

San Mateo County Employees' Retirement Association  
**Minutes of the Audit Committee**

**July 23, 2002 – Audit Committee Agenda**

**PUBLIC SESSION** – The Committee met in Public Session at 9:03 A.M.

- 1.0 Call to Order
- 2.0 Roll Call
- 3.0 Approval of the Minutes
- 4.0 Oral Communications From the Committee
- 5.0 Oral Communications From the Public
- 6.0 Investment and Finance Manager's Report
- 7.0 Board and Management Support Services & Audit Committee Report
  - 7.1 Entrance Interview for the June 30, 2002 Financial Audit
  - 7.2 Acceptance of Fourth Quarter 2001-2002 Administrative & Professional Budget Reports
  - 7.3 Authorization to Negotiate and Execute a Lease for SamCERA's Offices
  - 7.4 Acceptance of Report on SamCERA's Emergency Procedures Manual Series & Approval of extension of Contract with Mary Ann Gutoff
  - 7.5 Annual Review and Revision of *SamCERA's Code of Fiduciary Conduct*
  - 7.6 Further Review & Revision of *SamCERA's Education Policy*
  - 7.7 Review of need for Independent Counsel
  - 7.8 Approval of Topics for Legal Counsel Reviews
  - 7.9 Review of the 2002/2003 Property Value Optimization Plans
- 8.0 Other Business
- 9.0 Adjournment

**MINUTES OF SAMCERA'S Audit Committee of the Board**

- 1.0 Call to Order:** Mr. Lewis called the Public Session of the Audit Committee of the Board of Retirement to order at 9:06 A.M, July 23, 2002, in *SamCERA's* Board Room, Suite 280, 702 Marshall Street, Redwood City, California.
- 2.0 Roll Call:** Mr. Lewis, Mr. McMahon, Ms. Salas and Ms. Stuart. *Board Members in Attendance:* None  
*Staff:* Mr. Clifton, Mr. McCausland and Ms. Milan *Auditor:* Ms. Levintov and Mr. Prasad  
*Public:* None, *Retirees:* One
- 3.0 Approval of the Minutes:** The Audit Committee reviewed and accepted the Minutes of the April 23, 2002 Audit Committee.  
  
**Action: Motion by Ms. Stuart, seconded by Ms. Salas, carried unanimously to accept the Minutes of the April 23, 2002 Audit Committee.**
- 4.0 Oral Communications from the Committee:** None
- 5.0 Oral Communications from the Public:** Mr. John Murphy stated that it appears that the agenda for the Audit Committee is getting outside the scope of the Audit Committee Charter. Several items that are discussed at the Committee will need to be re-digested by the entire board. • Mr. McMahon said he partially agrees with Mr. Murphy. Not only is it duplication of work for Trustees but also it is

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duplication of work for staff. He believes some item should be taken up before the full Board.

• Mr. Lewis stated that in approving future agendas the Chair should look at them with an eye to scheduling only those items to which the Committee can add value. However, it is beneficial for the Audit Committee to review some of the issues in more depth than the full Board. Those items should be summarized and reported to the Board. • Mr. McCausland noted that on today's agenda the Audit & Investment Committee Charters are attached to the committee appointment item. Over the past three years the Board has delegated almost all non-investment & non-benefit items to this Committee. The Items that come to this Committee are those directed here by the Board. • Mr. Lewis reiterated that he sees benefit in the Committee being able to get down to the details on certain items. In the short time he has been on the board the amount of work that the Board is expected to review has grown. • Ms. Salas ask if the Committee would consider returning to a full day board meeting and eliminating the Committees. • The consensus of the Committee is that they will request that the Board review the structure under which they meet.

**6.0 Investment and Finance Manager's Report.** There is no report.

**7.0 Board and Management Support Services & Audit Committee Report**

**7.1 Entrance Interview for the June 30, 2002 Financial Audit.** Government Code Section 31593 mandates that *"The retirement board shall conduct an audit of the retirement system at least once every 12 months and report upon its financial condition."* The Board executed an engagement letter to retain the County of San Mateo's Internal Audit Division to perform a "Yellow Book Audit". The objective of this audit is to express an opinion as to whether the financial statements are fairly presented, in all material respects, in conformity with generally accepted accounting principles. In addition a "Yellow Book Audit" includes reports (that do not include opinions) on internal controls related to the financial statements and compliance with laws, regulations, and the provisions of contractual agreements.

Mr. Clifton reported that Mr. McCausland, Ms. Milan and he met with Ms. Irene Levintov, Mr. Ramen Prasad and Ms. Claudia Rodriquez on July 15 to discuss the audit. They discussed areas that may warrant additional review this year. One item discussed was crediting of Voluntary Time Off (VTO). It was determined that the VTO amounts would be immaterial. There were no other areas of concern.

• Mr. Lewis ask Mr. Prasad if he is aware of the letter that the Board sent to Mr. Huening regarding certain concerns about SamCERA's audit. Mr. Lewis asked Mr. Prasad to respond to the concern that over the years Auditors have had pressure on fees. This may cause them to replace the old fashion audit reviews with more analytical reviews, which may be one of the reasons that the industry is having these audit scandals. • Mr. Prasad assured the Committee that is not the case with SamCERA's audit. The scope of the audit remains the same and has not been narrowed. In addition he assured the Committee that the Audit Division is not in existence to make a profit. • Mr. McCausland stated that the scope has not narrowed, but the amount of testing is substantially less than three or four years ago. • Responding to Mr. McMahan, Mr. Prasad informed the committee that the sampling for disbursements is 25 checks. The sampling is approximately 10% of manual checks. • Mr. Prasad stated that if the total population was 10,000 they could sample 25, 50 or 100 and the results would not improve. If they were to do 4,000 they would have more conclusive evidence. The current sample allows them to derive an understanding of the procedure and determine if controls are in place.

• Ms. Salas noted the Committee directed staff to establish an audit schedule that would not put undo stress on SamCERA's limited staff. • Mr. Clifton reported that the audit schedule attached to this item was agreeable to staff and the auditor. The plan is to present the audited financials to the Board in

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October.

**Action: The Committee took no action. The Committee had no concerns to which they wished the Auditor to pay particular attention.**

**7.2 Acceptance of Fourth Quarter 2001-2002 Administrative & Professional Budget Reports.** Mr. Clifton reported on the Administrative and Professional Budgets. Final expenditures for both budgets were less than the approved allocation.

Below is the Professional Service Budget followed by the Administrative Budget.

CONTRACTOR	SERVICE	FEE	2001-2002 ESTIMATE	2001-2002 EXPENSE (ACCRUED)
William M. Mercer	Actuarial Consulting	0.43	\$50,000	\$52,300
Strategic Investment Solutions	Investment Consulting	1.19	145,000	\$145,838
Gray & Company	Investment Consulting	0.05	6,069	\$6,069
Stein & Lubin LLP	Legal Services	Hourly	5,000	\$0
Barclays Global Investors (BGI)	Indexed Portfolio Management	3.54	300,000	\$290,300
	Russell 1000 Index Fund	2.15	100,000	\$100,884
	Russell 2000 Index Fund	7.44	100,000	\$100,504
	US Debt Index Fund	4.00	100,000	\$88,912
Deutsche Asset Management	Domestic Fixed Income Management	25.54	500,000	\$461,631
Bank of Ireland Asset Management	Active International Equity Management	41.77	750,000	\$693,191
INVESCO Realty Advisors	Real Estate Management	7% of NOI	600,000	\$636,099
INVESCO	Acquisition Fee	100 bp	0	0
State Street Bank & Trust	Global Custody	0.96	120,000	\$117,129
TOTAL ESTIMATED CONTRACT FEES			\$2,476,069	\$2,402,558
<i>Market Value 06-30-2002</i>			\$1,215 Million	\$1,215 Million
Average Basis Points (1)			17.9	19.0

The table illustrates that expenditures (\$2,402,558) were less than anticipated (\$2,476,069). This is directly related to the -5.92% fiscal year decline in assets rather than the budgeted growth rate of 9.62%, which is specified in *SamCERA's Investment Plan*. Please remember that the budget estimates were adopted in early 2001 based on capital market assumption of mid-2000. The decline in assets also results in professional services being higher than expected when expressed in basis points against average assets.

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	<b>Budget Allotment (As Amended)</b>	<b>Year to Date Expenditures</b>	<b>Percentage Expended</b>	<b>Remaining Balance</b>	<b>Remaining Percentage</b>
Salaries	\$642,500	\$632,755	98.5%	\$9,745	1.5%
Benefits	\$207,500	\$204,912	98.8%	\$2,588	1.2%
<b>Salaries &amp; Benefits</b>	<b>\$850,000</b>	<b>\$837,667</b>	<b>98.5%</b>	<b>\$12,333</b>	<b>1.5%</b>
Board Expenses	\$8,000	\$7,900	98.8%	\$100	1.3%
<b>Insurance</b>	\$61,000	\$60,375	99.0%	\$625	1.0%
<b>Medical Evaluation</b>	\$14,000	\$11,276	80.5%	\$2,724	19.5%
<b>Member Education</b>	\$15,000	\$12,309	82.1%	\$2,691	17.9%
<b>Education &amp; Conference</b>	\$35,500	\$35,122	98.9%	\$378	1.1%
<b>Transportation &amp; Lodging</b>	\$47,500	\$47,163	99.3%	\$337	0.7%
<b>Software License &amp; Maintenance</b>	\$71,000	\$70,094	98.7%	\$906	1.3%
<b>Property &amp; Equipment</b>	\$20,500	\$9,967	48.6%	\$10,533	51.4%
<b>General Office Supplies</b>	\$10,000	\$9,754	97.5%	\$246	2.5%
<b>Postage, Printing &amp; Copying</b>	\$48,500	\$38,946	80.3%	\$9,554	19.7%
Leased Facilities	\$75,000	\$74,747	99.7%	\$253	0.3%
County Service	\$239,000	\$237,389	99.3%	\$1,611	0.7%
Other Administration	\$45,000	\$44,716	99.4%	\$284	0.0%
<b>Services &amp; Supplies</b>	<b>\$690,000</b>	<b>\$659,758</b>	<b>95.6%</b>	<b>\$30,242</b>	<b>4.4%</b>
<b>Fixed Assets</b>	<b>\$0</b>	<b>\$0</b>	<b>0.0%</b>	<b>\$0</b>	<b>0.0%</b>
<b>Grand Total</b>	<b>\$1,540,000</b>	<b>\$1,497,425</b>	<b>97.2%</b>	<b>\$42,575</b>	<b>2.8%</b>

*Salaries & Benefits* experienced a budget savings because monies were budgeted for overtime related to the implementation of Plan 3 purchase upgrades and a pending decision on Teamsters Local 856 litigation. Those monies were not utilized because Teamsters Local 856, the Board of Supervisors and the Board of Retirement appealed the Superior Court's decision on the Teamster's litigation, which delays implementation; and Plan 3 purchase upgrades were not fully implemented due to a delay in final acceptance of calculation procedures.

Within *Services & Supplies* staff reallocated some of the line item appropriations, but overall final line item appropriations are close to the original appropriation. *Software License/Maintenance* received the largest reallocation (\$11,000), which came from *Medical Evaluations* (\$6,000) and *General Office Supplies* (\$5,000). Classified under *Other Administration* are expenditures for the procedure manuals project (\$36,150) and evaluation of benefit administration software (\$8,550).

**Action: Motion by Ms. Salas, second by Mr. McMahon to recommend to the Board of Retirement**

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**that it accept the Fourth Quarter Budget Report.**

- 7.3 Authorization to Negotiate and Execute a Lease for SamCERA's Offices** Mr. McCausland reported that the real estate market in Redwood City is softening. He has received one proposal below \$2.00 a square foot for Class "A" office space. The proposal is for space in Redwood Shores at \$1.95. • The landlord for the current space at 702 Marshall presented a proposed for \$2.00 a square foot with 5.0% increases for the next three years. The landlord is offering only a three-year lease with expectations that the market will be higher at the conclusion of that lease. This proposal increasing SamCERA's current space through expansion across the hall to include a larger boardroom.

Ms. Stuart expressed her concern about moving out of downtown Redwood City. • Mr. McCausland reminded the Committee to complete the survey attached to this item. Responses in the surveys received to date are all over the ballpark. Staff needs the Board's direction to negotiate a new lease agreement. There are advantages to being in downtown, but there is not a lot of traffic into SamCERA's office. We may receive twenty members per month. Membership may not be disadvantaged by a move. However, staff that makes trips to the county offices may be disadvantaged. • There are no buildings in the downtown area less than \$2.00.

Mr. McCausland proposed to the landlord that the current lease be extended for three months at the current rent. The landlord will enforce a provision of the contract, which requires a holdover rate of 150% of the current rent. The holdover rate will be approximately \$9,100.

**Action: Motion by Ms. Stuart, second by Ms. Salas to recommend to the Board of Retirement that the Chief Executive Office be authorized pay the holdover rate of the current lease, which is approximately \$9,100 per month through the calendar year end. If a satisfactory lease has not been negotiated with the current landlord in forty-five days, staff will prepare to move before year-end. The motion passed unanimously.**

- 7.4 Acceptance of Report on SamCERA's Emergency Procedures Manual Series & Approval of extension of Contract with Mary Ann Gutoff.** The presentation of the Emergency Procedures Manual will be made at the Board Meeting. Mr. McCausland reported that the contract with Ms. Gutoff expired on April 19<sup>th</sup> while work was being done on the procedures for Mr. Hood, Mr. Clifton and Mr. McCausland. He requested that the term of the contract be extended from April 19<sup>th</sup> through June 30<sup>th</sup>. He further requested that the Chief Executive Office be authorized to pay \$10,985.00 for services provided by Ms. Gutoff after the official termination date of the original contract.

**Action: Motion by Ms. Salas, second by Ms. Stuart to recommend to the Board of Retirement that the agreement with Ms. Gutoff be extended from April 19, 2002 through June 30, 2002 and that the CEO be authorized to pay Ms. Gutoff \$10,985.00 for services provided between April 19<sup>th</sup> and June 30<sup>th</sup>. The motion passed unanimously.**

- 7.5 Annual Review and Revision of SamCERA's Code of Fiduciary Conduct.** Ms. Carlson was instructed by the Board review the *Code of Fiduciary Conduct* and reports her recommended amendments, if any. She surveyed several other pension plans. Her conclusion was that *SamCERA's Code* is one of the best, although Los Angeles County Employees' Retirement Association (LACERA) has a document that is very intriguing. • Mr. McCausland folded the LACERA *Code of Ethics* into the *SamCERA Code of Fiduciary Conduct*. The merging of the two documents adds an appendix, which is essentially a highlight of law related to fiduciary duty, conflicts of interest, incompatible activities and limitations on

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gifts. The proposed Code of Fiduciary Conduct may be found in the Board minutes for July 23, 2002 as item 0207.7.5 beginning on page 12.

**Action: Motion by Ms. Stuart, second by Mr. McMahon to recommend to the Board of Retirement that it approve *SamCERA's* amended *Code of Fiduciary Conduct*. The motion passed unanimously.**

- 7.6 Further Review & Revision of *SamCERA's* Education Policy.** • Mr. Lewis thought that this item was returned to committee to do two things. The Committee is to develop an education policy that would reasonably educate the Trustees and balance fiscal responsibility. With this policy the Committee has emphasized the former and is not being fiscally irresponsible. The emphasis was on education. • Salas believed that funding the policy was not the reason it was returned to committee. The issue was the amount of educational activities to complete per year. The standard was three and the Audit Committee could not decide whether to increase the standard to four. • Mr. McMahon believes this item should be discussed at the Board. Ms. Stuart and Mr. Lewis agreed.

**Action: By consensus the Audit Committee will recommend that the Board of Retirement review *SamCERA's* educational policy.**

- 7.7 Review of need for Independent Counsel** Mr. Lewis recommends that this issue be deferred until after the Board has had the reviews of legal counsel. • Mr. Clifton stated that Ms. Carlson would not be at the August meeting. Therefore the attorney reviews should be scheduled for September. • Mr. Lewis informed the committee that he may not be at the September meeting, but the interviews could proceed without him in attendance.

Mr. McCausland reminded the Board that *SamCERA* has an inactive contract with Baker McKenzie. Does the Committee wish to have the Board review the firm? • Mr. McMahon suggests that the contract be terminated. The committee agreed.

**Action: By consensus the Committee will recommend to the Board of Retirement that the legal counsel reviews are held over until September.**

**Action: Motion by Mr. McMahon, second by Ms. Stuart to recommend to the Board of Retirement that it cancel the contract with Baker McKenzie. The motion passed unanimously.**

- 7.8 Approval of Topics for Legal Counsel Reviews.** Mr. Clifton reported that this is the second time the Committee reviewed this list of questions and the legal counsel evaluation form. At the previous meeting the Committee made several suggestions and instructed staff to bring the amended list of questions back to the Committee.

**Action: Motion by Ms. Stuart, second by Mr. McMahon to recommend to the Board of Retirement that it accept the topics for legal counsel review and the legal counsel evaluation form. The motion passed unanimously.**

- 7.9 Review of the 2002/2003 Property Value Optimization Plans** Mr. Lewis believes that review of the Property Valuation Optimization Plans (VOP) should be with the Investment Committee. He notes that he has questions about the exit strategies, which is under the scope of the Investment Committee. • Mr. Clifton agrees that disposition strategies are the Investment Committee's responsibility, but the VOP's are the property budget and operational plan for the fiscal year. Those responsibilities are under the

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Audit Committee Charter. • Mr. Lewis questions whether the Committee has the ability to express an opinion regarding the proper budget and operational plan. It would take a great deal of study by the Committee including a visit to determine the condition of the property. *SamCERA* pays INVESCO to perform property due diligence. His preference is that the VOP's not be on the Audit Committee Agenda.

**Action: By consensus the Audit Committee will recommend to the Board of Retirement that review of the Value Optimization Plans reside with the Investment Committee.**

**8.0 Other Business:** None.

**9.0 Adjournment:** There being no further business Mr. Lewis adjourned the Committee at 9:58 A.M.