

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

**October 22, 2002 – Audit Committee Agenda**

**PUBLIC SESSION** – The Committee met in Public Session at 9:07 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 Acceptance of Monthly Financial Reports
  - 7.2 Acceptance of First Quarter 2002-2003 Administrative & Professional Budget Reports
  - 7.3 Acceptance of SamCERA's Audited Financial Statements & Accompanying Notes
  - 7.4 Acceptance of SamCERA's Response to the 6/30/2002 Audit's Management Letter
  - 7.5 Introduction of *SamCERA* Comprehensive Annual Financial Report
  - 7.6 Acceptance of KPMG's Audited Financial Statements for SamCERA's Real Estate Portfolio
- 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 9:07 A.M, October 22, 2002, in *SamCERA's* Board Room, Suite 280, 702 Marshall Street, Redwood City, California.
- 2.0 Roll Call:** Mr. Lewis, Ms. Salas, Ms. Stuart and Ms. Tonsfeldt. *Board Members in Attendance:* None  
*Staff:* Mr. Clifton, Mr. McCausland and Ms. Wong *Auditor:* Ms. Levintov, Ms. Rodriguez and Mr. Prasad *Public:* None, *Retirees:* One
- 3.0 Approval of the Minutes:** The Audit Committee reviewed and accepted the Minutes of the July 23, 2002 Audit Committee.  
  
**Action: Motion by Ms. Salas, seconded by Ms. Tonsfeldt, carried unanimously to accept the Minutes of the July 23, 2002 Audit Committee.**
- 4.0 Oral Communications from the Committee:** None
- 5.0 Oral Communications from the Public:** None
- 6.0 Investment and Finance Manager's Report.** Mr. Clifton introduced an Education Request form and an Education Report form that are currently being used by staff. During *SamCERA's* budget process, Trustees and staff select educational events. The Board Chair approves the Trustee and Chief Executive Officer sections. The CEO approves the staff selections. During the fiscal year other educational opportunities arise for which there is no budgetary authority. Staff recommends that the Retirement Board require completion of an Education Request Form prior to attending a non-budgeted event. The

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form states the name of the person making the request, the dates of travel and the destination. It also allows for the projected expenditure including registration, transportation, lodging and meals. Finally it requests a brief description of the event, generally the conference topic or theme. • **Action:** The Audit Committee by consensus will recommend to the Board of Retirement that any Trustee or staff who wishes to attend an educational event that has not been approved during the budget process must complete an Educational Request form and have it approved by the appropriate authority. The appropriate authority for Trustees and the CEO is the Board Chair. The appropriate authority for staff is the CEO.

Mr. Clifton described the Educational Report form that is being completed by SamCERA's Staff. He reminded the Committee that the Board's Educational Resolution mandates that after attending an educational event the attendee must provide a brief report to the Board on the event. The form completed by staff provides for the name, location, and cost of the event. It also requests the travel dates, the conference title and a summary and highlight of the event. • **Action: None** The consensus of the Committee is that an oral report from a Trustee after attending an educational event is adequate.

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

**7.1 Acceptance of Monthly Financial Reports.** Mr. Clifton introduced a monthly financial report. He reported that the statements fairly represent *SamCERA's* Financial Statements. However, for the purposes of the monthly report they will be titled preliminary. This is due to the fact that most months *SamCERA's* General Ledger will not be closed by the mailing date for the Board's agenda items.

The monthly report includes but is not limited to the Statement of Fiduciary Net Assets (Comparative Year to Date) and Statement of Changes in Fiduciary Net Assets. Those reports are below.

**The Statement of Fiduciary Net Assets and the Statement of Changes in Fiduciary Net Assets Comparative Year-to-Date for the period ending September 30, 2002 appear on the following two pages.**

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**San Mateo County Employees' Retirement Association**  
**Statement of Fiduciary Net Assets - Comparative YTD**  
**For the Month Ending September 2002**  
**PRELIMINARY**

	2002	2001	change
<b>ASSETS</b>			
CASH AND CASH EQUIVALENTS	(441,337)	21,568,023	(22,009,360)
<b>RECEIVABLES</b>			
Contributions	0	0	0
Due from Broker for Investments Sold	7,016,847	3,982,662	3,034,185
Investment Income	1,925,032	2,187,337	(262,305)
Other Receivable	2,743	33,780	(31,037)
<b>TOTAL ACCOUNTS RECEIVABLES</b>	<u>8,944,622</u>	<u>6,203,779</u>	<u>2,740,843</u>
PREPAID EXPENSE	141,173	116,165	25,008
<b>INVESTMENTS AT FAIR VALUE</b>			
Domestic Fixed Income Securities	354,780,056	393,801,919	(39,021,863)
International Fixed Income Securities	0	0	0
Domestic Equities	514,826,472	561,412,446	(46,585,974)
International Equities	149,377,595	157,362,344	(7,984,749)
Real Estate	86,580,187	92,104,210	(5,524,023)
Held for Securities Lending	0	0	0
Other Investment	0	0	0
	<u>1,105,564,310</u>	<u>1,204,680,919</u>	<u>(99,116,609)</u>
FIXED ASSETS	28,792	187,595	(158,803)
LESS ACCUMULATED DEPRECIATION	(20,199)	(169,404)	149,206
	<u>8,593</u>	<u>18,190</u>	<u>(9,597)</u>
OTHER ASSETS	0	0	0
<b>TOTAL ASSETS</b>	<u><b>1,114,217,362</b></u>	<u><b>1,232,587,077</b></u>	<u><b>(118,369,715)</b></u>
<b>LIABILITIES</b>			
Investment Management Fees	0	0	0
Due to Broker for Investments Purchased	6,169,891	4,365,283	1,804,608
Mortgage Note Payable	7,212,640	7,370,875	(158,235)
Other	1,653,371	1,488,331	165,040
<b>TOTAL LIABILITIES</b>	<u><b>15,035,902</b></u>	<u><b>13,224,488</b></u>	<u><b>1,811,413</b></u>
<b>NET ASSETS HELD IN TRUST FOR PENSION BENEFIT</b>	<b>1,099,181,460</b>	<b>1,219,362,588</b>	<b>(120,181,128)</b>

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**San Mateo County Employees' Retirement Association**  
**Statement of Changes in Fiduciary Net Assets - Comparative YTD**  
**For the Month Ending September 2002**  
**Preliminary**

	2002	2001	Change
ADDITIONS			
CONTRIBUTIONS			
Employer Contribution	31,955,533	30,876,653	1,078,881
Employee Contribution	3,608,825	3,313,683	295,142
TOTAL CONTRIBUTIONS	35,564,358	34,190,336	1,374,022
INVESTMENT INCOME			
Interest and Dividends	2,818,534	4,602,427	(1,783,892)
Net Appreciation (Depreciation) in fair value of investments	(123,692,077)	(110,784,163)	(12,907,914)
Less Investment Expense	47,333	(110,212)	157,545
NET INVESTMENT INCOME	(120,920,876)	(106,071,525)	(14,849,351)
OTHER ADDITIONS	8,041	15	8,026
TOTAL ADDITIONS	(85,348,477)	(71,881,174)	(13,467,303)
DEDUCTIONS			
ASSOCIATION BENEFITS			
Service Retirement Allowance	14,458,314	13,635,705	822,609
Disability Retirement Allowance	2,302,967	1,978,762	324,205
Medical Benefits	260,658	235,496	25,163
Survivor, Death and Other Benefits	171,508	174,039	(2,531)
TOTAL ASSOCIATION BENEFITS	17,193,447	16,024,002	1,169,445
REFUND OF MEMBER CONTRIBUTIONS	424,847	429,530	(4,684)
ADMINISTRATIVE EXPENSE	290,189	274,324	15,865
TOTAL DEDUCTIONS	17,908,482	16,727,856	1,180,626
NET INCREASE	(103,256,959)	(88,609,030)	(14,647,929)
Net Assets Held in Trust for Pension Benefits:			
Beginning of Period	1,207,471,455	1,307,971,618	
End of Period	1,104,214,495	1,219,362,589	

**Action: By consensus the Audit Committee will recommend to the Board of Retirement that it accept the Preliminary Financial Report for the period ending September 30, 2002.**

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**7.2 Acceptance of First Quarter 2002-2003 Administrative & Professional Budget Reports.** Mr. Clifton reported on the Administrative and Professional Budgets.

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	0.42	\$50,000	\$17,325
Strategic Investment Solutions	Investment Consulting	1.45	175,000	\$43,750
Stein & Lubin LLP	Legal Services	Hourly	15,000	\$1,500
Barclays Global Investors (BGI)	Indexed Portfolio Management	3.64	300,000	\$66,107
	Russell 1000 Index Fund	2.15	100,000	\$22,041
	Russell 2000 Index Fund	8.73	100,000	\$22,887
	US Debt Index Fund	4.00	100,000	\$21,179
Deutsche Asset Management	Domestic Fixed Income Management	25.57	465,000	\$114,822
Bank of Ireland Asset Management	Active International Equity Management	43.38	700,000	\$162,080
INVESCO Realty Advisors	Real Estate Management	7% of NOI	650,000	\$146,045
INVESCO	Acquisition Fee	100 bp	0	0
State Street Bank & Trust	Global Custody	1.0	120,000	\$29,258
TOTAL ESTIMATED CONTRACT FEES			\$2,475,000	\$579,386
<i>Market Value 06-30-2002</i>			\$1,200 Million	\$1,200 Million
Average Basis Points (1)			19.7	18.4

1) The calculation assumes asset growth of 8.25% and anticipates an average market value of \$1,257 million.

The management fee, as expressed in basis points, for the Russell 2000, Bank of Ireland Asset Management and Deutsche Asset Management are up slightly from last year. As portfolio asset decline the total dollar expenditure decreases, however the cost per dollar of asset increases. The same principal applies to Strategic Investment Solutions and State Street when the fee is expressed in basis points against SamCERA's total portfolio. • Mr. Lewis suggests that future Professional Budget reports distinguish between fixed cost services and sliding scale service. Although expressing the expenditure in basis points is useful it may be slightly misleading.

Mr. Clifton briefly reviewed the status of the Administrative Budget Initiatives. He reports that through the first quarter, *SamCERA* is on track in completing the Budget Initiatives on time and within budget. In addition he notes that this fiscal year's budget did not allow monies for office relocation. • Mr. McCausland reported on the site preparation and logistics of the move. A budget amendment resolution covering relocation expenses will be presented at the November Audit Committee.

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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	\$797,000	\$139,685	17.5%	\$657,315	82.5%
Benefits	\$245,000	\$43,005	17.6%	\$201,995	82.4%
<b>Salaries &amp; Benefits</b>	<b>\$1,042,000</b>	<b>\$182,690</b>	<b>17.5%</b>	<b>\$859,310</b>	<b>82.5%</b>
Board Expenses	\$8,000	\$0	0.0%	\$8,000	100.0%
Insurance	\$60,000	\$14,000	23.3%	\$46,000	76.7%
Medical Evaluation	\$20,000	\$250	1.3%	\$19,750	98.8%
Member Education	\$15,000	\$0	0.0%	\$15,000	100.0%
Education & Conference	\$29,500	\$7,245	24.6%	\$22,255	75.4%
Transportation & Lodging	\$54,700	\$5,227	9.6%	\$49,473	90.4%
Software License & Maintenance	\$60,000	\$525	0.9%	\$59,475	99.1%
Property & Equipment	\$28,000	\$4,200	15.0%	\$23,800	85.0%
General Office Supplies	\$15,000	\$2,494	16.6%	\$12,506	83.4%
Postage, Printing & Copying	\$50,000	\$16,582	33.2%	\$33,418	66.8%
Leased Facilities	\$133,500	\$30,549	22.9%	\$102,951	77.1%
County Service	\$238,300	\$26,428	11.1%	\$211,872	88.9%
Other Administration	\$40,000	\$0	0.0%	\$40,000	0.0%
<b>Services &amp; Supplies</b>	<b>\$752,000</b>	<b>\$107,499</b>	<b>14.3%</b>	<b>\$644,501</b>	<b>85.7%</b>
<b>Fixed Assets</b>	<b>\$40,000</b>	<b>\$0</b>	<b>0.0%</b>	<b>\$40,000</b>	<b>0.0%</b>
<b>Grand Total</b>	<b>\$1,834,000</b>	<b>\$290,189</b>	<b>15.8%</b>	<b>\$1,543,811</b>	<b>84.2%</b>

The table illustrates a year-to-date expenditure of \$290,189, which is 15.8% of budget. Expenditures are not straight line, but occur over the course of the year. Therefore, even though year-to-date expenditures are less than 25% for a quarter of the year, they are within expectations. One should note that the Fiduciary Insurance is accrued and paid quarterly this year.

The Quarterly Educational Expenditures Report. The Board's educational amendment limits expenditures to \$5,000 for trustees with two years experience. Staff does not have budgetary authority to pay expenditures over that amount. A trustee must receive Board approval to exceed the educational limit. A Travel Request form is attached. **Staff Recommendation.** Please review, amend as appropriate and recommend Board adoption of the form.

**Action: By consensus the Audit Committee will recommend to the Board of Retirement that it accept the Budget Reports for the quarter, which ends September 30, 2002.**

**7.3 Acceptance of SamCERA's Draft Audited Financial Statements & Accompanying Notes.**

SamCERA's Auditors Mr. Prasad, Ms. Levintov and Ms. Rodriguez were in attendance to present the draft of SamCERA's Audited Financial Statement. Mr. Prasad explained that SamCERA and his staff are completing work on the reserves, which is dependant upon completion of the June 30 Interest Crediting. The Actuary William M. Mercer is currently performing peer review on SamCERA's Interest Crediting Spreadsheet. • Mr. Lewis noted that during the last fiscal year SamCERA passed a Resolution amending its interest crediting methodology. Mr. Clifton noted that

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those changes necessitated changes in SamCERA's spreadsheet, which in part is what WM Mercer is reviewing.

The Audited Financial Statements will be on the November 26 Audit Committee and Board agenda.

**Action: None is required.**

- 7.4 Acceptance of SamCERA's Response to the 6/30/2002 Draft Audit's Management Letter.** Mr. Prasad reminded the Audit Committee that this is a draft of the Management Letter. • He reports that the draft Letter states there are no management item to report from the current audit. He and his staff do not anticipate this changing before the close of the audit. • The Letter contains one item from prior year audits, but the final version will contain two items. The audit team and SamCERA staff concur that there will be value in leaving the recommendation to perform timely reconciliations of member Reserves on SamCERA's General Ledger and Member Contribution on PensionGold, SamCERA's Retirement Benefit Administration System. During the entrance interview with staff and the Audit Committee, it was determined that SamCERA's internal controls around contribution cash flows was adequate to guarantee the accuracy of the flows. Further it was decided that PensionGold did not produce a reliable accounting report that could be used to reconcile with Member Reserves. Ms. Wong expended extensive time during the fiscal year in an attempt to use PensionGold reports for reconciliation. The conclusion is that PensionGold does not produce a report that may be relied upon for reconciliation. • Mr. Lewis notes that the Member Reserve reconciliation has been on the Management Letter for some time. His recommendation to the Committee is that it monitors the ongoing issue over this fiscal year. Staff should report back to the Committee at each meeting. The report should include at a minimum the amount of the difference and how it changes over time, the nature of the issues and how they change. The Committee will make a recommendation during next year's Entrance Interview regarding the disposition of this Management Letter Recommendation.

**Action: By consensus the Audit Committee instructed staff to submit a report regarding Member Reserve/Member Contribution Reconciliation at each meeting of the Audit Committee. The Audit Committee will consider these reports and make a recommendation on the disposition of this audit recommendation at the Entrance Interview for the Fiscal Year 2002-2003 audit.**

- 7.5 Introduction of SamCERA Comprehensive Annual Financial Report (CAFR).**

Mr. Clifton reminded the Committee that a large portion of the Comprehensive Annual Financial Report depends on the most recent actuarial data. The Board postponed the June 30, 2002 Actuarial Valuation so that it may utilize information from the County's Labor/Management Negotiations. The Actuarial Report is scheduled for presentation to the Board on January 28, 2003. Staff wishes to include the 2002 actuarial data in the 2002 CAFR and is seeking an extension for submission of the CAFR to the Government Finance Officers Association.

The Committee will hold over this item.

**Action: By consensus the Audit Committee instructs staff to request that the Government Finance Officers Association grant a filing extension until January 31, 2003 for SamCERA's Comprehensive Annual Financial Statement.**

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**7.6 Acceptance of KPMG's Audited Financial Statements for SamCERA's Real Estate Portfolio.**

The Management Investment Agreement between INVESCO Realty Advisors and *SamCERA* states in Section 6.5 Audits, “*Each year INVESCO shall provide for the preparation and submittal by September 30 to the Board of an independent audit of the Account as of June 30<sup>th</sup>, certified by a mutually agreed upon nationally recognized firm of certified public accountants.*”

KPMG was hired to audit the Statement of Assets and Liabilities, the related Statement of Operations, Statement of Changes in Net Assets, Statement of Cash Flows and the Notes to Financial Statements for each of *SamCERA*'s separate properties as of June 30, 2002 and 2001. Generally Accepted Accounting Principals mandate the form and content of Financial Statement(s) and the accompanying Notes to the Financial Statements.

The Committee briefly reviewed the audit process and the standard format for the audited financials. Staff referred to KPMG's opinion, which states in part, "In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of (the property name) as of June 30, 2002 and 2001, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. Neither staff nor the Committee noted issues within the statements that required additional discussion.

**Action: By consensus the Audit Committee will recommend that the Board of Retirement accept KPMG's Audited Financial Statements for SamCERA's Real Estate Portfolio.**

**8.0 Other Business:** None.

**9.0 Adjournment:** There being no further business Mr. Lewis adjourned the Committee at 10:03 A.M.