progress	Audit	Planned
16. Active Death Process – Follow Up*		Audit	Planned
17. Death Legal Process		Audit	Planned
18. Foreign Payee Audit		Audit	Planned
19. Member Account Settlement Process	In Progress	Audit	Planned
INFORMATION SYSTEMS			Est. Hours: 2100
20. IT Risk Assessment Follow-Up	In Progress	Consulting	Planned
21. Member Applications Change Control	In Progress	Audit	Planned
22. External Penetration Testing		Ext. Audit	Planned
23. Database Review		Audit	Planned
24. Management Project Review		Audit	Planned
FINANCIAL & INVESTMENT OPERATIONS			Est. Hours: 2400
25. External Financial Audit - Oversight		Ext. Audit	Ongoing
26. THC Real Estate Audits - Oversight		Ext. Audit	Ongoing
27. Actuarial Services - Oversight		Consulting	Ongoing
28. Foreign Tax Reclamation - Oversight	In Progress	Audit	Planned
29. Wire Transfers Audit	In Progress	Audit	Planned
30. THC Tax Liability Review		Consulting	Planned
31. Real Estate Investment Operations*		Ext. Audit	Planned
32. Real Estate Advisor Audits ¹	In Progress	Ext. Audit	Planned
33. Custodial Bank Risk Assessment*		Audit	Planned
			Total Hours: 9200

*An audit that was rolled-over from FYE 2018 Audit Plan that will commence in FYE 2019.

¹ Includes audits of Advisors managing debt program.

Attachment A

AUDIT PLAN FYE 2019

The following table provides a description of each audit area included in the FYE 2019 Audit Plan.

	PROJECT	DESCRIPTION
		MANAGEMENT, GOVERNANCE & COMPLIANCE
1.	Fiduciary Review	Internal Audit will spearhead the Fiduciary Review conducted by an independent third party. The purpose is to assess how well LACERA is meeting its governance and oversight responsibilities as well the effectiveness of its operations.
2.	Privacy Audit Reco. Coordination	Oversee and actively coordinate the implementation of the recommendations as stated in the external Privacy Audit final report.
3.	Compliance Committee	Participate on the Compliance Program Steering Committee in developing a framework for LACERA's formal compliance program.
4.	Business Continuity/ Disaster Recovery	Internal Audit will consult with management in updating and enhancing LACERA's Business Continuity/Disaster Recovery Program
5.	Continuous Auditing Program	Automated testing of LACERA transactions and information systems. It is performed to provide assurance that LACERA is in compliance with applicable laws and regulations as well as internal policies and procedures.
6.	960 Hours Testing	Annual audit to determine whether all rehired retirees have been rehired and are working in compliance with PEPRA and LACERA's Board policies.
7.	Pensionable Pay code Testing	Periodic test to verify that the plan sponsors' pay codes are in compliance with the Board of Retirement's determination on pensionability.
8.	Timecard Review	Test staff timecards and review organization-wide timekeeping controls to assess the accuracy of time reported and effectiveness of controls.
9.	Corporate Credit Card Audit	Audit of staff's credit card usage to verify compliance with LACERA's credit card and purchasing policies.
10.	Board and Staff Travel	Audit of Board and staff travel to ensure that expenses are in compliance with the LACERA Travel Policy.
11.	Inventory Controls	Review of management's inventory process for completeness and efficiency.
12.	Risk Assessment – FYE 2020	Internal Audit will assess risks and controls throughout the organization to plan for LACERA's overall audit needs and to develop the Audit Plan.
13.	Update Internal Audit Guide Book	Update Internal Audit's Operation Guide, specifically in the audit report writing standards section.
14.	Internal Audit Fraud Hotline	Update the Internal Audit Fraud Hotline to incorporate best practices into the process.

Internal Audit Plan – Fiscal Year End 2019
 July 05, 2018

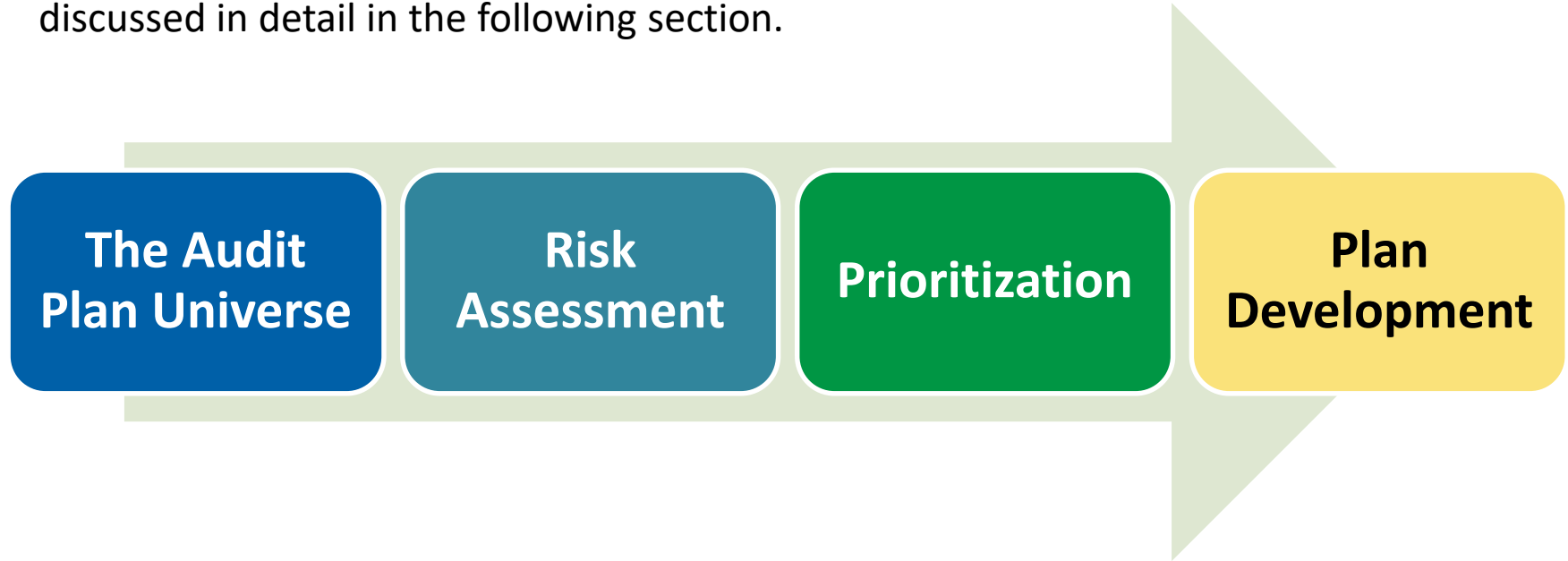
BENEFITS ADMINISTRATION		
15.	Benefits' Exception Report Review	Review LACERA's process for reviewing and managing exception reports related to Benefits data and transactions.
16.	Active Death Process – Follow Up	Review of Active Death case management in Benefits and Member Services. Also, follow-up of previous recommendations relating to this process.
17.	Death Legal Process	Assess the Benefits Division's internal controls for processing member death and legal split cases.
18.	Foreign Payee Audit	Periodic audit that confirms the living status of retirees living abroad.
19.	Member Account Settlement Process	Review of the cross-functional Member Account Settlements Process administered by Benefits and Financial & Accounting Services Division to provide assurance that controls are functioning as intended.
INFORMATION SYSTEMS		
20.	IT Risk Assessment Follow-Up	Internal Audit will follow-up on the implementation of recommendations from the IT Risk Assessment conducted during FYE 2018.
21.	Member Applications Change Control	Internal Audit will test current operating procedures and processes for changing or creating new membership application programs.
22.	External Pen. Testing	External Network Penetration testing is performed annually to assess the security of the internet accessible Member Portal.
23.	Database Review	Review of the Microsoft Access databases used throughout LACERA to facilitate member transactions and benefits processes. Assess management controls to prevent process disruptions in case a database fails.
24.	Management Project Review	Assess the implementation of LACERA Systems to meet business objectives.
FINANCIAL & INVESTMENT OPERATIONS		
25.	External Financial Audit - Oversight	Internal Audit manages the relationship with the LACERA Annual Financial Auditors to facilitate the annual financial statement audit.
26.	THC Real Estate Audits - Oversight	Internal Audit manages the relationship with the Real Estate External Auditors and oversees the audit engagements.
27.	Actuarial Services - Oversight	Internal Audit manages the relationship with the Actuarial Consultant and Auditor for services relating to actuarial projects.
28.	Foreign Tax Reclamation - Oversight	Oversee the external audit of LACERA's foreign tax withholding reclaim process.
29.	Wire Transfers Audit	Assess LACERA's internal controls for setting up and transacting wire transfers to outside parties
30.	THC Tax Liability Review	Internal Audit will work with consultants in assessing tax reporting requirements of THC real estate investments.
31.	Real Estate Inv. Operations	Review of the Real Estate Investment Operations to provide assurance that controls exist and are functioning as intended.
32.	Real Estate Advisor Audits	Contract compliance and operational review of LACERA's Real Estate Advisors
33.	Custodial Bank Risk Assessment	Contract compliance and operational review of custodial bank services

Internal Audit Plan

FYE 2019

Audit Plan Process

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



Risk Assessment

Understanding Risk

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

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

Risk Assessment

Risk Assessment Process

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

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

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

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

Risk Assessment

Risk Assessment Survey

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

The four key areas included in the survey are:

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

Internal Audit
Risk Assessment Survey | FYE 2018-19

LACERA
Los Angeles County Employees Retirement Association

Division: _____ Survey Completed By: _____ Date: _____

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

OPERATIONAL OBJECTIVES	
1. What are the key objectives/goals of your division?	
2. What are the most significant operational limitations that will prevent your division from accomplishing your divisional objectives? <i>Describe at a high level.</i>	
3. Are there any delays or backlogs in processes performed in your division? Why have they occurred?	
4. Are there any 2018-2019 strategic goals tied to work processes within your division?	
5. List significant processes or procedures in your division that are not documented with written procedures.	
6. Are there any specific control weaknesses or areas where controls could be further enhanced through additional segregation of duties or levels of approval, etc.? If so please describe at a high level.	
SIGNIFICANT CHANGES	
7. Have there been any significant staffing changes in the past year? How did these staffing changes impact your division?	
8. List new legislative mandates that have or will impact your division.	
9. List new (or significant changes to) processes or work functions established in your division within the past year. How has this impacted your division? Do you anticipate any significant changes in fiscal year 2018-2019?	
PRIVACY	
10. Do you have divisional privacy policies or procedures?	
11. Describe processes in your division where member data is sent outside of the organization (e.g., other agencies, financial institutions, doctor's offices).	
12. Do any vendors you oversee have access to LACERA confidential data (membership information or investment information bound by non-disclosure	

Prioritization

A Balancing Act

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

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



Plan Development

Oversight

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

Key Areas of Focus

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

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

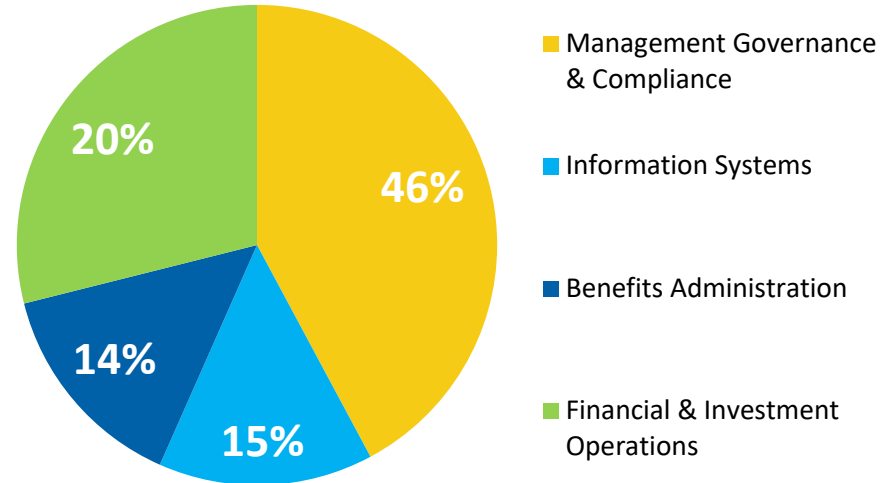
Plan Development

Resource Allocation FYE 2019

Our Audit Plan is based on 9200 hours of available work hours.

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

Projects by Type






July 5, 2018

TO: Each Member
2018 Audit Committee

Audit Committee Consultant
Rick Wentzel

FROM: Quoc Nguyen 
Principal Internal Auditor

FOR: July 18, 2018 | Audit Committee Meeting

SUBJECT: **Securities Lending Program**

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. Securities Lending Program
Kathryn Ton, Senior Internal Auditor
(Report issued: May 30, 2018)

Please note: attached to the report is another version of the report that includes questions and comments that staff received from your Committee as well as Internal Audit's responses.

Attachments



LACERA INTERNAL AUDIT DIVISION

Securities Lending Program

May 30, 2018

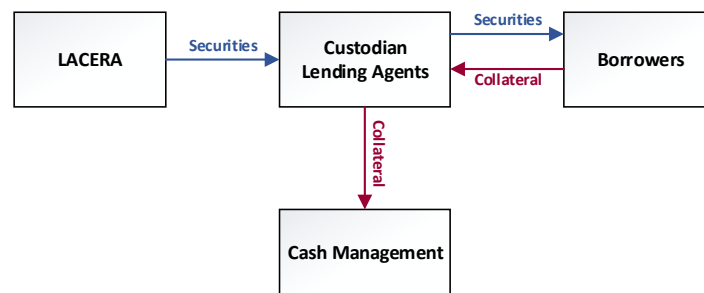
AUDIT PERFORMED BY:

Kathryn Ton, CPA, CFE

Senior Internal Auditor

EXECUTIVE SUMMARY

We reviewed LACERA’s securities lending program as part of the fiscal year 2018 audit plan. LACERA’s Investments Office is responsible for the proper management and monitoring of the securities lending program. State Street Bank and Goldman Sachs are lending agents to the program, and make investment decisions on LACERA’s behalf. LACERA’s earnings from the securities lending program are used to fund the benefits of 165,000 LACERA members. The purpose of this audit is to assess whether LACERA and the lending agents are in compliance with key provisions of the Securities Lending Agency Agreements (“SLAA”), as noted in the audit objectives on page 6 and Table A on page 8 of the report. The diagram below illustrates the process flows between the parties involved when administering the program.



The securities lending program is intended to generate incremental returns to offset administrative expenses at a manageable level of risk. For fiscal year 2017, LACERA had an investment portfolio of \$14.2 billion in lendable securities, \$1.4 billion of which were loaned to qualified borrowers. At a 10% utilization rate, one-tenth of LACERA’s fixed income and public equities portfolio were out on loan. LACERA generated \$6.8 million from the program, net of fees.

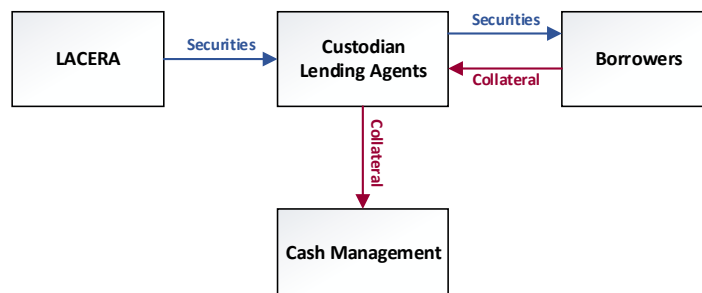
Based on our review, Internal Audit found the lending agents to be in compliance with the key SLAA provisions reviewed, and the related controls to be effective and functioning as intended. Specifically, we noted that the lending agents have adequate controls to loan securities to approved borrowers in the SLAA. In addition, there are automated systems and management oversight to ensure that the loans are collateralized at or above the contractual requirements. Moreover, the cash collateral was tested against the investment guidelines, and we did not note any exceptions. Lastly, we noted good controls in the income splits between LACERA and the lending agents to ensure compliance with the terms in the SLAA. We made two recommendations to the Investments Office for strengthening their oversight over the Program: (1) review and update the SLAA, and (2) assess the lending agents’ service fees. The details of our observations and recommendations are addressed in the report. We thank the Investments Office, State Street Bank, and Goldman Sachs for their assistance and cooperation with this audit.

SECURITIES LENDING PROGRAM

EXECUTIVE SUMMARY 2
INTRODUCTION..... 4
BACKGROUND 4
AUDIT OBJECTIVES 6
AUDIT SCOPE..... 6
AUDIT METHODOLOGY 7
AUDIT RESULTS 8

INTRODUCTION

We reviewed LACERA’s securities lending program as part of the fiscal year 2018 audit plan. LACERA’s Investments Office is responsible for the proper management and monitoring of the securities lending program. State Street Bank and Goldman Sachs are lending agents to the program, and make investment decisions on LACERA’s behalf. LACERA’s earnings from the securities lending program are used to fund the benefits of 165,000 LACERA members. The purpose of this audit is to assess whether LACERA and the lending agents are in compliance with key provisions of the Securities Lending Agency Agreements (“SLAA”), as noted in the audit objectives on page 6 and Table A on page 8 of the report. The diagram below illustrates the process flows between the parties involved when administering the program.



The securities lending program is intended to generate incremental returns to offset administrative expenses at a manageable level of risk. For fiscal year 2017, LACERA had an investment portfolio of \$14.2 billion in lendable securities, \$1.4 billion of which were loaned to qualified borrowers. At a 10% utilization rate, one-tenth of LACERA’s fixed income and public equities portfolio were out on loan. LACERA generated \$6.8 million from the program, net of fees.

BACKGROUND

LACERA has been administering the securities lending program under the direction of the Board of Investments. Since the program has been established, LACERA has delegated responsibilities to lending agents that specialize in securities lending services. LACERA’s securities lending program is managed by its custodian bank, State Street Bank and Trust Company (“SSB”), and a third-party lending agent, Goldman Sachs Agency Lending (“GSAL”). SSB’s investment management team, State Street Global Advisors (“SSgA”), invests the cash collateral received from both lending programs. The table below summarizes LACERA’s securities lending program structure.

Securities Lending Program Structure			
Lending Agent	Cash Management	Collateral Accepted	Securities Type
SSB	SSgA	Cash and non-cash	International Equities US Treasuries and US Agencies
GSAL	SSgA	Cash only	Domestic Equities Corporate Bonds

In securities lending, LACERA will loan securities to borrowers in exchange for collateral. Collateral can be in the form of cash or non-cash securities, and is at least 102% of the market value of the securities on loan. Income from securities lending is generated through (1) non-cash collateral fees and (2) cash collateral reinvestment. LACERA charges borrowers a fee for the non-cash collateral received as payment for the loan. Conversely, LACERA pays borrowers interest for the cash collateral received. However, the cash collateral is reinvested in short-term investments to generate a higher return than the interest paid to borrowers. When borrowers terminate the loan and return the securities, LACERA returns the collateral with interest – this is known as the rebate. Earnings in excess of the rebate are divided between LACERA and the lending agents on a pre-determined basis, based on the income splits negotiated in the SLAA.

Investment Earnings		
Lending Agent	LACERA Split	Lending Agent Split
SSB	85%	15%
GSAL	87%	13%

SECURITIES LENDING PROGRAM RISKS

While securities lending is generally a low-risk investment program, there are three main risks associated with securities lending: (1) borrower default risk, (2) collateral reinvestment risk and (3) operational risk. We discuss each risk below and the mitigating controls necessary to administer an effective securities lending program.

BORROWER DEFAULT RISK

One risk that LACERA considers is the credit or borrower risk – namely, the risk that borrowers will go bankrupt and not return the securities on loan. LACERA and the lending agents have a three-step approach to mitigate this risk. First, lending agents must undertake a formal process for evaluating the credit of each borrower before and after including them on the approved borrowers list. Second, LACERA requires borrowers to pledge collateral over and above the value of the lent securities to absorb potential losses. In case a borrower defaults, LACERA liquidates the collateral and purchases the securities on loan in the open market. Third, as a last resort, if there are insufficient funds from the collateral sale, LACERA receives indemnities from the lending agents for the full replacement of the securities on loan. Borrower defaults on securities loans are rare. LACERA has not been susceptible to losses from borrower defaults since the program's inception.

COLLATERAL REINVESTMENT RISK

Another risk is that SSgA invests the cash collateral, but LACERA bears 100% of the reinvestment risk under the terms of the agreement. Because LACERA invests the cash in money market funds and structured products, the collateral is exposed to credit and interest rate risk. Credit risk is the risk that an investment drops in value because of a credit quality downgrade or bond issuer default. Interest rate risk is the risk that an investment return will be less than the rebates paid to borrowers. LACERA has adopted conservative reinvestment guidelines as a control measure

to mitigate these risks. Overall, LACERA's collateral reinvestment portfolio is designed to be diversified in liquid, high credit quality, short-term fixed income securities.

OPERATIONAL RISK

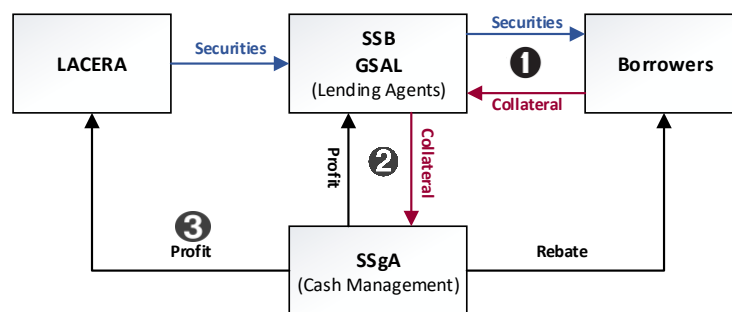
The last risk LACERA considers is operational risk, or the risk that a transaction does not work as planned because of human or system errors. Because securities lending is operationally intensive, this risk is mitigated by investing in automated systems and having staff routinely monitor borrower loan levels, mark-to-market activities, and investment guideline compliance.

AUDIT OBJECTIVES

Our audit objectives were to assess whether SSB and GSAL, the lending agents, are in compliance with key provisions of the SLAAs as noted below. Specifically, we verified the following:

- (1) **LENDING TRANSACTIONS:** SSB and GSAL lend to only approved borrowers and fully collateralize each loan according to the SLAAs.
- (2) **CASH COLLATERAL REINVESTMENT:** SSgA reinvests the cash collateral according to the investment guidelines outlined in the SLAA.
- (3) **INCOME & FEES:** Income splits and fees are calculated correctly and charged to LACERA according to the SLAAs.

In addition, we assessed the reasonableness of LACERA and the lending agents' operational controls when administering the program. The diagram below illustrates the areas reviewed as part of this audit.



AUDIT SCOPE

The audit scope covered:

- (1) Specific provisions within the 2013 LACERA-SSB SLAA and 2010 LACERA-GSAL SLAA.
- (2) Procedures on the daily collateral reconciliations.
- (3) Discussions with Investments Office around management of the program.
- (4) Onsite meetings with lending agents as it relates to:
 - Front office review with traders⁽¹⁾

- Middle office review with IT and risk management
 - Back office review with operations, legal, and compliance
- (5) Demonstrations of the securities lending online compliance reporting systems.
- (6) Controls and transactions testing⁽²⁾ to ensure operations are performed according to established procedures.

Notes:

⁽¹⁾ Internal Audit did not observe live trades between traders and borrowers, or review the database management systems for pricing securities at the lending agencies.

⁽²⁾ The review period covered LACERA's fiscal year 2017. Internal Audit reviewed the daily compliance reports for the month of June 2017, and the daily compliance reports for the last day of each month-end for fiscal year 2017.

AUDIT METHODOLOGY

(1) To test for compliance with SLAA provisions as it relates to lending transactions:

- Compared the SLAA list of approved borrowers to borrowers named in the daily investment activities. This control test offered visibility into the borrowers as well as LACERA's exposure levels at each of the lending agencies.
- Examined LACERA's loan exposure for each counterparty relative to the entire loan amount. The concentration levels were calculated for each borrower on the last day of each month-end for fiscal year 2017.
- Determined whether lending agents mark-to-market securities at the minimum protective levels based on the market value of the securities on loan. This control test was to verify that loans are fully collateralized at 102% and 105% for domestic and international securities, respectively.

(2) To test for compliance with SLAA provisions as it relates to cash collateral reinvestment:

- Determined concentration levels for each asset class and compared levels to SLAA guidelines.
- Verified weighted average maturities ("WAM") and weighted average lives ("WAL") of securities in the collateral funds for compliance with SLAA guidelines.
- Identified the asset class and credit quality of each investment for compliance with SLAA guidelines. SSB has 754 securities and GSAL has 974 securities.

(3) To test for compliance with SLAA provisions as it relates to income and fees:

- Reconciled daily loan balances in June 2017 (8,957 SSB and 17,350 GSAL records) to the monthly totals.
- Recalculated daily and monthly investment earnings at each lending agency.
- Determined accuracy of the income splits between LACERA and lending agents.
- Identified investment trends from cash and non-cash collateral received.
- Reviewed monthly invoices billed to LACERA for third-party lending services.

- (4) To assess the reasonableness of the operational controls in administering the program:
- Performed onsite review of SSB and GSAL offices to understand their operational controls.
 - Interviewed Investments Office staff responsible for oversight of the securities lending program.

AUDIT RESULTS

Overall, Internal Audit found the lending agents to have adequate controls and procedures for the three compliance areas reviewed. The table below summarizes Internal Audit’s assessment of ten SLAA provisions reviewed within LACERA’s securities lending program.

Table A: SLAA Provisions Reviewed

Area Reviewed	Metric	Metric Description	Reason	Compliance Assessment	
				State Street Bank	Goldman Sachs
Lending Transactions	Approved borrowers	Verified securities are loaned to borrowers who have been approved by LACERA.	Borrower default risk	✓	✓
	Borrower exposure	Determine market value and proportionate share of securities on loan with each borrower.	Borrower default risk	Not applicable (no provision exists)	✓
	Loan collateralization levels	Verified market value of collateral falls within market value of securities on loan at protective levels (102%/105%).	Market and liquidity risks	✓	✓
Cash Collateral Reinvestment	Asset type	Determined proportionate share of securities by asset class.	Risk profile	✓	Not applicable
	Credit quality	Verified credit rating for each security at time of purchase.	Credit risk	✓	Not applicable
	Weighted Average Maturity Weighted Average Life (WAM) / (WAL)	Calculated weighted average number of days to final payment and interest reset date for each security.	Interest rate risk	✓	Not applicable
Income and Fees	Earnings	Calculated earnings for each account and security.	Operational risk	✓	✓
	Securities trading special	Identified securities with high borrowing demand, noted by high fees paid by the borrower.	Risk profile	✓	✓
	Trends	Tracked cash and non-cash collateral received over time.	Risk profile	✓	✓
	Third-party flat fees	Analyzed flat fees charged to LACERA for security and wire transfers exchanged between SSB and GSAL.	Operational risk	✓	✓

Internal Audit observed the following good practices with administering the program:

- Lending agents have loan balances concentrated with high-quality borrowers.
- Lending agents provide indemnifications against borrower default.
- Segregation of duties exist between traders and the delivery of loaned securities.
- Lending agents have automated validation systems to ensure compliance with collateral guidelines.
- Cash management interacts with portfolio managers to confirm daily cash flows from lending activity.
- Lending agents and LACERA discuss investment strategies and performance regularly.
- Investment earnings are paid timely and accurately to LACERA.
- Lending agents have good security controls for their online reporting systems.

While we observed good practices at SSB, GSAL, and LACERA, we identified two opportunities for management to further strengthen their processes. Our observations and recommendations are detailed below.

Review SLAA Provisions on Non-Cash Collateral

A good practice is to periodically review and amend the SLAA guidelines to reflect the current market environment. Because of recent regulations around Dodd Frank and Basel III, we have seen a steady rise in the amount of non-cash collateral pledged. For fiscal year 2017, we have seen SSB accept 45% cash and 55% non-cash collateral from borrowers. Historically, the ratios have been skewed towards cash collateral. It would be prudent for management to revisit the LACERA-SSB SLAA and evaluate the impact of accepting cash and non-cash securities, because the non-cash collateral can alter the risk-return profile of the program. For example, we noted that 45% of cash collateral generated 60% of LACERA’s earnings, and 55% of non-cash collateral generated 40% of LACERA’s earnings. Management should be aware of the collateral risks, and ensure that there are adequate protections in the SLAA.

RECOMMENDATION

- 1. Investments Office to review the SLAA provisions and make necessary adjustments to non-cash collateral.**

Management Response

Investment office agrees that it is good practice to periodically review the SLAA—and amend it when appropriate—to ensure that the SLAA provisions remain consistent with market conditions. We are finalizing our annual report on the securities lending program, and that report will be an “information only” item on the June BOI calendar. As part of that report, we will review the SLAA. If any adjustments are needed for non-cash collateral, we will implement them during the first quarter of fiscal year 2018/2019.

Assess Fee Implications of Using Third-Party Agents

In an April 2017 memorandum to the Board of Investments, management expressed the need to periodically rebid the securities lending program as a good measure. Should this be done in the near future, it is good practice to understand the fee implications of using third-party lending agents and the impact on program cost and performance.

During our review, we observed two cases when LACERA incurred additional costs for using GSAL as a third-party lending agent. The first case involves cash management, and the amount SSgA billed LACERA to manage the two cash collateral funds. Currently, LACERA pays SSgA 5 basis points for the GSAL fund and 1 basis point for the SSB fund. Depending on the cash collateral funds' balances, a 4 basis points differential can mean several hundred thousand dollars for LACERA annually. The second case involves SSB (as LACERA's custodian bank) billing LACERA for handling security and wire transfers associated with GSAL's third-party lending program. For GSAL's program, the cost to LACERA was \$200,000, the annual fee maximum negotiated in the LACERA-SSB agreement. In contrast, SSB waives security and wire transfer fees for handling SSB's lending program.

Even though LACERA incurred additional costs for using GSAL as a third-party lending agent, it would be difficult to quantify or contend that LACERA is better off using a single lender over multiple third-party lenders. First of all, SSB and GSAL lend different security types for LACERA, so a true cost comparison could not be performed. Second of all, some of SSB's fees for custody banking, securities lending, and cash management are bundled together, so it would be difficult to measure the true cost of SSB's securities lending program on its own. LACERA may benefit from unbundling each SSB service offering and pricing it individually. In doing so, management can understand the costs-benefits of using third-party agents, and determine the best course of action for LACERA and the program going forward.

RECOMMENDATION

- 2. Investments Office to assess the fee implications of working with third-party agents for securities lending.**

Management Response

Subject to BOI approval, Staff anticipates issuing an RFP for securities lending services in fiscal year 2018/2019, and that search will include an assessment of all related fees, including for third-party agents.

We thank the Investments Office, State Street Bank, and Goldman Sachs Agency Lending for their assistance and cooperation with this audit.

NOTED AND APPROVED



Quoc Nguyen on behalf of:
Richard Bendall
Chief Audit Executive

Date: May 30, 2018

REPORT DISTRIBUTION

*2018 Audit Committee
Rick Wentzel
Internal Audit Staff*

*Robert Hill
James Brekk
Bernie Buenaflor
JJ Popowich*

*Jon Grabel
Vache Mahseredjian
Steven Rice
Christine Roseland*



LACERA INTERNAL AUDIT DIVISION

Securities Lending Program

Version with Audit Committee Comments & Internal Audit Responses

May 30, 2018

AUDIT PERFORMED BY:

Kathryn Ton, CPA, CFE

Senior Internal Auditor

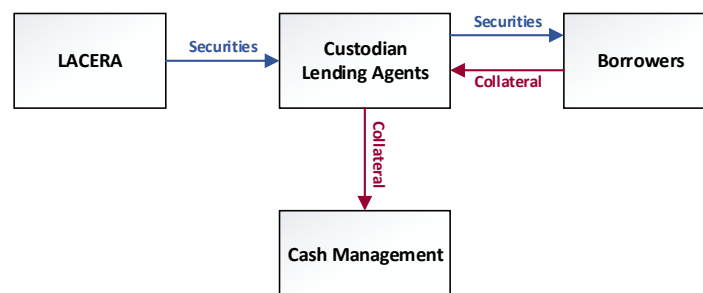
EXECUTIVE SUMMARY

We reviewed LACERA's securities lending program as part of the fiscal year 2018 audit plan. LACERA's Investments Office is responsible for the proper management and monitoring of the securities lending program. State Street Bank and Goldman Sachs are lending agents to the program, and make investment decisions on LACERA's behalf. LACERA's earnings from the securities lending program are used to fund the benefits of 165,000 LACERA members.

AC QUESTION: What is the "benefit" I receive as a current employee?

IA RESPONSE: The incremental income from the securities lending program contributes toward funding the defined benefit pension plan for vested LACERA employees at the time of retirement.

The purpose of this audit is to assess whether LACERA and the lending agents are in compliance with key provisions of the Securities Lending Agency Agreements ("SLAA"), as noted in the audit objectives on page 6 and Table A on page 8 of the report. The diagram below illustrates the process flows between the parties involved when administering the program.



The securities lending program is intended to generate incremental returns to offset administrative expenses at a manageable level of risk. For fiscal year 2017, LACERA had an investment portfolio of \$14.2 billion in lendable securities, \$1.4 billion of which were loaned to qualified borrowers. At a 10% utilization rate, one-tenth of LACERA's fixed income and public equities portfolio were out on loan. LACERA generated \$6.8 million from the program, net of fees.

Based on our review, Internal Audit found the lending agents to be in compliance with the key SLAA provisions reviewed, and the related controls to be effective and functioning as intended. Specifically, we noted that the lending agents have adequate controls to loan securities to approved borrowers in the SLAA. In addition, there are automated systems and management oversight to ensure that the loans are collateralized at or above the contractual requirements. Moreover, the cash collateral was tested against the investment guidelines, and we did not note any exceptions. Lastly, we noted good controls in the income splits between LACERA and the lending agents to ensure compliance with the terms in the SLAA. We made two recommendations to the Investments Office for strengthening their oversight over the Program: (1) review and update the SLAA, and (2) assess the lending agents' service fees. The details of our

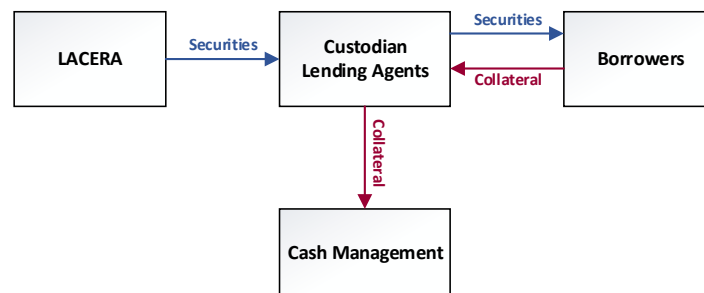
observations and recommendations are addressed in the report. We thank the Investments Office, State Street Bank, and Goldman Sachs for their assistance and cooperation with this audit.

SECURITIES LENDING PROGRAM

EXECUTIVE SUMMARY	2
INTRODUCTION.....	4
BACKGROUND	4
AUDIT OBJECTIVES	6
AUDIT SCOPE.....	7
AUDIT METHODOLOGY	7
AUDIT RESULTS	8

INTRODUCTION

We reviewed LACERA’s securities lending program as part of the fiscal year 2018 audit plan. LACERA’s Investments Office is responsible for the proper management and monitoring of the securities lending program. State Street Bank and Goldman Sachs are lending agents to the program, and make investment decisions on LACERA’s behalf. LACERA’s earnings from the securities lending program are used to fund the benefits of 165,000 LACERA members. The purpose of this audit is to assess whether LACERA and the lending agents are in compliance with key provisions of the Securities Lending Agency Agreements (“SLAA”), as noted in the audit objectives on page 6 and Table A on page 8 of the report. The diagram below illustrates the process flows between the parties involved when administering the program.



The securities lending program is intended to generate incremental returns to offset administrative expenses at a manageable level of risk. For fiscal year 2017, LACERA had an investment portfolio of \$14.2 billion in lendable securities, \$1.4 billion of which were loaned to qualified borrowers. At a 10% utilization rate, one-tenth of LACERA’s fixed income and public equities portfolio were out on loan. LACERA generated \$6.8 million from the program, net of fees.

AC QUESTION: Is this figure cumulative, regardless of duration of loan? If so, the 10% utilization rate seems low, no?

IA RESPONSE: Correct, this figure is cumulative regardless of duration of loan. Collectively, SSB and GSAL lent \$1.4 billion of \$14.2 billion securities (10%) for LACERA in FY 2017. Historically, LACERA’s utilization rate has been in the low to mid-teens over the past five years.

BACKGROUND

LACERA has been administering the securities lending program under the direction of the Board of Investments. Since the program has been established, LACERA has delegated responsibilities to lending agents that specialize in securities lending services. LACERA’s securities lending program is managed by its custodian bank, State Street Bank and Trust Company (“SSB”), and a third-party lending agent, Goldman Sachs Agency Lending (“GSAL”). SSB’s investment management team, State Street Global Advisors (“SSgA”), invests the cash collateral received from both lending programs. The table below summarizes LACERA’s securities lending program structure.

Securities Lending Program Structure			
Lending Agent	Cash Management	Collateral Accepted	Securities Type
SSB	SSgA	Cash and non-cash	International Equities US Treasuries and US Agencies
GSAL	SSgA	Cash only	Domestic Equities Corporate Bonds

In securities lending, LACERA will loan securities to borrowers in exchange for collateral. Collateral can be in the form of cash or non-cash securities, and is at least 102% of the market value of the securities on loan. Income from securities lending is generated through (1) non-cash collateral fees and (2) cash collateral reinvestment. LACERA charges borrowers a fee for the non-cash collateral received as payment for the loan. Conversely, LACERA pays borrowers interest for the cash collateral received. However, the cash collateral is reinvested in short-term investments to generate a higher return than the interest paid to borrowers. When borrowers terminate the loan and return the securities, LACERA returns the collateral with interest – this is known as the rebate. Earnings in excess of the rebate are divided between LACERA and the lending agents on a pre-determined basis, based on the income splits negotiated in the SLAA.

Investment Earnings		
Lending Agent	LACERA Split	Lending Agent Split
SSB	85%	15%
GSAL	87%	13%

SECURITIES LENDING PROGRAM RISKS

While securities lending is generally a low-risk investment program, there are three main risks associated with securities lending: (1) borrower default risk, (2) collateral reinvestment risk and (3) operational risk. We discuss each risk below and the mitigating controls necessary to administer an effective securities lending program.

BORROWER DEFAULT RISK

One risk that LACERA considers is the credit or borrower risk – namely, the risk that borrowers will go bankrupt and not return the securities on loan. LACERA and the lending agents have a three-step approach to mitigate this risk. First, lending agents must undertake a formal process for evaluating the credit of each borrower before and after including them on the approved borrowers list. Second, LACERA requires borrowers to pledge collateral over and above the value of the lent securities to absorb potential losses. In case a borrower defaults, LACERA liquidates the collateral and purchases the securities on loan in the open market. Third, as a last resort, if there are insufficient funds from the collateral sale, LACERA receives indemnities from the lending agents for the full replacement of the securities on loan. Borrower defaults on securities loans are rare. LACERA has not been susceptible to losses from borrower defaults since the program's inception.

AC QUESTION: Have there been any losses in the program from other than borrower defaults, and if so, from what source?

IA RESPONSE: The securities lending program has generated a net profit every year. However, there was a loss in 2008 as a result of a defaulted security in the collateral pool managed by LACERA's former custodian (BNY Mellon). This loss amounted to \$872K. Staff provided two memos to the Board of Investments on this loss.

COLLATERAL REINVESTMENT RISK

Another risk is that SSgA invests the cash collateral, but LACERA bears 100% of the reinvestment risk under the terms of the agreement. Because LACERA invests the cash in money market funds and structured products, the collateral is exposed to credit and interest rate risk. Credit risk is the risk that an investment drops in value because of a credit quality downgrade or bond issuer default. Interest rate risk is the risk that an investment return will be less than the rebates paid to borrowers. LACERA has adopted conservative reinvestment guidelines as a control measure to mitigate these risks. Overall, LACERA's collateral reinvestment portfolio is designed to be diversified in liquid, high credit quality, short-term fixed income securities.

AC QUESTION: The prior sentence states SSgA invests the collateral. This sentence states that LACERA invests it.

IA RESPONSE: In this context we meant SSgA invests on LACERA's behalf.

OPERATIONAL RISK

The last risk LACERA considers is operational risk, or the risk that a transaction does not work as planned because of human or system errors. Because securities lending is operationally intensive, this risk is mitigated by investing in automated systems and having staff routinely monitor borrower loan levels, mark-to-market activities, and investment guideline compliance.

AC QUESTION: What does "operationally intensive" mean?

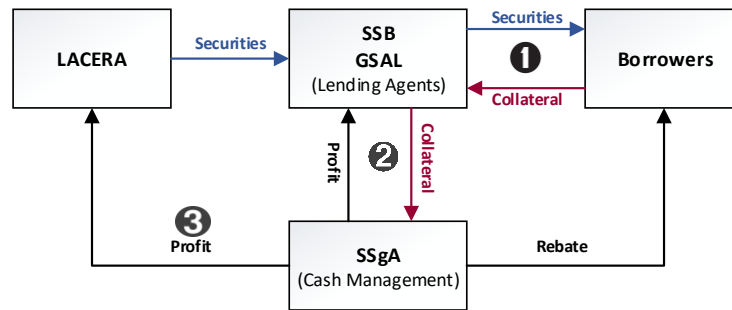
IA RESPONSE: Many operations in securities lending involve manual processes that have been mitigated by investing in automated systems. For example, SSB and GSAL have automated securities loan and return processing and the process for negotiating certain types of trades.

AUDIT OBJECTIVES

Our audit objectives were to assess whether SSB and GSAL, the lending agents, are in compliance with key provisions of the SLAAs as noted below. Specifically, we verified the following:

- (1) **LENDING TRANSACTIONS:** SSB and GSAL lend to only approved borrowers and fully collateralize each loan according to the SLAAs.
- (2) **CASH COLLATERAL REINVESTMENT:** SSgA reinvests the cash collateral according to the investment guidelines outlined in the SLAA.
- (3) **INCOME & FEES:** Income splits and fees are calculated correctly and charged to LACERA according to the SLAAs.

In addition, we assessed the reasonableness of LACERA and the lending agents' operational controls when administering the program. The diagram below illustrates the areas reviewed as part of this audit.



AUDIT SCOPE

The audit scope covered:

(1) Specific provisions within the 2013 LACERA-SSB SLAA and 2010 LACERA-GSAL SLAA.

AC QUESTION: Are these applicable in 2018?

IA RESPONSE: The SLAAs are evergreen contracts and applicable in 2018.

(2) Procedures on the daily collateral reconciliations.

(3) Discussions with Investments Office around management of the program.

(4) Onsite meetings with lending agents as it relates to:

- Front office review with traders⁽¹⁾
- Middle office review with IT and risk management
- Back office review with operations, legal, and compliance

(5) Demonstrations of the securities lending online compliance reporting systems.

(6) Controls and transactions testing⁽²⁾ to ensure operations are performed according to established procedures.

Notes:

⁽¹⁾ Internal Audit did not observe live trades between traders and borrowers, or review the database management systems for pricing securities at the lending agencies.

⁽²⁾ The review period covered LACERA's fiscal year 2017. Internal Audit reviewed the daily compliance reports for the month of June 2017, and the daily compliance reports for the last day of each month-end for fiscal year 2017.

AUDIT METHODOLOGY

(1) To test for compliance with SLAA provisions as it relates to lending transactions:

- Compared the SLAA list of approved borrowers to borrowers named in the daily investment activities. This control test offered visibility into the borrowers as well as LACERA's exposure levels at each of the lending agencies.

- Examined LACERA's loan exposure for each counterparty relative to the entire loan amount. The concentration levels were calculated for each borrower on the last day of each month-end for fiscal year 2017.
 - Determined whether lending agents mark-to-market securities at the minimum protective levels based on the market value of the securities on loan. This control test was to verify that loans are fully collateralized at 102% and 105% for domestic and international securities, respectively.
- (2) To test for compliance with SLAA provisions as it relates to cash collateral reinvestment:
- Determined concentration levels for each asset class and compared levels to SLAA guidelines.
 - Verified weighted average maturities ("WAM") and weighted average lives ("WAL") of securities in the collateral funds for compliance with SLAA guidelines.
 - Identified the asset class and credit quality of each investment for compliance with SLAA guidelines. SSB has 754 securities and GSAL has 974 securities.
- (3) To test for compliance with SLAA provisions as it relates to income and fees:
- Reconciled daily loan balances in June 2017 (8,957 SSB and 17,350 GSAL records) to the monthly totals.
 - Recalculated daily and monthly investment earnings at each lending agency.
 - Determined accuracy of the income splits between LACERA and lending agents.
 - Identified investment trends from cash and non-cash collateral received.
 - Reviewed monthly invoices billed to LACERA for third-party lending services.
- (4) To assess the reasonableness of the operational controls in administering the program:
- Performed onsite review of SSB and GSAL offices to understand their operational controls.
 - Interviewed Investments Office staff responsible for oversight of the securities lending program.

AUDIT RESULTS

Overall, Internal Audit found the lending agents to have adequate controls and procedures for the three compliance areas reviewed. The table below summarizes Internal Audit's assessment of ten SLAA provisions reviewed within LACERA's securities lending program.

AC QUESTION: The Compliance Assessment below suggests that the contractual provisions of the two contracts differ. Why is that?

IA RESPONSE: The contractual provisions are different because GSAL does not offer collateral investment management services. SSB's SSgA performs the investment management service for the GSAL cash collateral pool. In addition, the agreements were executed in different years and involve different security types.

Table A: SLAA Provisions Reviewed

Area Reviewed	Metric	Metric Description	Reason	Compliance Assessment	
				State Street Bank	Goldman Sachs
Lending Transactions	Approved borrowers	Verified securities are loaned to borrowers who have been approved by LACERA.	Borrower default risk	✓	✓
	Borrower exposure	Determine market value and proportionate share of securities on loan with each borrower.	Borrower default risk	Not applicable (no provision exists)	✓
	Loan collateralization levels	Verified market value of collateral falls within market value of securities on loan at protective levels (102%/105%).	Market and liquidity risks	✓	✓
Cash Collateral Reinvestment	Asset type	Determined proportionate share of securities by asset class.	Risk profile	✓	Not applicable
	Credit quality	Verified credit rating for each security at time of purchase.	Credit risk	✓	Not applicable
	Weighted Average Maturity Weighted Average Life (WAM) / (WAL)	Calculated weighted average number of days to final payment and interest reset date for each security.	Interest rate risk	✓	Not applicable
Income and Fees	Earnings	Calculated earnings for each account and security.	Operational risk	✓	✓
	Securities trading special	Identified securities with high borrowing demand, noted by high fees paid by the borrower.	Risk profile	✓	✓
	Trends	Tracked cash and non-cash collateral received over time.	Risk profile	✓	✓
	Third-party flat fees	Analyzed flat fees charged to LACERA for security and wire transfers exchanged between SSB and GSAL.	Operational risk	✓	✓

Internal Audit observed the following good practices with administering the program:

- Lending agents have loan balances concentrated with high-quality borrowers.
- Lending agents provide indemnifications against borrower default.
- Segregation of duties exist between traders and the delivery of loaned securities.
- Lending agents have automated validation systems to ensure compliance with collateral guidelines.
- Cash management interacts with portfolio managers to confirm daily cash flows from lending activity.
- Lending agents and LACERA discuss investment strategies and performance regularly.
- Investment earnings are paid timely and accurately to LACERA.
- Lending agents have good security controls for their online reporting systems.

While we observed good practices at SSB, GSAL, and LACERA, we identified two opportunities for management to further strengthen their processes. Our observations and recommendations are detailed below.

Review SLAA Provisions on Non-Cash Collateral

A good practice is to periodically review and amend the SLAA guidelines to reflect the current market environment. Because of recent regulations around Dodd Frank and Basel III, we have seen a steady rise in the amount of non-cash collateral pledged. For fiscal year 2017, we have seen SSB accept 45% cash and 55% non-cash collateral from borrowers. Historically, the ratios have been skewed towards cash collateral. It would be prudent for management to revisit the LACERA-SSB SLAA and evaluate the impact of accepting cash and non-cash securities, because the non-cash collateral can alter the risk-return profile of the program. For example, we noted that 45% of cash collateral generated 60% of LACERA's earnings, and 55% of non-cash collateral generated 40% of LACERA's earnings. Management should be aware of the collateral risks, and ensure that there are adequate protections in the SLAA.

AC QUESTION: For how long has each Agreement been in place? In lieu of revising agreement components to reflect then current market conditions, another option could be to re-solicit the business in its entirety, no?

IA RESPONSE: The agreements have been in place with SSB for 5 years and GSAL for 8 years. Correct, LACERA has the option to re-solicit the securities lending program in its entirety. Investments Office management has indicated in their response that they will be issuing an RFP for securities lending services in fiscal year 2018/2019.

RECOMMENDATION

- 1. Investments Office to review the SLAA provisions and make necessary adjustments to non-cash collateral.**

Management Response

Investment office agrees that it is good practice to periodically review the SLAA—and amend it when appropriate—to ensure that the SLAA provisions remain consistent

with market conditions. We are finalizing our annual report on the securities lending program, and that report will be an “information only” item on the June BOI calendar. As part of that report, we will review the SLAA. If any adjustments are needed for non-cash collateral, we will implement them during the first quarter of fiscal year 2018/2019.

Assess Fee Implications of Using Third-Party Agents

AC QUESTION: What I didn't see is an assessment of unbundling the securities lending program from the custodian. Unless you unbundle it from the custodian, you don't know if in fact your custodian is the best deal.

IA RESPONSE: Investments Office management will assess the feasibility of determining the costs of each SSB service as if they were unbundled during the next securities lending solicitation process.

In an April 2017 memorandum to the Board of Investments, management expressed the need to periodically rebid the securities lending program as a good measure. Should this be done in the near future, it is good practice to understand the fee implications of using third-party lending agents and the impact on program cost and performance.

AC QUESTION: I agree, but it is also reasonable to understand the role of the third-party lending agent. The fee may be prudent for its role.

IA RESPONSE: We agree. The role of a third-party lending agent should also be considered.

During our review, we observed two cases when LACERA incurred additional costs for using GSAL as a third-party lending agent. The first case involves cash management, and the amount SSgA billed LACERA to manage the two cash collateral funds. Currently, LACERA pays SSgA 5 basis points for the GSAL fund and 1 basis point for the SSB fund. Depending on the cash collateral funds' balances, a 4 basis points differential can mean several hundred thousand dollars for LACERA annually. The second case involves SSB (as LACERA's custodian bank) billing LACERA for handling security and wire transfers associated with GSAL's third-party lending program. For GSAL's program, the cost to LACERA was \$200,000, the annual fee maximum negotiated in the LACERA-SSB agreement. In contrast, SSB waives security and wire transfer fees for handling SSB's lending program.

Even though LACERA incurred additional costs for using GSAL as a third-party lending agent, it would be difficult to quantify or contend that LACERA is better off using a single lender over multiple third-party lenders. First of all, SSB and GSAL lend different security types for LACERA, so a true cost comparison could not be performed. Second of all, some of SSB's fees for custody banking, securities lending, and cash management are bundled together, so it would be difficult to measure the true cost of SSB's securities lending program on its own. LACERA may benefit from unbundling each SSB service offering and pricing it individually. In doing so, management can understand the costs-benefits of using third-party agents, and determine the best course of action for LACERA and the program going forward.

RECOMMENDATION

2. Investments Office to assess the fee implications of working with third-party agents for securities lending.

Management Response

Subject to BOI approval, Staff anticipates issuing an RFP for securities lending services in fiscal year 2018/2019, and that search will include an assessment of all related fees, including for third-party agents.

We thank the Investments Office, State Street Bank, and Goldman Sachs Agency Lending for their assistance and cooperation with this audit.

NOTED AND APPROVED



Quoc Nguyen on behalf of:
Richard Bendall
Chief Audit Executive

Date: May 30, 2018

REPORT DISTRIBUTION

*2018 Audit Committee
Rick Wentzel
Internal Audit Staff*

*Robert Hill
James Brekk
Bernie Buenaflor
JJ Popowich*


*Jon Gabel
Vache Mahseredjian
Steven Rice
Christine Roseland*



July 5, 2018

TO: Each Member
2018 Audit Committee

Audit Committee Consultant
Rick Wentzel

FROM: Quoc Nguyen 
Principal Internal Auditor

FOR: July 18, 2018 | Audit Committee Meeting

SUBJECT: **Tier 2 Retiree Healthcare Benefits Program**

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. Tier 2 Retiree Healthcare Benefits Program
Nathan Amick, Internal Auditor
(Report issued: June 19, 2018)

Please note: attached to the report is another version of the report that includes questions and comments that staff received from your Committee as well as Internal Audit's responses.

Attachments



June 19, 2018

TO: Each Member
2018 Audit Committee

Audit Committee Consultant
Rick Wentzel

FROM: Nathan Amick 
Internal Auditor

FOR: July 18, 2018 | Audit Committee Meeting

SUBJECT: Tier 2 Retiree Healthcare Benefits Program

EXECUTIVE SUMMARY

As part of the fiscal year 2018 Audit Plan, Internal Audit staff reviewed LACERA's process for identifying retirees who should be enrolled in the new Tier 2 Retiree Healthcare Benefits Program (Tier 2). Based on our review and testing of Retiree Healthcare ("RHC") Division's related internal controls, we found that RHC management has a well-established process for identifying Tier 2 participants to ensure that those retirees are enrolled in the correct Tier 2 program.

BACKGROUND

On June 17, 2014, the Board of Supervisors approved a recommendation issued from the County's Chief Executive Officer to change the Retiree Healthcare Benefits Program by adding a new tier, Tier 2. Due to the rising costs of medical benefits, it became apparent to both the County and LACERA that the previous Retiree Healthcare Benefits Program structure ("Tier 1") would become financially unstable in the future. In an effort to reduce the County's unfunded OPEB liability and ensure the longevity and perpetuity of the Retiree Healthcare Benefits Program, the County, along with LACERA and SEIU representatives, worked together to change the Retiree Healthcare Benefits Program by adding a second tier of benefits for employees hired after June 30, 2014.

With the rising costs of medical benefits being the primary concern for the County, Tier 2 participants will not receive subsidized healthcare for spouses or dependents, unlike Tier 1. In addition, Tier 2 participants must enroll in a Medicare subsidized plan at age 65, while Tier 1 participants are not required to participate in such plans. Consequently, it is imperative for RHC Division staff to determine what healthcare program the retiree should be enrolled in.

Like Tier 1 participants, Tier 2 participants must have at least 10 years of service credit to be eligible for a medical subsidy. Tier 2 members without 10 years of service, along with their spouses and dependents, can participate in the Tier 2 Program but will not be eligible for a subsidy. As a result, Tier 2 members will not begin receiving their medical subsidies until July 1, 2024, with possible exceptions for service-connected disability retirees.

AUDIT PROCESS

As part of the audit, we reviewed the identification process of retirees who should be enrolled in Tier 2. Our objective was to assess the effectiveness of RHC's internal controls in the identification process mentioned above. To attain our objective, we interviewed RHC and Systems Division management and staff, and reviewed relevant Tier 2 reports, memos, and enrollment checklists.

AUDIT RESULTS

As a result of our interviews and review process, we determined that management has adequate controls for ensuring that County employees hired after June 1, 2014 are correctly enrolled in the Tier 2 Program. Specifically, management has two key controls for identifying retirees who should be enrolled in the Tier 2.

- 1.) A "Potential Tier 2 Members Report" is generated monthly by the Systems Division, and identifies newly retired members meeting Tier 2 eligibility requirements. We met with Systems Division staff and reviewed the query used to generate the "Potential Tier 2 Members Report". Based our review, the query correctly identifies retirees meeting Tier 2 eligibility requirements. We also tested RHC's review of the "Potential Tier 2 Members Report", and verified that RHC staff reviews the report and correctly labels the member's Workspace account when members meet Tier 2 eligibility.
- 2.) An "Enrollment Form Processing Checklist" is prepared by RHC staff for each new retiree enrolling in a healthcare benefits program. The checklist requires that RHC staff document the retirees hire date and "reciprocal status" to assess whether the retiree is eligible for the Tier 1 or Tier 2. LACERA members hired after June 30, 2014 could still qualify as Tier 1 members if they were members of another public retirement system prior to June 30, 2014 that has reciprocal status with LACERA. After the "Enrollment Form Processing Checklist" is completed, two additional RHC staff review the checklist for completeness and accuracy. We randomly selected 10 retiree healthcare enrollees and verified that a checklist was completed and reviewed by two additional RHC staff.

CONCLUSION

As required by the County, LACERA must enroll all new members hired after June 30, 2014 in the new Tier 2 Retiree Healthcare Benefits Program. Based on our review and testing of Retiree Healthcare Davison's related internal controls, we found that LACERA has a well-established process for identifying Tier 2 participants to ensure that those participants are correctly enrolled in the Tier 2 program.

NOTED AND APPROVED



Quoc Nguyen, Principal Internal Auditor, on behalf of:

Richard Bendall

Chief Audit Executive

Date: June 19, 2018

CC:

2018 Audit Committee

Rick Wentzel

Internal Audit Staff

Robert Hill

James Brekk

JJ Popowich

Bernie Buenaflor

Steven Rice

Cassandra Smith

Mary Phillips

**Version with Audit Committee Comments & Internal Audit Responses**

June 19, 2018

TO: Each Member
2018 Audit Committee

Audit Committee Consultant
Rick Wentzel

FROM: Nathan Amick 
Internal Auditor

FOR: July 18, 2018 | Audit Committee Meeting

SUBJECT: **Tier 2 Retiree Healthcare Benefits Program**

EXECUTIVE SUMMARY

As part of the fiscal year 2018 Audit Plan, Internal Audit staff reviewed LACERA's process for identifying retirees who should be enrolled in the new Tier 2 Retiree Healthcare Benefits Program (Tier 2). Based on our review and testing of Retiree Healthcare ("RHC") Division's related internal controls, we found that RHC management has a well-established process for identifying Tier 2 participants to ensure that those retirees are enrolled in the correct Tier 2 program.

BACKGROUND

On June 17, 2014, the Board of Supervisors approved a recommendation issued from the County's Chief Executive Officer to change the Retiree Healthcare Benefits Program by adding a new tier, Tier 2. Due to the rising costs of medical benefits, it became apparent to both the County and LACERA that the previous Retiree Healthcare Benefits Program structure ("Tier 1") would become financially unstable in the future. In an effort to reduce the County's unfunded OPEB liability and ensure the longevity and perpetuity of the Retiree Healthcare Benefits Program, the County, along with LACERA and SEIU representatives, worked together to change the Retiree Healthcare Benefits Program by adding a second tier of benefits for employees hired after June 30, 2014.

With the rising costs of medical benefits being the primary concern for the County, Tier 2 participants will not receive subsidized healthcare for spouses or dependents, unlike Tier 1. In addition, Tier 2 participants must enroll in a Medicare subsidized plan at age 65, while Tier 1 participants are not required to participate in such plans. Consequently, it is imperative for RHC Division staff to determine what healthcare program the retiree should be enrolled in.

Like Tier 1 participants, Tier 2 participants must have at least 10 years of service credit to be eligible for a medical subsidy. Tier 2 members without 10 years of service, along with their spouses and dependents, can participate in the Tier 2 Program but will not be eligible for a subsidy. As a result, Tier 2 members will not begin receiving their medical subsidies until July 1, 2024, with possible exceptions for service-connected disability retirees.

AUDIT PROCESS

As part of the audit, we reviewed the identification process of retirees who should be enrolled in Tier 2. Our objective was to assess the effectiveness of RHC's internal controls in the identification process mentioned above. To attain our objective, we interviewed RHC and Systems Division management and staff, and reviewed relevant Tier 2 reports, memos, and enrollment checklists.

AUDIT RESULTS

As a result of our interviews and review process, we determined that management has adequate controls for ensuring that County employees hired after June 1, 2014 are correctly enrolled in the Tier 2 Program. Specifically, management has two key controls for identifying retirees who should be enrolled in the Tier 2.

- 1.) A "Potential Tier 2 Members Report" is generated monthly by the Systems Division, and identifies newly retired members meeting Tier 2 eligibility requirements. We met with Systems Division staff and reviewed the query used to generate the "Potential Tier 2 Members Report". Based our review, the query correctly identifies retirees meeting Tier 2 eligibility requirements. We also tested RHC's review of the "Potential Tier 2 Members Report", and verified that RHC staff reviews the report and correctly labels the member's Workspace account when members meet Tier 2 eligibility.

AC Question: Two questions: 1) I found it interesting that you are not interested in the Tier classification until eligibility kicks in. Why is that? 2) Isn't it the hire date alone that triggers application of a Tier 2 classification, absent reciprocal issues? If so, why isn't the employee assigned a Tier 2 classification upon first entering LACERA's system, making the subsequent "labelling" of the account unnecessary unless there is a reciprocal issue?

IA Response: Since the retirement processing and healthcare enrollment of Tier 2 members are still relatively new and uncommon, the exception report and subsequent labeling serve as an additional control for RHC staff to ensure that Tier 2 retirees are enrolled in the correct plan. Correct, the membership date triggers the application of Tier 2 except for reciprocal issues. By August 2018, Workspace will be programmed so that a Tier 1 or Tier 2 label will automatically

appear on the interface of each member account. The classification will also account for reciprocal issues.

- 2.) An “Enrollment Form Processing Checklist” is prepared by RHC staff for each new retiree enrolling in a healthcare benefits program. The checklist requires that RHC staff document the retirees hire date and “reciprocal status” to assess whether the retiree is eligible for the Tier 1 or Tier 2. LACERA members hired after June 30, 2014 could still qualify as Tier 1 members if they were members of another public retirement system prior to June 30, 2014 that has reciprocal status with LACERA. After the “Enrollment Form Processing Checklist” is completed, two additional RHC staff review the checklist for completeness and accuracy. We randomly selected 10 retiree healthcare enrollees and verified that a checklist was completed and reviewed by two additional RHC staff.

AC Question: And did you agree with the determination staff made?

IA Response: Yes, we agreed with their determinations.

CONCLUSION

As required by the County, LACERA must enroll all new members hired after June 30, 2014 in the new Tier 2 Retiree Healthcare Benefits Program.

AC Question: At the time of hire or the time of eligibility?

IA Response: At the date of enrollment which occurs after retirement.

Based on our review and testing of Retiree Healthcare Davison’s related internal controls, we found that LACERA has a well-established process for identifying Tier 2 participants to ensure that those participants are correctly enrolled in the Tier 2 program.

NOTED AND APPROVED



Quoc Nguyen, Principal Internal Auditor, on behalf of:
Richard Bendall
Chief Audit Executive

Date: June 19, 2018

CC:

*2018 Audit Committee
Rick Wentzel
Internal Audit Staff*

*Robert Hill
James Brekk
JJ Popowich*


*Bernie Buenaflor
Steven Rice
Cassandra Smith
Mary Phillips*



July 5, 2018

TO: Each Member
2018 Audit Committee

Audit Committee Consultant
Rick Wentzel

FROM: Quoc Nguyen 
Principal Internal Auditor

FOR: July 18, 2018 | Audit Committee Meeting

SUBJECT: **Contract Monitoring Program Status Update**

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. Contract Monitoring Program Status Update
Kathryn Ton, Senior Internal Auditor
(Report issued: June 19, 2018)

Please note: attached to the report is another version of the report that includes questions and comments that staff received from your Committee as well as Internal Audit's responses.

Attachments



June 19, 2018

TO: Each Member
2018 Audit Committee

Audit Committee Consultant
Rick Wentzel

FROM: Kathryn Ton, CPA, CFE *KT*
Senior Internal Auditor

FOR: July 18, 2018 | Audit Committee Meeting

SUBJECT: **CONTRACT MONITORING PROGRAM STATUS UPDATE**

INTRODUCTION

Internal Audit reviewed LACERA's contract monitoring program as part of the fiscal year 2018 audit plan. This was in response to a prior audit finding in which LACERA continued doing business with a vendor who had an expired contract. Management addressed the internal audit finding in a January 2016 memo to the Operations Oversight Committee ("OOC"), and committed to building a robust contract monitoring process which would prevent such future occurrences. Management's contract monitoring process⁽¹⁾ would involve:

- (1) Identifying and collecting LACERA contracts
- (2) Developing a contract management system to store and monitor existing contracts.

Internal Audit met with management, and learned that the implementation of the contract monitoring program is still in-progress. Therefore, we performed a high-level review of the program at its current state. A more detailed audit will be performed once the program is fully implemented. The purpose of this memo is to update the Audit Committee on (1) management's existing plans and progress and (2) areas in need of management's attention while the rollout is underway.

BACKGROUND

Contract monitoring is an important area of compliance, because an effective contract monitoring program can help manage financial and operational risks when working with third-party vendors. Third-party vendors are contractually obligated to perform 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. Management is mitigating

⁽¹⁾ (1) and (2) are focused on the compilation of contracts for all divisions except the Investments Office. The Investments Office, in conjunction with the Legal Office, maintain and manage investment related contracts. Investments Office staff monitor the contracts of their investment managers and investment related vendors.

those risks by building a contract management system to account for and monitor all existing contracts.

MANAGEMENT'S PLANS

Based on our review, management is headed in the right direction with the buildout of the contract management system ("CMS") application. Currently, the CMS acts as a repository for LACERA contracts and can accomplish items (1) and (2) above. Upon completion of the CMS, the system can then be beta tested and implemented. In addition, we observed that members from the Executive Office, Administrative Services Division, and Systems Division have developed instruction manuals, forms, and training materials for contract owners. Contract owners are division managers or their designees, who initiate, negotiate, monitor, and close out each contract. In contrast, the Administrative Services Division will manage the CMS and oversee the contract monitoring program. Some oversight responsibilities will include notifying contract owners when contracts near their expiration dates, and performing an independent check on invoices against the contract terms. The contract owners are still responsible for the day-to-day contract compliance functions, and ensuring that invoices match the payment terms of the contract.

AREAS IN NEED OF MANAGEMENT'S ATTENTION

Integrating Microsoft Great Plains with the CMS

One area that can be improved is the database management system used to track invoice payments, which is separate from the CMS. The Administrative Services Division uses a Microsoft Access database to monitor the cumulative balances paid to a vendor. These balances are tracked outside of Microsoft Great Plains, LACERA's accounts payables system. Using Microsoft Access creates additional work, because Administrative Services staff must re-enter information from the invoices into an Access database after the information was already entered by Financial and Accounting Services Division ("FASD") staff. FASD staff enters invoice information into Microsoft Great Plains in order to pay invoices.

RECOMMENDATION

- 1. The Systems Division work with Administrative Services to integrate Microsoft Great Plains with CMS where practical to minimize redundant work.**

Management Response

Systems Division agrees with the recommendation and will work with Administrative Services to integrate Microsoft Great Plains with CMS where practical to minimize redundant work. The estimated date for implementing this recommendation is October 31, 2018.

Each Member, Audit Committee

June 19, 2018

Page 3 of 3

CONCLUSION

LACERA is on the path of accomplishing its contract monitoring program objectives. We did note one recommendation for the Systems Division to work with Administrative Services to integrate Microsoft Great Plains with CMS where practical. Internal Audit will perform a comprehensive audit once the CMS application is fully implemented.

NOTED AND APPROVED



Quoc Nguyen, Principal Internal Auditor, on behalf of:

Richard Bendall

Chief Audit Executive

Date: June 19, 2018

CC:

2018 Audit Committee

Rick Wentzel

Internal Audit Staff

Roxana Castillo

Robert Hill

James Brekk

JJ Popowich

Bernie Buenaflor

Steven Rice

Kim Hines

**Version with Audit Committee Comments & Internal Audit Responses**

June 19, 2018

TO: Each Member
2018 Audit Committee

Audit Committee Consultant
Rick Wentzel

FROM: Kathryn Ton, CPA, CFE 
Senior Internal Auditor

FOR: July 18, 2018 Audit Committee Meeting

SUBJECT: **CONTRACT MONITORING PROGRAM STATUS UPDATE**

INTRODUCTION

Internal Audit reviewed LACERA's contract monitoring program as part of the fiscal year 2018 audit plan. This was in response to a prior audit finding in which LACERA continued doing business with a vendor who had an expired contract. Management addressed the internal audit finding in a January 2016 memo to the Operations Oversight Committee ("OOC"), and committed to building a robust contract monitoring process which would prevent such future occurrences. Management's contract monitoring process⁽¹⁾ would involve:

- (1) Identifying and collecting LACERA contracts
- (2) Developing a contract management system to store and monitor existing contracts.

Internal Audit met with management, and learned that the implementation of the contract monitoring program is still in-progress. Therefore, we performed a high-level review of the program at its current state. A more detailed audit will be performed once the program is fully implemented. The purpose of this memo is to update the Audit Committee on (1) management's existing plans and progress and (2) areas in need of management's attention while the rollout is underway.

BACKGROUND

Contract monitoring is an important area of compliance, because an effective contract monitoring program can help manage financial and operational risks when working with third-party vendors. Third-party vendors are contractually obligated to perform services

⁽¹⁾ (1) and (2) are focused on the compilation of contracts for all divisions except the Investments Office. The Investments Office, in conjunction with the Legal Office, maintain and manage investment related contracts. Investments Office staff monitor the contracts of their investment managers and investment related vendors.

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. Management is mitigating those risks by building a contract management system to account for and monitor all existing contracts.

AC QUESTION: Do you consider Purchase Orders to be contracts? If not, what is the dollar maximum of a purchase order at LACERA?

IA RESPONSE: Yes, LACERA considers a Purchase Order to be a contract once the vendor issues an acknowledgement accepting the purchase order terms and conditions.

MANAGEMENT'S PLANS

Based on our review, management is headed in the right direction with the buildout of the contract management system ("CMS") application. Currently, the CMS acts as a repository for LACERA contracts and can accomplish items (1) and (2) above. Upon completion of the CMS, the system can then be beta tested and implemented. In addition, we observed that members from the Executive Office, Administrative Services Division, and Systems Division have developed instruction manuals, forms, and training materials for contract owners. Contract owners are division managers or their designees, who initiate, negotiate, monitor, and close out each contract. In contrast, the Administrative Services Division will manage the CMS and oversee the contract monitoring program. Some oversight responsibilities will include notifying contract owners when contracts near their expiration dates, and performing an independent check on invoices against the contract terms. The contract owners are still responsible for the day-to-day contract compliance functions, and ensuring that invoices match the payment terms of the contract.

AC QUESTION: The CMS is targeted for when?

IA RESPONSE: Management expects deployment by the end of the year.

AREAS IN NEED OF MANAGEMENT'S ATTENTION

Integrating Microsoft Great Plains with the CMS

One area that can be improved is the database management system used to track invoice payments, which is separate from the CMS. The Administrative Services Division uses a Microsoft Access database to monitor the cumulative balances paid to a vendor. These balances are tracked outside of Microsoft Great Plains, LACERA's accounts payables system. Using Microsoft Access creates additional work, because Administrative Services staff must re-enter information from the invoices into an Access database after the information was already entered by Financial and Accounting Services Division ("FASD") staff. FASD staff enters invoice information into Microsoft Great Plains in order to pay invoices.

AC QUESTION: If I am understanding this correctly, CMS is a system being developed by LACERA staff. Given the agency's connections to Microsoft enterprise systems, did staff consider if Microsoft had a product to meet the agency's needs, in lieu of developing a stand-alone and then interfacing it with the Microsoft enterprise system?

IA RESPONSE: CMS is based on an existing LACERA document management platform. Management is customizing the system to meet its specific contract management needs. Management did consider several options including Microsoft. Management determined that the current option best met LACERA's needs.

RECOMMENDATION

1. The Systems Division work with Administrative Services to integrate Microsoft Great Plains with CMS where practical to minimize redundant work.

Management Response

Systems Division agrees with the recommendation and will work with Administrative Services to integrate Microsoft Great Plains with CMS where practical to minimize redundant work. The estimated date for implementing this recommendation is October 31, 2018.

CONCLUSION

LACERA is on the path of accomplishing its contract monitoring program objectives. We did note one recommendation for the Systems Division to work with Administrative Services to integrate Microsoft Great Plains with CMS where practical. Internal Audit will perform a comprehensive audit once the CMS application is fully implemented.

NOTED AND APPROVED



Quoc Nguyen, Principal Internal Auditor, on behalf of:

Richard Bendall
Chief Audit Executive

Date: June 19, 2018

CC:

2018 Audit Committee
Rick Wentzel
Internal Audit Staff
Roxana Castillo

Robert Hill
James Brekk
JJ Popowich

Bernie Buenaflor
Steven Rice
Kimberly Hines

2018

FOR INFORMATION ONLY

Audit Plan Status Report

FYE 2018 Plan Status as of June 30, 2018

Submitted to the Audit Committee
July 18, 2018

In This Report

WORK COMPLETED & IN PROGRESS.....	3
ONGOING TESTING, MONITORING & CONSULTING	13



AUDIT COMMITTEE

of the Board of Retirement & Board of Investments

Michael S. Schneider - Chair

Vivian Gray – Vice Chair

Herman Santos - Secretary

David Green

Shawn R. Kehoe

Joseph Kelly

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

Perla Gonzalez Senior Secretary

AUDIT COMMITTEE CONSULTANT

Rick Wentzel, CPA

EXECUTIVE SUMMARY

On behalf of the Internal Audit team, we are pleased to submit the **Internal Audit Annual Report (Report)** of the Los Angeles County Employees Retirement Association (LACERA) for the Fiscal Year Ended (FYE) June, 30 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 Fiscal Year Ended June, 30 2018, there were 12,883 staff hours available. A total of 10,797 staff hours (84%) were applied to audit projects, while 2,086 staff hours (16%) were applied to administrative projects. At the beginning of the fiscal year in July 2017, the FYE 2018 Audit Plan consisted of thirty-seven (37) projects. As the fiscal 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, thirty (30) projects have been initiated during the year with twenty-one (21) completed and nine (9) in various stages of progress toward completion. Seven (7) projects have not yet been undertaken and will be rolled over into the FYE 2019 Audit Plan. One (1) project was removed since management developed a functional committee to address the risk in this area.

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.

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

Sincerely,



Leisha Collins, Principal Internal Auditor, and
Quoc Nguyen, Principal Internal Auditor, on behalf of:

Richard Bendall

Chief Audit Executive

INTERNAL AUDIT PLAN FYE 2018

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

INTERNAL AUDIT PLAN FYE 2018		TOTAL HOURS: 10,600		
MANAGEMENT, GOVERNANCE & COMPLIANCE		EST. HOURS: 3,800		
PROJECT	STATUS	TYPE	FREQUENCY	
1. Continuous Auditing Program	Completed	Audit	Ongoing	
• New Payee Validation	Completed	Audit	Periodic	
• Over 90 Payee Testing	Completed	Audit	Periodic	
2. Contract Compliance Program	Completed	Audit	Planned	
3. Internal Controls Training ⁴		Consulting	Planned	
4. Privacy Training	Completed	Consulting	Planned	
5. Los Angeles County Rehired Retirees Audit (960 Hours Testing)	Completed	Audit	Periodic	
6. Pensionable Paycode Testing	Completed	Audit	Periodic	
7. Felony Convictions Plan Sponsor Reporting ²		Audit	Periodic	
8. Corporate Credit Card Audit ¹		Audit	Planned	
9. Board and Staff Travel ¹		Audit	Planned	
10. Inventory Controls	In Progress	Audit	Planned	
11. Quality Assurance Improvement Program FYE 2018	Completed	Admin	Periodic	
12. Risk Assessment – FYE 2019	Completed	Admin	Annual	
13. RHC Benefits Program Funding Audit	Completed	Audit	Planned	
14. Internal Audit Consulting Pool – RFP	Completed	RFP	Planned	
15. Compliance Committee	Completed	Consulting	Planned	
16. Privacy Audit Recommendation Monitoring	Completed	Consulting	Planned	
BENEFITS ADMINISTRATION		EST. HOURS: 2,000		
17. Benefits' Process Management Group ³	Completed	Consulting	Planned	
18. Benefits' Exception Report Review Process	In Progress	Audit	Planned	
19. Active Death Process ¹		Audit	Planned	
20. Member Death Verification Process	Completed	Audit	Planned	
21. Tier 2 Healthcare Benefits Program	Completed	Audit	Planned	
22. Member Account Settlement Collection Process	In Progress	Audit	Planned	
23. Physician Selection, Monitoring, and Compensation	Completed	Audit	Planned	
INFORMATION SYSTEMS		EST. HOURS: 2,000		
24. Business Continuity Planning	In Progress	Consulting	Planned	
25. Data Backup/Retention Testing	Completed	Audit	Planned	
26. Member Applications Change Control	In Progress	Audit	Planned	
27. Systems Penetration Testing	Completed	Ext. Audit	Periodic	
28. IT Risk Assessment	In Progress	Ext. Audit	Planned	
FINANCIAL & INVESTMENT OPERATIONS		EST. HOURS: 2,800		
29. External Financial Audit - Oversight	Completed	Ext. Audit	Annual	
30. Actuarial Audit - Oversight	Completed	Ext. Audit	Annual	
31. Foreign Tax Reclamation - Oversight	In Progress	Ext. Audit	Planned	
32. Wire Transfers Audit	In Progress	Audit	Planned	
33. Real Estate Investment Operations ¹		Ext. Audit	Planned	
34. Real Estate Advisor Audits	In Progress	Ext. Audit	Periodic	
35. Securities Lending Compliance Review	Completed	Audit	Planned	
36. Real Estate Debt Program Review ¹		Ext. Audit	Planned	
37. Custodial Bank Review ¹		Audit	Planned	
ADDITIONAL/UNPLANNED PROJECTS				
38. THC Financial Audit Oversight	Completed	Ext. Audit	Unplanned	

¹This Item will rollover to the fiscal year ending 6/30/2019 Audit Plan

²Project will be forwarded to LA County Auditor-Controller.

³Project removed since management developed a functional committee to address this audit area.

⁴Due to decreased staffing resources anticipated for FYE 2019, this project will be considered for FYE 2020 Audit Plan.

The following provides a more detailed narrative of both the planned and unplanned Internal Audit projects completed or in progress for the period of July 1, 2017 to June 30, 2018. The projects are ordered by Division. Project detail includes the objective, rationale, and a brief synopsis of the project’s conclusion or status

ADMINISTRATIVE SERVICES

Business Continuity Planning

DIVISION(S)	ADMINISTRATIVE SERVICES	REPORT DATE	TBD
OBJECTIVE	Provide consulting to Administrative Services management in their revision and upgrade of LACERA’s business continuity plan including: <ol style="list-style-type: none"> 1. Business impact analysis <ol style="list-style-type: none"> a. processes that are critical and order of importance b. recovery time, and recovery point objectives 2. Develop crisis management plan roles and responsibilities 		
RATIONALE	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.		
PROGRESS	Internal Audit is participating in a cross-functional oversight committee. A Business Continuity Planning vendor has been selected, scope of work contract was signed and work to begin in July.		

Contract Compliance Program

DIVISION(S)	ADMINISTRATIVE SERVICES	REPORT DATE	June 19, 2018
OBJECTIVE	The purpose of this review was to update the Audit Committee on (1) management’s existing plans and progress with implementing a contract monitoring program and (2) areas in need of management’s attention while the rollout of the Program is underway.		
RATIONALE	Internal Audit reviewed LACERA’s contract monitoring program as part of the fiscal year 2018 audit plan. This was in response to a prior audit finding in which LACERA continued doing business with a vendor who had an expired contract. Management addressed the internal audit finding in a January 2016 memo to the Operations Oversight Committee (“OOC”), and committed to building a robust contract monitoring process which would prevent such future occurrences. Internal Audit met with management, and learned that the implementation of the contract monitoring program is still in-progress. Therefore, we performed a high-level review of the program at its current state.		
CONCLUSION	<p><u>COMPLETED:</u> Internal Audit concluded fieldwork and issued the audit report June 19, 2018.</p> Internal Audit has completed the audit and issued the memo on June 19, 2018. LACERA is on the path of accomplishing its contract monitoring program objectives. We did note one recommendation for the Systems Division to work with Administrative Services to integrate Microsoft Great Plains with CMS where practical. Internal Audit will perform a comprehensive audit once the CMS application is fully implemented.		

BENEFITS

Member Death Verification Process

DIVISION(S)	BENEFITS - BENEFITS PROTECTION UNIT (BPU)	REPORT DATE	OCT 31, 2017
OBJECTIVE	Assess the internal controls and process design of the member death verification process.		
RATIONALE	<p>The audit was part of our fiscal year 2017-2018 audit plan, added as a result of our risk assessment. The Benefits Protection Unit (BPU) was created within the Benefits Division back in January 2016 to coordinate LACERA's efforts in the detection, prevention, and reduction of payments to deceased members.</p> <p>The BPU works with a third party vendor to assist LACERA in detecting member deaths as timely as possible. This process is important for preventing benefit overpayments. Without timely notifications or identification, payments to deceased members can potentially go on for months or years before being detected.</p>		
CONCLUSION	<p>COMPLETED: Internal Audit concluded fieldwork and issued the audit report October 31, 2017.</p> <p>Internal Audit found that LACERA's member death verification process is designed effectively and is comparable or more robust than other public pension funds that we surveyed. Additionally, we performed testing on a sample 50 death notifications received from our death notification vendor and noted that staff followed up timely and placed payment holds on the members' account if they were verified as deceased, which prevented the possibility of an overpayment.</p> <p>However, we noted a couple opportunities for management to strengthen the process, which included enhancing management's vendor monitoring controls and placing payment holds on member accounts in the rare instances that staff, after exhausting all efforts, cannot confirm the living status members that were reported as potentially deceased from the vendor.</p>		

Benefits' Exception Report Review Process

DIVISION(S)	BENEFITS	REPORT DATE	N/A
OBJECTIVE	The audit objectives were to assess the adequacy and effectiveness of the controls for the Benefits' Exception Report Review process.		
RATIONALE	This area has not previously been reviewed by Internal Audit and was included in the audit plan for fiscal year 2018. It is important for Benefits to use the exception reports effectively and timely, to ensure members accounts and payments are accurate.		
PROGRESS	Due to other audit projects of higher priority, which require staff resources, this audit has been postponed until next fiscal year.		

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	<p>The purpose of the Program Management Group (PMG) audit was to assess the Benefits administration's set of policies and procedures in order to do the following:</p> <ul style="list-style-type: none"> • Determine whether PMG's policies and procedures can be implemented across all divisions and if so, • Expand on PMG's efforts to develop an organization-wide set of policies and procedures. <p>Currently LACERA follows a best practice performance metric rather than a formal, documented set of standards.</p>		
CONCLUSION	<p>LACERA has established a cross-divisional team to create organization-wide policies and procedures. The compliance committee and sub-committee ("Policy on Policies") were created based on one of Alston & Bird's recommendations from the 2016 Privacy Audit. The committees are led by LACERA's Chief Counsel, and have established deliverables by calendar year-end. The Policies on Policies Committee will present the newly created policies and procedures to the Joint Organizational Governance Committee for review and approval. Because management has already moved forward with the establishment of policies and procedures, Internal Audit did not perform this audit and will not roll forward this audit for FY18.</p>		

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	Field work for this audit has been concluded. We are in the process of drafting the report.		

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><u>COMPLETED:</u> 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

Los Angeles County Rehired Retirees Audit (PEPRA 960 Hours Testing FYE 2017)

DIVISION(S)	EXECUTIVE OFFICE	REPORT DATE	OCT 31, 2017
OBJECTIVE	<p>To determine whether all retirees temporarily rehired, were done so in compliance with State and federal laws and LACERA policies.</p> <p>The State of California’s County Employees Retirement Law provides that Los Angeles County has the option to re-employ retirees for up to 120 days (960 hours) per fiscal year, on a strictly temporary basis, without affecting their retirement status or benefits. Additionally, the Public Employees’ Pension Reform Act of 2013 and LACERA policy requires a bona fide break in service prior to the retiree being rehired by the County.</p>		
RATIONALE	<p>Compliance with State law and LACERA policy helps ensure that LACERA retains its “qualified” tax deferred status. As this is a critical risk to LACERA, Internal Audit performs a 100 percent compliance test of all rehired retirees employed by the County each year.</p>		
CONCLUSION	<p>COMPLETED: Internal Audit concluded fieldwork and issued the audit report October 31, 2017.</p> <p>Internal Audit determined that for the Fiscal Year Ended June 30, 2017 there were some minor issues of non-compliance with legal requirements and LACERA policies. These issues were reported to the County's Chief Executive Office - Benefits, Compensation Policy, and Employee Relations Division and they are in the process of implementing workable solutions to mitigate these issues in the future.</p>		

Compliance Committee

DIVISION(S)	EXECUTIVE OFFICE	REPORT DATE	N/A
OBJECTIVE	<p>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.</p>		
RATIONALE	<p>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.</p>		
PROGRESS	<p>Internal Audit is continuing to meet and consult with Management and participate with the Compliance Committee on the development of the formal compliance program.</p>		

FINANCIAL AND ACCOUNTING SERVICES

LACERA Annual Financial Audit Facilitation – FYE 2018

DIVISION(S)	FASD	MEMO DATE	TBD
OBJECTIVE	Facilitate LACERA's annual external financial statement audit for FYE 2018.		
RATIONALE	External auditors require assistance with coordinating meetings with the Divisions, collecting data, assisting with documentation exchanges, and ensuring timely responsiveness from LACERA management and staff to complete their work within the determined timeframe.		
PROGRESS	Plante Moran has completed its on-site fieldwork, which focused primarily on evaluating LACERA internal controls and testing benefit payments. Plante Moran will return in September 2018 to commence its on-site final fieldwork. The audit will be completed by mid-October 2018, and Plante Moran will present the results of the financial audit at the December 2018 Audit Committee meeting.		

Wire Transfers Audit

DIVISION(S)	FASD	REPORT DATE	TBD
OBJECTIVE	The audit objectives are to assess the controls over LACERA’s investment operations to verify that wires are authorized, documented, and processed accurately.		
RATIONALE	We reviewed LACERA’s electronic wire transfers process as part of the fiscal year 2018 audit plan. Wire transfers pose a financial and headline risk to LACERA if proper controls are not in place. The potential loss as a result of fraud can be substantial due to the size and speed of wire transactions.		
PROGRESS	Internal Audit is in the final stages of fieldwork and anticipates finalizing the report by July 31, 2018.		

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. Internal Audit advises, directs, assists; with inquiries and timely responsiveness from LACERA staff and management in order to complete their work satisfactorily in a suitable fashion.		
PROGRESS	This is an ongoing project. This project was completed June 30, 2018 for Fiscal Year ended June 30, 2018 and will resume July 1, 2018 for Fiscal Year ending June 30, 2019.		

INTERNAL AUDIT

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

DIVISION(S)	INTERNAL AUDIT	MEMO DATE	N/A
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	<u>COMPLETED:</u> Staff selected four firms for the audit pool		

LACERA Annual Risk Assessment – FYE 2019

DIVISION(S)	INTERNAL AUDIT	MEMO DATE	June 30, 2018
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.		
CONCLUSION	We have completed the organizational risk assessment for Fiscal Year End 2019. The results of this assessment are the basis for our “ Internal Audit Plan for Fiscal Year End 2019. ” The projects included in our 2019 Audit Plan are designed to provide coverage of key risks identified as a result of this risk assessment. This audit plan will be formally presented to the Audit Committee at the July 2018 Audit Committee Meeting for their approval.		

Internal Audit Quality Assurance Improvement Program (QAIP)

DIVISION(S)	INTERNAL AUDIT	MEMO DATE	June 30, 2018
OBJECTIVE	Internal Audit will maintain a Quality Assurance and Improvement Program as required by the Institute of Internal Auditing (IIA) Standards.		
RATIONALE	In our 2015 Quality Assurance Review (QAR), our consultant recommended that LACERA Internal Audit develop a formal QAIP program to be in compliance with IIA standards. Internal Audit, while always implemented some form of the QAIP program, did not have a formalized program that fully complied with standards. Internal Audit believes that a formal QAIP is important with the on-going administration of Internal Audit and will add value to the work performed by staff. Internal Audit developed and implemented a QAIP in 2016.		
CONCLUSION	Internal Audit updated our QAIP on June 28, 2018 and will present a status update to the Audit Committee at the July 18, 2018 meeting.		

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, and then oversee the audit performed by the firm selected by Board of Investments.		
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. WTAX is in the process of completing the audit. A report will be issued to the BOI upon completion.		

Securities Lending Compliance Review

DIVISION(S)	INVESTMENTS	REPORT DATE	May 30, 2018
OBJECTIVE	The audit objectives are to assess whether LACERA and the lending agents, State Street and Goldman Sachs, are in compliance with key provisions of the Securities Lending Agency Agreements.		
RATIONALE	We reviewed LACERA's securities lending program as part of the fiscal year 2018 audit plan. The securities lending program is intended to generate incremental returns to offset administrative expenses at a manageable level of risk. There are three main risks associated with securities lending: (1) borrower default risk, (2) collateral reinvestment risk, and (3) operational risk. Each risk and the mitigating controls are discussed in the report to administer an effective securities lending program.		
CONCLUSION	<p>COMPLETED: Internal Audit concluded fieldwork and issued the audit report May 30, 2018.</p> <p>Internal Audit has completed the audit and issued the report on May 30, 2018. Based on our review, Internal Audit found the lending agents to be in compliance with the key SLAA provisions reviewed, and the related controls to be effective and functioning as intended. We made two recommendations to the Investments Office for strengthening their oversight over the Program: (1) review and update the SLAA and (2) assess the lending agents' service fees.</p>		

INVESTMENTS

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 this project separately 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	This is an ongoing project. This project was completed June 30, 2018 for Fiscal Year ended June 30, 2018 and will resume July 1, 2018 for Fiscal Year ending June 30, 2019.		

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>		

RETIREE HEALTH CARE

Retiree Tier 2 Healthcare Benefits Program

DIVISION(S)	Retiree Healthcare	REPORT DATE	June 15, 2018
OBJECTIVE	Internal Audit assessed Retiree Healthcare’s internal controls for identifying retirees who must be categorized as Tier 2 recipients when enrolling in a healthcare benefits program.		
RATIONALE	Tier 2 participants will not receive subsidized healthcare for spouses or dependents, unlike Tier 1. In addition, Tier 2 participants must enroll in a Medicare subsidized plan at age 65, while Tier 1 participants are not required to participate in such plans. Consequently, it is imperative for the Retiree Healthcare Division (RHC) to determine what healthcare program the retiree should be enrolled in.		
CONCLUSION	<p><u>COMPLETED:</u> Internal Audit concluded fieldwork and issued the audit report June 15, 2018.</p> <p>Based on our review and testing of Retiree Healthcare (“RHC”) Division’s related internal controls, we found that RHC management has a well-established process for identifying Tier 2 participants to ensure that those retirees are enrolled in the correct Tier 2 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><u>COMPLETED:</u> Internal Audit concluded fieldwork and issued the audit report February 12, 2018.</p> <p>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

Information Technology Risk Assessment

DIVISION(S)	SYSTEMS	REPORT DATE	TBD
OBJECTIVE	Internal Audit will issue a Request-For-Proposal (RFP) to conduct a Risk Assessment of the entire information technology operations area consisting of policy review, data security, and risk exposure. A baseline of opportunities for improvement will be established.		
RATIONALE	Best Practice to address IT risk.		
PROGRESS	Internal Audit used a Regional Cooperative Agreement (RCA) originating from another large Southern California county. The Security Risk Analysis Services provided in the RCA aligned with LACERA’s needs and the RCA process followed LACERA’s purchasing policy guidelines. Work has begun with onsite management and staff interviews along with physical observations. It is anticipated that the project will be completed during July.		

ONGOING TESTING, MONITORING & CONSULTING

The following provides a brief narrative of ongoing Internal Audit projects for the period of July 1, 2017 to June 30, 2018. 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

Over 90 High Risk Payees Continued Process Test (CPT)

DIVISION(S)	BENEFITS	REPORT DATE	N/A
OBJECTIVES	To identify “high risk” member accounts that need to be further investigated by LACERA’s Benefit’s Protection Unit (BPU).		
RATIONALE	<p>LACERA has a fiduciary duty to help ensure the protection of member benefits as well as funds in the LACERA Trust. Based on LACERA’s experience, certain member account attributes are associated with a higher than normal likelihood of the following situations:</p> <ul style="list-style-type: none"> • The member is alive but due to their current condition (mental state, physical state, old age) someone is misappropriating the members benefit, • The member is deceased but the death is concealed from LACERA so the benefits continued to be paid. <p>While these cases are rare and very difficult to identify, Internal Audit can use data analytics against LACERA’s member data to identify a population of retirees with these attributes, which may increase our chances of identifying these situations and stopping them before they go on for too long, lowering the overall impact to our members and/or the Trust. Some of the member account attributes we look for include, changes to address and banking information, and not having been high risk verified, all within a recent 24 month period.</p>		
PROGRESS	We identified 43 payees that met our high risk criteria. We provided results to the BPU for follow-up. BPU has already that 33 of the 43 cases that we forwarded had no issues. Secondary steps are underway in an attempt to verify the final 10. Final results and a memo will be brought to the Audit Committee in Dec. 2018.		

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 to new service and disability retirees and new survivor payees.</p> <p>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.</p> <p>Internal Audit examines 100% of the new benefit payees using computer assisted audit techniques.</p>
RATIONALE	Internal Audit performs this monthly fraud test due to our independence from the operations.
CONCLUSION	Internal Audit has tested 100 percent of all new benefit payees from July 2017 through June 2018. Internal Audit found no exceptions to the scheduled new benefit payees. This project was completed June 30, 2018 for Fiscal Year ended June 30, 2018, and will resume July 1, 2018 for Fiscal Year Ending June 30, 2019.

EXECUTIVE OFFICE

Pensionable Paycode Testing

DIVISION(S)	INTERNAL AUDIT, QUALITY ASSURANCE, BENEFITS, SYSTEMS DIVISION	REPORT DATE	N/A
OBJECTIVES	<p>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.</p> <p>Verify that each pay code used is coded correctly by the Plan Sponsor (e.g., either “yes” as pensionable or “no” as non-pensionable)</p> <p>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)</p>		
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</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	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.		

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	Executive Management has established a cross-functional team to address the implementation of the Privacy Audit recommendations, many of which will simultaneously assist in the formalization of the compliance function at LACERA. The team will coordinate the implementation and the standardization of policies and procedures and the establishment of a compliance framework. The team has identified specific divisions as the primary owners of the Privacy Audit recommendations. Internal Audit 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 July 18, 2018 meeting, under separate cover.

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 responsible for delivering Privacy Training to all new hire employees. However, the Chief Privacy Officer and Privacy responsibilities will be transitioning to the Legal Office effective July 2018. The Legal Office will be completing the final update of the new Privacy Training following the adoption of the new Retiree Healthcare Privacy Policies and the approved update of the LACERA Privacy Policy. Once these policies are approved, the Legal Office will finalize the training to be delivered to staff at a date to be determined.

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 March 1, 2018 through June 30, 2018. This project will continue through the following fiscal year ending June 30, 2019

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	This project was completed June 30, 2018 for Fiscal Year ended June 30, 2018 and will resume July 1, 2018 for Fiscal Year ending June 30, 2019.

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 566 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 project was completed June 30, 2018 for Fiscal Year ended June 30, 2018 and will resume July 1, 2018 for Fiscal Year ending June 30, 2019.

SYSTEMS

Member Applications Change Control

DIVISION(S)	SYSTEMS	REPORT DATE	TBD
OBJECTIVES	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.		
RATIONALE	As part of our fiscal year 2017-18 Audit Plan, Internal Audit is reviewing the Member Applications Change Control Process to verify that only authorized and tested changes to member applications are implemented.		
PROGRESS	Internal Audit has completed the fieldwork and is currently in the process of finalizing the report to management for their review. We anticipate the final report will be issued by July 30, 2018		



FOR INFORMATION ONLY

July 2, 2018

TO: Each Member
Audit Committee

Audit Committee Consultant
Rick Wentzel

FROM: Leisha Collins 
Principal Internal Auditor

Quoc Nguyen 
Principal Internal Auditor

FOR: July 18, 2018 Audit Committee Meeting

SUBJECT: INTERNAL AUDIT GOALS REPORT

The following Internal Audit Goal Report includes a status update on the completion of Fiscal Year End (FYE) 2018 goals, as well as the Internal Audit Goals proposed for FYE 2019. We welcome the opportunity for any discussion, clarification, or feedback from your Committee.

LC
Attachment

Internal Audit Goals – FYE 2018

The following details the statuses of Internal Audit's goals for the period ending June 30, 2018:

Goal 1: Manage the completion of the FYE 2018 Audit Plan and develop a realistic risk-based Audit Plan for FYE 2019.

Performance Measures:

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

Status: Complete

Staff executed (completed and in-progress) 81% of projects from the FYE 2018 Audit Plan. Staff will provide the status of completion at the July 2018 Committee Meeting. Staff will also provide the Audit Committee an overview of the risk assessment and development of the proposed FYE 19 Audit Plan.

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

Performance Measure:

- *Internal Audit will provide the Audit Committee with the formal framework for the QAIP by the December 2017 Audit Committee Meeting.*
- *Internal Audit will update the QAIP checklist and present a status update to the Audit Committee at the July 2018 meeting.*

Performance Measure:

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

Status: In Progress

Staff completed the QAIP checklist in fiscal year 2018, however, due to reduced staffing resources, it is necessary to roll-over the completion of the QAIP assessment to the first quarter of Fiscal year 2019. Staff will present the results to the Audit Committee at the December 2018 meeting.

Each Member, Audit Committee
Re: Internal Audit Goals Report
July 2, 2018

Goal 3: Update the Internal Audit Divisions Disaster Recovery Plan

Performance Measures:

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

Status: Completed/Ongoing

Staff revises and updates the Internal Audit Division section of the LACERA Disaster Recovery Plan when requested by the Administrative Services Division. Our section of the plan is current.

Goal 4: Develop and implement audit performance and report writing standards along with Internal Audit staff training on the standards

Performance Measures:

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

Status: In Progress

In April and May of 2018, Staff attended a three-day writing workshop on written communication. The skills learned, as well as best business writing practices and report writing will be incorporated into the report writing standards in the Internal Audit Guide. This goal is rolled-over to FYE 2019.

Internal Audit Goals – FYE 2019

Goal 1: Manage the completion of the FYE 2019 Audit Plan and develop a realistic risk-based Audit Plan for FYE 2020.

Performance Measures:

- Execute 80%* of the projects included in the FYE 19 Audit Plan by June 30, 2019. (*Note: 80% allows for flexibility due to changes in LACERA business practices and special requests.)
- Internal Audit will provide the FYE 2019 Audit Plan to the Audit Committee for approval at the July 2019 meeting.

Goal 2: Develop and implement audit performance and report writing standards based on Internal Audit staff training provided in FYE 2018

Performance Measures:

Update the Internal Audit Operation Guide with the new audit performance and report writing standards by June 30, 2019.

Goal 3: Revise the Recommendation Follow-up Process to enhance the efficiency and effectiveness of the reporting platform

Performance Measures:

Revise the Recommendation Follow-up tracking and reporting platform to ensure that recommendations, action plans, and agreed upon implementation dates, are clearly communicated to management and reported to the Audit Committee. We anticipate completed the revised platform by June 30, 2019.

Goal 4: Monitor and measure Internal Audit efficiency using the internal evaluation of the Quality Assurance and Improvement Program (QAIP) and report results of the QAIP to the Audit Committee

Performance Measures:

Internal Audit will update the QAIP self-assessment and present a status update to the Audit Committee by June 20, 2019.





FOR INFORMATION ONLY

July 5, 2018

TO: Each Member
2018 Audit Committee

Audit Committee Consultant
Rick Wentzel

FROM: Quoc Nguyen 
Principal Internal Auditor

Gabriel Tafoya 
Senior Internal Auditor

FOR: July 18, 2018 Audit Committee Meeting

SUBJECT: **Recommendation Follow-Up Report**

AUDIT RECOMMENDATION IMPLEMENTATION SUMMARY

From March 1, 2018 through June 30, 2018, the following audit recommendation activity occurred:

- Three (3) new recommendations were made during this reporting period. These recommendations resulted from the Contract Monitoring Update Program, and the Securities Lending Program audits.
- Eight (8) recommendations were implemented.
 - Two (5) were implemented by the Benefits Division.
 - Seven (3) were implemented by Disability Retirement Services.

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

AUDIT RECOMMENDATIONS STATUS
March 1, 2018 – June 30, 2018

Division	New Recommendations	Implemented/ Closed	Management Accepts Risk	Pending
Administrative Services:	1			6
Benefits Division:		5		8
Communications:				
Disability Litigation:				
Disability Retirement:		3		
Executive-Org. level:				
FASD:				
Human Resources:				
Internal Audit:				
Investments:	2			1
Legal:				
Member Services:				
Quality Assurance:				
Retiree Health Care:				
Systems:				3
Actuary:				
Total:	3	8	0	18

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.

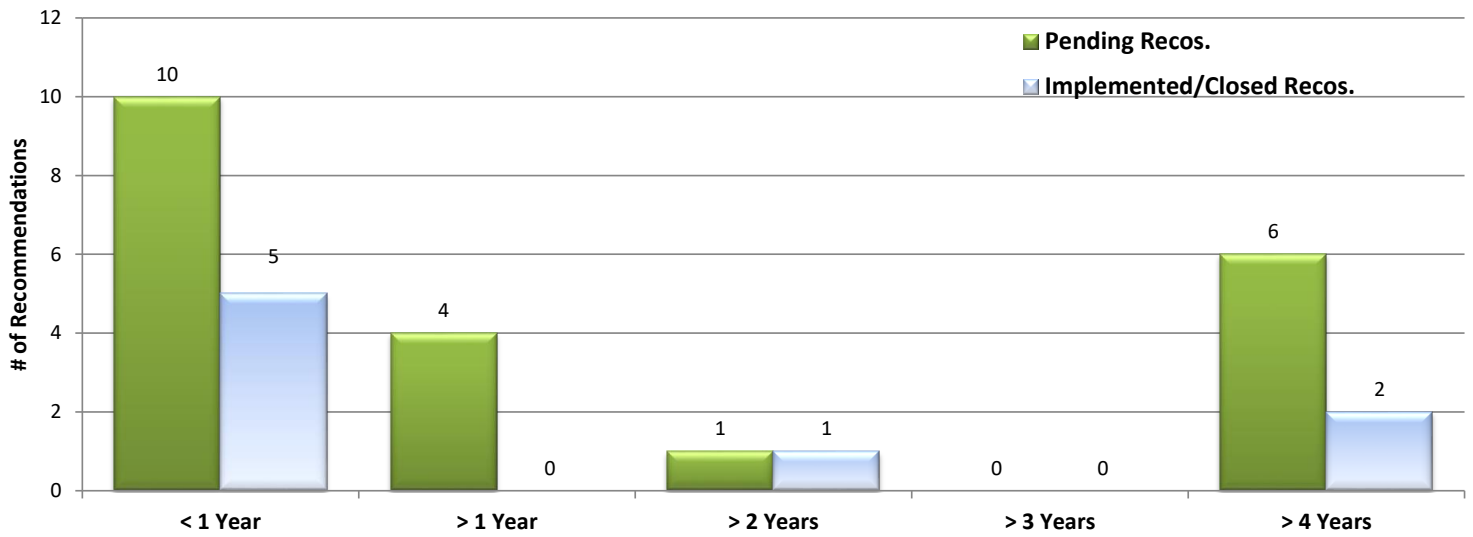
It is not the responsibility of the Chief Audit Executive to resolve the risks identified during audit work. However, in accordance with IIA Performance Standard #2600, it is Internal Audit's responsibility to communicate the acceptance of risks when the Chief Audit Executive concludes that Management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

March 1, 2018 through June 30, 2018



Pending Recos.	< 1 Year	> 1 Year	> 2 Years	> 3 Years	> 4 Years
Administrative Services	1	3			3
Benefits Division	4	1			3
Communications					
Disability Retirement					
FASD					
Human Resources					
Internal Audit					
Investments	2		1		
Legal					
Systems Division	3				
Retiree Healthcare					
Pending Total:	10	4	1	0	6

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

Audit Recommendation Follow Up

Administrative Services

Status: **New**

Audit Project: **Contract Monitoring Update Program (June 19, 2018)**

Issue:	Recommendation	Actual	Estimated	Revised
Duplicate Work is Performed to Capture Payment Information	Monitor Contract Expenses		10/31/2018	

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	9/30/2018
Inconsistent levels of participation from key stakeholders	Improve Planning and communication of Office Renovation projects		12/31/2016	9/30/2018
Change Orders are not adequately documented or addressed in written procedures	Develop and codify process for managing Change Orders		12/31/2016	9/30/2018

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

Issue:	Recommendation	Actual	Estimated	Revised
Greater clarity needed in Purchasing Policy & related Admin Manual	Admin Services Division should modify & expand both the Purchasing Policy and the related Admin Manual		12/30/2011	9/30/2018
Daily operating procedures ("desk procedures") need enhancement re control procedures	Procurement Unit should update & expand its written, daily operating procedures		12/31/2011	9/30/2018
"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	9/30/2018

Audit Recommendation Follow Up

Benefits

Status: **Implemented**

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	6/30/2018	12/31/2013	6/30/2018

Audit Project: **Member Death Record Process (October 31, 2017)**

Issue:	Recommendation	Actual	Estimated	Revised
Data Confidentiality and Privacy - Monitor Benefits External Vendors	Data Confidentiality and Privacy - Monitor Benefits External Vendors	6/28/2018	3/31/2018	
Lower Probability Death Matches	Consider Implementing a Similar Payment Hold Process as the One Used for the ADR Process	6/28/2018	6/30/2018	

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

Issue:	Recommendation	Actual	Estimated	Revised
No documented procedures for staff that process Returned Automatic Deposit Receipt (ADR) holds	Develop documented procedures for staff that process ADR holds		6/30/2014	6/30/2019

Audit Project: **SCD Tax Indicator (July 3, 2013)**

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

Status: **Pending**

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

Issue:	Recommendation	Actual	Estimated	Revised
--------	----------------	--------	-----------	---------

Audit Recommendation Follow Up

Benefits

Status: **Pending**

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

Issue:	Recommendation	Actual	Estimated	Revised
Birth Certificate Missing for Options Retirees	Implement a Certificate Requirements Review		6/29/2018	9/30/2018

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

Issue:	Recommendation	Actual	Estimated	Revised
Controls over Certificates Processing	Update the Organization-wide Certificates Policy		6/29/2018	6/30/2019

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

Issue:	Recommendation	Actual	Estimated	Revised
1st Payment - Separation of Duties	Implement secondary review		12/31/2012	9/30/2018

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	9/30/2018

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

Issue:	Recommendation	Actual	Estimated	Revised
Expand the Automation of Special Payment Approvals	Automate the Approvals of Special Payments Processes Where Approvals are Currently Performed Manually		12/31/2017	12/31/2018

Audit Project: **Member Death Record Process (October 31, 2017)**

Issue:	Recommendation	Actual	Estimated	Revised

Audit Recommendation Follow Up

Benefits

Status: **Pending**

Audit Project: **Member Death Record Process (October 31, 2017)**

Issue:	Recommendation	Actual	Estimated	Revised
Data Confidentiality and Privacy - External Partners Monitoring - Control System	Data Confidentiality and Privacy - External Partners Monitoring - Control System		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	9/30/2018

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

Issue:	Recommendation	Actual	Estimated	Revised
Recreating Timelines	Develop a Process for Certifying Member Timelines		6/30/2016	9/30/2018

Audit Recommendation Follow Up

Disability Retirement Services

Status: **Implemented**

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

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

Audit Recommendation Follow Up

Investments

Status: **New**

Audit Project: **Securities Lending (May 30, 2018)**

Issue:	Recommendation	Actual	Estimated	Revised
LACERA Incurs Additional Cost for Using Third Party Agents	Assess Fee Implications of Using Third-Party Agents		6/30/2019	
The Increase in Non-Cash Collateral Alters the Risk-Return Profile of the Program	Review SLAA Provisions on Non-Cash Collateral		9/30/2018	

Status: **Pending**

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

Issue:	Recommendation	Actual	Estimated	Revised
No formal Information Management System or Customer Relationship Management (CRM) System to manage information	Consider implementing a CRM System		6/30/2016	12/31/2018

Audit Recommendation Follow Up

Systems

Status: **Pending**

Audit Project: **Data Backup/Retention Testing (February 14, 2018)**

Issue:	Recommendation	Actual	Estimated	Revised
Disaster Recovery Test Exercise Needed	Schedule System Recovery Exercise		12/31/2018	
Macintosh System Backup Process Deficiency	Include Macintosh System With Offsite Storage Process		6/30/2018	7/31/2018

Audit Project: **Systems Penetration Testing 2017 (January 25, 2018)**

Issue:	Recommendation	Actual	Estimated	Revised
Internal Metadata Information Found on Published Documents	Enforce Metadata Disclosure Restrictions		1/31/2018	7/31/2018

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	6	9/30/2018	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	6	9/30/2018	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	6	9/30/2018	<p>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 09/30/2018.</p> <p>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.</p> <p>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.</p> <p>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. Estimated Completion date 09/30/2018.</p>
Benefits	1st Payment - Separation of Duties	Implement secondary review	5	9/30/2018	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	4	9/30/2018	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.
	Recreating Timelines	Certify Member Timelines	4	9/30/2018	The ACE training program is currently being developed by a team made up of QA, Benefits, and the former QA Division Manager.

Investments	<i>No Formal Information Management System or CRM system to manage information</i>	<i>Consider implementing CRM system</i>	2	12/31/2018	<i>Due to limited Systems staffing resources the action plan for this recommendation was postponed until after the Systems Division implemented the org-wide operating systems conversion in July 2017. Since then, Investments and Systems staff have been collaborating to select a vendor. The team is currently assessing the capabilities of two vendors. The goal is to select a vendor by September and rollout a new system by year end. In the meantime, staff continues to manage investment related information using LACERA's existing network folders and directories.</i>
--------------------	------------------------------------------------------------------------------------	-----------------------------------------	---	------------	-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------



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**



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**