

Tom Watson
Interim Retirement Administrator



Telephone: (707) 463-4328
(707) 467-6473
Fax: (707) 467-6472

MENDOCINO COUNTY
EMPLOYEES' RETIREMENT ASSOCIATION
625-B KINGS COURT
UKIAH, CALIFORNIA 95482-5027

Date: April 9, 2014
To: Board of Retirement
From: Tom Watson, Interim Retirement Administrator *Tom Watson*
Subject: Review of the Independent Auditor's (Gallina LLP) Report (dated March 11, 2014) on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements (as of June 30, 2013) Performed in Accordance with Government Auditing Standards

Background

The Board of Retirement received the Independent Auditor's Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards issued by the auditor's firm, Gallina LLP and dated March 11, 2014 (see Attachment E). This Report was based on Gallina's audit performed of accounting and retirement system records for the year ending June 30, 2013. The Report was received by the Board of Retirement at its March 19, 2014 meeting along with the June 30, 2013 Financial Statements and Comprehensive Annual Financial Report (CAFR).

Upon receipt of this Report, the Board of Retirement directed staff to review this Report and to bring back to the Board of Retirement an update with any new Policies, Procedures or other documents necessary to address the Report findings in deficiencies as noted in the Report. This update (with attachments A - E) is staff's response.

(Note: Crystal Ekanayake reviewed these materials and responded via e-mail. The e-mail is found as Attachment F.)

Discussion and Findings

1. Plan Records

Gallina recommended that MCERA adopt written policies and procedures designed to mitigate the Association's risk with regard to regulatory compliance. Such procedures would outline the various responsibilities applicable to the Retirement Administrator and those parties that are responsible for executing the procedures.

As noted in the management response, the Board of Retirement has a Strategic Plan with mission statement and core values; a Charter for the Board of Retirement and the Retirement Administrator with clear statements for the governance and management of MCERA showing roles and responsibilities of the key decision-making bodies within MCERA; and the Audit and

Discussion and Findings (continued)

1. Plan Records (continued)

Budget Committee Charter with Budget Adoption Policy. In addition to these documents MCERA has Bylaws and other Charters and Policies. These documents are all located on the MCERA "RETIRE (S:)" (a computer network drive shared by all MCERA staff) in a file folder labeled "BOARD POLICY AND PROCEDURES" with the various documents in individual files as noted. In fact, there is a Word file labeled "Policy Charter Listing Current & Potential" that enumerates many, many policies and procedures with about half of them implemented or updated (noted date of adoption or revision) and half not yet implemented or recently revised (see Attachment A).

As the management response indicates, as to the day-to-day duties of staff and the current "variety of information systems to track member information" the Pension Gold integrated and automated member information system will provide the much needed single information system. Staff time is better devoted to implementing this system than trying to document systems and procedures for multiple systems that will be obsolete upon completion of the Pension Gold project.

2. Segregation of Duties

The changes noted in the management response in further review of a retiree's file for initial payment have been made. The Retirement Specialist II reviews the calculation by the Senior Retirement Specialist and the member ledger balances are confirmed. In addition to this, the Senior Retirement Specialist prepares an Excel spreadsheet showing the prior payroll run figures, changes to that payroll (new retirees, deceased, continuances, etc.) and insures that the resulting new payroll figures balance with the County's MUNIS payroll system. This spreadsheet also shows the accounts payable amounts (income tax withholding payment, retiree organization dues deductions, etc.) and is forwarded on to the Financial/Investment Officer and Retirement Administrator. The Financial/Investment Officer and/or Retirement Administrator can then make further review of new retirees.

The "spot checking" of retirees who have been on retiree payroll for years can be done by the Financial/Investment Officer or Retirement Administrator on a random sampling basis. If just ten files per month were pulled and reviewed for ten months of the year, the entire retiree population would be reviewed over the course of about 13 years. Given that the retirees from 2014 on have had extra scrutiny when they are first input onto retiree payroll, this may be less problematic in the future.

A draft "Retiree Payroll Verification Procedures" document is forwarded with this Review as Attachment B.

Discussion and Findings (continued)

3. Authorization of Plan Expenses

I can verify that the Administrative Assistant first reviews invoices for payment and forwards these on to the Retirement Administrator for review and initial. The County's MUNIS accounting system contains MCERA vendor contract information including the maximum that can be paid out on the contract. In discussion with the Administrative Assistant, we can begin to have the paper contract file pulled to go with the invoice so that the invoice can be reviewed in the context of the contract and then have the Retirement Administrator initial or sign that the invoice has been reviewed within the context of the contract's parameters.

A draft "Service Provider Invoice Review Procedure" is forwarded with the Review as Attachment C.

4. Monitoring Compliance with the Service Agreements

To help insure a regular monitoring of Service Agreements by someone other than those involved with contract negotiations (including the Retirement Administrator), I propose the following language addition to the Audit and Budget Committee Charter for the Board of Retirement's review, amendment and approval (*new language in italics*):

"DUTIES AND RESPONSIBILITIES

1. The Audit and Budget Committee will...

...
e. Meet at least annually with the Retirement Administrator to discuss the effectiveness of the internal financial and operational control policies *and receive a Report of Review of Service Agreements prepared by the Financial/Investment Officer;*

...
... "

The current Audit and Budget Committee Charter is provided as Attachment D.

Recommendation

I recommend that the Board of Retirement direct staff to begin utilizing the Procedures as written in Attachments B and C and to adopt the additional language to the Audit and Budget Committee Charter as written in italics above.

**MENDOCINO COUNTY EMPLOYEES' RETIREMENT ASSOCIATION
CHARTERS AND GOVERNANCE POLICIES**

	BY-LAWS
	Article I: Administration
	Article II: Meetings
	Article III. Membership
	Article IV. Contributions
	Article V. Sworn Statement
	Article VI. Prior Service
	Article VII. Allowance for Public Service
Revised 7/17/2013	Article VIII. Procedures for Hearings on Disability Retirement
	Article IX. Health Insurance
Revised 8/21/2013	Article X. Board of Retirement Eligibility and Election
Revised 10/2013 & Approved by BOS 11/05/13	Article XI. Amendments
	CHARTERS
Adopted 1/16/13	Board Strategic Plan
Adopted 11/7/12	Mission Statement
Adopted 11/7/12	Core Values
Adopted 2/20/13	Audit & Budget Committee Charter
	Board Chair Charter
	Board Vice Chair Charter
	Committee Chair Charter
	Governance Committee Charter

A

**MENDOCINO COUNTY EMPLOYEES' RETIREMENT ASSOCIATION
CHARTERS AND GOVERNANCE POLICIES**

Adopted 3/20/13	Retirement Administrator Charter
Adopted 3/20/13	Retirement Board Charter
	POLICIES
	Acceptance and Reporting of Gifts
Adopted 7/17/2013	Actuarial Funding Policy
	Administrative Hearings Policy
Adopted 3/20/13	Assessment & Determination of Compensation Enhancements Policy
Adopted 10/16/13	Board Communications Policy
	Board Disclosure Policy
Draft to BOR 4/18/2012	Board Policy Development Process (Presented as POLICY FOR BOARD MEMBER REQUESTS TO PLACE ITEMS ON THE AGENDA)
	Board Performance Review
Adopted 2/20/13	Budget Adoption Policy
Adopted 1/18/12	Cash Management & Rebalancing Policy
	Disability Retirement Reemployment Policy
Adopted 7/17/2013	Disability Retirement Procedures
	Disposition of Equipment Policy
	Due Diligence Policy
	Fact Sheets
	Hearing Officer Selection & Retention Policy
	Indemnity & Defense Policy
Adopted 6/16/2010	Interest Crediting & Undistributed Earnings Policy
Adopted 9/2010	Investment Policy Statement

**MENDOCINO COUNTY EMPLOYEES' RETIREMENT ASSOCIATION
CHARTERS AND GOVERNANCE POLICIES**

	Legislative Policy
Adopted by Resolution 10/19/11	Model Regulations for 401(h) Account
	Monitoring & Reporting Policy
Adopted 2/15/12 Revised 3/20/13	Overpayment Policy
Adopted 11/9/11	Placement Agent Disclosure Policy
	Planning Policy
	Proxy Voting Policy
	Quiet Period Policy
	Record Retention Policy
Adopted 9/19/2012	Retirement Administrator Performance Evaluation Policy
Adopted 9/19/2012	SACRS Voting Authority Policy
	Securities Litigation Policy
	Service Provider Selection Policy
Adopted 12/16/2009 Amended & Adopted 12/12/2012	Trustee Education and Travel Policy

DRAFT

Mendocino County Employees' Retirement Association Retiree Payroll Verification Procedures

Effective May 1, 2014

To help ensure appropriate payments to retired members, the following procedures are to be implemented by staff effective May 1, 2014.

The Senior Retirement Specialist will prepare the original calculations of monthly retirement allowances for newly retired members. The Retirement Specialist II will review the member's file with the calculations made and verify or correct such calculations. The Retirement Specialist II will also review the member ledger balances to ensure that the Senior Retirement Specialist's calculations are correct. The Senior Retirement Specialist will input the retired member's information into the retiree payroll system in MUNIS. The Senior Retirement Specialist will enter the retired member's gross pay and deductions onto the Excel spreadsheet which is prepared each payroll cycle to ensure that the payment information coming from the MUNIS retiree payroll system is in balance. Upon the death of a retired member, the same processes will occur with review by the Retirement Specialist II of the Senior Retirement Specialist's calculations and work including the review by the Retirement Specialist II of the retired member's file. Upon the completion of the balancing of the retiree payroll, a copy of the Excel spreadsheet used for such balancing will be forwarded to the Retirement Administrator, the Financial/Investment Officer and the Administrative Assistant (for the Board of Retirement agenda). The files of the newly retired members and deceased retired members will be forwarded to the Retirement Administrator or Financial/Investment Officer for final review.

The Retirement Administrator or the Financial/Investment Officer will review the retiree payroll Excel spreadsheet and retired members' files to insure that the calculations have been made by the Senior Retirement Specialist and reviewed by the Retirement Specialist II. The files are then forwarded to the Administrative Assistant for placing on the Board of Retirement agenda. The Administrative Assistant will then file these for future reference and audit.

Ongoing, the Retirement Administrator or the Financial/Investment Officer will randomly pull ten files of retired members each month for ten months each year to insure that the payments being made to the retirees are correct. The random sampling will be made from retired members who retired before May 1, 2014. This review must be noted by date in the retired member's file and the retired member's name withdrawn from future random samplings.

These procedures will need to be reviewed and amended upon completion of the Pension Gold Software system that will integrate various automated systems currently in use by MCERA staff.

DRAFT

Mendocino County Employees' Retirement Association Contracted Service Provider Invoice Review Procedures

Effective May 1, 2014

Upon receipt of an invoice from a MCERA Contracted Service Provider, the Administrative Assistant will pull the Service Provider's contract file. [If the Service Provider is a regular utility (e.g. water, electric, gas, etc.) or County Department and there is no contract on file, this step is not needed]. The Administrative Assistant will review the information in the contract file (including prior invoices) to insure correctness. The Administrative Assistant will ready the invoice for review by the Retirement Administrator by noting the service providers' total contract amount (if any) and having all prior invoices in the file for review. The Administrative Assistant will then forward the invoice and the contract file (with invoices) on to the Retirement Administrator for review.

The Retirement Administrator will review the contract file and invoice information and compare this with the most recent budget report. If the Retirement Administrator finds that the expenditure is appropriate, the Retirement Administrator will note on the invoice that the contract and invoice have been reviewed and are found to be appropriate and sign off to approve the invoice for payment. The Retirement Administrator will return the approved invoice with the contract file to the Administrative Assistant.

The Administrative Assistant will process payment of the approved invoice in MUNIS and forward a copy to the County's Auditor-Controller's Office for processing of payment. Once payment is generated, the Administrative Assistant will record payment information on the approved invoice, will make a copy for MCERA accounting and will file the paid invoice and contract file for future reference and audit purposes.

INTRODUCTION

1. The Board of Retirement has established an Audit and Budget Committee to assist it in overseeing the Audit and Budget functions within MCERA.
2. The Audit and Budget Committee will make recommendations on matters pertaining to the annual financial audit and budget of MCERA to the Board of Retirement
3. The Board Chair will appoint four members of the Board to the Audit and Budget Committee and designate one member to serve as the committee chair.

DUTIES AND RESPONSIBILITIES

1. The Audit and Budget Committee will, from time to time, as determined to be in the best interest of MCERA:
 - a. Examine and recommend to the Board for approval the objectives and scope of annual financial Audit and Budget, including the audit plans of the external financial auditor, the duties and responsibilities of the external financial auditor, and the timing and engagement fee of the annual financial audit;
 - b. Meet with the external financial auditor to review and discuss the annual financial statements;
 - c. Review the findings of the external financial auditor and review of Management Letter, and any response thereto;
 - d. Recommend the approved annual financial statements to the Board of Retirement for approval;
 - e. Meet at least annually with the Retirement Administrator to discuss the effectiveness of the internal financial and operational control policies;
 - f. Review the engagement of the external financial auditor at least every three years and make recommendations to the Board as to the appointment or recruitment of the external financial auditor;
 - g. Review the findings or comments of any regulatory agencies concerning financial statements or other information of MCERA;
 - h. Review the proposed fiscal year budget prior to presentation to the Board of Retirement.

MONITORING AND REPORTING

1. The Audit and Budget Committee will:
 - a. Review, at least every three years, the performance and independence of the external financial auditor, including the impact of any non-audit services performed for MCERA by the auditors, or any affiliate thereof, on such independence;
 - b. Review any significant changes in accounting practices or policies that may have an impact on MCERA or the Fund;
 - c. Report regularly and make recommendations as deemed appropriate.
2. The Committee will perform any other duties that are assigned to it by the Chair of the Board.

CHARTER HISTORY

1. This Charter was adopted by the Board of Retirement on February 20, 2013.

**Independent Auditor's Report on Compliance and on Internal Control Over
Financial Reporting Based on an Audit of Financial Statements
Performed in Accordance with Government Auditing Standards**

March 11, 2014

Board of Retirement
Mendocino County Employees' Retirement Association
625 B Kings Court
Ukiah, CA 95482

We have audited the statement of net assets available for benefits of the Mendocino County Employees' Retirement Association (the Association) as of June 30, 2013, and the related statement of changes in net assets available for benefits for the year then ended, and have issued our report thereon dated March 11, 2014. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

In planning and performing our audit, we considered the Association's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the Association's financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Association's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Association's internal control over financial reporting.

Our Responsibilities

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and, therefore, there can be no assurance that all such deficiencies have been identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies.

Definitions Related to Internal Control Deficiencies

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency or combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the Association's financial statements will not be prevented, or detected and corrected on a timely basis. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

E

Segregation of Duties:

The monthly retirement payments function currently has an inadequate segregation of duties. The same person inputs new members into the retirement payroll system and prepares the calculation of the monthly retirement benefit and transmits the data to the County Auditor/Controller's Office for processing. There appears to be little if no oversight of the monthly retirement payroll other than the review of new member retirements to ensure the calculation of the retirement benefit has been correctly calculated. All retirement payroll checks processed by the County Auditor/Controller's Office are completely sealed and are forwarded to MCERA for mailing to the members (or pick up by the members at the MCERA office). There is the potential for an MCERA employee to set up a fictitious member within the retirement payroll system and to generate a monthly check to the individual, which would be mailed on a monthly basis and not likely attract further attention until the year end member data is provided to the actuary from which to perform the annual valuation.

We recommend that the monthly retirement payroll be reviewed by a person other than the person processing the payroll and that an analysis be performed which outlines the new retirees added to payroll during the month and any other changes made (COLAs, corrections, etc.). We also recommend that the Retirement Administrator designate a MCERA staff member who will perform spot checks on a semi-annual or quarterly basis of a selection of retirees and determine whether their monthly payment amount is indeed correct and that they are eligible to receive retirement payments.

Management Response: Agree. Changes in procedures have been made to include all new files and are reviewed by a Retirement Specialist II after the calculation has been made by the Senior Retirement Specialist. In addition, the member ledger balances are confirmed by the Retirement Specialist II to ensure that the calculation amount conducted by the Senior Retirement Specialist is equal to the amount in the member ledger. A procedure has not been developed to perform spot checks on a regular basis, but the Senior Retirement Specialist does perform ad hoc checks on the files when the opportunity presents itself. The implementation of a pension administration system will greatly improve the calculation of member benefits, allow for verification and checking of benefits and contributions received. It is anticipated that the pension administration system will free up time of the existing staff which will enhance the ability to perform spot checks on files.

Authorization of Plan Expenses

We noted that administrative expenses appear to be paid from Association earnings without evidence of review or approval by the Retirement Administrator. We also did not note any evidence that the fees charged were compared to the service agreements to determine if the fees were correctly charged under the agreement or recomputed to ensure they were mathematically correct. Although nothing came to our attention causing us to believe that errors may have occurred, sufficient procedural controls do not appear to be in place.

E

Board of Retirement
MCERA
March 11, 2014
Page 5

such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards

This report is intended solely for the information and use of the Board of Retirement, the management of Mendocino county Employees' Retirement Association and the State Controller's Office and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,



GALLINA LLP

Judy Zeller - Responses to Internal Documentation

From: "Ekanayake, Crystal" <CEkanayake@gallina.com>
To: "Thomas Watson (watsont@co.mendocino.ca.us)" <watsont@co.mendocino.ca.us>
Date: 4/3/2014 4:57 PM
Subject: Responses to Internal Documentation
Attachments: image002.jpg

Hi Tom,

After reviewing the correspondence you forwarded to me on Monday, here are my thoughts and suggestions. I have included our initial recommendations in italics and then my thoughts (underlined) on the information sent over as a response to the recommendations.

- We recommend that the Association adopt a written set of policies and procedures designed to mitigate the Association's risk with regard to regulatory compliance. These procedures should outline the various responsibilities applicable to the Retirement Administrator and those parties that are responsible for executing the procedures.*

The response to this particular recommendation cites the impending Pension Gold project and the need to focus staff time towards that end, rather than updating and revamping policies and procedures under the existing collection of systems and processes for MCERA. While we fully agree that a cost-benefit analysis must be performed prior to undertaking any significant project, we recommend that this be completed (per the memo, about half of the procedures have been updated and the other half have not yet been updated) unless the Pension Gold project will be fully implemented and operational within the next 6 – 12 months. Safeguarding MCERA's assets is critical to the effectiveness of the Association and having solid internal controls and procedures is integral to achieving this goal. If the new system will take several years to fully implement, then the existing system needs to be safeguarded through up-to-date policies and procedures.

- We recommend that the monthly retirement payroll be reviewed by a person other than the person processing the payroll and that an analysis be performed which outlines the new retirees added to payroll during the month and any other changes made (COLAs, corrections, etc.). We also recommend that the Retirement Administrator designate a MCERA staff member who will perform spot checks on a semi-annual or quarterly basis of a selection of retirees and determine whether their monthly payment amount is indeed correct and that they are eligible to receive retirement payments.*

The new Retiree Payroll Verification Procedures document, to be implemented effective May 1, 2014 addresses the above comment. Since we are not presenting our letter formally, which would normally be accompanied by a discussion of the recommendation, I will provide some additional guidance. The most effective procedure would be to have 2 people independently calculate the monthly retirement allowance for newly retired members and then to compare the calculations and determine any reasons for differences – this is a more effective procedure than a review of another person's calculations as the reviewer will tend to follow the calculation or logic rather than applying a calculation independently. I have also suggested during discussions while on site during audit fieldwork that a reconciliation be performed on a quarterly basis of all changes in the retiree payroll – this would be accomplished on a summary sheet, which starts with the payroll amount (in total) from the last quarter and then details the new members collecting benefits, any members who have passed away and are no longer collecting

F

monthly benefits (or whose beneficiary is receiving reduced benefits) and any other changes such as QDROs, etc. The goal is to recap all changes to the payroll so that the reviewer can then determine if any follow up activity or comparison to retiree files is needed.

For the quarterly spot checks, checking 10 member files each month for a 10 month period achieves the sampling and spot checking initiative, but I would instead recommend that a sampling methodology be considered by certain attributes – this would create a risk-based approach and would focus time and energy on member files that appeared to fall outside of tolerances, rather than haphazardly selecting 10 files for each of 10 months. We have very powerful data extraction software which may prove helpful in designing these samples and pull from various attributes rather just by member name or number. If you would like to discuss this further, please let me know. This approach would be more of a rifle rather than a shotgun and would result in better audit sampling rather than waiting for the passage of time to test most of the member files.

3. *We recommend that the Association establish a process for reviewing and authorizing administrative expenses prior to payment from Association assets and require evidence of such review and authorization to be indicated on the invoice or other documentation.*
4. *We recommend that a person who is independent of the negotiations of the service agreements perform periodic checks on the service providers' compliance with the service agreements; that fees charged are within the guidelines of the agreements; that fees are properly attributable to the Association's operation; and that fees, if assessed to the plan, are properly charged and allocated.*

The new Contract Service Providers Invoice Review Procedures, when implemented, adequately address the above findings and recommendations (items #3 and #4). Having the contract or service agreement along with copies of prior invoices against which to compare fees will be helpful to the persons both reviewing and approving the invoices and would prevent any amounts being paid from MCERA resources that were not in accordance with the service agreements. Evidencing the review through a signature or initial serves as documentation that the control function occurred and that there was a reviewer and approver.

I welcome a telephone discussion if you feel necessary.....otherwise please forward this e-mail onward to Judy for inclusion with committee materials.

Thanks,

Crystal A. Ekanayake

Audit Partner



GALLINA LLP
 2870 Gold Tailings
 Court
 Rancho Cordova, CA
 95670
 916.638.1188 (Office)
 916.266.8446 (Direct)
cekanayake@gallina.com
www.gallina.com

IRS Circular 230 Disclosure: We are required to inform you that any U.S. tax advice contained in this message (including any additional enclosures) is not intended or written to be used, and cannot be used, for the purpose of (1) avoiding penalties under the Internal Revenue Code; or (2) promoting, marketing, or recommending to another party any matters addressed herein.