AUDIT COMMITTEE MEETING OF THE BOARD OF ADMINISTRATION
RETIREMENT BOARD
WATER AND POWER EMPLOYEES' RETIREMENT PLAN

MEETING – November 3, 2004

Present:

Gerard McCallum II	Chairperson
Lilly Calvache	Committee Member

Absent:

Mike Moore	Retiree Member – Vice Chairperson
Vacant	Board Member

Others Present:

Robert K. Rozanski	Acting Retirement Plan Manager
Sangeeta Bhatia	Assistant Retirement Plan Manager
Irene Colon	Recording Secretary
Mike Wilkinson	Deputy City Attorney

The meeting was called to order at 10:08 a.m.

Committee Member, Ms. Lilly Calvache, asked Mr. Robert Rozanski, Acting Retirement Plan Manager, to indicate what the Board was going to review and what they were going to act on.

Mr. Rozanksi indicated two agenda items and stated that Mr. Brainard Simpson from Simpson and Simpson, the auditors for the Retirement Plan, were here to present the results of their audit of the Retirement Plan's financial statements for the fiscal year ending June 30, 2004. He expressed, in addition, Mr. Simpson will also discuss the Audit Committee's responsibility as it relates to the Sarbanes Oxley Act. He then acknowledged Mr. Simpson who approached the Board Table.

Mr. Simpson acknowledged the introduction from Mr. Rozanksi, and stated that he is one of the engagement partners on the audit of the pension plan. He introduced Miss Grace Yuen, who he stated is also a partner, of the firm and indicated that she was the onsite engagement partner for the plan. He went on to explain to the Board what their responsibilities are as auditors and their required communications to the Audit Committee as promulgated by the American Institute of CPA's. He further explained, their responsibilities, under the Generally Accepted Auditing Standards, is to provide the Board with assurance regarding the fairness of the presentation of the financial statements and explained that since their work is done on a test basis, it was not to be construed as absolute assurance, but general assurance on the fairness of the financial statements. As part of their work, they are required to evaluate each significant accounting control within the Plan and those significant accounting controls are indicated in the notes to the financial statements. He stated they saw no unusual transactions that appeared during the year of their audit. He said, within the financial statements, there are estimates used by management, which they looked at and agreed with. He further stated that there are no significant audit adjustments proposed by Simpson and Simpson during the audit, and the financial statements, presented to them, are the ones represented in the audit report. He continued, Simpson and Simpson saw no management consultant consultations, with other accountants about the audit or accounting policies, so the Plan did not go outside of the consultation with Simpson and Simpson. He added there were no major issues discussed in connection with their retention as auditors. He further explained that they had no disagreements with management during the audit process and had no difficulties in working with management in the audit process and expressed that staff was very cooperative and helpful. He then placed and provided before the Board a draft of the audit report. He stated the audit report is in draft form until the current actuarial report is approved by the Board and noted, assuming the report is approved; it will be issued as presented to the Board. He further commented they have issued their opinion on the financial statement which is an unqualified opinion as has been issued on the Plan for all the years that Simpson & Simpson has served as auditors. He also said, included in the financial statement is the Statement of Plan Assets, the Statement of Changes in Plan Assets, and the notes to the financial statements. Mr. Simpson introduced Miss Grace Yuen to the Board to talk about the various fluctuations in the financial statements and some of the highlights. He also added that before he turned the table over to Miss Yuen, he expressed to the Board that Simpson and Simpson did not issue a management letter, and they saw no weaknesses in internal control or any management issues that they felt needed to be brought to the Board or the Audit Committee's attention. They also found no material weaknesses in the internal control or management structure of the Plan. He then turned the table over to Miss Yuen.

Miss Yuen requested the Board to turn to page 15 and 16, which she indicated was the statement of the Plan Assets for the Retirement Fund and the Statement of Changes in Net Assets for the Retirement Fund. She stated the total net assets for the Retirement Fund increased by $403 million and if you take a look at the assets total, investments increased by 68 million and total receivables decreased by approximately $13 million, liability decreased by $347 million which is mainly due to the security lending because as of the year end, the Plan was not engaged in as much security lending because it was in transition to the full discretion investment strategy. She further commented that because there is less activity in security lending there is also less liability. She called the Board's attention to page 16 showing the changes of the Plan Net Asset, stating it has increased by $403 million mainly due to the appreciation in fair value of investments and also due to the increase of contributions, both member and Department contribution, which is due to the increase in the number of contributing members. Miss Yuen asked if there were any questions on the Retirement Fund. No one responded. She continued and pointed out that on page 17 and 18, the Disability Fund net assets decreased by approximately by $3.6 million due primarily to (looking on page 18) an increase in benefit payments for temporary disability and also due to decrease in fair value of investments.

Committee Member Calvache asked Miss Yuen for what year.

Miss Yuen responded, for the year 2004. She continued that for this particular fund assets are mostly in bonds or short-term investments. She stated the market is lower for bonds, which is why, for the disability fund; there is actually a slight decrease in the fair value of the investment, which is 1.6 million. She pointed out; that looking at the middle of page 18 it shows there is actually a decrease in the fair value of the investment of $1.6 million. She continued, on page 19 and 20 to the Death Benefit Fund. She stated the Death Benefit Fund net asset also decreased by approximately $4.3 million. She noted, page 20 also reflects a decrease in the fair value of the investment by 1.1 million an increase the death benefit provided to members by approximately $1.3 million. Miss Yuen requested that the Board turn to page 32, which is supplementary information, which is required by GASB 25, that they had to include in the supplementary section. She pointed out the 2004 funded ratio is 97.3%; however, she pointed out that this was based on a draft actuarial report which has not yet been approved by the Board.

Mr. Simpson asked the Board if there were any questions on the report that was not covered in their presentation.

Committee Member Calvache answered in the negative but commented that she needed to review the numbers since what she has before her is in draft form and she may have some questions for staff.

Mr. Rozanski responded in the affirmative.

Mr. Simpson stated he wanted to talk about Sarbanes Oxley. He explained that in it's current state, it deals primarily with public companies and all it's requirements deal with companies that issue equities to the public. He said that there is a belief in their profession that the requirements of Sarbanes Oxley would begin to trickle down to other organizations especially governmental organizations that issue bonds to the public, but currently it does not deal with municipalities or other governmental agencies that issue bonds. He continued that most organizations are looking at Sarbanes Oxley to at least try to come into compliance, because they believe that the recommendations of Sarbanes Oxley are good for the organization and they would like to see them implemented. He further commented that several non profit organizations that Simpson and Simpson audits have looked at Sarbanes Oxley and have tried to implement some of the visions under this act. He pointed out that one of the requirements under Sarbanes Oxley deals with the responsibilities of the audit committee. He continued that Sarbanes Oxley places the responsibilities of financial reporting squarely on the shoulders of the audit committees of the Board of Directors of public companies that issue equities to the public. Mr. Simpson pointed out that the Audit Committee's responsibilities under the Sarbanes Oxley, if the Board chooses to comply, would be responsibility for the financial reporting accuracy of the financial statements of the Plans that Simpson and Simpson audited. Mr. Simpson explained that one of the responsibilities is that on the audit committee should be a person knowledgeable of financial activities and this person should not be closely related to the management of the organization. He continued that under this responsibility the AICPA has defined some of the responsibilities that the audit committee should completely understand and begin to perform. These include the financial reporting as he indicated and also coordinating the audit effort with the independent auditors. Under Sarbanes Oxley the Board is given the responsibility of selecting the auditors. He further commented that in order for the audit committee to carry out these responsibilities, they must understand and identify the risks associated with financial reporting. He said that these risks have to be identified and the committee must have knowledge of what pressures there are on earnings to assess these risks and look at the risks related to internal control. He said that Sarbanes Oxley gave some examples.

Committee Member Calvache interjected and asked Mr. Simpson if the Board had a copy of what Mr. Simpson was reading.

Mr. Simpson responded, he would provide a summarized, written copy to the Board.

Mr. Simpson continued, denoting the risks stated under Sarbanes Oxley which the Audit Committee should be aware of, such as, external conditions, technology changes and their effect, on down turns in the industry, and the earnings expectations. He stated these were some of the risks that the Board should look at along with operating characteristics of the organization such as frequent organizational and management changes, whether they are inexperienced management, and if there were significant complex transactions. He indicated that all these risks need to be looked at, in addition, what kinds of pressures are there in respect to earnings, is management rewarded based upon earnings and what kind of pressures are put forth to bear that will cause management to over state earnings. Mr. Simpson stressed that the Board is also responsible for internal controls that are in place within the organization to detect fraud advantage reporting. In conclusion he stated that these were the requirements of the audit committee under Sarbanes Oxley, which basically places the responsibility for active management reporting on the shoulders of the audit committee of the Board of Directors. Mr. Simpson asked the Board if there were any questions.

The Board conveyed that they saw no problems with what was read to them with regards to the rules of compliance.

Mr. Simpson expressed that the auditors will present a copy of an outline of what was just presented to the audit committee.

Committee Member Calvache responded and requested from Mr. Simpson that the Board would like a copy of the presentation in writing.

Mr. Simpson responded that he would comply with Committee Member Calvache's request.

Committee Member Calvache asked the Board if they had any questions.

Chairperson Gerard McCallum II commented he had no questions but raised concern on how the Audit Committee proceeds from here.

Committee Member Calvache commented to Simpson and Simpson that they had named several responsibilities for the Committee. She further stated that the Board had no knowledge of the draft presented before the Board or whom Simpson and Simpson had spoken to or worked with regarding the information presented to the Board. She also commented to Simpson and Simpson that there were several items that had not been completed. She expressed that by not being made aware beforehand, this was overwhelming.

Chairperson McCallum II interjected that this is not just not an oversight of these procedures noting that they are already behind, he pointed out that the procedures have already taken place. He also stated he is not familiar with the policies and procedures in terms of how the audits are conducted. He stated he felt this is the first place the Committee has to start and noted they are looking at a considerable amount of work and time.

Mr. Rozanski asked if he could make a few comments and address Chairperson McCallum II concerns and comments to put the Board at ease about the presentation placed before them.

Mr. Rozanski continued, that these requirements for Sarbanes Oxley are voluntary as it relates to our organization. He said it is not mandated that we follow the procedures, but it is the choice of the Audit Committee. He said that we have been operating in a way that is normal for other entities, wherein management works with the auditors. He continued to say that with the heightened concerns in the public sector where companies are selling stock and all the issues that have risen in the last several years, it is intended that Sarbanes Oxley place the responsibility on the Audit Committee. He further commented, the belief is at that level the responsibility goes right to the top and, therefore, it may strengthen the controls surrounding the organization as a whole. He further added, if the Audit Committee would like to consider moving through that process and take responsibility under Sarbanes Oxley whether it be full responsibility for all the elements that are applicable or portions thereof, that would be something needed for discussion by the Board. He suggested that the Board ask for assistance and guidance from the auditors on how that process could be put in place.

Chairman McCallum II agreed with Mr. Rozanski and stated that the Board should set up some charter responsibilities and review the complete responsibilities of an audit committee based upon Sarbanes Oxley. He felt that there were some key issues which as a fiduciary responsibility to the Board the Audit Committee should be particularly concerned about such as oversight, possible theft and fraud, integrity of the audit and selection of the auditors.

Committee Member Calvache responded and agreed with Chairperson McCallum II. She further commented and emphasized that there were several responsibilities that Simpson and Simpson read to the Board that she was not aware of. She also mentioned that Mr. Rozanski had mentioned that the Board worked under normal operations when management works with the auditors and wanted an explanation of what was meant by “normal”.

Mr. Rozanski explained, typically what happens is at the end of the year, and throughout the years in some cases as it relates to the Department, there are reviews that take place either quarterly or on an annual basis. The auditors come in and review all of the controls as it relates to the recording of the transactions from an accounting perspective. He said, in addition, they conduct tests on a statistical sampling type basis to assure themselves that there are no material misstatements in the financial statements and on that basis they then issue reports to the Board or in this case, the Audit Committee that would say that in the event that they did find some material weaknesses they would be obligated to bring those to the Board or Audit Committee’s attention. He gave an example of findings that there were weaknesses in controls as it relates to disbursements, which may lead to possible theft or loss of funds. He added, generally it would be incumbent upon management to respond on what measures or steps to put in place to insure that do not happen. He expressed often times they make recommendations in terms of specifics such as, there should be a segregation of duties, etc. He further commented, usually there are adjustments that may need to be made because errors are made and, to the extent that they find problems or errors with these transactions, they may expand the scope of their audit because of concerns that this may be a serious problem. He commented that if this occurs, they then sit down with management and adjustments have to be made. He continued that if management agrees with their adjustments, there would probably be no harm no foul. He explained if management does not, then it is a matter that could be construed as an issue. He said generally if the controls are okay and there are no issues that come up, then they would issue what they call an unqualified opinion which is consistent with what Mr. Simpson had indicated, which means in effect that you have a clean bill of health as if relates to no material misstatements in the financial statements.

Committee Member Calvache asked Simpson and Simpson how often the audit is conducted and for what period and length of time and what time of year.

Mr. Simpson responded, it was conducted annually.

Miss Yuen responded that normally they begin the audit in mid August and complete the audit by mid September, which is approximately a 4-week period. She continued that they also have to wait for the actuary report and the approval from the Board in order to finalize the report.

Chairman McCallum II, indicated that he would like a calendar of when the actuary is engaged, the start of the preparation for the audit, and the Department Heads that are involved, so that the process of looking at the integrity of our internal sources can begin. He commented that a good portion is to look at the charter so that we can list our responsibilities and determine what portions pertain to staff and make sure we are comfortable with that and which portion the actuary adheres to.

Committee Member Calvache commented that she wanted to feel comfortable with what Simpson and Simpson had done and what the Audit Committee had been told in order to approve the audit report. She also inquired, when a draft was mentioned, did this draft go to management before it came before the Board and then management has the opportunity to give input.

Mr. Simpson responded in the affirmative and expressed that this is to make sure that they are in agreement with the disclosures in the report, the numbers, and the financial statements etc. He further commented, on the purpose of Sarbanes Oxley and what it attempted to do. He explained that because of the significant corporate failures over the last few years, what was revealed was a gap in internal controls between management of the organization and the Board of Directors. He further elaborated, in many of the corporate failures, management perpetuated the flaw in financial reporting and the Board was not able to catch that because there were no internal controls between the Board and management. He explained that in the Board's Charter responsibilities, the most significant aspect of this responsibility is the assessment of risks. He explained it was necessary to assess risks, which could prevent management from reporting fraud, and to determine what are the incentives for management to do that. He further explained that once those incentives are dealt with, the Audit Committee has followed the necessary process to detect if there was any fraud in respect to the financial report. He continued that with the internal control assessment, the risk there would deal with fraud below that level and their responsibility as auditors was to test internal controls to make sure that issues in which there are weaknesses in internal control do not go undetected with the result of fraud. He reiterated that it was the auditor's responsibility. He further stated they had seen no internal control weaknesses and believed controls are in place to protect the assets of the Plans.

Committee Member Calvache asked if the audit has been going on for many years.

Mr. Simpson responded in the affirmative.

Committee Member Calvache asked Mr. Rozanski if the Board has had an audit committee before.

Mr. Rozanski responded, he was not sure if the Retirement Plan had one, but he assured Committee Member Calvache that the Department's Board has an audit committee that has been in place for many years. He also commented that in light of all that has happened in corporate america it has become a big issue and so a lot of entities, whether they are required to or not, are taking a hard look at some of the responsibilities under Sarbanes Oxley just as this Committee is doing by trying to make sure that they fully understand what the responsibilities are and so that they are properly discharged.

Committee Member Calvache inquired if the Audit Committee would meet again after Simpson & Simpson provides the Committee with a list of their responsibilities of the Audit Committee.

Chairperson McCallum II suggested that after they receive the list from Simpson & Simpson, another Audit Committee should be set. They will then look at the full gambit of Sarbanes Oxley and determine the responsibilities of the Audit Committee.

The Board acknowledges Simpson and Simpson and thanked them for attending the meeting.

Committee Member Calvache thanked the Board and the meeting was adjourned at 10:31 a.m.

GERARD MCCALLUM II Chairperson	LILLY CALVACHE Committee Member
IRENE COLON Acting Secretary	ROSANN LOPEZ Recording Secretary