

DELAWARE STATE EMPLOYEES PENSION FUND  
AUDIT COMMITTEE MINUTES APRIL 26, 2005  
WILMINGTON, DELAWARE

ATTENDEES:

AUDIT COMMITTEE

Robert Allen  
Bill Markell  
Joel Poorman

PENSION OFFICE

David Craik  
Kim Vincent  
Alice Simon  
Kathy Kunkle

Present for portions of the meeting:

KPMG

Fran Murphy  
Evelyn Zerener

STATE AUDITORS

Ron Draper  
Candace Casto

OTHER:

Marsha Kramarck, Deputy Attorney General  
Rob Gooderham, Ashford Capital Group

The primary purpose of the meeting was to discuss the audit plans for fiscal year 2005. In addition the Audit Committee was briefed on the status of the Governance Committee, the Disability Project and a new investment vehicle the Fund will be using.

I. AUDIT PLAN FISCAL YEAR 2005

- This year the Pension Fund [Fund] will use a new public accounting firm, KPMG. KPMG has performed the State of Delaware audit for the past four years but has not been used before by the Fund. They will use their own personnel to perform both the financial and information technology audits. The State Auditors will review all their work but not assist in the information technology audit as they have in prior years. The report will be signed only by KPMG and not jointly with the State Auditor.
- Fran Murphy reviewed the audit objectives, which will highlight People Soft applications and internal controls. KPMG will advise of any recommendations for improvements in the Fund's internal controls. Murphy also outlined KPMG's audit approach and methodology, which includes having a "Concurring Review Partner" objectively review the procedures and findings.

- The engagement letter is still being finalized by the State Auditors Office and should be issued by the end of April.
- David Craik reviewed the current status on the recommendations made in the 2004 audit Management Letter from The Siegfried Group. Basically all seven items have been implemented.
- During fiscal year 2005, there have been no changes in Pension Office personnel; however, there is a new accounting/reporting system that has been implemented by the custodian bank in January and the custodian for international securities was changed from State Street to Bank of New York in November 2004. There are no new accounting regulations, which will impact the Fund in 2005.
- The timeline for the audit field work will be-----information technology to be done in June; financial audit field work will start the first week of August [Evelyn Zerenner will meet with Alice Simon in May to review data required and the desired format to help the Pension Office be prepared for the audit]; draft report is to be ready by September 2, with the report being sent to the printer on September 8; final report submitted to the Board for their meeting on September 30.
- In view of the implementation problems with Mercantile's new Sungard system, Poorman requested a meeting with Mercantile. The annual year-end meeting had been deferred because of Sungard's pending implementation and it now seems appropriate to discuss the issues.
- KPMG personnel left the meeting at this time.

## II DISABILITY PROJECT UPDATE

The current disability coverage for Delaware employees has “no return to work” and rehabilitation clauses; no review after age 60; and payments based on years of service. The proposal is to place disability coverage with a private insurer. Under the proposed new plan the first 20 days would be counted as “sick leave”; over the next 6 months the insurance company would administer a program to pay 75% of salary; after these two periods pay drops to 60% of salary. The State pays for the first two periods [20-days sick leave and 6 months of 75% salary]. The State will fund this program by utilizing approximately one percentage point of the current employer pension fund contribution rate. The thinking is the insurance company will be more successful in getting the disabled workers back to work than the current system. Legislature approval is required to proceed with this project.

## III BEST PRACTICES—GOVERNANCE

Joel Poorman and David Craik brought the Audit Committee up to date on the work being done on governance and the items to be reviewed.

#### IV INVESTMENT ALTERNATIVES

Rob Gooderham of Ashford Capital and Marsha Kramark of the Attorney General's office joined the meeting. Gooderham outlined a new investment vehicle to be used by the Fund---currency futures. Mellon Capital, a Delaware firm, would manage the investment. The futures contracts will be held in a custody account in New England and the traders are located in California. This set up is geographically different than a similar currency futures vehicle Mellon offers in the Cayman Islands.

The attractiveness of this vehicle is two-fold [1] there is a low correlation between the currency market and the equity/fixed income markets and [2] there are "inefficiency" in the currency market where many of the transactions are not motivated by economics. For example, corporations will hedge currency transactions because of their individual exposure. Likewise central banks participate based on their assessment of their individual currency. Neither of these parties' actions is based strictly on the general trends of the currency market thus creating "inefficiency".

Mellon Capital will make currency contracts both long and short to take advantage of the inefficiencies they find in the market. Investment is restricted to eleven major developed currency markets [US dollar, Canadian Dollar, GB Pound, Euro, Swiss Franc, Norwegian Krone, Swedish Kroner, Danish Krone, Japanese Yen, Australian Dollar, and New Zealand Dollar] Similar to the commodity futures with Mount Lucas, Mellon will hold cash in U.S. Government notes to settle the contract at their termination.

Cc: Philip Reese  
David Craik  
Alice Simon  
Members of the Audit Committee