

MINUTES OF THE AUDIT & COMPLIANCE COMMITTEE MEETING
July 25, 2017

Members Present:

David Morris, Vice Chairperson
Renee Friedman, Appointed Trustee
Loren Iglarsh, SERS Retiree

Others in attendance:

Tim Blair, Executive Secretary
Casey Evans, Chief Internal Auditor
Staceyann Cabey-Kaufmann, Internal Auditor

The Audit and Compliance Committee convened on Tuesday, July 25, 2017, at 9:00 a.m. in the System's Springfield office with a videoconference location at the Bilandic Building in Chicago. A quorum of the committee members was present. Seeing that there were no public comments, Vice Chairperson Morris moved to approve the minutes from the April 25, 2017 Audit and Compliance Committee meeting with Retiree Iglarsh seconding the motion. CIA Evans began the meeting first discussing the annual review of the two-year internal audit plan and internal audit charter.

The Internal Audit Charter was annually updated to reflect changes in the Internal Auditing Standards and generally provides the mission, purpose, authority, and responsibility of the internal audit function. The two-year internal audit plan was presented as CIA Evans discussed planned audits for FY2018. A small sample of the planned audits was discussed which included recalculations of monthly benefits each quarter, IT modernization reviews as developments are completed, an IT Security Review, and an audit of the Qualified Illinois Domestic Relations Order.

The group discussed possible considerations in audit procedures which included sampling higher dollar annuitants and reciprocal or other manual calculations when performing recalculations. The auditors will be looking at a mixture of benefits including retirement, survivor, and disability benefits. Typically, most pension cases are very straightforward, but the risk does lie with more complicated or manual benefit calculations. If the auditors are able to isolate the more difficult transactions, they will skew their testing which should produce better audit results.

Discussion ensued to if the auditors would look at administrative rights to the Systems' database. CIA Evans stated that the audit will be using federal standards known as NIST (National Institute of Standards and Technology) and testing will be performed on System access rights of various programs and databases. Following discussion of the planned internal audits for FY2018, Trustee Friedman moved to approve the internal audit charter and two-year audit plan. Vice Chairperson Morris seconded this motion and these internal audit documents were approved.

The Committee moved on to discuss recently completed and issued internal audit reports. CIA Evans noted that Staceyann and he had worked hard to complete two larger audit projects at the end of the fiscal year which included audits of Survivor and Death Benefits and Cash Receipts and Receivables. The Survivor and Death Benefits audit consisted of member file review and benefit recalculations within the calendar years of 2015, 2016, and 2017. The objective of the audit was to determine the survivor and death benefits paid were accurate and to substantiate benefit eligibility through reviewing the member's file contents. A focus was placed on reviewing the internal controls in the processes, examining the Pension Sections

business continuity efforts, and considering the adequacy of member education related to survivor and death benefits.

During this audit, 60 survivor annuities were sampled and tested for accuracy and file completeness. This involved the internal auditors first recalculating the member's retirement annuity before calculating the survivor's annuity payable. CIA Evans explained that since the survivor's benefit is based on the member's retirement benefit at death, it was necessary to recalculate the original gross monthly retirement benefit and then project forward any benefit adjustments or benefit increases. This resulted in more work for the auditors but allowed them to review the accuracy of both retirement and survivor benefits.

During this testing, the auditors' calculations were typically within \$0.01 to \$0.05 due to rounding of decimal places in the calculations and no significant issues were noted. In the review of member file contents, CIA Evans explained that Staceyann and he routinely saw evidence that the necessary eligibility documents such as applications, birth certificates, death certificates, marriage certificates and various other support was properly retained.

In the auditor's discussion with staff regarding computerized system controls in processing survivor and death benefits, it was learned that legacy system weaknesses exist that could allow for bypassing of manual controls or could potentially cause calculation errors in certain isolated instances. After review of the system controls, one finding was drafted that pointed to the system limitations noted. Management had accepted this finding and stated that fixes will be put into place during the modernizing of the benefit systems.

The Committee discussed the recently completed cash receipts and receivable audit of FY2017. CIA Evans stated that during May and June, internal audit reviewed cash receipts and receivables to determine the recording, reporting, and deposit of all cash receipts was timely and accurate. In addition, the auditors reviewed internal controls and segregation of duties in the process of maintaining cash receipts and receivables. Finally, the auditors also placed an emphasis on determining account receivables are timely collected with evidence of ongoing collection efforts.

CIA Evans briefly highlighted the various types of cash receipts received by the System and noted the largest cash receipts received is for the State's required contribution to the pension funds and for deposits related to any sales of investments. He explained that essentially these are fund transfers from the Office of the Comptroller and therefore some of the risks are reduced because there is not a physical exchange of cash or negotiable document. Thirty cash deposits totaling over \$256 million were tested and the auditors determined the deposits were properly supported, approvals were present, and the deposit was accurate and timely deposited. Further, no internal control issues were noted in a review of the administration of cash receipts or deposits.

Internal audit placed a focus on the largest receivable category, claims arrearages. Thirty claims arrearages were reviewed totaling over \$848,000. In review of claims arrearages, one finding was drafted that noted weaknesses in the accounts receivable process. This included accounts that were significantly delinquent in repayment and in some cases, no avenue for collection existed to recoup these funds. The auditors also determined that these accounts should be considered for write-offs. Further, the auditors noted that in a portion of the accounts sampled, there was no recent evidence of collection of these bad debts. CIA Evans explained that in discussing these issues with staff, it was learned that the systems and processes used in managing receivables are very manual, not streamlined, and there is no level of automation present. Recommendations were provided in the audit report for future enhancements needed during the computerized systems modernization and management agreed with the audit finding and recommendations provided.

CIA Evans also explained that the internal auditors were also heavily involved in the recent IT developments through attending various meetings, providing insight into internal controls needed and performing testing of the application. It was explained that the most recent development was for the Judges' and General Assembly Retirement Systems retirement setup. This project was chosen as a stepping stone towards the development of the much larger benefit setup for SERS. Internal Audit's largest contribution to the development was through their request of additional internal controls for the executive approval, denial, and review of benefit calculations. In addition, controls were requested when benefit overrides were needed. The internal auditors will be involved with future developments which will include planned changes to optional service purchase setups, review of SERS retirement setups, and review of accounting arrearages.

Upcoming internal audit work was discussed which includes an audit over the Qualified Illinois Domestic Relations Order (QILDRO). It was explained that the QILDRO is a division of retirement, refund or death benefits due to legal separation or divorce of a member. This essentially does not create a new benefit or provide any greater benefit amount, but rather results in a portion of the member's gross monthly benefit being payable to an ex-spouse or other dependent named in the court order. Internal audit would be testing for compliance with statutory provisions of the Pension Code related to QILDRO and would be performing more benefit recalculations. Along with IT development work that will be upcoming, the auditors will also start planning for the IT Security Review which would be a larger project.

CIA Evans noted the external auditors were back on site for testing but it was still very early in the audit process. He noted that typically in the fall, he is busy gathering documents, tasking out audit requests, and answering questions from the external auditors. CIA Evans stated that the addition of Staceyann will be a great benefit to the System as she will be able to continue internal audit projects as the external audit progresses. This should help keep internal audit projects moving forward towards completion. During the January committee meeting, the group will likely have a much better understanding of the audit's progress and any potential issues noted.

The Committee moved on to the discussion of any new or old business. Seeing that there was no new business or old business for discussion, Retiree Iglarsh moved to adjourn the meeting with Trustee Friedman seconding the motion. The Audit and Compliance Committee adjourned at 10 a.m. to begin the scheduled Board of Trustees meeting. The next scheduled meeting of the committee will be Tuesday, October 31, 2017, at 9:00 a.m.