

Fiduciary Performance Audit of the School Employees Retirement System of Ohio

Conducted on Behalf of the
Ohio Retirement Study Council

May 11, 2017



Introductions

- Rick Funston, Managing Partner, Funston Advisory Services LLC
- Keith Johnson, Partner, Reinhart Law
- Randy Miller, Principal, Funston Advisory Services LLC

Overview

- The Funston Advisory Services (FAS) team began our fiduciary performance audit of SERS during October 2016; the final report was submitted in early February 2017
- We reviewed six major areas, as specified in the RFP:
 1. Board Governance and Administration
 2. Organizational Structure and Staffing
 3. Investment Policy and Oversight
 4. Legal Compliance
 5. Risk Management and Controls
 6. IT Operations

Process

- Our fiduciary audit approach and activities included:
 - Review of over 200 SERS policies, procedures, and reports
 - Interviews with all trustees and over 30 SERS executives, as well as over 20 outside service providers
 - Use of peer benchmarking data from seven prior studies
 - In April 2017, we also completed a post-implementation review of the new SMART (SERS Member and Retiree Tracking) system

Reasonable Reassurance

- This evaluation was a fiduciary review and not a forensic investigation, a comprehensive compliance audit or an audit of financial statements
- Our review was intended to provide reasonable, but not absolute, reassurance on matters within scope of the project as addressed in the final report; however, a review of this nature cannot serve as a guarantee regarding past, current or future instances of fraud, malfeasance, compliance or performance
- Our work product is subject to the accuracy of data and information in the public domain or provided by the client and its agents, including information received in interviews and due diligence activities
- The scope of the project did not include independent verification or background checks of employees, service providers, third parties or accuracy of such data or information

Overall Findings

- Overall, the School Employees Retirement System of Ohio (SERS) is a well-run organization
 - The Board is appropriately authorized and actively engaged
 - Delegations appear prudent, staff are competent and roles and accountabilities are clear
 - SERS is compliant with pertinent legislation and regulations
 - Investment policy and oversight are robust and the investment organization has matured
 - Controls appear effective and the Internal Audit department does an effective job of providing independent reassurance
- Throughout the organization, we found examples of what we consider leading practices, as well as practices that are consistent with prevailing practices at peers

Overall Findings

- We identified no “red flags”
- However, as with any organization, improvements can always be made
- We made recommendations in each of the six areas:
 1. Board Governance and Administration
 2. Organizational Structure and Staffing
 3. Investment Policy and Oversight
 4. Legal Compliance
 5. Risk Management and Controls
 6. IT Operations

1. Board Governance and Administration

- In general, SERS' governance is strong – there appears to be effective Board oversight, delegations are prudent and powers reserved for the Board are clear
- SERS conflict of interest policies and practices are appropriate and effective
- SERS administration costs have been slightly higher than its peer group
- Now that the new SMART (SERS Member and Retiree Tracking) system has been implemented, SERS should re-evaluate its resource deployment
- SERS should also consider automating its budgeting process

2. Organizational Structure and Staffing

- SERS' organizational structure and management span of control is typical for a retirement system of SERS' scale, delegation of authority is clear, and the organization appears to function effectively
- SERS' human resources policies are comprehensive and its compensation structure appears to be effective
- The new SMART system should provide opportunities for SERS to improve its monitoring of member satisfaction

3. Investment Policy and Oversight

- SERS has a robust set of investment policies and procedures which are applied by a stable, well-credentialed professional staff
- SERS has implemented a number of improvements in its investment operations over the past three years
- SERS' investment staff have a focus on manager fees and effectively manage overall investment management costs
- Several aspects of SERS investment policies and practices can be considered leading practice:
 - Delegation of manager selection to staff
 - Separate operational due diligence team in manager selection
 - Investment portfolio rebalancing processes
- Overall, SERS' investment policies and practices are sound and are consistent with leading or prevailing practice

4. Legal Compliance

- SERS has established appropriate policies, procedures and practices to ensure it remains within IRS compliance
- SERS' legal function is staffed appropriately, outside counsel is qualified, and legal fees appear reasonable
- Board members and staff receive appropriate conflict of interest and ethics training
- All investment transactions and contracts we reviewed were approved and closed in accordance with investment policies

5. Risk Management and Controls

- SERS' financial control structure is appropriate
- SERS' accounting and reporting policies and practices are adequate; several improvement opportunities were identified
- Internal Audit has significantly improved over the past 18 months and is operating effectively
- Although SERS has improved its contract monitoring processes, it should consider implementing a contract management system
- Although SERS has improved its record management processes, it could benefit from a more capable record management system
- SERS has begun to implement an Enterprise Risk Management (ERM) capability, but could benefit from a more holistic approach to implementation

6. IT Operations

- Activities related to the SMART system implementation have dominated SERS' IT agenda for the past several years
- SMART “go-live” was successfully implemented in February 2017 and post-implementation follow-up activities are being effectively managed
- The project organization and use of third parties for the SMART implementation were leading practice
- IT security standards are appropriate, and use of third party experts appears to be effective
- Now that the SMART go-live is completed, it would be appropriate for SERS to revisit several areas:
 - Application needs in other areas of SERS
 - Future technology roadmap
 - IT sourcing strategies

Statutory Requirements

- Certain statutes should be reconsidered by the General Assembly:
 - The requirement to increase utilization of Ohio-qualified brokers is a lagging practice which creates an administrative burden and creates the potential for fraud/malfeasance
 - The typical public pension fund in the U.S. has one custodial bank; due to current Ohio law, SERS has two, plus a separate recordkeeper, resulting in higher costs and unnecessary operational complexity
 - The statute which designates the Treasurer of State as custodian is a lagging practice which adds a layer of unnecessary complexity
 - The requirement for the custodial bank to be “located in the state” eliminates four of the five major global custodial banks from consideration; the result is a separate sub-custodial bank for international operations, adding cost and complexity

Summary

- Overall, SERS operates effectively and Board oversight appears prudent
- SERS leadership has been receptive to our recommendations
- The General Assembly should consider certain changes to statutes related to:
 - Requirement to utilize Ohio-qualified brokers
 - Custody

Additional FAS Team Members

- Gina Eubanks, CIA, CISA, CCSA, CRMA
- Dan Grossberg, CPAA, CISA
- Megan Jackson, J.D.
- Jon Lukomnik
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For further information

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