

**SOUTH CAROLINA RETIREMENT SYSTEM INVESTMENT COMMISSION
AUDIT COMMITTEE MEETING**

**SC Retirement System Investment Commission
1201 Main Street, 15th Floor
Columbia, SC 29201
Meeting Location: Presentation Center
Tuesday, September 3, 2015 at 10:00 a.m.**

Committee Members Present:

Mr. Allen Gillespie, Chairman
Ms. Peggy Boykin
Mr. Edward Giobbe

Others present for all or a portion of the meeting on September 3, 2015: Corleon Brown, Betsy Burn, Andrew Chernick, Dori Ditty, Michael Hitchcock, Monica Houston, Robert Feinstein, Tricia Miller and Eric Nelson from the South Carolina Retirement System Investment Commission; John Page from South Carolina Public Employee Benefit Authority; and Wayne Pruitt from the State Retirees Association of South Carolina.

- I. **CALL TO ORDER AND CONSENT TO AGENDA:** Chairman Allen Gillespie called the meeting of the Audit Committee (“Committee”) to order at 10:01 a.m. Mr. Edward Giobbe made a motion to adopt the Agenda as presented, and Ms. Peggy Boykin seconded the motion, which was unanimously approved.

- II. **APPROVAL OF MINUTES (February 10, 2015; May 14, 2015):** The Committee read the draft Minutes from February 10, 2015, which had been carried over from the last meeting. Mr. Giobbe inquired about the seventh paragraph of the draft Minutes regarding the differences between the Tamale and Conifer systems. Ms. Monica Houston clarified that Conifer will now also be used as a repository and to gather information and Tamale will be the repository for due diligence. A discussion between Mr. Andrew Chernick, Mr. Giobbe and Chairman Gillespie took place regarding investment management fees and how Conifer will be used for investment management fee gathering and the differences in how Tamale will be used. Mr. Giobbe asked if there was significant overlap in the systems’ functions. Mr. Chernick further described the difference between the two systems, stating that Conifer is used in gathering the information for fees and Tamale is used in the gathering of due diligence information. Mr. Chernick noted that Conifer goes beyond the gathering of the information in its provision of fee validation services. Mr. Chernick noted that references to CliftonLarsonAllen in the minutes should be connected as one word rather than three separate words. Chairman Gillespie inquired about the item in the February minutes “Fee rebate issue/Fee term change” and Mr. Chernick explained that the item reflected the need for a standardized contract management process where changes to contracts are communicated to all stakeholders. Mr. Giobbe made a motion to adopt the February 10, 2015 Minutes, and Ms. Boykin seconded the motion, which was unanimously approved.

Ms. Houston reviewed the process of how the Minutes are prepared with Mr. Danny Varat providing the initial draft and Ms. Houston finalizing the drafts. Ms. Houston noted that the long term goal is to have Audit Committee materials posted to Watchdox two weeks prior to a meeting and stated that currently items such as minutes should be posted no

less than one week prior to the meeting. The draft May 14, 2015 Minutes were carried forward to a future meeting.

- III. AUDIT COMMITTEE FOLLOW-UP:** Ms. Houston provided the Committee with a brief overview of how the Follow-up report is prepared and presented. Ms. Houston then presented the Committee with a list of open and closed items on the Committee's Follow-Up Report. The first open item discussed was the topic of Iran/Sudan Divestment, for which Mr. Robert Feinstein provided the Committee with an update. Mr. Feinstein provided detail about a law pertaining to Iran divestment, which focuses primarily on the energy sector, and the Sudan law which focuses on the military and energy sectors. Chairman Gillespie and Mr. Giobbe both inquired about the types of laws in place and how the Fund will know when the Portfolio is affected. Mr. Feinstein explained that there are two state laws in effect, that also have Federal laws behind them. He further explained there is currently a list of companies for Iran already in place and the list for Sudan is in the process of being developed through a procurement. Mr. Feinstein explained that a review of the entire portfolio was part of the process based on the list of companies from the providers. Mr. Feinstein noted that the proposed policies related to this topic were being reviewed by Senior Management and will eventually be presented to the Commission. Chairman Gillespie and Mr. Giobbe inquired about the depth of the agency's involvement for divestment for offshore commingled structures run by foreign nationals and indirect investments. Mr. Feinstein explained that commingled holdings, limited partnerships and similar structures and index funds were exempt from the divestment requirement pursuant to law. He also provided additional detail on the process that the providers follow in performing their evaluation as well as the sector and industry constraints of applicable laws.

Ms. Houston asked for an update from Mr. Michael Hitchcock regarding the compensation consultant engagement. Mr. Hitchcock summarized that RSIC has been working with the consultants from Towers Watson on creating a comprehensive compensation system, including recommendation on the investment staff performance incentive compensation. He stated that RSIC has received guidance on how to proceed from Towers Watson. Mr. Hitchcock noted that he will be presenting a detailed report to the Commission at the October Meeting.

Ms. Houston reviewed the recently closed items from the Follow-Up Report. Ms. Houston noted that the closed items included the statutory requirement of 70% allocation to equity on cost versus market basis; addition of timelier standard reporting, investment and operational due diligence presentation, Committee recommendation that the SIOP be revised to reflect the utilization of the market basis in calculation of the 70% allocation to equity and that a testing procedure be developed by management.

Chairman Gillespie inquired about two items, the first was the Agreed Upon Procedures to be performed by CliftonLarsonAllen and the second was the status of the Investment Contract Management review. Ms. Houston noted that both items will be discussed in detail later in the meeting.

- IV. ENTERPRISE RISK MANAGEMENT AND COMPLIANCE:** Chairman Gillespie introduced Mr. Eric Nelson to present the Enterprise Risk Management and Compliance Report. Mr. Nelson began his presentation by stating that there were no material compliance exceptions during the last period. He also indicated that he has spent two-thirds of his time on compliance matters and the remaining one-third on enterprise risk

management. He noted that the Annual Manager Compliance Questionnaire took a little longer than expected due to the internal review processes.

Chairman Gillespie requested that Mr. Nelson provide the Committee with a risk grid for the next meeting. Chairman Gillespie also asked about the progress of the report from the Legislative Audit Council's review. Mr. Andrew Chernick and Ms. Boykin both stated that they had expected the report to have been completed but due to additional questions and information gathering by the Legislative Audit Council, the report is expected to take a few more weeks to complete. Chairman Gillespie asked Mr. Nelson to provide the Committee with the Enterprise Risk Management Policy for review.

Mr. Giobbe asked about the process for monitoring conflicts of interests. Mr. Nelson explained the Sourcing and Conflicts Disclosure Form is relied upon on a deal by deal basis. He also noted that he provides mandatory yearly staff training on the topic. Ms. Boykin asked Ms. Houston about the status of the Ethics and Conflicts of Interest Audit to which Ms. Houston responded that the audit has not been completed.

Next, Mr. Nelson went into detail about the Funston report and what items had been completed. Mr. Nelson noted that the State Ethic's Commission has not performed an audit on the filing of the Statements of Economic Interests ("SEIs") filed by the appropriate staff and Commissioners. Ms. Dori Ditty explained that the Ethics Commission can audit the SEIs at any time.

Mr. Giobbe expressed concerns about the issues reported in the news related to BNY Mellon pricing of ETFs. The Committee engaged in a short conversation regarding fees, pricing, ETFs and mutual funds. Mr. Chernick offered to reach out to the State Treasurer's Office regarding this issue and follow up with the Committee.

Mr. Nelson went through the remaining outstanding policies that he planned to review with the legal department as listed in the RSIC Internal Development/Revision Tracking document. Ms. Houston expressed interest in reviewing the Internal Controls and Fraud Policy and Mr. Nelson agreed to provide the policy to Ms. Houston. Ms. Boykin inquired about a list of recommended policies that the RSIC currently does not have in place. Mr. Nelson explained that there are approximately twelve policies that are currently not in place that he would recommend implementing. He would like to meet with appropriate RSIC staff before he begins to draft those policies. Chairman Gillespie asked about the difference between policies and procedural details. Mr. Nelson stated that polices should not contain extensive procedural details, and he will be going through the policies to see what level of procedures are attached to them, which will need to be reviewed yearly. He noted that procedures should be separately documented. Mr. Nelson also suggested that a policy documenting the details of the process for implementing and periodically reviewing policies would be helpful.

- V. INTERNAL AUDIT PLAN PROGRESS:** Ms. Houston began her presentation by reviewing the 2014 – 2015 Audit Plan update, as of August 31, 2015. Ms. Houston recommended that several items from the 2014-2015 Audit Plan be carried over to the 2015 – 2016 Audit Plan, such as the Investment Approval and Funding Audit, Securities Lending Audit, Entity Level Controls and Contract Management consulting projects. Ms. Houston stated that the Contract Management consulting project had to be carried over with approximately 80 hours of work remaining.

Ms. Houston provided a breakdown of remaining 2014-2015 Audit Plan items along with the number of hours needed for completion. She explained that the Ethics and Conflicts of Interest Audit had been performed by an intern with Mr. Chernick's assistance. Ms. Houston stated that she needs to review the draft report, and if there are no significant findings, the report should be completed by September 30, 2015. She stated that the report for the Performance Reporting Audit has been drafted and incorporates management's comments, and has approximately two hours remaining until completion. The Annual Investment Plan ("AIP") and Statement of Investment Objectives and Policies ("SIOP") Compliance Audit follow up has a couple of matters outstanding with 100 hours planned and with 15 hours remaining until completion. Ms. Houston stated that the Agency Relationships Audit has approximately 105 hours performed, year to date, and has approximately 20 hours remaining to complete and should be completed by September 30, 2015. Ms. Houston noted that she had not originally planned on having to perform work on Hewitt EnnisKnupp, but due to the reliance of the agency on information provided by Hewitt EnnisKnupp, she felt additional review of the organization was appropriate for the Agency Relationships Audit. Ms. Houston noted that the Annual Investment Report Audit follow up, which Ms. Gail Cassar had been working on, is close to being completed. Ms. Houston stated that she has not reviewed the work and stated approximately 12 hours were needed to complete the audit follow up and issue a report. Ms. Houston noted that the 2014-2015 Audit Plan update includes 129 hours and she recommended that 80 of those hours be moved to the 2015-2016 Audit Plan. Ms. Houston noted this leaves about 49 hours to complete the 2014-2015 Audit Plan, projected to be completed by September 30, 2015.

Lastly Ms. Houston reviewed the Contract Compliance Review for the fiscal year Audit Plan 2013-2014 which had been carried over to the 2014 – 2015 Audit Plan. Ms. Houston discussed this item and recommended that this review be removed from the Audit Plan and moved to the purview of the agency's compliance role. Mr. Chernick stated that he had begun reviewing the report and also suggested that this be moved to Mr. Nelson's responsibilities.

Upon completion of Ms. Houston's review, Ms. Boykin asked what the total numbers of hours used for the 2014-2015 Audit Plan were and if Ms. Houston was recommending to extend the Audit Plan deadline until September 30, 2015 Ms. Boykin also asked Ms. Houston to provide a breakdown of the hours which would include Ms. Houston's work hours, hours worked by temporary resources, and outsourced hours used to work on the 2014-2015 Audit Plan.

Ms. Houston stated that she could provide Ms. Boykin with the Resource Plan. Ms. Houston continued breaking down the hours by category as follows: Ethics and Conflicts of Interest Audit was worked on by an internal intern; Performance Reporting Audit was contracted out, Information Technology (GCC) consulting was performed by Elliott Davis and they were also asked to follow up in the 2015-2016 Audit Plan, which was included in the proposed budget; Performance Incentive Compensation Audit; AIP and SIOP Compliance Audit follow up, and Agency Relationships Audit were performed by Ms. Houston; the Annual Investment Report Audit follow up was contracted out; Internal Audit Policies and Procedures item was completed by Ms. Houston along with some hours being contracted out. Management Requests such as Annual Investment Plan Review or Ad Hoc assignments that were not on the Audit Plan had been allotted 200 hours. Ms. Boykin requested a breakdown of the management assignments for the 2014-2015 Audit Plan year. Ms. Houston stated that she could provide a breakdown of those assignments but

she did not have a formal document on which she had been tracking the exact number of hours for each management assignment. Ms. Boykin asked Ms. Houston to keep track of requests from management and resources needed to complete requests going forward.

Chairman Gillespie stated that he had asked for some budget information that might be helpful and it will be reviewed and discussed in Executive Session. Chairman Gillespie stated that in the past a large amount of hours were allocated for Management Requests but now it is approximately 10% of the Plan. Ms. Houston offered to walk through how she spends her time in Executive Session. Ms. Boykin stated that she wanted a more realistic Audit Plan and suggested that seeing plans for three years going forward would help the Committee match expectations with realistic resources.

VI. 2015-2016 INTERNAL AUDIT PLAN: Ms. Houston discussed the number of hours that were allocated for the proposed 2015-2016 Audit Plan and stated that the proposal requires more than one FTE. Ms. Houston discussed her role as the principal auditor and the number of hours she spends on administrative work and actual audit work. Next, she discussed the proposed Resource Plan in great detail regarding the risk levels assigned to various areas from the agency. Ms. Houston discussed how the Risk Assessment process would work in relation to work performed by the Director of Enterprise Risk and Compliance, but noting that internal audit practices include independent assessment of the risks. Ms. Houston provided detailed information on how the proposed Audit Plan is developed in light of the risk tolerance levels of the Committee, how the availability of resources impacts the work performed, and how organizational risk is impacted by resource availability. Ms. Boykin noted that she did not believe that auditing Fees and Expenses every year is the best utilization of audit resources. Chairman Gillespie pointed out that there have been evolving processes and procedures related to Fees and Expenses can reintroduce risk following an audit. Ms. Boykin requested a long term audit plan for the placement of risks be prepared and provided to the committee. Chairman Gillespie voiced concerns about the status of the Conifer reports relating to investment management fees and expenses. Mr. Chernick told Chairman Gillespie that the Conifer information was used in developing the AIP. Ms. Houston then continued to go into further detail about the levels of risks for various categories and stated she believed a long term plan was unrealistic and it would exceed resources. Ms. Boykin reiterated her request for a long term plan and stated that it was up to the Committee to prioritize what information they need to make decisions and a long term audit plan was needed. Ms. Houston agreed to provide the Committee with the long term plan. Ms. Boykin stated that the long term plan should include every item included in the risk assessment. Ms. Houston noted that she has been doing in-depth, detailed reports that the Committee has not seen or asked about.

Mr. Hitchcock provided the Committee with an overview of how the management had prepared input on the Risk Assessment and where the management team believes the highest levels of risk are within the organization. Mr. Hitchcock asked Mr. Chernick to provide a summary of the input from management. Mr. Chernick discussed in great detail what the management team reviewed and believes are high priorities for Audit going forward. Mr. Chernick noted that management's perspective is that the Operational Due Diligence audit is more appropriate as a consulting engagement. He also noted that management's opinion is that Fees and Expenses audit is not a priority or the best use of audit hours. He also noted that a consulting project in the area of Agency Relationships/Vendor Management would be a better use of audit resources. He noted that management had not added any areas of risk that were not previously included in the

Risk Assessment. Ms. Houston expressed concern that she did not believe a consulting review of Fees and Expenses would provide an appropriate level of assurance and accuracy of financial information for which she believed PEBA was relying on for the inclusion in the CAFR. Ms. Boykin explained that she did not believe that the Fees and Expenses audit had provided reliance or been relied on by the external auditor, CliftonLarsonAllen. Based on the timing for the CAFR's preparation and when the prior audit was completed, reliance was not likely, but Ms. Boykin stated she would confirm this to be accurate with CliftonLarsonAllen.

- VII. EXECUTIVE SESSION:** Mr. Giobbe made a motion to go into Executive Session to obtain advice from legal counsel and to discuss personnel matters pursuant to S.C. Code Ann. Sections 30-4-70(a)(1) and (a)(2). Chairman Gillespie stepped down as Chairman, and seconded the motion, which passed unanimously.

The Committee reconvened in open session. Chairman Gillespie reported that no action had been taken during Executive Session; the Committee received legal advice and personnel updates.

Mr. Giobbe made a motion to approve the proposed 2015-2016 Audit Plan without the proposed Resource Plan, Ms. Boykin seconded the motion which was passed unanimously. Chairman Gillespie asked for any questions. Ms. Houston stated that the RSIC might lose the contract with Elliot Davis if the proposed Resource Plan is not approved. Ms. Boykin stated that she would agree to approving the projects' resources, for Valuation of Investments, Investment Due Diligence, and Operational Due Diligence audits to CliftonLarsonAllen and to Elliott Davis for the Information Technology (GCC) consulting. Chairman Gillespie stated the Motion would be amended to approve resources for those two outsourced providers' items only. Chairman Gillespie moved to amend the Motion, Ms. Boykin seconded the motion which was unanimously approved.

VIII. ADJOURNMENT

There being no further business, Mr. Giobbe moved to adjourn. Ms. Boykin seconded the motion, which passed unanimously, and the meeting adjourned.

[Staff Note: In compliance with S.C. Code Ann. §30-4-80, public notice of and the agenda for this meeting were delivered to the press and to parties who requested notice and were posted at the entrance, in the lobbies, and near the 15th Floor Conference Room at 1201 Main Street, Columbia, SC, on September 1, 2015 at 1:37 p.m.]