

**AUDIT COMMITTEE MEETING MINUTES  
OF TENNESSEE CONSOLIDATED RETIREMENT SYSTEM (TCRS)  
March 27, 2015**

The Audit Committee of the Board of Trustees of the Tennessee Consolidated Retirement System met on Friday, March 27, 2015, at 8:00 a.m. The meeting was held in the Tennessee Tower, Conference Room P with Chairman Michael Barker presiding.

The following members were present: Chairman Michael Barker; Mayor Ken Wilber, Tennessee Municipal League; Commissioner Rebecca Hunter, Tennessee Department of Human Resources; Mr. Charles Archer, Tennessee Department of Revenue.

Others present were: Mr. David Lillard, Jr., State Treasurer; Mr. Rick DuBray, Deputy Treasurer, Support Services; Mr. Michael Brakebill, Chief Investments Officer, Tennessee Department of Treasury; Ms. Gail Moses, Auditor, Tennessee Comptroller of the Treasury, Division of State Audit; Mr. Andy Furlong, Director of Internal Audit, Department of Treasury; Ms. Jill Bachus, Director of TCRS; Mr. Jamie Wayman, Assistant Director of TCRS; Ms. Kim Morrow, Director of Accounting, Tennessee Department of Treasury; Mr. Daniel Crews, Director of Private Equity Investments, Tennessee Department of Treasury; Mr. Mathew Haitas, Real Estate Investments Analyst, Tennessee Department of Treasury; Ms. Jennifer Selliers, Compliance Officer, Tennessee Department of Treasury; Britt Wood, Internal Auditor, Tennessee Department of Treasury; Ms. Doreen Zientar, Internal Auditor, Tennessee Department of Treasury; and Mr. Andy McArthur, Internal Auditor, Tennessee Department of Treasury.

**Call Meeting to Order**

Chairman Barker called the meeting to order. Chairman Barker asked if any changes were needed to the minutes of the prior meeting. No changes were suggested. Mayor Wilber motioned to accept the minutes and Commissioner Hunter seconded the motion. The minutes of the last Audit Committee meeting were unanimously approved.

**Discuss Fair Value Estimates (Private Equity and Real Estate)**

Mr. Andy Furlong introduced Mathew Haitas and Daniel Crews from the Investments Division of the Tennessee Department of Treasury. Mr. Haitas explained the change in valuation frequency from annually to quarterly reflecting industry standards. Real estate holdings will continue to be appraised every three years by an external appraiser.

Mr. Crews described the fair value method for valuing private equity holdings. The private equity valuations that appear on the financial statements are the prior quarter valuations adjusted for fund cash flows for the final quarter of the fiscal year. The unrealized values reported in the financial statements are subject to change with fluctuations in the market. Valuations for illiquid assets are also heavily based on previously assessed values which causes a smoothing effect over time.

Chairman Barker asked if anyone had any questions for Mr. Haitas and/or Mr. Crews. Seeing none, the committee moved on to the next item on the agenda.

### **Review TCRS Audit Report Issued by the Comptroller's Office**

Ms. Gail Moses stated that the Comptroller's office has issued an unmodified opinion on the financial statements for the fiscal year ended June 30, 2014. The audit report presents one finding related to census data.

Commissioner Hunter asked if the auditors for the participating employers would be able to conduct a census data analysis that would reasonably assure compliance with GASB 67 and 68. Treasurer Lillard mentioned the AICPA White Paper that addresses the requirements of GASB 67 and 68. The Treasurer also mentioned that currently only a few states have a census data integrity program in place. Other states are developing the program as a result of the AICPA White Paper.

### **Review Financial Statements and Significant Accounting and Reporting Standards**

Ms. Morrow mentioned the changes brought about by GASB Statement 67. The changes vary in magnitude. A small change going forward is reference to the "Plan Net Position" now being recognized as the "Fiduciary Net Position" in an effort to highlight the fiduciary responsibility of the plan administrator. Larger changes involve separate reporting for Local Government and Local Education Agencies (LEAs). The Treasury did not include comparative financial statements in its fiscal year 2014 financial statements as a result of these changes.

GASB 67 clarifies reporting standards found in GASB 25. The intent of GASB 67 is to improve financial statement presentation for the users. GASB 68 has the requirement changes relevant to the employers. Local Governments and Local Education Agencies will include a line item for "Net Pension Liability" on the face of financial statements rather than simply including the pertinent information in notes to the financial statements.

### **Review Financial Integrity Act Report**

Mr. Furlong spoke about the required risk assessment for each division of the department. Ms. Zientar is consulting with the Department of Finance and Administration to develop new procedures for the risk assessments that are consistent with recent changes to the COSO Framework.

### **Internal Audit Update**

#### **A. LEA Census Data Testing**

Mr. McArthur discussed the scope of the data analysis being conducted on census data from LEAs. The intent of the analysis is to determine whether the plan actuaries

are using accurate and complete data when calculating the employer's net pension liability.

The LEAs that have been contacted have shown support for the analysis. The analysis is also reliant on third party data sources such as the Department of Motor Vehicles, Department of Labor, and Department of Education. The use of Audit Command Language (ACL) software has allowed the auditors involved in the project to test one hundred percent of the population rather than sampling. Testing the entire population produces test results that pinpoint questionable data, allowing for a more efficient and effective analysis and data correction efforts.

### **B. Concord Data Analysis Update**

Ms. Wood discussed the Concord Data Analysis. She expressed appreciation for the interdepartmental support and assistance with providing third party data. Ms. Wood spoke with representatives from the Office of the Comptroller of the Treasury. Together, Ms. Wood and the representatives established criteria for the analysis and expectations of the project.

Ms. Wood mentioned one of the issues discovered already during the analysis. Test work on recorded employee gender and birthdates revealed the need for the plan actuaries to reference the person table within Concord to calculate estimated net pension liability on more complete data. Testing to date has resulted in low error rates throughout the state.

### **Private Equity Disclosure**

Chairman Barker stated the Private Equity Disclosure was available in the meeting packet. The Chairman opened the floor for discussion and questions concerning the disclosures. No one in attendance commented or raised any questions. Chairman Barker then proceeded to the next item on the agenda.

### **Discuss Failure to Timely Pay Withholding Taxes**

Mr. DuBray spoke about the summary report included in the meeting packet pertaining to the Treasury's failure to timely remit its employee withholding taxes to the IRS. The Accounting Division of the Department of Treasury has taken actions to mitigate the risk of a similar incident reoccurring. The staff person responsible for completing the transaction was new to the position. The controls in place at the time of the error added complexity to the transaction. The transaction process involved reporting the liability and initiating the payment with multiple steps in the interim. The transaction was left incomplete and the Treasury incurred a 10% penalty for late remittance of payment.

Treasury management has since reviewed the procedures in place for completing the transaction. Management decided to add multiple levels of review. Additionally, notifications are sent to management to continuously update the appropriate individuals

of the Treasury's liability position. Reconciliations are completed on a daily basis to assure payments are made timely and the Treasury is not reliant on multiple divisions or other departments to complete a single transaction.

Ms. Morrow added that the Accounting Division is able to confirm ACH transactions are complete on a real-time basis. Mr. DuBray mentioned that the Legal Division of the Treasury has consulted with outside counsel that specializes in tax issues in an attempt to resolve the matter and reduce or eliminate the penalty imposed by the IRS. The Treasury is optimistic that a favorable outcome will be reached since evidence exists supporting the Treasury's intent to properly file and pay its tax liability.

Chairman Barker stated he had spoken with Mr. Furlong about the transaction. The Chairman recommended that this transaction and other similar transactions be addressed in the Treasury's risk management activities as a checklist item to avoid repeating the mistake. Mr. DuBray stated that the transaction was not previously in the risk management checklist, but it will be included and closely monitored going forward.

### **Concord Update**

Ms. Bachus provided the Committee with a Concord update. The Concord development team has continued to address problem incident reports while working with North Highland and Deloitte. TCRS issued Member Annual Statements in December 2014 exclusively online for the first time. Approximately 40% of the members reviewed their statement. Concord staff continues to promote the member self-service portal available in Concord. Form 1099s were available to retirees through Concord allowing those to whom they were issued the ability to retrieve the form on demand after January 2015.

Testing of the Concord system continues as new sections and segments of the system become available to the members. The GASB statements mentioned earlier in this meeting do affect TCRS operations. TCRS staff and management are actively addressing the changes to have information available to participating employers on a timely basis.

Employer reporting has improved since the launch of Concord. Many employers are reporting earlier in the month than they had previously. Ms. Morrow stated that 154 out of 207 employers had posted contribution submissions for the month of March. Delays in processing State files related to internal problems are currently being addressed and a solution is expected in the near future.

### **Other Business**

Chairman Barker asked Treasurer Lillard if he had any comments for the Committee to consider. Treasurer Lillard began by seconding Ms. Bachus's comments about Concord implementation. Treasurer Lillard stated that he initially thought of Concord as an IT project. He quickly realized that Concord is far more complex than a simple project and it has fundamentally changed TCRS operations.

Treasurer Lillard mentioned that TCRS has progressed from managing a single defined benefit plan to managing multiple plans for different members since he took office in 2009. Concord is an integral part of managing the increased complexity in TCRS operations. The Treasury has been able to maintain low risk through the use of advanced software by the Internal Audit Division and the dedication of the staff to make Concord a success.

Chairman Barker commended the Treasurer and the Treasury staff for its successful launch of Concord and seamless integration of the new system. Chairman Barker then invited Mr. Brakebill to address the Committee.

Mr. Brakebill expressed appreciation for the Investment Division's efforts to stay current on accounting and asset valuation standards. Mr. Brakebill stated the movement to fair value for private equity asset valuation, abandoning the lower of cost or market method previously used, has allowed the Treasury to present the value of its holdings more accurately without the need for large adjustments to the Treasury's balance sheet. Real estate value is now assessed quarterly thereby improving the accuracy of the Investment Division's perspective of its net position and operating environment.

Chairman Barker expressed his appreciation for the Treasury's efforts and dedication to safeguarding the funds held by TCRS to assure members will receive the benefits promised to them in retirement.

#### **Adjournment**

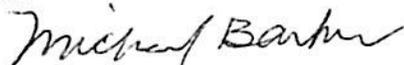
Chairman Barker stated that if there were no additional items to be discussed, the meeting could be adjourned. Commissioner Hunter made a motion to adjourn the meeting. The motion was properly seconded by Mayor Wilber. The Committee unanimously voted to adjourn the meeting.

**Respectfully Submitted,**



**Andy Furlong**  
**Director of Internal Audit**

**Approved:**



**Michael Barker**  
**Chairman of the Audit Committee**