M E M O R A N D U M

TO: Audit Committee
Jon Strinden
Ron Leingang

FROM: Jamie Kinsella, Internal Auditor

DATE: May 22, 2008

SUBJECT: **February 20, 2008 Audit Committee Meeting**

In Attendance:
Jon Strinden, via conference call
Ron Leingang
Rebecca Dorwart
Jamie Kinsella
Sharon Schiermeister
Sparb Collins
Leon Heick
John Mongeon, Brady Martz
Aaron Webb, Attorney General's Office

The meeting was called to order at 10:33 a.m.

I. November 21, 2007 Audit Committee Minutes

The audit committee minutes were examined and approved by the Audit Committee.

II. Internal Audit Quarterly Report

A. Internal Audit Quarterly Report – Included with the audit committee minutes was the Internal Audit quarterly report which listed all of the projects that are in active status as of January 31, 2008. Discussion was held regarding the Blue Cross Blue Shield (BCBS) 2003-2005 Interest Calculation Report Review. The audit committee concurred with management's decision to close this biennium.

Quarterly Audit Recommendation Status Report – As stated in the Audit Policy #103, the Internal Audit Division is to report quarterly to management and the audit committee the status of the audit recommendations of the external auditors, as well as any found by the internal auditor. At the Loss Control Committee December meeting, the committee discussed how to better monitor and ensure progress is being made to implement the recommendations. As a result of this discussion, a few changes were made to the quarterly report. Ms. Kinsella reviewed the changes to the report format, explained reassignment of

some recommendations so they can be completed before the external auditors return in August. The recommendations from Brady Martz's management letter were added. Staff found there were two identical recommendations, one from the Internal Auditor and one from Brady Martz. Staff will remove the Internal Audit recommendation when this is reported in May. There are now 16 outstanding recommendations. One of the six recommendations from Brady Martz is a carryover from fiscal year June 30, 2006 management letter. A review of the report shows 1 completed and progress made on 4.

III. Administrative

A. Request for Quality Assurance Review – The International Standards for the Professional Practice of Internal Auditing requires the quality assessment (QA) include both internal and external assessment. This standard became effective January 1, 2002, so the first review should have been completed by January 1, 2007. Extenuating circumstances at NDPERS precluded the Internal Audit Division from completing this requirement. After discussion, the audit committee recommended that staff query Brady Martz whether having a quality assurance review would make an impact on their reliance on Internal Audit's work and bring this back to the May meeting.

B. Audit Committee Meeting Date & Time – The May audit committee meeting is scheduled for May 21, 2008 at 10:30 am. Ms. Kinsella indicated she is concerned about the start time since the amount of material covered during the meetings has increased. Ms. Kinsella inquired if the audit committee would be willing to move the start time to 10:00 am. The audit committee agreed to move all start times to 10:00 am.

C. Internal Audit Annual Audit Report for 2007 - Included with the audit committee materials was a copy of the annual Internal Audit Report for 2007 for review and approval. By general consensus, the audit committee approved the report.

D. Internal Audit Charter Review Matrix– Ms. Kinsella conveyed that since staff reviews the Audit Committee Charter by utilizing a matrix the same thing was done to the Internal Audit Charter. Included with the audit committee materials was a copy of the matrix for review. This review indicated no changes are necessary for the Internal Audit Charter. This item was informational only.

E. Audit Committee Charter Revision – This item was tabled until the May 2008 audit committee meeting.

F. Audit Committee Charter Review Matrix – At the last audit committee meeting Ms. Kinsella provided the audit committee with the results of the Audit Committee Charter Review matrix. There were several issues that needed further research, which was completed and presented to the committee. The results of this are described below.

1. Item #2 required that the audit committee attempt to appoint committee members who are knowledgeable and experienced in financial matters, including the review of financial statements. The deliverable is to indicate in

the audit committee minutes which member is knowledgeable and experienced in financial matters, including the review of financial statements. The audit committee determined that Mr. Jon Strinden and Ms. Becky Dorwart are knowledgeable and experienced in financial matters, including the review of financial statements, and was so noted in the minutes.

2. Item #9 discussed financial reporting standards. The ninth bullet stated "Understand how management develops interim financial information, and the nature and extent of internal and external auditor involvement." Interim financial information had not been prepared and presented to the Board since late in 1999, due to staffing shortages in the accounting division. The Association of Public Pension Fund Auditors were polled to determine if they implement this best practice. It was determined that most did not have this as a provision in their charter, but one auditor did implement it stating that the best approach is for pension funds to match the quality of accounting that we expect from corporations, thus they should strive to produce financial statements timely. The audit committee felt that the provision should remain in the audit committee charter, with the understanding that they were not required to receive and review interim financial statements, but to understand how management develops the interim financial information.

3. Item #10 discussed risk assessment. The second bullet stated that the Audit Committee will: "Periodically review that the organization has a comprehensive policy on risk management". At this time the agency does not have a policy on risk management.

   Ms. Kinsella indicated she searched on the Risk Management web site for their policy and found their Mission and Policy statements, which was included with the audit committee materials. This policy addresses employee and public safety, property and data protection, environmental safety, vehicle fleet safety, and security. While all of these issues are important, these issues are being addressed by the PERS Loss Control Committee, as well as our disaster recovery plan.

   In addition, research was done with the Association of Public Pension Fund Auditors to determine what "Comprehensive Policy on Risk Management" meant to them. Some of the agencies have a policy that is specific to their organization. In other words, if they administer pension funds, they utilized the document called "Operational Risks of Defined Benefit and Related Plans and Controls to Mitigate those Risks" as their risk policy, and if they administer investments, they used a document called: "Statements of Key Investment Risks and Common Practices to Address Those Risks". Both of these documents have been adopted by the Association of Public Pension Fund Auditors and NASRA and were provided to the audit committee. The Audit Committee requested that management continue dialog on developing a comprehensive risk management policy and bring a progress report to the May meeting.

4. Item #13 discussed the audit committee's understanding of the purpose of the financial statements audit…" The ninth bullet stated the Audit Committee

"Provide guidelines and mechanisms so that no member of the Audit Committee or organization staff shall improperly influence the auditors or the firm engaged to perform audit services. Research found the contract stating:

Conflict of Interest

Offerors must disclose any instances where the firm or any individuals working on the contract has a possible independence problem or conflict of interest and, if so, the nature of that conflict (e.g. nonaudit services performed for the Client). The Auditor reserves the right to cancel the award if any interest disclosed from any source could either give the appearance of a conflict or cause speculation as to the objectivity of the offeror's proposal or auditor independence. The Auditor's determination regarding any questions of independence or conflict of interest is final.

In addition there is an Internal Audit Policy #104 that discussed Independence. A copy of this was provided to the Audit Committee. The Internal Audit Division has not been in compliance with this policy. The Audit Committee requested that Internal Audit review, update if necessary, and implement the policy by the May meeting.

G. Annual Performance Evaluation – It is time for the annual performance evaluations. The due date for having these completed is March 31. Mr. Collins discussed this with the audit committee and they agreed to do the evaluation the same as last year.

H. Confidential Meeting between Internal Audit and Audit Committee - The meeting between the audit committee and the internal audit division is scheduled to take place in February of each year. Due to the time constraints this item was tabled until the May 2008 audit committee meeting.

IV. Miscellaneous

A. Pharmacy Benefits Manager (PBM) Project – Since the last meeting staff has continued to press the case for an audit of Prime relating to rebates. Included with the audit committee materials was an email string that was started when Mr. Webb, legal counsel, drafted a proposed request from PERS to the Attorney General asking about the ability to maintain any audit information relating to Prime as confidential. Staff forwarded that draft to BCBS to ensure that if we moved ahead with the request and if the Attorney General ruled that PERS could keep the information "confidential" that it would cover all of their concerns. During this discussion the other items that came forward were relating to "waiving sovereign immunity" and "liquidated damages". Ms. Kinsella pointed out that in the email that BCBS directed PERS to seek the authority of the Insurance Commissioner on this material. Staff recommended the following:

1. Invite the Insurance Department to the next meeting to discuss what they do and how it relates to PERS efforts.

2. Ask Prime what level of liquidated damages they feel could be asked for if a breach did occur. Pursuant to state law, PERS can agree to liquidated damages, however, PERS must have a legislative appropriation for the amount. Therefore, it would be helpful for PERS in considering this to know what the level of such damages could be if requested.

By general consensus, the audit committee approved staff's recommendation.

B. NDPERS Board Planning Meeting – In December, there was a planning meeting held by the Board. Per the December 3, 2007 minutes that relate to the audit committee:

Investment Board Review - Mr. Collins reported that the Audit Committee is reviewing topics relating to the State Investment Board. This included inviting the RIO auditors to the next Audit Committee meeting.

The action items for the Audit Committee are as follows:

√ The audit committee should review and examine the usefulness of hiring an independent firm such as CEM to review the effectiveness of our investment program.

√ The audit committee should also meet with the SIB to discuss the various asset classes, the types of investments in the classes and the effect, if any, on the overall plan risk.

√ The audit committee should periodically review and monitor the investment management fees.

It was determined by the audit committee that these action items should be for the investment committee.

C. LASR Project Status – Included with the audit committee minutes was the first PERSLink quarterly status report. PERS is required to file this report with ITD throughout the duration of the system replacement project. The first three months were the planning phase. In the future the report will have more details. The planning phase went well and the project is on time and on budget. Staff also included their involvement in the Joint Application Design (JAD) meetings to date. This item was informational only.

D. Brady Martz & Associates – Mr. John Mongeon from Brady Martz presented what he does when auditing RIO's investments. Discussion followed.

E. Report on Consultant Fees - According to the Audit Committee Charter, the audit committee should "Periodically review a report of all costs of and payments to the external financial statement auditor. The listing should separately disclose the costs of the financial statement audit, other attest projects, agreed-upon-procedures and any non-audit services provided." Included with the audit committee materials was a copy of the report showing the consulting, investment and administrative fees paid during the quarter ended December 31, 2007. This

report was presented to the Board at the January board meeting.

F. Publications – Included with the audit committee materials was the latest Tone at the Top publications from the Institute of Internal Auditors.

The meeting adjourned at 12:00 p.m.