



## Ohio Public Employees Retirement System

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January 3, 2008

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

Dear Mr. Hutras:

Pursuant to R.C. 145.095, enclosed please find the 2007 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,

A handwritten signature in black ink, appearing to read "Chris DeRose", is written over the typed name.

Chris DeRose  
Executive Director

Attachment



## **Audit Committee Annual Report**

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

**Subject:** **OPERS Audit Committee Report- 2007**

**Date:** January 2, 2008

The following report documents the activities of the OPERS Audit Committee and Internal Audit Department for 2007. This summary outlines:

- Major Audit Reviews Completed (please see attached schedule)
- Audit Committee Meetings and Actions Taken
- 2008 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 21, 2007-** The audit committee met for the first time in 2007, with several new board members present. The committee received an initial orientation on transition issues and audit committee responsibilities outlined in the OPERS Audit Committee charter. An update on the Investment Division compliance manager reporting structure change was provided. The committee also received the quarterly status report of significant audit issues and recommendations. In addition, an initial operational report of the new Crestline Hedge Fund, completed jointly by Deloitte & Touche and internal audit staff, was provided.

**April 18, 2007** – The audit committee received a consulting report presented by Investemnt Training and Consulting Institute. This review focused on the investment audit risk assessment process and the resulting audit approach considerations. Internal Audit management and staff reviewed the results and responses to the recommendations were presented. These changes were incorporated into the respective 2007 and 2008 audit plans going forward as appropriate.

The results of an internal review of the OPERS employer billing and penalty process was also discussed.

**May 16, 2007** – The Clifton Gunderson auditors presented the results of the 2006 OPERS financial examination. In addition, management letter comments on internal controls were presented and discussed with the audit committee. Internal Audit management also reviewed the results of an internal review conducted prompted by an inquiry.

The committee also received the executive summary of reviews completed during the previous six months with significant audit issue comments presented.

The quarterly status report of significant audit issues and recommendations was distributed to the audit committee prior to the scheduled June,2007 regular board meeting.

**September 12, 2007-** Internal Audit management and staff provided an overview of the audit process and cycle. An explanation and discussion of the risk assessment process was given to the committee in advance of the discussion scheduled later in the month. The discussion emphasized how results are integrated into the proposed annual audit plan.

**September 26, 2007-** The audit committee reviewed and approved the proposed 2008 Audit Plan and risk assessment. The committee also reviewed and discussed the proposed 2008 internal audit operating budget and staffing. This departmental budget will be approved as part of the OPERS overall annual budget process in December, 2007.

**December 18, 2007-** Clifton Gunderson external auditors were present for a preliminary discussion of the 2007 OPERS financial examination with the Audit Committee. In addition, they explained new risk standards and any applicability to OPERS.

Internal Audit management also provided updates on both results of the 2007 audit plan and a revised look at 2008. This discussion was necessitated by a recent staff termination and its potential impact on investment reviews planned.

The audit committee reviewed and approved the 2007 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.

## **2008 Annual Audit Plan**

The 2008 audit plan and risk assessment was reviewed and approved by the OPERS Audit Committee at the September 26, 2007 meeting. The priority review areas are summarized on the attached audit plan document.

### **Special Reviews**

The following major review was completed during 2007 with appropriate comments indicated.

Investment Risk Assessment Review- Investment Training and Consulting Institute (ITCI) completed a comprehensive review of the OPERS internal audit investment risk assessment methodology and audit approach for investments. This review had been suggested after discussions with the OPERS Audit Committee for purposes of benchmarking investment audit risk and coverage against best practices. Recommendations outlined were incorporated into both the remainder of the 2007 audit plan as well as planning for 2008.

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

Respectfully submitted:

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

**OPERS INTERNAL AUDIT  
2007 AUDITS COMPLETED**

AUDIT AREA	STATUS OF RECOMMENDATIONS	SIGNIFICANT COMMENTS
Investment Flex Trade System IT Review	Recommendations Implemented	No Level 1 (high risk) audit comments
Additional Annuity	No Recommendations Presented	None
Derivatives Review	Substantive Agreement to Recommendations Presented	OPERS Board still reviewing and clarifying Investment Division policy and portfolio guidelines
Global Bonds Compliance	Recommendations Implemented	In addition to external managers, internal staff is now required to complete a compliance statement
Health Care HCPP IT System Review	Recommendations Implemented	No Level 1 (high risk) audit comments
Board and Staff Travel	Recommendations Implemented	The Ohio Ethics Commission is presently reviewing revised Travel Policy provisions
Disability Retirement Process Review	Recommendations Implemented	The 1099 adjustment process was revisited with staff and additional training provided
Crestline Hedge Fund Review	Manager process comments were provided by Deloitte & Touche for consideration and discussion with OPERS Investment management	This was the initial hedge fund manager review completed and was completed jointly by Deloitte & Touche and OPERS internal audit staff
Consultant Review- Investment Risk	No Recommendations Presented	None
Castle Harlan General Partner Review	Recommendations Implemented	The General Partner is developing its code of ethics
BGI External Manager Review	No Recommendations Presented	None
Bristol External Manager Incentive Fee Calculations	No Recommendations Presented	None
Employer Penalty Reporting and Appeals Process	Recommendations Implemented	The Penalty Appeals process requirements were revised; OPERS also continues to pursue legislative changes to remedy the Revised Code intent and application of employer penalty charges
PAAMCO Hedge Fund Review	No Recommendations Presented	None
Account Balance Transfers- Other Retirement Systems	Recommendations Implemented	None
Public Manager Search Policy Review	Recommendations Implemented	Stricter adherence to OPERS RFP guidelines on deadline requirements was agreed upon going forward

**OPERS INTERNAL AUDIT  
2007 AUDITS COMPLETED**

AUDIT AREA	STATUS OF RECOMMENDATIONS	SIGNIFICANT COMMENTS
Actuarial- Plan F and Health Care Enhancements	Recommendations Implemented	None
Board General Consultant Review	No Recommendations Presented	None
Benefit Pension System Enhancements (BEPS)- IT Review	Recommendations Implemented	Minimum Distribution calculation clarification requested from IRS (publication text language and example inconsistent); current OPERS interpretation, based on IRS text language, is reasonable
Finance Internal Inquiry	No Recommendations Presented	None
Inactive Accounts Controls Review	Recommendation Pending	OPERS pursuing legislative change to ensure consistency of all transfers to the income fund
Real Estate Manager Review- Parkway Properties	Recommendation Pending	Manager developing internal valuation procedures, consistent with OPERS Private Real Estate Policy
Refund Process Review	No Recommendations Presented	None
AIG General Partner Review	No Recommendations Presented	None
TOPS System- Purchased Service Credit IT Review	Recommendations Implemented	Additional follow up of Member Benefits System
Actuarial Factors	Recommendations Implemented	None
Non US Equities Compliance Review	No Recommendations Presented	None
US Equities Compliance Review	No Recommendations Presented	None
Employer Payroll Reporting and Accounting Review	No Recommendations Presented	None
Investments Compliance Review	Recommendations Under Review	US Equities changes being reviewed within Investment Division
Health Care System Eligibility and Paid Claims Review	Recommendations Being Addressed	Additional accounting control reports are being developed with scheduled completion in the 1 <sup>st</sup> quarter, 2008
Survivor Benefits Process Review	Recommendations Being Addressed	None
IT Active Directory Review	Report and Recommendations Being Reviewed by Management	Two recommendations were deemed "high risk", requiring extensive discussion and immediate resolution with IT; review was focused on unnecessary application functionalities at some access control servers and network settings

**OPERS INTERNAL AUDIT  
2007 AUDITS COMPLETED**

AUDIT AREA	STATUS OF RECOMMENDATIONS	SIGNIFICANT COMMENTS
First Reserve General Partner Review	Review Completed with Discussion Ongoing	
JPMorgan Chase Custody Transition Review Defined Contribution Accounting and Reporting	Review Ongoing  Review Ongoing	Review not yet completed, based upon securities reconciliation and performance transition issues with JPMorgan Chase
Pension Death Claims and Death Match Process Review	Review Ongoing	
Eagle Pace/Star Investment Accounting Data Warehouse Post Implementation Review	Review Ongoing	
Personal Trading Quarterly Reviews also Annual Report)	No Recommendations Presented	Annual report and discussion of OPERS personal trading with Audit Committee in December as required by charter
Manager and Vendor Ethics Confirmation Review Including Investment Manager Relationships	Review Ongoing	No previous year ethic issues were identified; annual random confirmation of gifts to board and staff in progress
Audit Confirmation Letter Programs	Periodic Reviews Completed and Ongoing	None
Personal Pre Approval Trading System Process	No Recommendations Presented for this 2007 System Implementation	None
Investment Incentive Compensation Review	Review Ongoing	

**OPERS Internal Audit Plan**  
**Detail on Critical Audit Priority Reviews - 2008**

Reporting Entity	Audit Area(s)	Objective
Investments/Internal Asset Mgt.	Global Bonds	This review will be co-sourced with the Investment Training and Consulting Institute and will verify that internal controls effectively mitigate the risks (operational, accounting, reporting, etc.) associated with the life of a fixed income trade.
Investments/Internal & External Asset Mgt.	Derivatives	This review will examine compliance with the derivatives policy.
Investments/External Asset Mgt.	<ul style="list-style-type: none"> <li>* Public Manager Review (1)</li> <li>* Private Equity Manager Review (1)</li> <li>* Private Real Estate Manager Review (1)</li> </ul>	These reviews will focus on investment management agreement compliance, due diligence documentation, investment valuation policy compliance, management reporting, etc.
Investments/Investment Policies	<ul style="list-style-type: none"> <li>* Defined Benefit Policy Review</li> <li>* Health Care Policy Review</li> <li>* Defined Contribution Policy Review</li> <li>* Opportunistic Policy Review</li> <li>* Member Directed Policy Review</li> <li>* Cash Management Policy Review</li> </ul>	These reviews will focus on compliance and management reporting for Board approved investment policies.
Investments/Total Fund	<ul style="list-style-type: none"> <li>* Incentive Compensation</li> <li>* Performance Reporting</li> </ul>	* These reviews are intended to ensure that investment performance reporting is both accurately and consistently reflected based upon investment accounting and custodian bank reporting to generate proper incentive compensation payments.
IT- Investments	Trade Order Management System	New Trade Order Management solution ( scheduled for implementation in 2008-09) will be reviewed.
IT- Investments	Messaging Infrastructure Solution	3rd party messaging solution between Investment staff, intended to move OPERS into real time processing, will be evaluated from a control standpoint.
IT- Finance	Plan Specific Accounting	This represents the IT component examining the controls over subsidiary reporting details.
IT- Finance	ECS and Cash System Upgrades	These system upgrades will be reviewed to assess automated controls over EFT payment processes, electronic deposit transmissions, electronic unauthorized contribution payments and multiple allocations.



**OPERS Internal Audit Plan**  
**Detail on Critical Audit Priority Reviews - 2008**

Reporting Entity	Audit Area(s)	Objective
IT-Finance	New Payroll System	IT controls for this Human Resources solution will be reviewed with modules for employee resource and timesheet tracking, benefit enrollment and project tracking.
IT Security	Network Security	A 3rd party review will be identified and completed, based upon results from the Vulnerability Assessment and Security Policy/Compliance Assessment
Finance- Accounting	Great Plains G/L Reporting and accounting solution enhancement	This review will consist of both a financial and IT component, to address reporting by plan system enhancements as well as enhanced subsidiary reporting details.
Finance- Defined Contribution	Accounting	Review will examine accounting controls and reporting for the DC plan.
Finance- Accounting	Administrative Expenses	Review will examine process for paying vendors, validating activity and compliance with policy guidelines.
Finance- Accounting	Centralized Purchasing	Organizational change to a centralized function requires assessment of overall compliance and adequacy of control network.
Benefits Admin- Health Care	Health Care Cash Flows	Focus will be directed toward reviewing health care costs reporting, accounting and reconciliation controls within various health care cash flow components.
Benefits Admin- Retirement Benefits	Pension System Rewrite Evaluation	This consulting review will be a participation in OPERS assessment of proposed changes to the various pension system.
Benefits Admin- Health Care	VEBA	This review will examine accounting, reconciling and reporting for the Defined Contribution health care vehicle.
OPERS	Payroll System Solution	The new payroll system conversion and reconciliation will be reviewed.
OPERS	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	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 Internal Audit Plan**  
**Detail on Critical Audit Priority Reviews - 2008**

Reporting Entity	Audit Area(s)	Objective
OPERS	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	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.