



## KENTUCKY RETIREMENT SYSTEMS

**William A. Thielen, Interim Executive Director**

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August 29, 2011

Honorable Crit Luallen  
Auditor of Public Accounts  
209 St. Clair Street  
Frankfort, KY 40601-1817

Re: KRS Report on the Implementation of Recommendations Contained in the Audit Report  
Titled: "Examination of Certain Policies, Procedures, Controls, and Financial Activities of  
Kentucky Retirement Systems"

Dear Ms. Luallen:

This letter and the accompanying document constitute the report of Kentucky Retirement System (KRS) Board of Trustees regarding its efforts to implement the recommendations contained in your report on the Examination of Certain Policies, Procedures, Controls, and Financial Activities of Kentucky Retirement Systems, which was issued on June 28, 2011.

I am pleased to report that the great majority of recommendations made in your report have been fully implemented by KRS. A few additional recommendations will be considered and acted upon by the KRS Board of Trustees at its meeting on November 17, 2011. The attached document titled: "Auditor of Public Account Recommendations and Kentucky Retirement Systems Responses" provides the details concerning our implementation of each recommendation made in the report.

If you or any of your staff have questions regarding our report, or need additional information or documentation, please do not hesitate to contact me.

Sincerely,

William A. Thielen  
Interim Executive Director  
Kentucky Retirement System

Cc: Brian Lykins

## AUDITOR OF PUBLIC ACCOUNTS RECOMMENDATIONS AND KENTUCKY RETIREMENT SYSTEM RESPONSES

### I. Finding 1 Recommendations:

- A. We recommend that KRS ensure that all information required by the Placement Agent Statement of Disclosure Policy is presented to the Board of Trustees or a designated committee in a clear and transparent manner.

*KRS Executive Management has complied with this recommendation. In addition to adopting the recommendations of the APA, it is important to note that the Board also instructed Staff to clarify and broaden the scope of this disclosure to ensure that it applies to all investment managers hired by KRS, not just those using placement agents. Therefore, in coordination with the KRS Legal Department, Investment Staff has created a Manager disclosure questionnaire. This questionnaire includes detailed questions regarding all information required regarding placement agents, lobbyist registration, financial relationships or conflicts between Manager and politicians or staff and regulatory proceeding activity. This form will be completed by each new fund Manager and presented to the Investment Committee for review prior to any investment commitment.*

- B. We also recommend that KRS Trustees ensure full compliance with Placement Agent Statement of Disclosure Policy and inquire as to whether there is a placement agent involved in an investment decision.

*KRS Executive Management has complied with this recommendation. Please see response to Finding 1 Recommendation A.*

- C. We further recommend that the KRS Internal Audit Division ensure that the criteria used in their findings are based on the actual and complete policy requirement when comparing what should be happening to what is happening and report noncompliance with the policy.

*The KRS Division of Internal Audit will comply with this recommendation and ensure that the criteria used in their findings are based on the actual and complete policy requirements when comparing what should be happening to what is happening and report noncompliance with the policy.*

### II. Finding 2 Recommendations:

- A. We recommend that the KRS Board amend the Placement Agent Statement of Disclosure Policy to include a specific party responsible for obtaining the disclosure information from investment managers. This may be specific to the CIO or include other related KRS investment staff.



***KRS Executive Management has complied with this recommendation. A revised Statement of Disclosure and Placement Agent policy was presented at the August 2, 2011 Investment Committee meeting. The revised policy was approved and the approval was ratified by the Board of Trustees at its August 18, 2011 meeting.***

- B. We also recommend that the KRS Legal Office work in conjunction with the KRS investment staff to develop a questionnaire to be distributed to potential investment managers to collect the required placement agent information.

***KRS Executive Management has complied with this recommendation. Please see response to Finding 1 Recommendation A.***

- C. We further recommend that the KRS Board revise the Placement Agent Statement of Disclosure Policy to ensure that all items disclosed by an investment manager are presented to the Investment Committee for review and consideration. Investment Committee members should be aware of all requirements in the investment policies to ensure they are enforced and used to guide the work of investment staff as committee members intended.

***KRS Executive Management has complied with this recommendation. Please see response to Finding 1 Recommendation A.***

- D. Finally, we recommend that the KRS Board amend the Placement Agent Statement of Disclosure Policy to require the investment manager include political contributions made by the placement agents to any Kentucky official within the prior two years.

***KRS Executive Management has complied with this recommendation. A revised Statement of Disclosure and Placement Agent policy was presented at the August 2, 2011 Investment Committee meeting. The revised policy was approved and the approval was ratified by the Board of Trustees at its August 18, 2011 meeting.***

### **III. Finding 3 Recommendations:**

- A. We recommend that KRS Investment Committee members ensure that all adopted investment policies are carried out by staff as intended. This can be accomplished by requiring reports and disclosures concerning the activities of investment staff and KRS contractors as discussed in Findings 2 and 4. Investment Committee members should ensure they are familiar with the adopted policies so that they are able to ask the mandatory questions related to these policies. We also recommend that the KRS Investment Committee and Board strengthen the Placement Agent Statement of Disclosure Policy by establishing guidelines for how the information provided is evaluated. This includes what action to take if a conflict is revealed between the placement agent and KRS staff members or officials.

***KRS Executive Management will comply with this recommendation. In terms of the Statement of Disclosure and Placement Agent policy, a revised policy was presented at the August 2, 2011 Investment Committee meeting. The revised policy, which includes a***

*process for evaluating information and dealing with conflicts, was approved and the approval was ratified by the Board of Trustees at its August 18, 2011 meeting.*

- B. Finally, we recommend to further enhance transparency the General Assembly consider requiring the registration of placement agents as executive agency lobbyists with the Executive Branch Ethics Commission. This action may require expanding the definition of "Executive agency" in KRS 11A.201(6) to include Kentucky Retirement Systems.

*KRS Board and Executive Management will support this recommendation. Information regarding this recommendation will be presented to the Kentucky General Assembly for consideration.*

#### **IV. Finding 4 Recommendations:**

- A. We recommend that KRS investment staff and Investment Committee members ensure consistent compliance with all established investment policies. In addition to the information currently required to be presented to the Investment Committee under the addendum to the Transaction Policy for Limited Partnerships, investment staff should include the following information:

- The specific KRS investment policy and strategy associated with the investment and how that investment meets the requirements;
- Which firms were considered as the primary options;
- What steps were undertaken to locate the firms considered and all individuals or firms involved in identifying investment options and their services;
- Any risks associated with the recommended investment and the mitigating factors that allowed the investment to be recommended; and,
- A recommendation from at least one investment consultant on contract with KRS or explanation of why no consultant recommendation could be given.

*KRS Executive Management has complied with this recommendation. A revised Investment Transactions Procedures Policy was presented at the August 2, 2011 Investment Committee meeting. A revised policy which includes a requirement that the recommended information be presented, was approved and the approval was ratified by the Board of Trustees at the August 18, 2011 meeting.*

- B. We also recommend that KRS establish a formal method for investment staff to convey concerns about a potential investment to Investment Committee members when their concerns are not addressed by the recommendation memo. This method should alleviate the concern of reprisal. Investment staff should also be informed to bring concerns to the KRS Division of Internal Audit if possible fraud is suspected.



*KRS Executive Management will comply with this recommendation. A proposal to implement a system that will allow members, staff, and the general public to anonymously report suspected fraud, dishonesty, etc. was presented to the Legal, Governance and Compliance Committee on August 2, 2011. The Committee approved the proposal to establish an anonymous reporting link on the KRS internet and intranet sites and to establish a toll-free telephone hotline which can be used to anonymously report fraud, dishonesty, etc. The Committee's decision was ratified by the Board of Trustees at its August 18, 2011 meeting. The internet and intranet links and the telephone hotline should be operational in early September.*

**V. Finding 5 Recommendations:**

- A. We recommend that the KRS Audit Committee develop and approve procedures that document the requirements related to special audits requested by management or external sources. Because the Audit Committee is only required to meet on a quarterly basis, procedures must be developed to guide the day-to-day activities of the Division of Internal Audit. The adopted procedures should state the Audit Committee's process to request and approve special audits, whether preliminary research should be conducted prior to approval, the amount of the Audit Committee's involvement in the audit scope and methodology, the type and method of communicating information to the Audit Committee prior to the completion of the audit, the distribution of the draft audit report, and when a special meeting should be conducted to discuss a special audit.

*Language to implement this recommendation has been incorporated into the KRS the Division of Internal Audit (IA) Procedures Manual at Section 5 page 19.*

- B. We recommend that the Fraud Management Policy be integrated into the Internal Audit Procedures Manual. See Finding 9 for further discussion.

*Language to implement this recommendation has been incorporated into the KRS the Division of Internal Audit (IA) Procedures Manual at Section 3 page 10.*

**VI. Finding 6 Recommendations:**

- A. We recommend that the KRS Division of Internal Audit conduct all audit fieldwork in an independent manner separate from the influence of KRS management. Managements' role is to provide the requested documents but it does not include performing audit procedures or evaluating documents, audit findings, or audit conclusions.

*Internal Audit agrees with and will comply with the recommendation that management doesn't perform audit procedures or evaluate documents, audit findings, or audit conclusions. However, Internal Audit does not agree that KRS management may not be used to support or complement the Internal Audit Activity. As stated in the Institute of*

***Internal Auditors International Professional Practices Framework (IPPF) Practice Advisory 1210.A1-1 (1) "Each member of the internal audit activity need not be qualified in all disciplines. The internal audit activity may use external service providers or internal resources that are qualified in disciplines such as accounting, auditing, economics, finance, statistics, information technology, engineering, taxation, law, environmental affairs, and other areas as needed to meet the internal audit activity's responsibilities."***

- B. We also recommend that the Director of Internal Audit retain outside counsel if there is any perceived conflict in the use of the KRS General Counsel for legal assistance, as allowed for under the Audit Committee Charter. Outside counsel also includes the assistance of the Attorney General's Office as allowed for under KRS 61.645(11).

***Internal Audit agrees with and will comply with the recommendation and will retain outside legal counsel if there is any perceived conflict in the use of the KRS General Counsel.***

- C. We recommend that the Division of Internal Audit operate with the understanding that audit working papers are not subject to the open records law, KRS 61.872, as allowed for in KRS 61.878(1)(i) and (j) and as stated in various Kentucky Attorney General opinions. However, it should be clearly understood that a document already subject to open records that is placed in audit working papers retains its identity as an open record.

***Internal Audit agrees with and will comply with the recommendation and will operate with the understanding that audit working papers are not subject to the open records law, KRS 61.872, as allowed for in KRS 61.878 (1)(i) and (j) and as stated in various Kentucky Attorney General opinions. Internal Audit understands that a document already subject to open records that is placed in audit working papers retains its identity as an open record.***

## **VII. Finding 7 Recommendations:**

- A. We recommend that the Audit Committee approve an annual budget of the Division of Internal Audit based on the approved internal audit plan. The Director of Internal Audit should request the amount of funds estimated to conduct the internal audits approved by the Audit Committee. Any additional funding should also be requested by the Director of Internal Audit to the Audit Committee for approval. In addition, budgeted funds should be related to completing or expanding the internal audit plan, such as expenses for external audit assistance, independent counsel, technology upgrades, or other expenditures necessary for the internal audit function to operate as approved by the Audit Committee. Once approved by the Audit Committee, the annual budget for the Division of Internal Audit should be ratified by the full Board of Trustees to be included in the KRS budget by the COO.

***Language to implement this recommendation has been incorporated into the KRS the Division of Internal Audit (IA) Procedures Manual at Section 2 page 7. Also, Internal Audit prepared a draft copy of the annual budget for the Division of Internal Audit for***



***Fiscal Year 2012. The Internal Audit annual budget will be incorporated into the KRS administrative budget. See the response to item B below.***

- B. We also recommend that the budget for the Division of Internal Audit be well documented as a specific item in the KRS budget. The amounts available should be clearly budgeted and used by the KRS Audit Committee as a planning tool to monitor the resources that are available for the internal audit function.

***KRS Executive Management will comply with this recommendation. The Director of Internal Audit will work with the Chief Operations Officer to develop a biennial budget request for the Internal Audit Division. All expenses (i.e., travel related expenses, conference registration expenses, educational/certification expenses, publication expenses, data service/software expenses, etc.) will be included in the budget. Additionally, any expected expenses for external contracts will be included in the audit budget. The COO and KRS accounting staff have already worked together to revise the internal administrative budget to separately account for internal audit operating expenses so that periodic expense reports can be made to the KRS Audit Committee and Board of Trustees.***

#### **VIII. Finding 8 Recommendation:**

- A. We recommend that the full Audit Committee of the Board of Trustees participate in the evaluation of the Director of Internal Audit as required by the Internal Audit Procedures Manual. Members of the Audit Committee may seek input from the Executive Director or any other appropriate KRS staff, but only Audit Committee members should be directly involved in the evaluation meeting with the Director of Internal Audit. The opinions of KRS management should be tempered by the fact that the Audit Committee and the Director of Internal Audit are responsible for evaluating KRS operations.

***Language to implement this recommendation has been incorporated into the KRS the Division of Internal Audit (IA) Procedures Manual at Section 4 page 13. However, Internal Audit does not agree fully with the recommendation. When there is a quorum of the Audit Committee members present, then the Audit Committee must have an open public meeting. Therefore, if all audit members are present to conduct the Director of Internal Audit's performance review it would be conducted in an open public meeting. There is no statutory regulation allowing the performance review to be conducted in closed session, unless disciplinary action or termination is discussed. Also, since the Executive Director has the day to day contact with the Internal Audit Director, the Executive Director should be involved in the performance review. The Audit Committee only meets on a quarterly basis for a few hours at a time. Therefore, Internal Audit agrees that the Audit Committee Chair and the Vice Chair along with the Executive Director perform the Internal Audit Director's performance evaluation, due to the dual reporting of the Internal Audit Director, functionally to the Audit Committee, and administratively to the Executive Director.***

**IX. Finding 9 Recommendations:**

- A. We recommend KRS revise its current Fraud Management Policy to remove the requirement of an investigative team and incorporate the Fraud Management Policy fully under the internal audit function.

*Language to implement this recommendation has been incorporated into the KRS the Division of Internal Audit (IA) Procedures Manual at Section 3 page 10. However, Internal Audit does not agree to remove the requirements of an investigative team and to incorporate the Fraud Management Policy fully under the internal audit function. Industry best practice from the Association of Certified Fraud Examiners Sample Fraud Policy states "Any irregularity that is detected or suspected must be reported immediately to the Director \_\_\_\_\_, who coordinates all investigations with the Legal Department and other affected areas, both internal and external." The amended policy will be presented to the Audit Committee at the November quarterly meeting.*

- B. We recommend the Audit Committee determine whether to conduct a formal investigation based on the recommendations of the Director of Internal Audit and input from Audit Committee members.

*Internal Audit agrees with and will comply with the recommendation that the Audit Committee determines whether to conduct a formal investigation.*

- C. We further recommend the Audit Committee determine the process for distributing the draft investigative report. See Finding 5 recommendations.

*Language implementing this recommendation has been incorporated into the KRS the Division of Internal Audit (IA) Procedures Manual at Section 3 page 10 and Section 5 page 19.*

**X. Finding 10 Recommendations:**

- A. We recommend that the KRS Board revise its policies to address the timing of staff or trustee reimbursements to KRS for any personal expenditure that may have been paid by KRS. A stringent deadline should be established, as well as, the actions taken for those that do not comply with this policy.

*Language implementing this recommendation has been incorporated into the KRS Travel Policy at Section 2(A).*

- B. We recommend that the KRS Board revise its policies to establish guidelines and limits on spending for the purpose of entertainment. The policy should clearly define the circumstances when it is appropriate to incur such expenses, the purpose for the expenses, and the maximum purchase amount allowed.



*This recommendation has been implemented by the elimination of language in the KRS Travel Policy that authorizes "entertainment" expense reimbursements (See Page 8 at G). Language has also been inserted in the policy at Section 2(A) which makes clear that reimbursement will only be made for the specific types of expenses authorized by the policy, which do not include "entertainment" expenses.*

- C. We also recommend that the KRS Board revise its ProCard policy to require ProCard holders to submit invoices and any other documentation necessary to support the charges made. The policy should also establish a specified amount of time allowed for this submission and the actions that will be taken for those that violate the policy.

*Language has been inserted in the Procurement Card Policy on Page 2 at #5 and on Page 3 at #17 to implement these recommendations.*

- D. We finally recommend that the KRS Board revise its new trustee orientation policy to require that it is performed within the first months of the trustee's service on the Board. The policy should require that the orientation be facilitated by a knowledgeable, independent party, such as a Board attorney or consultant with an emphasis on the legal and fiduciary responsibilities of Board trustees. The Board should consider requiring presentations by the CIO and other director level personnel as part of the orientation as well.

*Language to implement these recommendations has been inserted in the Trustees Education Program document on Page 3, Chapter 2(2), (3) and (4).*

#### **XI. Finding 11 Recommendations:**

- A. We recommend that KRS enforce its policy requiring pre-approval for travel and the reviewer consider whether lodging is the most economical for the location. Any travel expenditures incurred without proper pre-authorization should be brought to the attention of the KRS Board for determination as to the appropriateness of the trip and related expenses.

*KRS Executive Management will ensure that the terms of the KRS Travel Policy are enforced. Language has been inserted in the KRS Travel Policy at Page 5, Section 5(B) to implement this recommendation.*

- B. We recommend that the KRS Board revise its travel policies to require that Request for Travel forms be submitted along with the travel vouchers to ensure that employees only receive reimbursement for the business related expenses that were pre-approved.

*Language has been inserted in the KRS Travel Policy at Page 5, Section 5(B) to implement this recommendation.*

- C. We recommend that KRS revise its Request for Travel forms to include a space for the Executive Director or his designee to document the date of approval.

*The Request for Travel Form has been revised to implement this recommendation.*

**XII. Finding 12 Recommendations:**

- A. We recommend the KRS Board revise its conflict of interest policy to include, at a minimum, a requirement for the CIO, Investment Directors, and General Counsel to file an annual written conflict of interest statement.

*Language has been inserted in the Conflicts of Interest and Confidentiality Policy at Section 4(1) on page 3 to implement this recommendation.*

- B. We further recommend the KRS Board expand upon its conflict of interest statement to allow for an actual listing of relationships or actions that may cause a potential conflict. The form should identify the types of relationships and actions that should be disclosed, such as investments, past work relationships, political contributions, speaking engagements, gifts, or other potential conflicts of interest that may be of possible interest to KRS. This form should allow the individuals to provide a brief description of the relationship or action listed and should be regularly updated by individuals as their circumstances change.

*Language has been inserted in the KRS Conflicts of Interest Statement to implement this recommendation.*

**XIII. Finding 13 Recommendations:**

- A. We recommend that KRS Board trustees comply with all KRS Board policies and not use the trustee position to improve his or her professional interest. If the trustee's career is in the investment industry, extra caution is necessary to avoid the appearance of conflicts.

*The KRS Board of Trustees will ensure that members of the Board are aware of all Board policies and their obligation to comply with those policies through its Board of Trustees Education Program.*

- B. We recommend trustees follow the KRS Board bylaws to refer all news media inquiries to the Executive Director and do not discuss matters that affect KRS or the Board generally with the news media.

*The KRS Bylaws have been amended to require all media inquiries to be referred to the KRS Board of Trustees Chair or the Executive Director.*

- C. We also recommend that the KRS Board revise its Conflict of Interest and Confidentiality Policy to include specific penalties or a process to be followed when a trustee is found to have violated policy requirements or bylaws.

*Language has been inserted in the KRS Conflicts of Interest and Confidentiality Policy at Section 5, pages 4-6 to implement this recommendation.*



- D. We further recommend that trustee disciplinary actions taken as a result of policy violations be disclosed during a public KRS Board meeting and that the action be documented in the Board meeting minutes.

*Language implementing this recommendation has been inserted in the KRS Conflicts of Interest and Confidentiality Policy at Section 5(12).*

**XIV. Finding 14 Recommendation:**

- A. We recommend that the KRS Board revise its procurement policies to no longer allow pension funds to be spent on monthly prizes. In lieu of using pension funds for retirement gifts, receptions, or other service recognition awards, KRS employees should be limited to receiving a certificate or plaque. If KRS staff would like to continue providing these awards, prizes or gifts, the expense should be collected from personal funds rather than at the expense of KRS members.

*The language in the KRS Procurement Policy at Definitions, Section 15 and Part VII, D, which related to and authorized retirement and other personal gifts, has been eliminated.*

**XV. Finding 15 Recommendations:**

- A. We recommend the KRS Board create a multifaceted process through which KRS and its Board can effectively receive anonymous reports from individuals within and outside of its organization. While this may be accomplished through revising its current Fraud Management Policy, the expanded policy should ensure that the process is sufficiently independent to offset any risk of internal influence over the fraud investigation process. See Finding 9.

*KRS Executive Management will comply with this recommendation by placing information and links on its external and internal websites which will allow members and staff to make anonymous reports. Additionally, KRS will establish a toll-free telephone number for anonymous reporting of fraud, dishonesty, etc. Language will be inserted in the Fraud Management Policy regarding the process for anonymous reporting of suspected fraud or other issues.*

- B. We further recommend the KRS Board ensure that the process for anonymously reporting concerns is formally documented in KRS policies and properly disseminated to its employees and made available the public. The information should be easily accessible through the KRS internet website. We also recommend KRS consider including this information when issuing newsletters to its members.

*KRS Executive Management will comply with this recommendation by placing information and links on its external and internal websites which will allow members and staff to make anonymous reports. Additionally, KRS will establish a toll-free telephone*

*number for anonymous reporting of fraud, dishonesty, etc. Information will also be included periodically in the KRS member newsletter regarding the process for anonymous reporting.*

- C. We finally recommend that the KRS Board include additional language in its policy to clearly document the employee protections that are available under the Kentucky Whistleblower Act.

*KRS Executive Management will comply with this recommendation by inserting language in the Fraud Management Policy and the Confidentiality and Conflict of Interest Policy concerning employee protections provided under the Kentucky Whistleblower Act.*

**XVI. Finding 16 Recommendations:**

- A. We recommend that KRS include the administrative costs to operate the health insurance portion of the retirement system in the KRS budget that is approved by the Board and General Assembly.

*KRS Board and staff are continuing to explore the legality of this recommendation with outside legal counsel and the practical impact of the recommendation on the KRS administrative budget. Implementation of this recommendation, if determined to be legally and otherwise feasible, will not occur until July 1, 2012, since the additional expenditures were not included in the KRS budget approved by the General Assembly in 2010 and will have to be included in the KRS budget request for the 2013 and 2014 biennial budget.*

- B. We recommend that the KRS Board require staff to provide to the Board quarterly budget-to-actual expenditure reports. This report should be detailed by budget line item and should include an explanation for significant variances.

*KRS Executive Management will comply with this recommendation. Language has been inserted in the KRS Bylaws at Section 1.3n to implement this recommendation. The first Budget-to-Actual expenditure report covering FY 2011 was made to the Board of Trustees at the August 18, 2011 meeting.*

- C. We also recommend that the KRS Board require staff to provide to the Board quarterly investment expenditure reports. This report should present investment costs by expense category so that specific investment activities can be monitored by the KRS Board. Expenses paid from the pension and insurance fund should be monitored by the KRS Board.

*KRS Executive Management will comply with this recommendation. KRS investment and accounting staff are currently developing an investment expense report which will be reported quarterly to the KRS Investment Committee and the KRS Board of Trustees.*

- D. We further recommend that the KRS Board require staff to provide to the Board an annual report of executive staff salaries. The report should provide their salaries for a three-year



period to allow for comparative data and fully disclose salary data. The KRS Board should request additional salary data on all KRS staff as needed in their review of the KRS salary structure.

*KRS Executive Management has complied with this recommendation. Language has been inserted in the KRS Bylaws at Section 1.2c and Section 1.3m, which fully implements this recommendation. In the future, KRS leadership staff comparative salary data will be presented to the Board at its regular quarterly meeting in August each year, unless the Board directs staff to present the data at a different time or more frequently. The first report was presented to the Board of Trustees at the August 18, 2011 meeting.*

**XVII. Finding 17 Recommendations:**

- A. We recommend the KRS Board adopt a budget that includes certain investment related expenses such as travel, education, and conferences that are not already included in the KRS budget. This budget should be monitored by the KRS Board to document their awareness of the funds used for investment purposes.

*KRS Executive Management will comply with this recommendation. The Chief Investment Officer will work with the Chief Operations Officer to develop a biennial budget request for the investment division. The first instance of this budget will be presented for the upcoming 2013/2014 fiscal years. All expenses (i.e., travel related expenses, conference registration expenses, educational/certification expenses, publication expenses, data service/software expenses, etc.) other than direct investment management fees and commissions paid to investment managers will be included in the budget. The COO and KRS accounting staff have already worked together to revise the internal administrative budget to separately account for investment operating expenses so that periodic investment expense reports can be made to the KRS Investment Committee and Board of Trustees. These quarterly reports will begin at the November 2011 Investment Committee meeting. Early estimates indicate that the inclusion of Investment expenses in the KRS Administrative Budget will mean an increase in the total budget amount of approximately \$1.9 million dollars. For the 2011-2012 fiscal year, this amount has not been budgeted or included in the budget appropriation. The projected additional amount will be included in the KRS budget request for the next biennium – fiscal years 2013 and 2014 as discussed above.*

- B. We also recommend KRS staff provide regular quarterly reports to the KRS Investment Committee and full Board of budget to actual investment expenditures. The reports should be formatted in a clear and concise manner to facilitate the committee members' review of these expenditures made from various pension and insurance funds.

*KRS Executive Management will comply with this recommendation. See the response to the immediately preceding recommendation.*

- C. We also recommend that KRS ensure that personal trips taken in association with business travel be clearly identified and that leave balances be reduced as appropriate. The purpose of the daily travel, as stated on the travel voucher, should be an accurate and concise representation of the traveler's activity on that day.

***KRS Executive Management will comply with this recommendation.***

- D. In addition, we recommend that KRS create a consolidated database to formally document meetings and costs incurred by KRS investment personnel. Staff should be appointed to record this information and maintain the database. Information on meetings, either local or out-of-state, should be provided in advance to ensure that all meetings are known and documented. The actual costs incurred for a meeting should be recorded in the database so that a complete record is maintained for monitoring and budget purposes.

***KRS Executive Management will comply with this recommendation. Several Investment divisions have been tracking most of this information since 2010. This process will be expanded to all asset classes and include any expenses related to the entries on a go forward basis.***

- E. We further recommend that KRS provide regular reporting to its Investment Committee members detailing the investment meetings conducted and the costs incurred by KRS investment staff, including the CIO. This report should contain the date of the meeting, the purpose, the location, and the associated costs. This report should be presented for informational purposes to allow for discussion of the effectiveness of the meeting and to ensure additional accountability and transparency.

***KRS Executive Management will comply with this recommendation. A summary of the newly expanded database discussed above will be presented to the Investment Committee quarterly beginning in November 2011.***

#### **XVIII. Finding 18 Recommendation:**

- A. We recommend that KRS staff ensure that KRS Board meetings and its committee meetings are transcribed in a timely manner as prescribed and required by the KRS Board bylaws. The appropriate number of KRS staff should be assigned the responsibility of transcribing the meeting minutes to ensure that there is adequate coverage based on the number and length of full KRS Board and committee meetings. The internal review process of the draft meeting minutes should also be evaluated to ensure that an effective and timely process is in place.

***KRS Executive Management will comply with this recommendation. Except in extraordinary circumstances, Executive Management will ensure that Board and Committee meeting minutes are prepared and presented at the next regular meeting of the Board or Committee for approval.***



**XIX. Finding 19 Recommendations:**

- A. We recommend the same disclosure requirements and application process be followed for both appointed and elected KRS Board trustees. At a minimum, these requirements should include a current and detailed resume, a cover letter detailing the applicant's specific qualifications to be an effective KRS Board trustee, authorization for a background check, acknowledgement of any felonies, and a formal application. We recommend this information be provided by potential appointees and election candidates at the initiation of the application process or election process.

*Action on this recommendation has been deferred until the meetings of the Board of Trustees and board committees in November.*

- B. To ensure a consistent process, we recommend KRS perform a background check of candidates for elected trustee. This check should be performed and the results distributed to the KRS trustees prior to considering candidates that will be placed on the election ballot.

*Action on this recommendation has been deferred until the meetings of the Board of Trustees and board committees in November.*

- C. We recommend that the KRS Board document background, experience, and qualifications for each trustee on the website's "Meet the Board" page.

*Action on this recommendation has been deferred until the meetings of the Board of Trustees and board committees in November.*

**XX. Finding 20 Recommendation:**

- A. We recommend a maximum number of terms be established for an individual to successively serve as Board Chair or Vice Chair. If legislation is not passed, we recommend that the KRS Board vote to limit the terms of the Board Chair and Vice Chair. In selecting the term limit for the Board Chair, a balance is needed to ensure stability but to also rotate the concentration of power held by one individual.

*Language has been inserted in the KRS Bylaws at Section 1.1j and k on page 2 to implement this recommendation concerning Board officer term limits.*

**XXI. Finding 21 Recommendation:**

- A. We recommend that the KRS Board Audit Committee seek, at least periodically, more than just an external financial statement audit of the retirement system. With additional external audit services, the Board could obtain a more in-depth analysis of any function or aspect of the retirement system (administrative, investment, or benefit delivery), comparison of

policies to practice, and gain valuable insight into how operations might be improved as well the best practices identified in other states.

*Language to implement this recommendation has been incorporated into the KRS the Division of Internal Audit (IA) Procedures Manual at Section 5 page 19. Also, outsource audits have been included as a line item in the Internal Audit Budget . The Audit Committee continues on an on-going basis to evaluate external audits to be performed.*

**END**