



# **OPERS Ohio Public Employees Retirement System**

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January 8, 2007

Mr. Aristotle Hutras  
Ohio Retirement Study Council  
88 East Broad Street, Room 1175  
Columbus, OH 43215

Dear Aris:

Pursuant to R.C. 145.095, enclosed please find the 2006 annual Audit Committee Report of the OPERS Retirement Board. This report summarizes internal audit activities and identifies actions taken by the Audit Committee during the preceding year.

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

Sincerely,

Chris DeRose  
Executive Director





## **Audit Committee Annual Report**

**To:** Ohio Retirement Study Council (ORSC)

**Subject:** OPERS Audit Committee Report- 2006

**Date:** December 19, 2006

The following report documents the activities of the OPERS Audit Committee and Internal Audit Department for 2006. This summary outlines:

- Major Audit Reviews Completed (please see attached schedule)
- Audit Committee Meetings and Actions Taken
- 2007 Annual Audit Plan (priority review areas)
- Special Reviews Completed

### **Summary of OPERS Audit Committee Meetings and Actions**

The OPERS Audit Committee met on the following dates with any specific considerations addressed:

**March 15, 2006-** The Audit Committee met and discussed the Investment Compliance alignment considerations. The final audit evaluation and proposed recommendation will be presented at the 3<sup>rd</sup> Quarter Audit Committee meeting. In addition, the Audit Committee Charter was discussed as part of the biennial process. The committee also received the quarterly status report of significant audit issues and recommendations.

**May 16, 2006** - The KPMG auditors were present to provide the results of the 2005 OPERS financial examination. There were no management letter comments presented by the external auditors. The Audit Committee reviewed a purchasing policy compliance matter. The committee was also briefed on the preliminary results of the external quality assurance review completed of the internal audit process. The final report was provided in June, 2006 with the Audit Department generally complying ( highest category) with the IIA International Standards for the Professional Practice of Internal Auditing. In addition, the committee also received an executive summary report of major audit activities for the prior six months.

**October 2, 2006** – The Audit Committee reviewed and approved the following: 2007 audit plan; the 2007 internal audit administrative and time budget/staffing. The committee also reviewed the organizational risk assessment and the 2007 priority review areas identified through this process. In addition, the chief audit executive discussed the external quality assurance review recommendations presented and plan of action response. The committee also received the quarterly status report of significant audit issues and recommendations.

**November 15, 2006**- The Audit Committee reviewed the Internal Audit/Finance Division recommendation for the external auditor appointment, as required by the Audit Committee charter. The auditor change was necessitated by KPMG resignation after being named as defendant in an OPERS lawsuit. The committee supported the selection of Clifton Gunderson as the OPERS external auditor for the financial statement review years 2006-2010. OPERS decision was communicated to the Auditor of State for final approval.

**December 19, 2006** - The Audit Committee reviewed and approved the 2006 draft of the OPERS Audit Committee Annual Report to ORSC. The committee also received an executive summary report of major audit activities for the prior six months. In addition, committee reports provided include: the annual report of OPERS Personal Trading compliance; the annual disclosure of all fees paid to external auditor; and the quarterly status report of significant audit issues and recommendations.

## **2007 Annual Audit Plan**

The 2007 audit plan and risk assessment was reviewed and approved by the OPERS Audit Committee at the October 2, 2006 meeting. The priority review areas are summarized on the attached audit plan document.

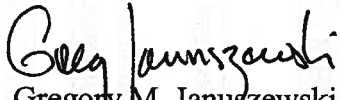
## **Special Reviews**

The following major review was completed during 2006 with appropriate comments indicated. External Quality Assurance Review- The initial peer review of the OPERS Internal Audit Department was conducted, as now required every five years by the Professional Practices Framework of the Institute of Internal Auditors (IIA). The OPERS Internal Audit Department

generally complies with the IIA's International Standards for the Professional Practice of Internal Auditing (highest ranking).

Please let me know if you would like any additional information.

Respectfully submitted:

  
Gregory M. Januszewski  
OPERS Internal Audit Manager  
(614)- 222-0080

**OPERS INTERNAL AUDIT  
2006 AUDITS COMPLETED**

AUDIT AREA	STATUS OF RECOMMENDATIONS	SIGNIFICANT COMMENTS
Securities Lending	Recommendations Implemented	None
DB2 IT Technical Review	Recommendations Implemented	Level 1 risks (high and requiring immediate attention) were addressed with appropriate resolution plan
Employer Billing Assessment	No Recommendations Presented	None
Pension Tax Reporting	Recommendations Implemented	None
Pension Overpayment Review	Recommendations Implemented	Legislative initiative to clarify Ohio Code intent required
Investment Compliance	Recommendations Implemented	Internal Audit reviewing organizational reporting alignment considerations
Real Estate Consultant	Recommendations Implemented	Formalize completion of all due diligence process steps
Real Estate Valuations	No Recommendations Presented	All valuations tested by 3 <sup>rd</sup> party were reasonable
Communications Purchasing	Recommendations Implemented	Guidelines for documenting purchases were reviewed with appropriate corrective action
TPG Private Equity Review	No Recommendations Presented	None
Brokers Commission Review	Recommendations Implemented	Investment staff will evaluate alternative execution analysis services for fixed income analysis
Estimates Review	Recommendations Implemented	None
Investran Private Equity	No Recommendations Presented	None
Investment Incentive Comp Review	No Recommendations Presented	None
Eagle Conversion -- Phase 1	Recommendations Implemented	Investment accounting data steward responsibilities were clarified
Service Retirement Review	Recommendations Implemented	None
MedCo Pharmacy Claims	Recommendations Implemented	Next RFP Proposal will further refine PBM contractual requirements
Domestic Equities Compliance	Recommendations Implemented	None
Capital Budgeting and Accounting	Recommendation Implemented	Review of cost reclassifications enhanced and Finance training provided to management staff
PRISA Real Estate Review	Recommendations Implemented	Consultant and Investment staff will continue to pursue right to audit clauses within contractual agreements of open ended commingled funds
Sarofim Real Estate Review	Recommendations Implemented	None
MCM Private Equity Review	Recommendations Implemented	Management fee calculations and contract provision were clarified
Linsalata Private Equity	No Recommendations Presented	None

**OPERS INTERNAL AUDIT  
2006 AUDITS COMPLETED**

AUDIT AREA	STATUS OF RECOMMENDATIONS	SIGNIFICANT COMMENTS
Private Real Estate Policy Compliance	Recommendations Implemented	Real Estate Managers to provide data directly to consultant
Private Equity Compliance	Recommendations Implemented	Policy revised to identify specific responsibility for compliance reporting
Board and Staff Travel	Recommendations Implemented	OPERS is reviewing itemized receipt requirement compliance
Asset Allocation and Rebalancing Review	Recommendations Implemented	Formal policies for asset allocation rebalancing responsibilities were defined
Eagle Conversion- Phase II	Recommendations Implemented	Phase I issues are being satisfactorily addressed
Administrative Expenses	Recommendations Implemented	Vendor validation requirements were developed
Cash Management	Recommendations Implemented	None
HCPP Review Status	Ongoing Recommendations Presented	Systems program logic changes being reviewed
Stone Harbor External Manager Review	No Recommendations Presented	None
Imaging Review Status	Recommendations Implemented	None
QEBA Benefit Review	Recommendations Implemented	None
Corporate Actions	Recommendations Implemented	None
Lowe RE Manager Review	Recommendations Implemented	Property management agreements should reflect current fee structures
DC Plan Expense Review	No Recommendations Presented	None
HB 98 (BEPS) System Review	Recommendations Implemented	None
TOPS Service Credit System	Review Ongoing	System program logic test results are being reviewed and corrected
Purchasing Follow up Review	Recommendations Presented to Management	OPERS reviewing overall purchasing policy
Investment Compliance Reporting Considerations	Recommendation Discussed with Audit Committee	Compliance Manager hired and reporting changes within Investment Division are being transitioned
Investment Soft Dollars	Recommendations Presented to Management	Soft Dollar policy should define internal portfolio guidelines
Citistreet DC Review	Review Ongoing	
Quarterly Personal Trading Reviews and Annual Summary	Recommendations Implemented	The process was enhanced for timely distribution and orientation of Personal Trading manual and guidelines to new staff
Bristol Real Estate Manager Incentive Fee	Third party review initiated	
Derivatives Review	Review Ongoing	
Flex Trade IT Review	Review Ongoing	
Board and Staff Travel	Review Ongoing	

**OPERS INTERNAL AUDIT  
2006 AUDITS COMPLETED**

AUDIT AREA	STATUS OF RECOMMENDATIONS	SIGNIFICANT COMMENTS
Wellington External Manager Review	Recommendations Presented to Management	None
Manager and Vendor Ethics Confirmation Review	Review Ongoing	Annual random confirmation of gifts to board and staff in progress
Personal Pre Approval Trading System Process	Review Ongoing	Per Approval Trading System to be introduced January, 2007
External Quality Assurance Review- Internal Audit	Recommendations Implemented	2007 Timeline for certain administrative and reporting recommendations during initial transition period



**OPERS Internal Audit Plan**  
**Detail on Critical Audit Priority Reviews - 2007**

<b>Reporting Entity</b>	<b>Audit Area(s)</b>	<b>Objective</b>
Investments/Private Equity	Investment Manager/General Partner Reviews (3)	These reviews will continue focusing on investment management agreement compliance, due diligence documentation, investment valuation policy compliance and management reporting.
Investments/Real Estate	Investment Manager Reviews (2)	These reviews will continue focusing on investment management agreement compliance, due diligence documentation, investment valuation policy compliance and management reporting and be completed by internal staff.
Investments/Opportunistic	Hedge Fund Manager and Active Currency Reviews (2)	These reviews will focus on the investment management agreement and compliance for this opportunistic investment. Third party participation review and assistance will be utilized when appropriate.
Investments/Total Fund	Consultant Review	This review will examine compliance with provisions outlined in the current board consultant agreement.
Investments/Public Market Manager Reviews	<ul style="list-style-type: none"> <li>* External Manager Reviews (3)</li> <li>* Public Manager Search Policy Review</li> <li>* External Manager Oversight Review</li> </ul>	These reviews will assess a number of key areas as follows: - Investment management agreement compliance - Management reporting - Investment compliance guidelines and practices - Manager ethics and trading policies - OPERS manager evaluation and selection process <b>Note: the hedge fund manager and external manager oversight reviews will require third party (external audit) consulting assistance as appropriate.</b>
Investments/Total Fund	Incentive Compensation & Investment Performance Calculations	This review is intended to ensure that investment performance reporting is both accurately and consistently reflected based upon Eagle Pace/Star investment accounting system activity and custodian bank reporting links to generate proper incentive compensation payments.

**OPERS Internal Audit Plan**  
**Detail on Critical Audit Priority Reviews - 2007**

<b>Reporting Entity</b>	<b>Audit Area(s)</b>	<b>Objective</b>
Investments/Total Fund	Investment Accounting, Reporting, Reconciliations, Etc. - A Continuous Audit Process	Review will determine if investment accounting and custodian bank databases are synchronized allowing the generation of accurate and consistent internal reports on a daily/monthly basis for internally and externally managed assets (and flag potential problem areas for subsequent review/inquiry with investment accounting staff). In addition, a review will focus on Eagle post implementation reporting issues.
Investments/Total Fund	Investment Compliance (3)	These ongoing reviews will address investment policy compliance for the asset classes as well as the organizational reporting changes implemented during 2006-2007.
Finance- Accounting	Payroll	Follow up review of this area will examine payroll system reporting and policy guidelines compliance, while reviewing payroll documentation.
Finance- Accounting	Travel	These ongoing periodic reviews determine board and staff compliance with OPERS Travel policies and identifies any issues requiring further review.
Finance- Contribution Reporting	Contribution Reporting- Employee, Employer Billing, Accounting	Review will examine accounting, reconciliation controls and reporting for the Savings System and the EASE Employers Reporting System.
Finance- Defined Contribution	DC Plan Review and DC System Enhancements	Review will examine accounting controls and reporting for the DC plan as well as planned system accounting and reporting enhancements.
Benefits Admin. - Member Benefits	TOPS Purchased Service Credit Application and Transfers to Other Systems	These system/operational reviews focus on validating the purchased service credit calculations for all service credit types and ensure they are consistent with Ohio Revised Code and transfers made to other Ohio retirement systems.
Benefits Admin. - Refunds/Inactive Accounts	Refunds and Savings System Data	Review of Member Refunds activity will be completed with audit confirmations. In addition, internal processes directed at inactive member account activity will be reviewed.
Benefits Admin. - Retirement Benefits	Multiple Beneficiaries ( House Bill 98), Survivor Benefits, and FAS Projection Calculations	These system/operational reviews will ensure internal processes are sound, and proper application controls are present to both process changes and areas affected by recent legislation.

**OPERS Internal Audit Plan**  
**Detail on Critical Audit Priority Reviews - 2007**

<b>Reporting Entity</b>	<b>Audit Area(s)</b>	<b>Objective</b>
Benefits Admin. - Health Care	HCCP Eligibility/Claims Paid Review	This extensive automated driven audit will verify the eligibility of all claims paid with the HCCP changes introduced.
Benefits Admin. - Health Care	Health Care Cash Flows and GASB 43	These two separate reviews will focus on the health care costs/cash flows and reviewing the accounting components used in determining the unfunded health care liability projection.
OPERS - Other	Contracts	Internal review will be completed to ensure that OPERS legal executed contract agreements are present with level of consistency in reporting formats if applicable.
OPERS - Other	Ethics	This ongoing review will verify that OPERS managers, business partners and vendors are in compliance with Ohio Ethics laws prohibiting gifts to OPERS staff and board.
OPERS - Other	Human Resources Administrative Review	This review will be completed in conjunction with payroll review to assess consistency of information and documentation maintained in employee files.

