

**MINUTES OF THE
TEXAS MUNICIPAL RETIREMENT SYSTEM
Finance & Audit Committee of the Board of Trustees**

September 6, 2007

On September 6, 2007, the Finance & Audit Committee (Committee) of the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a meeting at 2:34 p.m. at TMRS Headquarters, located at 1200 North IH 35, Austin, Texas, with the following members present:

Finance & Audit Committee

Roy Rodriguez, Chair
April Nixon

Present also were:

Eric Henry, Executive Director
Rhonda Covarrubias, Director of Finance
Gary Craig, Director of Investments
Eric Davis, Deputy Executive Director
Bernie Eldridge, Director of Human Resources
David Gavia, General Counsel
Nancy Goerdel, Investment Officer
Patricia Brown, Executive Assistant
Terrence Kendall, Legal Counsel
Steve Harding, Independent Fiduciary Services
Bob Klausner, Klausner & Kaufman, PA

The meeting was called to order at 2:34 p.m. and Ms. Nixon gave the invocation.

Consider and Act on Adoption of Minutes of August 16, 2007 Board of Trustees Finance & Audit Committee Meeting

Mr. Henry introduced this agenda item. Mr. Rodriguez announced that he had no corrections to the minutes of the August 16, 2007 meeting, and asked Ms. Nixon for comment. She also had no questions or comments, accepting the minutes as presented at the meeting.

Ms. Nixon moved to adopt the minutes of the August 16, 2007 Finance & Audit Committee meeting; Mr. Rodriguez seconded the motion, which carried unanimously.

Update on Internal Auditor Position

Mr. Eldridge stated that he worked with Mr. Harding to adjust the internal auditor position description and has posted that position on numerous websites, both state and national. Several applications have been received; only two contain the necessary minimum qualifications for the position. Additional postings of the position on other websites and news publications may be made before the position is filled.

Consider and Act on Amendment to Finance & Audit Committee Charter

Mr. Henry introduced this item and asked Mr. Gavia to lead the discussion. Mr. Gavia explained the following changes to the charter:

- the Committee will consist of three members of the Board of Trustees, rather than two;
- except for matters dealing with hiring and dismissal of the internal auditor, Committee action will require the concurrent vote of at least two members;
- the Committee will have the authority to hire and dismiss the internal auditor with such action requiring the concurrent vote of all three members of the Committee; and
- the Committee will consult with TMRS staff as necessary and as stated in the *TMRS Compensation Administration Guidelines*.

Mr. Henry commented that the requirement that Committee action on the internal auditor be by unanimous vote was added at Mr. Simpson's request. Mr. Henry also stated that the position will report to the Committee, but will work daily with the Executive Director.

Ms. Nixon moved to adopt the suggested changes to the Committee charter and to recommend these changes to the full Board for approval; Mr. Rodriguez seconded the motion, which carried unanimously.

External Auditor Presentation: KPMG

At this time, Chris Stone, Sandra Traub, and Susan Warren of KPMG began their presentation to the Committee regarding their proposal to provide external auditing services to TMRS.

Ms. Warren stated that KPMG has considerable experience auditing public and private pension plans. The firm provides specialized pension audit training to its employees. Locally, the firm currently provides auditing services to the Texas County and District Retirement System (TCDRS), Capital Metro, and the City of Austin retirement system, among others. The team that would be working with TMRS was introduced. KPMG has an office in Austin consisting of several partners, auditors, and support staff. Ms. Warren, the audit partner who would be in charge of this engagement, offices in KPMG's Austin office.

Ms. Warren discussed how any new asset allocation or alternative investing by TMRS would be handled by KPMG, along with any changes in actuarial funding methods. Additionally, KPMG has worked with the System's actuary (The Segal Company) in the past.

Ms. Traub then discussed her firm's proposal regarding TMRS. When warranted, a management report or letter would be presented to TMRS at the end of the audit. The audit partner would attend a minimum of two meetings; more if necessary and if requested by the Committee.

Ms. Warren discussed the fee range proposed by KPMG.

Ms. Warren then answered staff questions that had been provided to KPMG earlier. Mr. Harding asked questions regarding auditing procedures relating to discovery of fraud, year-end trading, and audit adjustments. Mr. Henry asked if KPMG performs internal control reviews;

Ms. Warren answered affirmatively. He also asked how KPMG will be able to ascertain whether TMRS is utilizing the correct actuarial methods; Ms. Warren stated that KPMG's actuary will review the actuarial valuation, actuarial assumptions, and perform other procedures, but will not perform another separate actuarial valuation. Mr. Klausner asked at this time if KPMG is familiar with cash balance plans, to which Ms. Warren responded yes, as the firm works with

TCDRS, the 'sister' plan to TMRS. Another question directed toward the firm centered on staffing given that KPMG would be auditing TCDRS at the same time as TMRS; Ms. Warren stated there were no staffing issues at this time and she did not anticipate any in the future. After some general discussion, the KPMG representatives concluded their presentation and left the room.

External Auditor Presentation: Deloitte & Touche LLP

Julia Petty and Dena Jansen represented Deloitte & Touche LLP (D&T) during this presentation. Ms. Petty works in the Houston office and has worked with the firm for eighteen years; she has a public sector background. Ms. Jansen works in the Austin office and has worked on the TMRS engagement for four years.

Ms. Petty explained that D&T is dedicated to client service, and that there are strong controls in place to insure independence. As the firm takes a risk-based approach, the firm's auditors work with the client to determine where potential risk areas may be. Deloitte & Touche performs an information systems risk control audit before the general audit begins. In discussing personnel on the team, Ms. Petty stated that this includes financial auditors, information systems auditors, and internal actuaries. Deloitte & Touche does not believe it is necessary to rotate auditing firms to maintain independence and to insure that the audit is being performed by a 'fresh set of eyes.' Deloitte & Touche accomplishes this by periodically rotating the partner in charge of the audit off of the engagement. The System benefits from this by eliminating the transition costs associated with bringing in a new auditor.

Ms. Jansen then explained the audit process or plan. Ms. Petty stated that D&T expected to attend quarterly Committee meetings, but would meet with the Committee as often as it requested. She also stated that the fee D&T set out in the proposal is negotiable. Ms. Petty then responded to staff questions which had been previously provided to D&T. After additional discussion, the D&T representatives concluded their presentation and left the room.

At this time, a discussion of both firms was held by the Committee, staff, and consultants. Mr. Rodriguez asked how often the auditor would meet with TMRS, to which Mr. Harding responded at least twice per year, and that going forward, any external audit firm will now begin interacting with the newly formed Committee, not just with staff as in prior years.

Ms. Covarrubias suggested that the firm might attend the March Committee meeting and walk the Committee through the audit plan at that time (with the audit commencing in April); the firm could then attend the June Committee meeting to present the audit findings at that time.

It was noted that KPMG appeared to have slightly stronger pension auditing credentials and that the presence of the KPMG partner being located in Austin was a plus. Having a 'fresh set of eyes' audit TMRS, i.e. having a new audit firm to audit TMRS was also a positive.

As a result, Ms. Nixon moved that the Committee recommend to the full Board that KPMG be engaged as the external auditor for TMRS beginning with the 2007 audit, provided a reasonable fee is negotiated with the firm; Mr. Rodriguez seconded the motion, which carried unanimously.

At this time, Mr. Harding updated the Committee on the calendar and task matrix and recommended, for inclusion on a subsequent Committee meeting agenda, (1) review of proposed 2008 budget, (2) status of internal auditor hiring process, and (3) renewal of depository and trust agreement.

There being no further business to come before the Committee, the meeting was adjourned at 5:15 p.m.

Eric Henry
Executive Director
& Chief Investment Officer

Roel 'Roy' Rodriguez, PE
Committee Chair