

NEW MEXICO
PUBLIC EMPLOYEES RETIREMENT ASSOCIATION
AUDIT & BUDGET
COMMITTEE MEETING

July 14, 2015

This meeting of the Public Employees Retirement Board Audit & Budget Committee was called to order by Chair Stewart Logan at approximately 9:00 a.m. on the above-cited date in the PERA Building, Fabian Chavez Jr. Board Room, 33 Plaza La Prensa, Santa Fe, New Mexico.

Following the Pledge of Allegiance, roll was called by Executive Director Wayne Propst and a quorum was established as follows:

Members Present:

Stewart Logan, Chair
Jackie Kohlasch, Vice Chair
John Reynolds

Member(s) Excused:

Dianna Duran
Tim Eichenberg

Other Member(s) Present:

Patty French
Louis Martinez
Paula Fisher
Dan Mayfield

Staff Members Present:

Wayne Propst, Executive Director
Susan Pittard, Chief of Staff/General Counsel
Jonathan Grabel, Chief Investment Officer
Greg Trujillo, Deputy Director
Karen Risku, Deputy General Counsel
Claudia Armijo, Assistant General Counsel
Renada Peery-Galon, ASD Director
Natalie Cordova, Controller/Chief Financial Officer
Judy Olson, Executive Assistant
Sam Ojinaga, Bureau Chief, Contribution Accounting
Christina Keyes, Portfolio Manager
Greg Portillos, IT Director
Eric Martinez, PERA Building Property Manager

Others Present:

Wayne Lloyd, Lloyd & Associates
Sheb Mirando, Lloyd & Associates
Anthony Armijo, Borrueal, LLC
Jessica Bundy, REDW
Matt Doxtator, REDW

2. APPROVAL OF AGENDA

Mr. Reynolds moved to approve the agenda as presented. His motion was seconded by Chair Logan and passed by unanimous [3-0] voice vote.

3. APPROVAL OF CONSENT AGENDA

Chair Logan said he reviewed the consent agenda and found it accurate and complete.

Mr. Reynolds moved to approve the consent agenda. His motion was seconded by Ms. Kohlasch. The motion passed by unanimous [3-0] voice vote.

4. CURRENT BUSINESS

Chair Logan informed those present that the items on this morning's agenda were all informational and no action would be taken.

A. Informational Item: Status of Building Repair

Architect Wayne Lloyd reported on the building repair work which is close to completion. He expected the flashing would be completed next week. He commended the Contractor, stating he has done an excellent job and added that the project exceeded his expectations. The flashing was delayed because of the weather and while the project has not exactly met the schedule the work product is excellent.

The sealant has been applied and it should be known that this type of material requires maintenance every two to five years.

Mr. Lloyd said some of the spalling and cracking of the earth was very loose and had to be peeled back further to better bond the patching. The color matching with the new mud has been excellent. He credited the selection committee with choosing the right contractor.

The coping is heavy gauge and sticks out 2 inches beyond the wall so the drip line is out away from the wall. Mr. Lloyd said this will address the problem of water seeping behind the earth wall, then freezing and thawing.

Sheb Mirando, Lloyd & Associates, said there were two coats of sealant, a base and a finish of two different products.

Mr. Lloyd reminded the committee that none of this is a structural problem; it is purely aesthetic.

Ms. Kohlasch asked how much the agency will need to budget to address the possibility of resealing every few years. Mr. Mirando said it was not necessary to have a contractor or a specialty laborer apply the water-based product. He said the very nature of rammed earth makes it difficult to know when it will show signs of wear in terms of the finish.

Mr. Lloyd said the general contractor recommended sealing the interior.

Mr. Propst thanked Mr. Mirando and Mr. Lloyd for their professionalism. This has been a long project and he was confident it was done right with general contractor Mr. Simms. With the exception of the State Capitol, Mr. Propst said the PERA building is the most beautiful in state government and thanks to the hard work it will continue to hold that distinction.

Ms. Kohlasch asked about guarantees from the contractor and Mr. Lloyd said there was none because the project had already failed and it was not requested in the RFP documents.

B. Informational Item: Status Report on PERA's Accounting Process Improvement Project [*Exhibit 1: Borrueal, 7/14/15 Status Report*]

Mr. Propst said when he arrived at PERA he recognized accounting issues that required a thorough deep review. He felt fortunate that Anthony Armijo who had served for many years as the comptroller for the State of New Mexico was willing to come onboard and has facilitated significant progress in the year and a half he has contracted with PERA. He thanked Natalie Cordova for her thoroughness. Mr. Propst said where PERA's accounting process is today is night and day over where it was three years ago.

Anthony Armijo presented information via power point and said he was amazed at the progress PERA has made in such a short period of time. He said he has 40 years of forensic auditing experience and he lauded staff for the rapid changes they have made. All of the staff that he has worked with at PERA deserve accolades. This is a continuous improvement project with the goal of identifying where improvements can be made and is dependent on management and staff. The organization has improved, is more solid and more conducive to continuous improvement.

Mr. Armijo said things were not in good shape when he came onboard which was reflected in PERA's June 30, 2013 (FY13) financial statement as noted by the auditor. The auditors offered the following deficiencies:

- Year-end financial close – reliable year-end financial reporting
- Accuracy of internal and external report of plan contribution
- Accuracy of participant and annuitant data
- Internal controls over payments to beneficiaries and member refunds
- Understandable and reliable accounting records

- Suitable experience and expertise with highly complex technical accounting and financial reporting matters, including those related to investments

Mr. Armijo said these were all serious findings translating that the numbers were not reliable. He emphasized that for a \$15 billion organization to not have reliable and understandable records is a red flag. In fact, one of the findings indicated that PERA lacked the expertise to properly account for investments and investments equal close to 99 percent of the organization's assets.

Mr. Armijo said these were all significant deficiencies and are generally not seen in audit reports.

Ms. French asked if the findings were specific to the RIO system. Mr. Armijo said they were not.

Mr. Armijo reviewed the scope of the project that was being completed in phases:

- Document and evaluate PERA's accounting systems to provide PERA a tool to assess and improve the efficiency, effectiveness, and economy of its accounting systems
- Identify and implement sound accounting processes, including related controls, to insure accurate, reliable financial reporting
- Train PERA staff in new, more effective accounting processes
- Work conducted as joint effort by PERA staff and Borrue, LLC

He repeated that PERA's staff jumped on the issues and has been instrumental in the project's success.

Mr. Armijo said basically the numbers were being calculated and then backed into. An accounting system should record business events, summarize them and report. Instead PERA was backing into the numbers and covering up a lot of mistakes. He said these were not small amounts. In fact, when he read the audit comments he questioned whether things could be that bad and when he got into the work he discovered they were much worse. The expertise for PERA has to be down in the transaction level.

Mr. Armijo said his firm prepared flow charts, transaction matrices, and internal controls. He said the RIO system is a very good database and the problems are configuration and have nothing to do with the structure within the software.

Mr. Armijo demonstrated a model to achieve continuous improvement and how it applies to government. By becoming more competitive, capacity increases and everyone benefits: employees and membership of PERA. PERA did a "phenomenal job" and in his 40 years of experience, Mr. Armijo has never seen corrections and moving forward done as expeditiously as at PERA.

The two concepts: numbers must tie to assets and you've got to know what you're doing. He reviewed the two phases and processes within those phases of work that have been completed. Staff implemented a daily reconciliation process and anything that is not recorded will show up right away.

In response to Ms. French's question of whether RIO is a good accounting database for PERA, Mr. Armijo stated it is an excellent system and needs configuration tweaks which staff is currently doing. He said as his investigations deepened the more configuration and clerical errors were revealed.

Mr. Armijo discussed the improvements that PERA has implemented including the institution of several levels of review and recognizing and recording all business events. He thanked Mr. Propst for his leadership and hiring the right people which has made the improvement project successful. He listed the many in staff that have helped to make the project successful.

Ms. French said she was speechless upon learning of the serious accounting system issues and thanked Mr. Propst for taking the lead. She was pleased PERA was heading in the right direction.

Mr. Reynolds asked whether PERA needed to restate any past annual reports. Mr. Armijo said there was a restatement this year but anything further he did not think was necessary. Mr. Reynolds commended staff for their willingness to examine and correct these deficiencies and continuous improvement.

Chair Logan said he too was surprised by the magnitude of issues that required attention. He said he was very pleased that staff has stepped up to the plate and thanked all those involved. He asked whether PERA was appropriately staffed. Mr. Propst said PERA was approved for another accountant this year. Natalie Cordova, Controller/CFO said one of the key pieces to improve PERA's overall processes has been the work that Mr. Armijo brought to the table. She said one of the most important components to improvement is communication.

Mr. Propst said the change in PERA's custody bank will also help improve the overall system. Staff still has work to do but he was very pleased with the direction.

Responding to Ms. French's question regarding custody bank issues, Jonathan Grabel, Chief Investment Officer, said this was one of the reasons PERA changed custody banks. BNY Mellon has standardized reports and to the extent those reports are not sufficient a technician will be provided to work on customization. Mr. Grabel said staff has been having weekly multi-departmental phone calls with BNY Mellon. He thanked Kristine Varela for her collaborations with accounting.

C. Informational Item: Internal Audit Report Presentation

Ms. Cordova said REDW has been working with PERA on an internal audit of census data and contributions. The importance of census data is highlighted by GASB 67/68 and she anticipated REDW will be providing this audit on an annual basis.

REDW Senior Manager Jessica Bundy said the audit focuses on evaluating the accuracy of the census data. REDW also assessed contribution reporting and its accuracy. She said they analyzed the April 2015 census database of 65,467 active members by identifying certain things that would be considered unusual and set those criteria. Those items include: birth date errors, lacking address, gender, ID, first name, invalid social security number, and other errors. The errors were provided to PERA to correct.

Working with the external auditors, REDW took a sample of 278 members from 10 employers and an additional 63 from all employers and tested for application data agreed with PERA information. They then took that information to the member employers to compare the census data to the employee personnel file. Pay rates were also verified with PERA and the employee personnel file as were the employee and employer contributions. Timeliness of remittance of payroll reports and funds were also checked with the employer.

Matt Doxtator, REDW, said in the recalculation of contributions within the pay period tested, of the 278 employees there were no discrepancies. He offered a general observation that PERA staff was not defensive about the discrepancies but rather asked how the discrepancies could be corrected. The issues have to do with educating the employer to obtain accurate and complete information.

Mr. Doxtator said many of the discrepancies could be resolved by locating additional documents. A lot of the discrepancies can be fixed on the back end when the employee retires, however, that causes strain on PERA and creates inefficiencies.

REDW recommends cleaning up historical data and reviewing the process going forward. Other recommendations:

- Employer training to explain the importance of accurate data
- Require support information for member with employer submittal
- Analyze the capability of the RIO system for the employee to fill out applications on line
- Consider using the system validations to cross reference information from the member application to the payroll uploads
- Use the inactive option in the RIO system to remove members from the active database who have not had payroll uploads for a certain period of time

Greg Trujillo, Deputy Director, said while RIO does not currently have the capability for online PERA applications, potential RIO enhancements can make that possible. He said there are identity management services that could verify social security numbers.

Ms. Kohlasch reminded staff that there is a large portion of PERA's population that is unwilling to enter personal data onto a computer because of security issues or basic logistics.

Ms. Bundy said a problem is employers do not update information on employees. Mr. Trujillo said it is ultimately the employee's responsibility to inform PERA of a name change, etc.

In summary, Mr. Doxtator said RIO is a robust system that has cross validation features that could be better utilized.

Ms. Cordova reviewed management's response to the internal audit report. Contribution accounting staffing has increased and is in a better position for efficiency and improved employer training both onsite and by phone. She noted that contribution accounting staff have each been assigned a region in which to oversee employers. In the records department, PERA has made it a priority to enter forms received from members and employers in a timelier manner. Staff is also reviewing historical records and all of these processes increases efficiency. Future steps include continued employer training, system validations, employer penalties and strategic project planning, stated Ms. Cordova.

Mr. Trujillo said staff is reviewing each of the validations before implementing that process. Regarding penalties, Mr. Trujillo said employers will receive a quasi-bill and have six months to correct the issue. Following that period penalties will be levied. He said as the penalty notion is fleshed out and prepared for implementation Board support will be paramount.

Sam Ojinaga, Bureau Chief, Contributions Accounting, said employer response to correcting issues has improved greatly with his staff going out to the employers. Regional training and individual meetings with the employers have been very successful. Mr. Trujillo recognized the staff increase in Contribution Accounting has greatly helped to address these issues.

Ms. Cordova noted that last year's external audit was the first time the AICP issued guidance that the auditors should pay more attention to this type of data and test it more thoroughly than they have in the past because of GASB 67/68. She said while there were many issues identified in the sample tested the issues are of lesser concern because they do not influence the actuarial data in a material matter.

D. Informational Item: Update on GASB 67/68 Reporting

Ms. Cordova said information and communication to the employer participants is key to the process. PERA staff has dedicated resources to statewide outreach and she reviewed the presentations that have occurred which included IPOC, NM Society CPAs, NM Association of Counties, and others.

Ms. Cordova said many governments in the municipal PERA plan have the option of paying a percentage up to 75 percent of an employee's contribution, commonly referred to as the "pickup." The GASB 67 implementation guide requires plans like PERA to account for those pickups dependent on how that employer accounts for them. There are two options to the

pickups. Staff has talked with GASB to discuss the situation further and to inform them of the magnitude of burden it places on plans. PERA has roughly 183 employers that can choose this pickup option for over 15 plans. GASB did not offer any alternatives to PERA having to obtain responses from each individual employer participant in order to figure out how they account for their pickup.

Staff has determined the most efficient way to gather this required information is to request confirmation of the employer participants. An email blast went out to participant employers. She reviewed a worksheet sent out to the employers. Ms. Cordova noted that once the information is gathered staff will have to shift the contributions based on the responses received. The shift will be reflected in the FY14 financial statement and in the Schedule of Employer Allocations. She noted a significant number of employers do pickups on behalf of their members and financial statements will need to be reissued to show that shift. Overall, this significantly increases an already complex GASB 68 compliance. Based on the current confirmation response timeline, PERA has revised the timeline for issuance of the Schedule of Employer Allocations to early to mid-August 2015.

Susan Pittard, Chief of Staff/General Counsel clarified that there are two types of pickups and state employees enjoy a tax deferral and those contributions are treated as employer contributions for tax purposes.

Ms. Pittard said regardless of how an employer accounts for pickups, they are all includable for purposes of employees' pension. They are all pensionable wages when received by PERA. The difference is whether the employee pays FICA on them.

Mr. Propst commented that this pickup issue and how it relates to GASB reporting is far more than an obstacle and has been a difficult issue to work through. This is a national issue that plans across the country will be grappling with. He said Moss Adams and staff have worked hard on this.

The committee commended staff for their work on this issue.

E. Information Item: Review of FY15 Year-End Budget Status

Renada Peery-Galon, ASD Director stated PERA had a budget of \$40,356,500 for FY15 and six BARs increases over the fiscal year in the amount of \$3,175,715. Total expenditures for FY15 is \$42,885,425 leaving an available balance of \$646,790 or 1.5 percent of the overall budget.

Ms. Peery-Galon advised the Committee that Patrick Alarid left PERA and Valerie Sandoval will be the budget manager for PERA with a focus on financial services and budget.

Responding to Ms. French's concern about requests for BARs in the past, Ms. Peery-Galon said the unknowns are the hard part in budget preparation and unforeseen, unexpected needs can impact a budget. Staff will be monitoring necessary funds to fill vacant positions as

projections are underway. Ms. Peery-Galon said she was reviewing items that came up in FY15 in contractual services to assess whether they will need to be placed into budget for FY17 as reoccurring items.

5. **OTHER BUSINESS**

None was presented.

6. **ADJOURNMENT**

Having completed the agenda, Chair Logan adjourned this meeting at approximately 12:00 p.m.

Approved by:



Stewart Logan, Chair
Audit & Budget Committee

ATTEST:



Wayne Propst, Executive Director

Attached Exhibit(s):

Exhibit 1: Borrue!l, 7/141/5 Status Report