

**South Carolina Retirement System Investment Commission
Audit Committee Meeting Minutes**

February 26, 2014

**South Carolina Retirement System Investment Commission
1201 Main Street, 15th Floor
Columbia, SC 29201
Meeting Location: Presentation Center**

Committee Members Present:

Mr. Allen Gillespie
Chairman Mr. Edward Giobbe
Mr. Travis Turner

Others present for all of a portion of the meeting on Wednesday, February 26, 2014:

Andrew Chernick, Sarah Corbett, Dori Ditty, Robert Feinstein, Hershel Harper, Monica Houston, James Manning, Nancy Shealy, Katie Walker, and Ron Wilder from the South Carolina Retirement System Investment Commission ("RSIC"); David Padgett from the State Treasurer's Office; Tammy Nichols and Faith Wright from the Public Employee Benefit Authority ("PEBA"); Wayne Pruitt and Donald Tudor from The State Retirees Association of South Carolina.

- I. **Call to Order:** Chairman Allen Gillespie called the meeting of the RSIC Audit Committee ("Committee") to order at 9:35 a.m. Chairman Gillespie introduced new Committee member, Mr. Travis Turner, the PEBA Interim Executive Director. Mr. Turner made a motion to approve the agenda for the February 26, 2014 Audit Committee meeting, which passed unanimously.

- II. **Approval of Minutes (November 13, 2013):** Chairman Gillespie requested that the approval of the minutes from November 13, 2013 be momentarily delayed since Mr. Edward Giobbe had not yet arrived to the meeting. Mr. Turner was not in attendance at the November 13, 2013 meeting and could not vote on the matter.

- III. **Audit Committee Follow-up:** Ms. Monica Houston, Internal Audit and Compliance Officer, detailed an open Audit Committee item, which was the Audit Committee self-evaluations. The original completion date for the self-evaluations was set for June 2014, but with the recent addition of Mr. Turner to the Audit Committee, Ms. Houston questioned whether the item should be postponed. After a brief discussion, it was

decided to keep the original completion date of June 2014 for the self- evaluations.

Ms. Houston briefly reviewed the completed Audit Committee items, including:

- Clarification of management letters and the Audit Committee Charter;
- Audit and Compliance staff evaluations;
- Rebalancing of the 2014 Audit Plan; and
- Presentation of newly adopted Audit & Compliance policies.

IV. Audit & Compliance Update: Mr. Andrew Chernick, Director of Audit and Compliance, reviewed the Deloitte Risk Assessment Dashboard tasks and noted the updates since the previous Audit Committee meeting on November 13, 2013. The tasks that are still in progress, but which have a portion completed include:

- Develop operational infrastructure
 - Specifications were developed and a RFP was issued for an Investment Administrator, which would include private market systems and a risk management system;
- Fully develop an investment risk management function
 - A risk RFP has been issued, finalists have been selected, and a demonstration has been scheduled;
- Develop a compliance function
 - RSIC has formally adopted an Employee Code of Ethics, a Personal Trading Policy, a Whistleblower Policy, and a Conflict of Interest/Gift Policy. Mandatory training with RSIC staff concerning these policies has been completed; and
- Obtain legislative approval for additional FTEs to address key person risk and further enhance external manager oversight
 - This task will continue to be ongoing and will adhere to the legislative process for approval.

For the tasks still in progress, Mr. Chernick detailed the next steps to be taken and the estimated timeline for completion of the entire task.

Based on questions asked by Chairman Gillespie and Mr. Turner, Mr. James Manning, RSIC Information Technology Director, clarified the Request for Proposal (RFP) process of finalizing a source for the investment risk management system. He noted that Commissioner involvement in the process was not feasible at the current time due to procurement rules and that information relative to the RFP could not be made available to Commissioners due to confidentiality restrictions. Mr. Manning also briefly discussed the Administrative and Private Market RFPs.

Mr. Edward Giobbe arrived at the meeting at 9:47 a.m., and Chairman Gillespie

reverted back to the Approval of Minutes (November 13, 2013) agenda item. After sufficient time was allotted for review, Mr. Giobbe made a motion to approve the minutes from the November 13, 2013 Audit Committee meeting. The motion passed unanimously, with Mr. Turner abstaining from voting since he was not present at that meeting.

V. Fiduciary Audit Progress Report: Mr. Chernick reminded the Committee that Funston Advisory Services is performing the Fiduciary Audit, which began in December 2013, and is being overseen by the South Carolina Inspector General. Mr. Chernick noted that phase one of the audit was completed, which included:

- Finalizing work plan;
- Reviewing documents and collecting survey data; and
- Conducting interviews.

Mr. Chernick stated that phase two of the Fiduciary Audit was partially completed and requires the completion of six assessments that include:

- Governance;
- Policy review and development;
- Organizational structure;
- Key investment administration function;
- Legal compliance; and
- Information technology services.

Mr. Chernick detailed phase three of the Fiduciary Audit that will include:

- Reviewing and discussing of the draft report;
- Receiving comments;
- Preparing final report;
- Conducting exit interviews; and
- Presentation to RSIC Full Commission Meeting.

Mr. Chernick stated that the final Fiduciary Audit report from Funston will be submitted by April 30, 2014, and will include an executive summary and detailed discussions on all six assessments areas within phase two.

VI. Audit Plan Progress Report: Ms. Houston referred to the Audit Plan Update handout given to the Committee, noting the progression as of January 31, 2014. Ms. Houston explained in detail the processes that have been moved to other quarters, placed on hold, and completed. The audit processes moved to another quarter for completion include:

- Valuation of Investments postponed to quarter one;
- Initial Due Diligence (Investment and Operational) postponed to quarter two; and

- Investment Approval and Funding beginning in quarter two.

The audit processes placed on hold include:

- Initial Due Diligence (Investment and Operational);
- Investment Contract Management; and
- Information Technology GCC.

The audit processes completed include:

- Management Fees and Expenses;
- Ethics/Conflicts of Interest for Compliance; and
- Incentive Compensation.

At the request of Chairman Gillespie and for the benefit of Mr. Turner, Ms. Houston provided a brief overview of the differences in the “Review Types” of Consulting, Audit, and Compliance, and explained the levels of “Risk Evaluation” and how they affect the Committee. Ms. Houston stated that the Internal Audit Policy and Procedure process had recently begun, because every five years a quality peer review is performed, and all policies and procedures must be in place before the review can commence.

Other changes to the Audit Plan included the re-categorization of “Contract Compliance” to a “Compliance” review type as opposed to “Audit” review type and “Ethics/Conflicts for Audit” was moved to next year’s Audit plan. Chairman Gillespie requested a motion to remove the “Ethics/Conflicts for Audit” from this year’s Audit Plan and be carried forward to the following year. Mr. Giobbe made the motion, which was seconded by Mr. Turner and passed unanimously.

VII. Internal Audit Co-sourcing: Ms. Houston reminded the Committee that the Audit team periodically utilizes outside vendors for certain projects. In an attempt to streamline the process of selecting a vendor when needed, a policy procedure has been created. The policy contains a list of three vendors that have been pre-approved by the South Carolina State Auditor, Mr. Richard Gilbert, and may be utilized. When a need arises and the budget request is approved, the goal is to utilize the approved outsourcing vendor list. Ms. Houston and Chairman Gillespie requested that the Committee review the proposed procedure and provide feedback within ten business days.

Commissioner Code of Ethics: Chairman Gillespie reminded the Committee that as part of the Compliance procedures, all RSIC staff were required to sign a Code of Ethics, which would provide guidance of the values and standards each employee is expected to abide. It was previously determined that for best practices, the Commissioners should also sign a similar Code of Ethics, and the Audit Committee was tasked with presenting a final copy to the full Commission for consideration. Discussion ensued about the details of the Commissioner Code of Ethics including the oath already taken by each Commissioner, periodic training to be involved, and the ethics built into the Governance Policies regarding Commissioners. Chairman Gillespie suggested that the Commissioner Code of Ethics draft be posted for all Commissioners to review and provide feedback. It was determined that finalization of the Commission Code of Ethics would be addressed at the special Audit Committee meeting in April being coordinated by Ms. Houston for discussion of the SIOP and AIP Internal Audit

results.

VIII. Strategic Planning – Internal Audit & Compliance: Chairman Gillespie explained to the Committee that based on the 2008 Independent Fiduciary Services (IFS) report, a recommendation was made for RSIC to “consider implementing an Enterprise Risk Management (ERM) framework”, which would add significant value to the organization and was the next logical step for best practices.

With the implementation of an ERM function, there would need to be a clearer delineation between Audit and Compliance, thus resulting in Mr. Chernick's job title changing to "Director of Enterprise Risk Management and Compliance" and Ms. Houston's title changing to "Chief Audit Officer", to better illustrate their new responsibilities within the ERM framework.

Following further discussion, it was determined that three action items be presented at the full

Commission meeting on March 13, 2014 that include:

- 1) Establishment of an Enterprise Risk Management (ERM) Function;
- 2) Bifurcation of Internal Audit and Compliance and Convergence of ERM and Compliance; and
- 3) Change management of the Internal Audit Function.

Chairman Gillespie relinquished his chair to Mr. Giobbe, due to his close involvement with the ERM project. Mr. Gillespie then made a motion that the three action items with an effective date of July 1, 2014, be presented to at the full Commission meeting on March 13, 2014. Mr. Turner seconded the motion and it passed unanimously.

- IX. Adjournment:** Given no further business, Chairman Gillespie adjourned the meeting at 11:28 a.m. [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, at 11:00 a.m. on February 20, 2014.]