



SCHOOL EMPLOYEES RETIREMENT SYSTEM OF OHIO

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LISA J. MORRIS
Executive Director

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Deputy Executive Director

September 20, 2013

Bethany Rhodes, Director
Ohio Retirement Study Council
88 East Broad Street, Room 1175
Columbus, Ohio 43215

Dear Ms. Rhodes,

Pursuant to R.C. 3309.044, enclosed please find a report of actions taken by the Audit Committee of the SERS Retirement Board during the preceding fiscal year, FY2013.

Please feel free to contact me if you have any questions.

Sincerely,

Lisa J. Morris
Executive Director

Enclosure

RETIREMENT BOARD

JAMES A. ROSSLER, JR.
Chair, Appointed Member

DANIEL L. WILSON.
Vice-Chair, Appointed Member

NANCY D. EDWARDS
Appointed Member

MADONNA D. FARAGHER
Employee-Member

CHRISTINE D. HOLLAND
Employee-Member

CATHERINE P. MOSS
Retiree-Member

BARBRA M. PHILLIPS
Employee-Member

DEBRA J. BASHAM
Employee-Member

VACANT
Retiree-Member

School Employees Retirement System Audit Committee Annual Report Fiscal Year 2013

The following report documents the activities of the SERS Audit Committee and the SERS Internal Auditor for FY2013. This report is prepared for the SERS Audit Committee and is separated into four areas:

- I. Audit Reviews Completed
- II. Special Projects Completed
- III. Summary of Audit Committee Meetings and Actions Taken
- IV. FY2014 Annual Audit Plan

I. Audit Reviews Completed

This section documents the SERS Internal Auditor's completed reviews and projects for FY2013.

External Quality Assessment Review: During the week of September 10th, the Institute of Internal Auditors (IIA) performed an external quality assessment review (QAR) of internal audit operations. The principal objectives of the QAR were to assess SERS Internal Audit activity's conformance to The IIA's *International Standards for the Professional Practice of Internal Auditing (Standards)*, evaluate Internal Audit activity's effectiveness in carrying out its mission (as set forth in its charter and expressed in the expectations of management), and identify opportunities to enhance its management and work processes, as well as its value to the organization.

As a part of the review, extensive interviews were held with SERS' Audit Committee Chair, SERS' administration and directors, external auditors, and staff. Also reviewed were the Internal Audit activity's risk assessment and audit planning processes, audit tools and methodologies, engagement and staff management processes, and a representative sample of the Internal Audit activity's working papers and reports.

At November's Board Meeting, the Board approved the responses to the IIA external quality assessment preliminary report. The IIA accepted all SERS responses with no changes. The final report was then issued by IIA. The final report can be found on the Board website.

Quality Assessment Review Follow-Up Work: The IIA recorded a number of observations which would improve the performance and efficiency of SERS internal audit. Internal Audit worked on the following IIA observations:

Audit Time Tracking: The IIA made an observation concerning the tracking of audit and non-audit time. During October 2012, a time tracking system was established to facilitate the management of audit activities.

Management Control Policy: A management control policy was written in December 2012 which defined the roles of internal control, management, audit committee, internal audit and external auditor roles.

Board Retreat Presentation – February 2013: The Internal Auditor gave a presentation on audit committees at the SERS Board retreat. The areas discussed included:

- Audit Committee Purpose
- Composition
- Meetings

- Audit Committee Charters
- Areas that an Audit Committee should focus on

Audit Committee Charter: Using feedback from the February Board retreat, a draft copy of an Audit Committee charter was prepared. The document followed the IIA model audit committee charter and included modifications from other pension internal audit departments. The Board provided their feedback and the changes were incorporated into the second revision of the charter. This document was approved at the March Board Meeting.

Internal Audit Operating Manual: This manual was revised to incorporate current IIA standards and audit practices. The manual includes IIA observations and practices on audit risk assessment procedures, engagement planning, work paper documentation, reporting and follow-up procedures. This manual was reviewed at the February Board Meeting.

Post Audit Survey Process: The IIA noted that surveying audit clients on a regular basis is a successful practice that helps improve internal audits activity perception with customers. Surveys from the Association of Pension Fund Auditors (APPFA) and other professional contacts were received. From these surveys, a client survey was developed that will be distributed to personnel after an audit is completed. The audit survey was reviewed at the March Board meeting.

Audit Committee Appointments: In April 2013, the SERS Board Chair appointed an audit committee chair and two board members to the audit committee. The audit committee met in May and June 2013.

Investment Incentive Compensation: The purpose of this audit was to review the controls and payments associated with the 2012 Investment Incentive Compensation program. This audit was a regularly scheduled review based on the three-year audit cycle. The purpose of the Incentive Plan is to provide a compensation package that allows SERS to recruit and retain the talent in the Investment Department that is necessary to attain investment returns that are above approved benchmarks.

The scope for the audit included a review of all nine investment incentive compensation payments for fiscal year 2012 (July 2011 – June 2012). The payments were examined to determine that they were properly computed based on the following attributes or control points tested:

- Verified that the incentive compensation plan was approved by the SERS Board before payment.
- Verified Investment personnel job titles to determine incentive compensation eligibility.
- Verified that the participant is employed and considered an active employee on the date the incentive compensation is paid.
- Verified investment performance measures and asset class weighting used in computing payments.
- Verified base salary used for purposes of computing incentive compensation.
- Recomputed incentive compensation payments and compared to SERS' payment calculations.
- Reviewed FY 2012 eligibility and payment waiver criteria for participants.
- Verified that incentive compensation payment calculations are reviewed and approved by the Executive Director.
- Verified, via payroll records, that the gross amount paid equates to the amount computed and the payee is the correct investment person.

The audit report was issued on December 6, 2012 with one minor audit comment.

MARS Change Reporting: The next two reviews were done as a result of a management letter comment from an external audit. In 2002, Internal Audit began quarterly reviews of online reports

for changes in contribution and service credit information, tracking overrides of calculated base disbursement amounts, and tracking demographic changes made to recipients of recurring benefits. The Member Accounting Record System (MARS) is SERS' internally developed computer system used to keep track of member and retiree information, payments, etc.

- **MARS Change Report - April / June 2012:** Report issued July 10, 2012. No material comments were noted.
- **MARS Change Report - July / December 2012:** Report issued February 8, 2013. No material comments were noted.

Investment Staff Disclosure Review: In 2007, SERS implemented a policy and procedure that covers the supervision of investment operations and disclosures by investment staff for the purposes of complying with Ohio law. It is imperative that the investment information and advice provided by SERS' investment staff is not impaired by conflicts of interest. Annually, investment staff files a report consisting of the following documents:

- Investment staff certification
- Individual's latest Financial Disclosure Statement filed with the Ohio Ethics Commission
- Individual's latest Professional Conduct Statement filed with the CFA Institute

A review was performed on these documents. The audit report was issued on July 29, 2012 with no material comments.

Investment Fiduciary Audit (Investment Performance): Investment performance measures were reviewed by Funston as part of the investment fiduciary audit. Therefore, this audit changed from investment performance to investment fiduciary audit. Internal Audit worked with SERS' senior management on reviewing proposals and vendor selection for the investment fiduciary audit review. The Internal Auditor was interviewed by Funston concerning internal audit activities and processes on January 30, 2013. Comments about Internal Audit's function were made to the Board during the May meeting.

II. Special Projects Completed

This section documents the SERS Internal Auditor's special projects for FY2012 and key comments identified.

Annual Audit Committee Report: The FY2012 Audit Committee report was reviewed at the September Board meeting and sent to the Ohio Retirement Study Council (ORSC) on September 24, 2012.

IIA Red Book Notes: At the October 2012 Board meeting, the Audit Committee heard a presentation from the IIA on the results of the external quality assessment. This assessment was performed on SERS Internal Audit operations. During the discussion, mention was made of the book on internal auditor standards of performance. The book is known in the internal audit world as the Red Book. The IIA has two audit standards books: The Yellow Book is for government auditors and the Red Book is used by all other auditors, which would include SERS.

During the October IIA presentation, a request was made to summarize the Red Book. This was a difficult task because the Red Book is a 200-page textbook of rules and standards of performance. In order to make this assignment manageable, Internal Audit was able to distill three main sections of this book:

- The IIA definition of Internal Audit
- Internal Audit Code of Ethics
- The International Standards for the Professional Practice of Internal Auditing

This report was organized into the three sections listed above. Lastly, a glossary of audit terms used was included with the terms defined. This report was completed on October 24, 2012.

Access Management Inquiry: At December's Board meeting, an inquiry was made as to SERS' frequency for auditing individual's access rights to its internal computers and related technology systems. A memo for the February Board Meeting was prepared responding to this inquiry.

Member and Retiree System (MARS) Replacement: The MARS computer system is in process of being replaced over the next three to four years. As a member of this team, the Internal Auditor is involved in joint application development team meetings with emphasis on data security controls. Status – Ongoing.

SERS Information Security Team: The purpose of this project team is to develop an expanded, enterprise-level SERS Information Security Program. While appropriate procedures exist today to preserve the integrity of SERS' electronic data, new threats created by changes in technology, modified internal and external business processes, and trends in criminal activity worldwide are driving the need to consistently apply and expand SERS' information security protections. The Internal Auditor's role on this committee is to review SERS' compliance with information security. Projects completed during FY2013 include:

- Development of a scorecard based on National Institute for Standards and Technology (NIST) standards that will be reviewed and completed yearly,
- Health Insurance Portability and Accountability Act (HIPAA) and Health Information Technology for Economic and Clinical Health Act (HiTECH) training yearly for all SERS employees.
- Development of an incident response system for the handling of protected health information.

III. Summary of Audit Committee Meetings and Actions Taken

This section identifies the dates of all meetings held and appropriate Audit Committee actions that took place at those specific meetings.

July 2012 – Internal Auditor presented the following reports:

- MARS Change Testing – April / June 2012

August 2012 – Audit Committee did not meet.

September 2012 – Internal Auditor presented the following reports:

- FY2013 Audit Committee Report for the Ohio Retirement Study Council
- Investment Staff Disclosure Review

October 2012 – The IIA presented the results of the SERS Internal Audit Quality Assessment Review performed in the first quarter of FY2013.

November 2012 – Internal Auditor presented the following reports:

- IIA Red Book Notes
- IIA Preliminary Quality Assessment Review Report Response

December 2012 – Audit Committee reviewed the FY2012 Annual Financial Statements presented by the external auditors. Full Board approved Audited Financial Statements.

Internal Auditor presented the following reports:

- IIA Quality Assessment Review Final Report
- Investment Incentive Compensation

January 2013 – Audit Committee did not meet.

February 2013 – Internal Auditor presented the following reports:

- Audit Committee Charter
- Internal Audit Operating Manual

- MARS Change Report for January / March 2012

March 2013 – Internal Auditor presented the following reports:

- Audit Committee Charter (2nd version)
- Post Audit Survey Process

April 2013 – Audit Committee did not meet. A new audit committee structure was implemented based on the IIA Quality Assessment Review recommendation for governance. A three person team of the SERS Board was appointed to the Audit Committee.

May 2013 – The first meeting of the new SERS Audit Committee discussed:

- Audit Committee Purpose
- The roles of the external and internal audits
- March / April Conference report
- Meeting Schedule

June 2013 – The Audit Committee discussed:

- Audit Committee Chair's discussion with external audit partner
- Internal Audit FY2014 Audit Plan update
- Quality Assessment Review recommendation progress

IV. FY2014 Annual Audit Plan

The one- and three-year audit plans for FY2014, FY2015, and FY2016, and risk assessment documents, were reviewed by the SERS Audit Committee in July 2013. The following documents Internal Audit's scheduled reviews and projects by department for FY2014.

<u>Department</u>	<u>Audit Project</u>
Member Services	No audits scheduled
Investments	Investment Staff Certification
Executive	Employee Payroll
Administrative Services	Purchasing
Information Technology	Access Security – MARS Enterprise Security Program
Finance / Health Care	Vendor Invoice Approval Process

If you have any questions about this report, feel free to call me at 614-222-5892.

Respectfully submitted:



D. Trzeciak, CPA, CFE, CRMA

Dennis A. Trzeciak, CPA, CFE, CRMA
Internal Auditor