NHRS Board of Trustees, Audit Committee
May 14, 2013

NOTE: These minutes from the May 14, 2013 Audit Committee meeting were approved and executed at the June 11, 2013 regular Meeting of the NHRS Audit Committee.

Audit Committee
Board of Trustees

The Public Minutes

New Hampshire Retirement System
54 Regional Drive
Concord, NH 03301

Committee Members: Catherine Provencher, Chair; John Beardmore; Karen McDonough; Jack Wozmak.

Staff: George Lagos, Executive Director; Timothy Crutchfield, Esq., Chief Legal Counsel; Jack Dianis, Director of Finance; Larry Johansen, Director of Investments; Nancy Miller, Director of Member Services; Mark Cavanaugh, Regulatory Compliance Officer/Staff Attorney; Heather Fritzky, Accounting and Financial Reporting Supervisor; John Browne, Internal Auditor. Also in attendance were Dave Gagnon, KPMG Engagement Partner, and Brian Shaughnessy, KPMG Senior Audit Manager.

Upon a request from the Chair, a motion was made by Mr. Wozmak to accept the minutes of the April 9, 2013 meeting. Mr. Beardmore seconded the motion, and it carried unanimously.

The Chair then asked Mr. Gagnon and Mr. Shaughnessy to present the 2013 KPMG Audit Plan. Mr. Gagnon started by referring the Committee to the handout provided and explained the audit plan outlines the collective roles and responsibilities of management, KPMG, and the Audit Committee with respect to financial reporting and the audit. He noted KPMG staffing would be consistent with last year thus providing continuity on the audit. Mr. Gagnon then went over the KPMG's audit objectives for NHRS, specifically reviewing those relating to the issuing of the report on the CAFR, recommending internal control improvements, and advising on the interpretation of new accounting requirements.

Mr. Shaughnessy next walked the Committee through the KPMG audit methodology and process of planning, control evaluation, and substantive testing, resulting in the issuance of an audit opinion, and if appropriate preparing a management letter commenting on controls. He noted KPMG is presently in the planning phase. This phase includes performing analytical procedures and reviewing critical changes at the System and in the industry, so as to identify areas where control risks are the highest. Mr. Shaughnessy then discussed the control evaluation approach where the risk of material misstatement is assessed, and the substantive testing where KPMG will vouch transactions, confirm balances, verifying the objectivity of assumptions. He also noted KPMG had recently issued an update to the management letter for Fiscal Year 2012 regarding progress made by the System in strengthening the due diligence process for purchasing alternative investments. Additionally Mr. Gagnon commented that these documentation improvements appeared robust, and KPMG would continue to work with the System in implementing documentation enhancements to address the second phase of KPMG's comments more directly linked to financial reporting and the monitoring of these investments.

Mr. Shaughnessy then updated the Audit Committee on other areas that will be given emphasis as part of the audit, i.e. conducting fraud interviews, assessing the Government Finance Officers Association comments on the prior year CAFR, and advising on CAFR disclosures. Based on a question from the Chair, there was a brief discussion of how, if at all, the selection of a new custodian might impact the audit. It was determined that if there was a change in custodians, it would not be until July 1, 2013, and therefore there would be no impact on the FY 2013 audit. Mr. Gagnon then briefly reviewed this year's engagement letter to be signed by the Audit Committee Chair to highlight changes from the previous year. The primary change noted impacts how KPMG will present its report to management. Mr. Gagnon explained the American Institute of Certified Public Accountants (AICPA) had initiated a Clarity Project, the goal of which was to make overall industry financial reporting more consistent and easy to understand for the general public. He noted the result of this project will be more headings, sections, and verbiage in future reporting. Mr. Gagnon stated that while he presently had no specific illustration to share, a good example would be that the auditor's opinion will now have a separate heading, "Opinion", which has not been there in the past.

Mr. Gagnon then provided an overview of the new pension standards, leading a discussion of how the two new Government Accounting Standards 67 and 68, Accounting and Financial Reporting for Pension Plans and Pensions, will impact the System and the employers. Per Mr. Gagnon, the first phase of GASB 67 is being implemented next fiscal year, and will be the base for measurements going forward. This will include how the System will determine the allocation of pension costs for each employer, significant assumptions to be used, and the rates to be used to discount the liability. The following fiscal year, GASB 68 becomes effective and that will be the standard that will have the greatest impact on employers because the pension liability that is allocated by the System will have to go on each employer's balance sheet and for some entities, this will now be the biggest liability. Per Mr. Gagnon, one of the primary concerns of the employers is how are their auditors going to get comfortable with the validity of this liability, and in return how is the System going to provide that assurance. The Chair noted that this is a national discussion that the System is participating in as to whether a separate audit will need to be done of that allocation methodology to each employer, and also if employers will need an actuarial opinion as to the soundness of the liability. Mr. Dianis also noted that besides the liability there is an issue of how an employer will determine its pension expense amount which will require amortizing certain expense components going forward. Lastly, Mr. Gagnon noted one of the most controversial aspects to this standard is the use of a blended rate to discount the net pension liability. This comes about if the net financial position available to pay benefits fails to meet or exceed the projected benefits for a period of time, a much lower muni rate would have to be used in place of the investment rate. This will create an even greater liability. Mr. Dianis noted that this has been discussed with the System's actuaries, and they were comfortable that this would not be necessary. The Chair commented that she felt the System has been doing a very good job to get the information out to employers. In closing, based on a question from Mr. Dianis asking about further guidance, Mr. Gagnon noted both GASB and the AICPA will be issuing documentation this summer for both the Pension Systems and the Auditors on implementing these standards.

Next Mr. Browne updated the Audit Committee on the status of items on the Audit Tracking Report. He noted there was one closed item, and that related to the strengthening of the procedures for soliciting employers to sign up Volunteer/Call Firefighters. This issue was addressed through the Member Accounting team, Legal, and the Executive Team reviewing and updating the process – in particular the solicitation letter and the form used to record those who apply for the benefits. This solicitation letter for FY 2014 was mailed out recently and thus the issue was closed. Per a question from the Chair as to the overall status of the Volunteer/Call Fire program, Mr. Lagos explained that staff had completed the additional research requested by the Benefits Committee and it would be presented to the Committee at its next meeting. Mr. Browne also noted one target date was changed on the tracker to have the management response be in sync with the Member Service plan currently in place to address the updating of all Judicial Retirement Plan procedures. And then in response to questions that had come up from Committee members at the last meeting, Mr. Browne briefly reviewed a memo included in the audit packet outlining controls over uncashed checks and how the System identifies retiree/beneficiary deaths. The memo covered everything from checks returned because of a postal delivery issue, to rejected retiree payments, to how the System monitors beneficiary deaths. Lastly, Mr. Browne noted he was in the process of wrapping up the Insurance Benefits audit and planned on having the report and issues list for the next meeting.

As the status of the GASB Reporting Standards had been reviewed in the KPMG presentation above, Mr. Dianis just noted that there is a pilot program he has organized to reach out to stakeholders to build consensus on implementation issues, and to ask them to bring to the attention of the Retirement System any points that they might feel are being missed.

There being no further business, the Committee scheduled the next meeting for 8:30 AM immediately prior to the Board meeting on June 11, 2013.

A motion to adjourn was made by Mr. Beardmore, seconded by Mr. Wozmak, and it carried unanimously.