



MINUTES

**Meeting of the Audit & Risk Committee
of the Board of Trustees of the
State Universities Retirement System
Thursday, March 9, 2017 1:20 p.m.
State Universities Retirement System
1901 Fox Drive
Main Conference Room
Champaign, IL 61820**

The following trustees were present: Dr. John Engstrom, Chair; Mr. Aaron Ammons, Mr. Tom Cross, Dr. Fred Giertz, Mr. Francis Idehen, Mr. Paul R.T. Johnson Jr., Mr. Craig McCrohon, Ms. Dorinda Miller, Dr. Steven Rock, Mr. Antonio Vasquez.

Others present: Mr. Martin Noven, Executive Director; Mr. Andrew Matthews, Chief Operating Officer; Ms. Phyllis Walker, Chief Financial Officer; Ms. Bianca Green, General Counsel; Mr. Albert Lee, Assistant General Counsel; Mr. Douglas Wesley, Interim Chief Investment Officer; Mr. Steve Hayward, Director of Internal Audit; Mr. Doug Taylor, Internal Auditor; May Springfield, Internal Auditor; Lou Ann Fillingham, Senior Investment Accounting Officer; Mr. Chris Hansen, Director of Operations; Ms. Cindy Gones, Manager of Tech Support; Mr. Doug Steele, Director of Application Development/Research; Ms. Angela Lieb, Director of Member Services; Ms. Kristin Houch, Legislative Liaison; Ms. Allison Kushner, Compliance and Corporate Governance Officer; Ms. Kelly Carson and Ms. Whitney Jones, Executive Assistants; and Ms. Mary Pat Burns of Burke, Burns & Pinelli.

Audit & Risk Committee roll call attendance was taken. Trustee Ammons, present; Trustee Cullen, absent; Trustee Engstrom, present; Trustee Giertz, present; and Trustee Johnson, present.

APPROVAL OF MINUTES

Trustee John Engstrom presented the minutes from the Audit & Risk Committee meeting of December 8, 2016. Trustee Aaron Ammons made the following motion:

- That the minutes from the December 8, 2016 Audit & Risk Committee Meeting be approved as presented.

Trustee Paul R.T. Johnson seconded and the motion carried with all trustees present voting in favor.

CHAIRPERSON'S REPORT

Trustee Engstrom remarked that he did not have a chair report.

INTERNAL AUDIT UPDATE

FY 2016 Compliance Audit Findings and SURS Responses

Mr. Steve Hayward presented the compliance audit draft findings for the fiscal year 2016 audit from the Illinois Office of the Auditor General. All findings were discussed amongst the committee and updates were given on SURS responses.

FY 2016 Financial Report Digest & Opinion

Mr. Hayward reviewed the FY 2016 Financial Audit Report Digest & Opinion, issued in January 2017. The digest from the Office of the Auditor General (OAG) provides a summary of the audit of SURS' financial statements each year. The opinion section of the report noted that SURS financial statements for the year ended June 30, 2016, were fairly stated in all material respects. No major findings occurred.

Required AU-C 260 Communications to the Board

Mr. Hayward reviewed the Required AU-C 260 Communications report prepared by BKD that summarizes communications with the board. Generally Accepted Auditing Standards require this letter to the board to ensure two-way communications between the board and auditors and to also provide the auditors an opportunity to comment on any problems noted during the audit. The report indicated that no problems, issues or difficulties were encountered during the audit process with SURS management.

FY 2016 Report on Allocation of Pension Amounts

Mr. Hayward discussed the FY 2016 OAG audit report on the pension schedules provided by BKD that summarizes the Schedule of Allocation and the specified liability column totals included in the Schedule of Pension Amounts the system for the year ended June 30, 2016. It was found that the schedules present fairly, in all material respects, the employer allocations as of and for the year ended June 30, 2016, in accordance with accounting principles generally accepted in the United States.

FY 2016 Comprehensive Annual Financial Report Review (Educational Topic)

Ms. Phyllis Walker, Ms. Lou Ann Fillingham and Trustee Engstrom presented the SURS fiscal year 2016 Comprehensive Annual Financial Report (CAFR). This discussion included the purpose of the CAFR, various components and highlights of the report. The discussion included detailed descriptions of the five report sections: Introductory, Financial, Investment, Actuarial and Statistical. Ms. Walker noted that SURS has received the GFOA award for financial reporting excellence for many years, along with the first-ever Public Pension Coordinating Council Award.

Ms. Fillingham highlighted the changes to the notes of the financial statements; specifically GASB Statement No. 72. This new statement effective for the fiscal year 2016 requires SURS to disclose all of its investments measured at fair value using a leveling hierarchy.

A copy of presentation titled "FY2016 CAFR Presentation" is incorporated as [Exhibit 1](#).

The educational session lasted for 15 minutes and concluded at 2:00 p.m.

INTERNAL AUDIT

Portable Refund Audit

Ms. May Springfield reviewed the Portable Refund and Lump-Sum Retirement Claims Audit. This audit reviewed the procedures for the payment of portable refunds and lump-sum retirements, as well as the entire claim payment and check writing process for the period between 6/1/15 and 9/30/16. It was noted the portable refund amounts average approximately \$39k while the traditional refunds average \$12.5k due to full interest payments and the employer match if the member had five years of service. No issues were identified and internal audit formed the opinion that the computer calculations of the portable refund and lump-sum retirement payments reasonably conform to the Illinois Pension Code and the rules of the system. Internal audit also formed the opinion that the payment procedures for portable refunds and lump-sum retirement claims are adequate.

Refund Audit

Ms. Springfield reviewed the Refund Claims Audit. This audit reviewed the procedures for the payment of separation refunds, as well as the entire claim payment and check writing process for the period between 6/1/15 and 9/30/16. No issues were identified and internal audit formed the opinion that the computer calculations of the separation refund payments reasonably conform to the Illinois Pension Code and the rules of the system. Internal audit also formed the opinion that the payment procedures for portable refunds and lump-sum retirement claims are adequate.

Travel & Administrative Expense Audit

Results from the Travel and Administrative Expense Audit were presented by Mr. Doug Taylor for the period 2/1/16 – 1/31/17. It was noted that although a few minor errors were found in the travel area, internal audit formed the opinion that the approval, payment and purchasing functions associated with the travel and administration expenses reasonably conform to the higher education travel statutes, SURS travel and purchasing administrative rules and policies and any other applicable rules of the state of Illinois. Details on the findings noted were also reviewed.

Death Match Process Overview

Mr. Hayward discussed current efforts by SURS to discover deceased annuitants and explained the 2011 reduction of records in the Social Security Administration's (SSA) Death Master File (DMF) and the current status of the DMF. SURS has used the death matching services provided by various vendors for many years and has used the Berwyn Group since 2001. SURS recently contracted for the use of Berwyn's Obit check service to offset the reduction of records in the DMF. It was reported that several million records were removed from the DMF in 2011 by the federal government. Internal audit also uses Covent/Bridge to perform personal alive and well checks on our oldest annuitants every two years. In conclusion, Mr. Hayward noted that staff is currently working with the Illinois Department of Public Health to begin the match process that will allow SURS to utilize the IDPH's vital records that SURS hopes will include death reports and related information not available through Berwyn.

INFORMATION SYSTEMS SECURITY UPDATE

Mr. Andrew Matthews highlighted security updates for several items. A vendor has been selected for phase II of the backbone upgrade which involves mostly software solutions. Implementation of phase II will begin upon successful contract negotiations. Mr. Matthews also recognized Chris Hansen and Cindy Gones efforts in these security enhancements and noted they have worked on implementing changes in administrative access levels and completion of the annual security awareness training for all staff, while also focusing on penetration testing and video surveillance.

Mr. Matthews and Ms. Cindy Gones spoke about a recent security upgrade to AirWatch. This product secures mobile devices and tablets, keeping all SURS information in a separate portal in case a device is lost or stolen.

INFORMATIONAL ITEMS NOT REQUIRING COMMITTEE ACTION

Mr. Hayward discussed internal audit's Quality Assurance and Improvement Program for calendar year 2016 and noted this report is required by IIA Standards. The Death Match and the Death Match Obituary Service reports were also reviewed.

PUBLIC COMMENT

There were no public comments presented to the Audit Committee.

There was no further business before the committee and Trustee Ammons moved that the meeting be adjourned. The motion was seconded by Trustee Johnson and carried with all trustees present voting in favor.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Martin Noven', with a long horizontal flourish extending to the right.

Mr. Martin Noven
Secretary, SURS Board of Trustees

MMN:kc

STATE UNIVERSITIES RETIREMENT SYSTEM

THE COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR) FISCAL YEAR ENDED JUNE 30, 2016

Presented by Trustee John Engstrom,
Lou Ann Fillingham and Phyllis Walker
March 9, 2017

OBJECTIVES

- Purpose of the CAFR
- Components of the CAFR
- GASB 67 and 68 Overview

PURPOSE OF THE CAFR

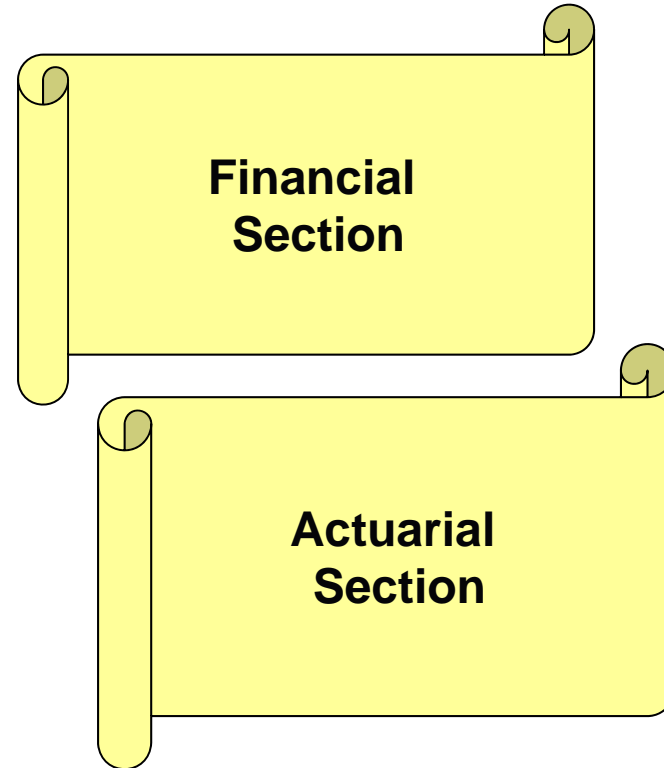
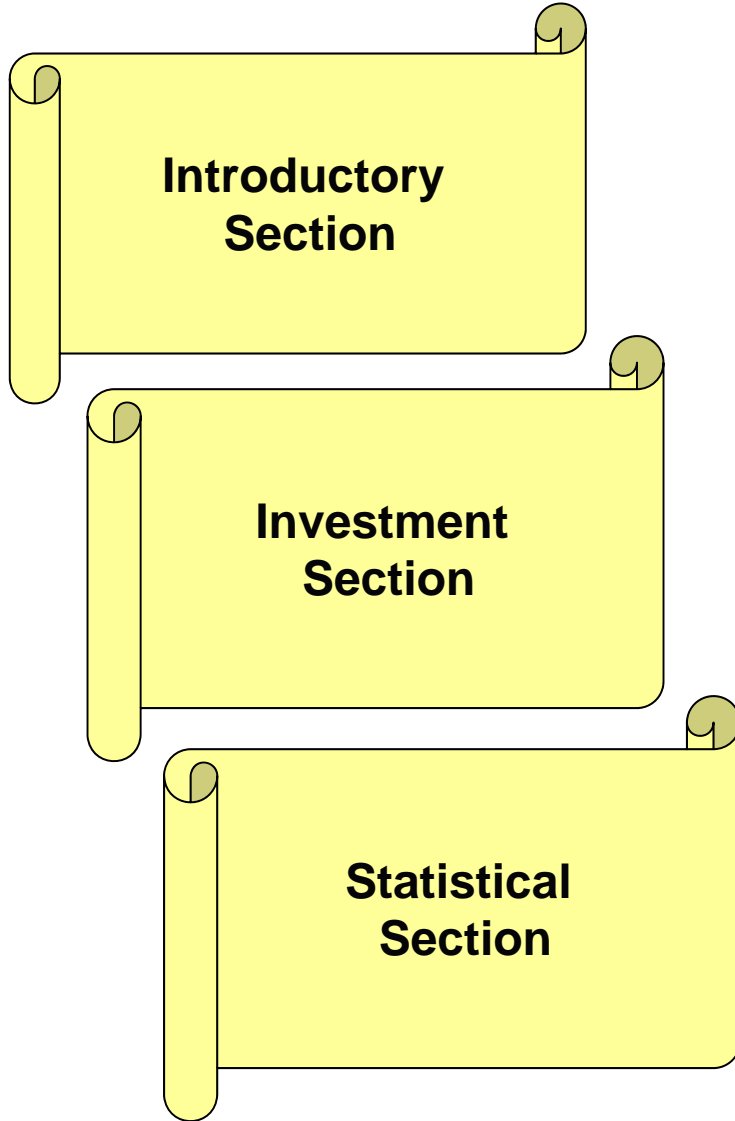
- PRESENTS THOROUGH AND DETAILED REPORT OF SURS' FINANCIAL CONDITION AND ACTIVITIES FOR THE FISCAL YEAR
- COMPLIES WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP)

MANAGEMENT RESPONSIBILITY

Management is responsible for the accuracy, completeness and fairness of the CAFR information.

CAFR SECTIONS

- 5 Sections



ORDER OF CAFR DOCUMENT

1. Introductory Section
2. Financial Section
3. Investment Section
4. Actuarial Section
5. Statistical Section

INTRODUCTORY SECTION

1. Certificate of Achievement for Excellence in Financial Reporting-June 30th 2015 CAFR 32nd Consecutive Year
2. Public Pension Coordinating Council Award
3. Letter of Transmittal
4. Principal Officers (Board and Administrative Staff)
5. Organizational Chart
6. Consulting and Professional Service Listing

FINANCIAL SECTION

1. Independent Auditor's Report
2. Management Discussion and Analysis (MD&A)
3. Basic Financial Statements
4. Notes to the Financial Statements
5. Required Supplementary Information (RSI)
6. Notes to RSI
7. Other Supplementary Information

FINANCIAL SECTION

- Independent Auditor's Report
 - Management's Responsibility
 - Auditor's Responsibility
 - Opinion – Unqualified/Clean Bill of Health
 - Other Matters
- Management Discussion and Analysis (MD&A) – narrative of past, present and future financial condition. Includes unusual events and uncertainties.
- Basic Financial Statements
 - Statement of Plan Net Position
 - Statement of Changes in Plan Net Position

FINANCIAL SECTION NOTES TO FINANCIAL STATEMENTS

- Description of SURS
- Summary of Significant Accounting Policies
 - Reporting Entity
 - Measurement – Accrual
 - Use of Estimates
 - Risks and Uncertainties
 - Cash and Short-Term Investments
 - Investments
 - Capital Assets
 - Administrative Expenses
 - Prior Year Comparative Info
 - New Accounting Pronouncements
- Contributions and Plan Net Position Designations
- Deposits and Investments
- Net Pension Liability
- Capital Assets
- Compensated Absences
- Insurance Coverage
- Post-Employment Benefits
- Lease Agreements
- Subsequent Event

FINANCIAL SECTION RSI, NOTES AND OTHER SUPPLEMENTARY INFORMATION

- Required Supplementary Information (RSI)
 - Schedule of Changes in employers Net Pension Liability and Related Ratios
 - Schedule of Employers Net Pension Liability
 - Schedule of Contributions from Employers and Contributing Entities
 - Schedule of Investment Returns
- Notes to Required Supplementary Information
- Other Supplementary Information
 - Summary Schedule of Administrative Expenses
 - Summary Schedule of Consultant Payments
 - Summary Schedule of Investment Fees and Administrative Expenses – Defined Benefit Plan

INVESTMENT SECTION

1. Letter of Certification
(Custodian)
2. Report of Investment Activity
3. Investment Summary
4. Investment Results
5. Investment Allocation
6. Supporting Schedules

GASB STATEMENT NO. 72

- Fair Value Measurement and Application
 - Requires disclosure by governmental entities regarding investments
 - Fair value measurements
 - Level of fair value hierarchy
 - Valuation techniques
 - Organized by type of asset or liability reported at fair value
 - Investments in certain entities that calculate net asset value (NAV) per share
 - Defines **investment** as a security or other asset that
 - A government holds primarily for income or profit and
 - Has a present service capacity to generate cash or to be sold to generate cash
 - Effective for periods beginning after June 15, 2015

GASB STATEMENT NO. 72

- Fair value hierarchy of inputs used for valuation
 - Level 1
 - Quoted prices in active markets for identical investments
 - Level 2
 - Observable inputs, other than quoted prices in Level 1, both directly and indirectly
 - Level 3
 - Unobservable inputs
 - NAV per share as practical expedient
 - No readily determinable fair value
 - Investment company per FASB Topic 946
 - Excluded from fair value hierarchy levels 1, 2 and 3

GASB STATEMENT NO. 72

- Disclosure includes all investments on the Statement of Plan Net Position

- Investments organized by type
 - Defined Benefit Plan
 - Self-Managed Plan

- NAV as practical expedient requires disclosure of
 - Description of investment
 - Unfunded commitments
 - Redemption frequency
 - Redemption notice period

GASB STATEMENT NO. 72

- Resources utilized for SURS disclosure
 - Northern Trust valuation and reporting service
 - Tool kit
 - Pricing guidelines
 - Fixed income fair value analysis by IDC Vantage
 - Suggested levels
 - SURS investment and finance staff
 - Review each security and Northern Trust suggested level
 - Determine final level for disclosure
 - Prepare CAFR disclosure text and tables

ACTUARIAL SECTION

1. Letter of Certification (Actuary)
2. Actuarial Report
 - a) Pension Financing
 - b) Actuarial Asset Valuation
 - c) Actuarial Cost Method
 - d) Employee Data
 - e) Valuation Results
 - f) Calculation of Actuarial Value of Assets
 - g) Analysis of Financial Experience
 - h) Change in the Unfunded Actuarial Accrued Liability
 - i) Summary of Major Actuarial Assumptions
3. Analysis of Funding
4. Tests of Financial Soundness
5. Changes in Plan Provisions

STATISTICAL SECTION

1. Financial Schedules
2. Statistical Analysis
3. Benefit Summary
4. Participating Employers

GASB – GOVERNMENTAL ACCOUNTING STANDARDS BOARD

- GASB is an independent organization that establishes financial and accounting reporting standards for state and local governments and pension plans

GASB 67 AND 68

- GASB Statement 67, Financial Reporting for Pension Plans, effective for fiscal year beginning June 30, 2013 for SURS
- GASB Statement 68, Accounting and Financial Reporting for Pensions, effective for fiscal year beginning June 30, 2014 for SURS Non-employer, the State of Illinois and SURS employers

State Universities Retirement System is a Cost-Sharing Plan

GASB 67 AND 68 COST-SHARING PLAN REQUIREMENTS

- Inclusion of proportionate share of Net Pension Liability (NPL) on the employer and non-employer contributing entity balance sheet
- Inclusion of proportionate share of pension expense on the employer and non-employer contributing entity income statement
- Additional note disclosures
 - Description of plan and benefits provided
 - Significant assumptions used to calculate NPL
 - 10 years of trend regarding liability and contributions
 - Sensitivity of NPL to changes in the discount rate

GASB 67 AND 68 TERMS

- Total Pension Liability (TPL) = portion of actuarial present value of projected benefit payments related to past periods based on entry age normal and blended discount rate
- Plan Net Position = market value of plan assets
- Net Pension Liability (NPL) = TPL less plan net position (similar to unfunded actuarial accrued liability)

GASB 67 AND 68 TERMS

- Pension expense = cost of pension benefits over a given period (previously the annual pension cost)
- Single Discount Rate =
 - Long-term expected rate of return on plan investments (net of expenses) that are expected for payment of pension benefits to the extent that plan net position is projected to be sufficient and
 - A yield or index rate for a 20-year, tax exempt general obligation (municipal) bond with average rating of AA or higher

GASB 67 VS STATUTORY FUNDING

	GASB 67 Financial Purpose	Statutory Funding Purpose
Actuarial cost method	Entry Age Normal	6 Allowable methods including SURS Projected Unit Credit
Discount rate	Long-term investment rate and tax-exempt municipal bond index	Long-term investment return rate
Asset valuation	Fair (market) value	Smoothing allowed
Amortization of Unfunded Actuarial Accrued Liability or Outflows (Inflows) of Resource	3.0381 years – 2016 recognition period for liabilities 5.000 years – 2016 recognition period for assets	Over a period no longer than 30 years

GASB 67 VS STATUTORY FUNDING

	GASB 67 Financial Purpose	Statutory Funding Purpose
Investment/Discount Rate	7.01%	7.25%
Plan Net Position/Actuarial Assets	\$17,005.6 million	\$17,701.6 million
Total Pension Liability	\$42,970.9 million	\$40,923.3 million
Net Pension Liability/Unfunded Actuarial Accrued Liability	\$25,965.3 million	\$23,221.7 million
Funding Ratio	39.57%	43.3%

GASB 67 SINGLE DISCOUNT RATE

Single Discount Rate, July 1, 2015	7.12%
Single Discount Rate, June 30, 2016	7.01%
Long-Term Expected Rate of Investment Return	7.25%
Long-Term Municipal Bond Rate, July 1, 2015*	3.80%
Long-Term Municipal Bond Rate, June 30, 2016*	2.85%
Last year ending June 30 in the 2016 to 2115 projection period for which projected benefits fully funded	2073

*"State & Local bonds" rate from Federal Reserve statistical release as of June 25, 2015 and June 30, 2016"

GASB 67 SENSITIVITY OF NPL TO THE DISCOUNT RATE AS OF JUNE 30, 2016 (\$ MILLIONS)

	1% Decrease 6.01%	Current Discount Rate 7.01%	1% Increase 8.01%
Net Pension Liability (NPL)	\$31,348.8	\$25,965.3	\$21,502.4

GASB 68

SPECIAL FUNDING SITUATION

- Defined as circumstances in which a Non-Employer entity is Legally Responsible for making contributions directly to a pension plan that is used to provide benefits to employees of another entity
- 40 ILCS 5/15-156 Obligations of State (Illinois)

WHAT SURS PROVIDES TO EMPLOYERS

- Notes to the Financial Statement Template
- Non-employer's Proportionate share and the employer's proportionate share of the net pension liability associated to them(Schedule of Employer's Allocation of the Net Pension Liability for Fiscal Year 2016) Allocation method based on employer defined benefit contributions
- Each employer's proportionate share of pension expense

GASB 68 – ALLOCATION OF NPL

FY17 Employer Schedules; Based on FY 16 Defined Benefit (DB) Employee (EE) Contributions to SURS

	SURS DB Employee	% OF TOTAL	ALLOCATION OF NET	ALLOCATION OF ON
<u>EMPLOYER</u>	<u>Contributions FY 16</u>	<u>DB EE Contributions</u>	<u>PENSION LIABILITY</u>	<u>BEHALF CONTRIBUTIONS</u>
BLACK HAWK COLLEGE	1,414,426.87	0.4880%	126,703,122.29	12,714,162.17
CARL SANDBURG COLLEGE	708,221.25	0.2443%	63,441,840.33	6,366,140.25
CHICAGO STATE UNIVERSITY	3,893,425.22	1.3432%	348,769,626.93	34,997,666.33
CITY COLLEGES OF CHICAGO	15,131,775.69	5.2204%	1,355,491,235.62	136,018,237.57
CMS - ILLINOIS CENTURY NETWORK	185,401.67	0.0640%	16,608,119.49	1,666,559.76
COLLEGE OF DUPAGE	7,115,672.07	2.4549%	637,415,682.34	63,962,167.69
COLLEGE OF LAKE COUNTY	4,422,825.60	1.5259%	396,192,850.09	39,756,401.07
DANVILLE AREA COMMUNITY COLLEGE	851,988.44	0.2939%	76,320,379.51	7,658,451.22
EASTERN ILLINOIS UNIVERSITY	5,543,157.99	1.9124%	496,551,246.00	49,826,973.11
ELGIN COMMUNITY COLLEGE	3,586,591.51	1.2374%	321,283,731.48	32,239,564.35
GOVERNORS STATE UNIVERSITY	3,168,187.76	1.0930%	283,803,489.39	28,478,568.82
HEARTLAND COMMUNITY COLLEGE	1,262,196.37	0.4355%	113,066,447.20	11,345,775.22
HIGHLAND COMMUNITY COLLEGE	674,402.69	0.2327%	60,412,403.30	6,062,148.10
WAUBONSEE COMMUNITY COLLEGE	2,468,123.14	0.8515%	221,092,312.84	22,185,747.83
WESTERN ILLINOIS UNIVERSITY	7,424,470.43	2.5614%	665,077,569.42	66,737,929.74
WM. RAINEY HARPER COLLEGE	4,382,580.30	1.5120%	392,587,711.28	39,394,639.51
TOTALS	291,238,092.82	100.0000%	25,965,271,744.00	2,605,513,343.00

QUESTIONS?