

Audit Committee Meeting

July 2015



Teacher Retirement System of Texas
1000 Red River Street, Austin, Texas 78701-2698

**TEACHER RETIREMENT SYSTEM OF TEXAS
BOARD OF TRUSTEES
AND
AUDIT COMMITTEE**

(Mr. Moss, Chairman; Ms. Charleston; Mr. Corpus; Ms. Palmer; & Ms. Sissney, Committee Members)

AGENDA

**July 24, 2015 – 10:45 a.m.
TRS East Building, 5th Floor, Boardroom**

1. Consider the approval of the proposed minutes of the June 12, 2015 committee meeting – Christopher Moss, Chair
2. Discuss matters related to governance, risk management, internal control, compliance violations, fraud, regulatory reviews or investigations, new and outstanding complaints, fraud risk areas, TEAM Projects risks, audits for the annual internal audit plan, or auditors' ability to perform duties – Ken Welch; David Cook; Adam Fambrough; Jay Masci, Provaliant; and David Roe, Bridgepoint Consulting
3. Receive a presentation from Focus Consulting on the executive evaluation process – Keith Robinson, Focus Consulting
4. Evaluate the performance of the Chief Audit Executive and consider a recommendation to the Board regarding the performance appraisal and compensation of the Chief Audit Executive – Brian Guthrie; Keith Robinson, Focus Consulting

NOTE: The Board of Trustees (Board) of the Teacher Retirement System of Texas will not consider or act upon any item before the Audit Committee (Committee) at this meeting of the Committee. This meeting is not a regular meeting of the Board. However, because the full Audit Committee constitutes a quorum of the Board, the meeting of the Committee is also being posted as a meeting of the Board out of an abundance of caution.

TAB 1



**TEACHER RETIREMENT SYSTEM OF TEXAS
AUDIT COMMITTEE MEETING
June 12, 2015**

The Audit Committee of the Teacher Retirement System of Texas met on Friday, June 12, 2015 in the boardroom located on the fifth floor of the TRS East Building offices at 1000 Red River Street, Austin, Texas. The following persons were present:

TRS Board Members

Christopher Moss, Audit Committee Chair
Nanette Sissney, Board Vice Chair, Audit Committee Member
Anita Smith Palmer, Audit Committee Member
T. Karen Charleston, Audit Committee Member
David Corpus, Audit Committee Member
R. David Kelly, Board Chair
Dolores Ramirez, Board Member
Todd Barth, Board Member

TRS Staff

Brian Guthrie, Executive Director
Ken Welch, Deputy Director
Amy Barrett, Chief Audit Executive
Karen Morris, Director, Pension Audit Services
Hugh Ohn, Director, Investment Audit Services
Jan Engler, Audit Manager, Internal Audit
Dinah Arce, Senior Auditor, Internal Audit
Lih-Jen Lan, Information Technology Audit Manager, Internal Audit
Dorvin Handrick, Information Technology Audit Manager, Internal Audit
Toma Miller, Senior Auditor, Internal Audit
Art Mata, Internal Audit Consultant, Internal Audit
Rodrigo Dominguez, Intern, Internal Audit
Carolina de Onís, General Counsel
Dan Junell, Assistant General Counsel
Beckie Smith, Assistant General Counsel
Heather Traeger, Chief Compliance & Ethics Officer, Legal Department
Don Green, Chief Financial Officer
Jamie Pierce, Director, General Accounting
Cindy Haley, Team Leader, Financial Reporting, General Accounting
Gloria Nichols, Senior Financial Accountant, General Accounting
Scot Leith, Director, Investment Accounting
Sylvia Bell, Director, Operations Group, Investment Division
Eric Lang, Senior Managing Director, Private Equity, Investment Division

TRS Staff (cont'd)

Sharon Toalson, Executive Assistant to the Chief Investment Officer, Investment Division
Barbie Pearson, Chief Benefits Officer
Francis Torres, Assistant Director of Benefit Services
Mike Rehling, Manager, Benefit Processing
Yimei Zhao, Assistant Director of Finance, TRS Health & Insurance Benefits
Jay LeBlanc, Director, Risk Management & Strategic Planning

Other Attendees

Steven Huff, Reinhart Boerner Van Deuren s.c.
Philip Mullins, Texas State Employee Union
Ted Melina Raab, Texas American Federation of Teachers
Angelica Ramirez, State Auditor's Office
Sonya Tao, State Auditor's Office

Audit Committee Chair Christopher Moss called the meeting to order at 8:00 a.m. with a quorum of committee members present.

1. APPROVE MINUTES OF MARCH 26, 2015 AUDIT COMMITTEE MEETING

On a motion by Ms. Anita Palmer, and seconded by Ms. Nanette Sissney, the proposed minutes of the March 26, 2015 Audit Committee meeting were approved as presented.

2. RECEIVE STATE AUDITOR'S OFFICE REPORTS

A. Audit of Incentive Compensation at Selected Agencies

Ms. Angelica Ramirez, Audit Manager, and Ms. Sonya Tao, Project Manager, both with the State Auditor's Office, appeared before the committee. Ms. Tao presented the results of the Audit of Incentive Compensation at Selected Agencies. She stated that the objective of the audit was to determine whether the Teacher Retirement System, the Permanent School Fund, the General Land Office, and the Employees Retirement System calculated and paid incentive compensation in accordance with their policies and procedures for the 2014 plan year. She indicated that no findings were reported for TRS and that the audit showed that TRS awarded and paid incentive compensation in accordance with policies and procedures.

B. Audit of Fiscal Year 2014 Employer Pension Liability Allocation Schedules

Ms. Amy Barrett informed the committee that the State Auditor's Office had not finalized this audit report and would present the results at a future Audit Committee meeting.

3. RECEIVE INTERNAL AUDIT REPORTS ON INDEPENDENT SCHOOL DISTRICT (ISD) AUDITS (Santa Maria ISD Audit, College Station ISD Audit, Presidio ISD Audit, El Paso ISD Audit)

Ms. Barrett began this presentation with a brief review of what led Internal Audit to begin conducting reporting entity audits. She stated that as a result of GASB 68, an accounting pronouncement made by the Governmental Accounting Standards Board (GASB), pension plans

are now required to provide each reporting entity with a carefully determined net pension liability amount to be reported on their financial statements. Additionally, the American Institute of Certified Public Accountants (AICPA) stated that pension plans are responsible for having good internal controls to ensure information being provided from reporting entities is complete and accurate. Ms. Barrett stated that Internal Audit began the ISD audits in order to provide some assurance in this area.

Ms. Dinah Arce provided an overview of the testing that was performed during the audits. She stated that four ISDs were selected for the first round of audits based on the results of a risk assessment conducted by Internal Audit staff. Testing focused on October 2014 payroll and employment after retirement reports submitted to TRS and included comparison to the source documentation from the school districts. Contracts and invoices of contract workers were also reviewed to determine if they were eligible for TRS membership and testing was performed to determine the accuracy of the census data reported to TRS during the month in question.

Mr. Art Mata presented the findings of the four audits. He stated that no errors were found related to the eligibility of contract workers and that all census data information reported to TRS for the test month was complete and accurate. In regard to the payroll and employment after retirement reports, he indicated that one or more errors were identified on reports submitted by all four school districts.

Ms. Barbie Pearson apprised the committee of actions being taken by the TRS Benefits Department to help address the audit findings. She stated that a majority of the errors identified are believed to be the result of the school districts misunderstanding either the specific reporting requirements or the associated TRS laws and rules. As a result, TRS will focus on education and training for reporting entities. She stated that to accomplish this TRS Reporting Entity Coaches are reaching out to each of the audited districts to assist in correcting the identified errors. Additionally, TRS is continuing to provide training classes for reporting officials at all 20 education service centers across the state and is in the process of reviewing and strengthening the training material provided.

Ms. Barrett added that an Employer Audits page has been added to the TRS website where reporting entities can see a list of identified common errors, access self-audit tools that allow them to proactively identify areas where they may be making errors, and an email address where they can submit questions.

4. RECEIVE INTERNAL AUDIT REPORTS

A. Semi-Annual Testing of Benefit Payments (Agreed-Upon Procedures)

Mr. Dorvin Handrick provided a review of the four tests performed during the Semi-Annual Testing of Benefit Payments and then presented the results of this period's testing.

Mr. Handrick stated that the first test focuses on validating the accuracy of annuity payments for recent retirees. This is accomplished, he said, by selecting a random sample of 30 annuity payments issued for recent retirees and agreeing all applicable calculation data with supporting documentation and then performing a recalculation of the annuity amount.

Mr. Handrick stated that the second test validates the calculated expiration dates established for three different annuity payment categories. The categories include guaranteed-period annuity options, disability retirements with less than 10 years of service, and expiration dates currently more than 50 years in the future. Testing involves the recalculation of the expiration date based on supporting documentation and comparing that against the date set in the information system.

Mr. Handrick stated that the third test verifies that recent retirees who are receiving normal-age service retirement benefits met all requirements for normal-age eligibility. This is tested by determining each annuitant's membership tier and evaluating their age and years of service credit against the applicable normal-age retirement eligibility criteria.

Mr. Handrick stated that the fourth test verifies whether manual payments issued during the test period were properly authorized and supported. This test is performed by randomly selecting a sample of 60 manual payments issued during the test period and reconciling the approval and amount of the payment to supporting documentation maintained in the TRS Imaging System.

Mr. Handrick then presented the test results for the current testing period. He stated that one exception was identified related to normal-age retirement eligibility. The error was the result of a transposition of numbers related to the birthdate of the retiree that resulted in the retiree being allowed to retire two months prior to reaching normal-age eligibility. He stated that management has agreed with the finding and has made changes within the information system that would prevent this error in the future. Additionally, management is working with the retiree to address any overpayments that may have resulted from this error.

B. Quarterly Investment Testing (Agreed-Upon Procedures)

Ms. Barrett presented the results of the Quarterly Investment Testing. She stated that no issues were identified for the quarter.

5. RECEIVE REPORTS ON THE STATUS OF PRIOR AUDIT AND CONSULTING RECOMMENDATIONS

During her review of outstanding audit recommendations, Ms. Barrett noted that three items turned orange this quarter indicating that they are past due for implementation. She stated that these recommendations were related to the audit of purchasing and contract administration and that Internal Audit believes that moving the implementation date out is appropriate as the agency is undertaking a thorough process to update the contract administration manual agency wide.

6. DISCUSS OR CONSIDER INTERNAL AUDIT ADMINISTRATIVE REPORTS AND MATTERS RELATED TO GOVERNANCE, RISK MANAGEMENT, INTERNAL CONTROL, COMPLIANCE VIOLATIONS, FRAUD, REGULATORY REVIEWS OR INVESTIGATIONS, NEW AND OUTSTANDING COMPLAINTS, FRAUD RISK AREAS, AUDITS FOR THE ANNUAL INTERNAL AUDIT PLAN, OR AUDITORS' ABILITY TO PERFORM DUTIES

Ms. Barrett reported that the department is on track to complete the audit plan with the possible exception of the Actuarial Data Controls Audit, which may be reported in November rather than September.

Ms. Barrett also informed the committee that she is in the process of developing the Fiscal Year 2016 Audit Plan and would be setting up phone conversations with each of the trustees to obtain their input.

Ms. Barrett stated that the department was on task to accomplish their performance measures with the exception of one measure. Rather than engage a service provider to conduct a health care audit, the department hired Ernst and Young (EY) to help build out data analytics capabilities that will include the health care area.

Ms. Barrett also informed the committee that Internal Audit is developing a request for qualifications (RFQ) for audit services expected to be posted by mid-September. She stated that the department posts an updated RFQ every four years.

Lastly, Ms. Barrett recognized several staff accomplishments for the quarter.

The meeting adjourned at 9:05 a.m.

Approved by the Audit Committee of the Board of Trustees of the Teacher Retirement System of Texas on the 24th day of July, 2015.

Attested by:

Christopher Moss
Chair, Audit Committee
Board of Trustees
Teacher Retirement System of Texas

TAB 2

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TAB 3



Executive Assessment Overview

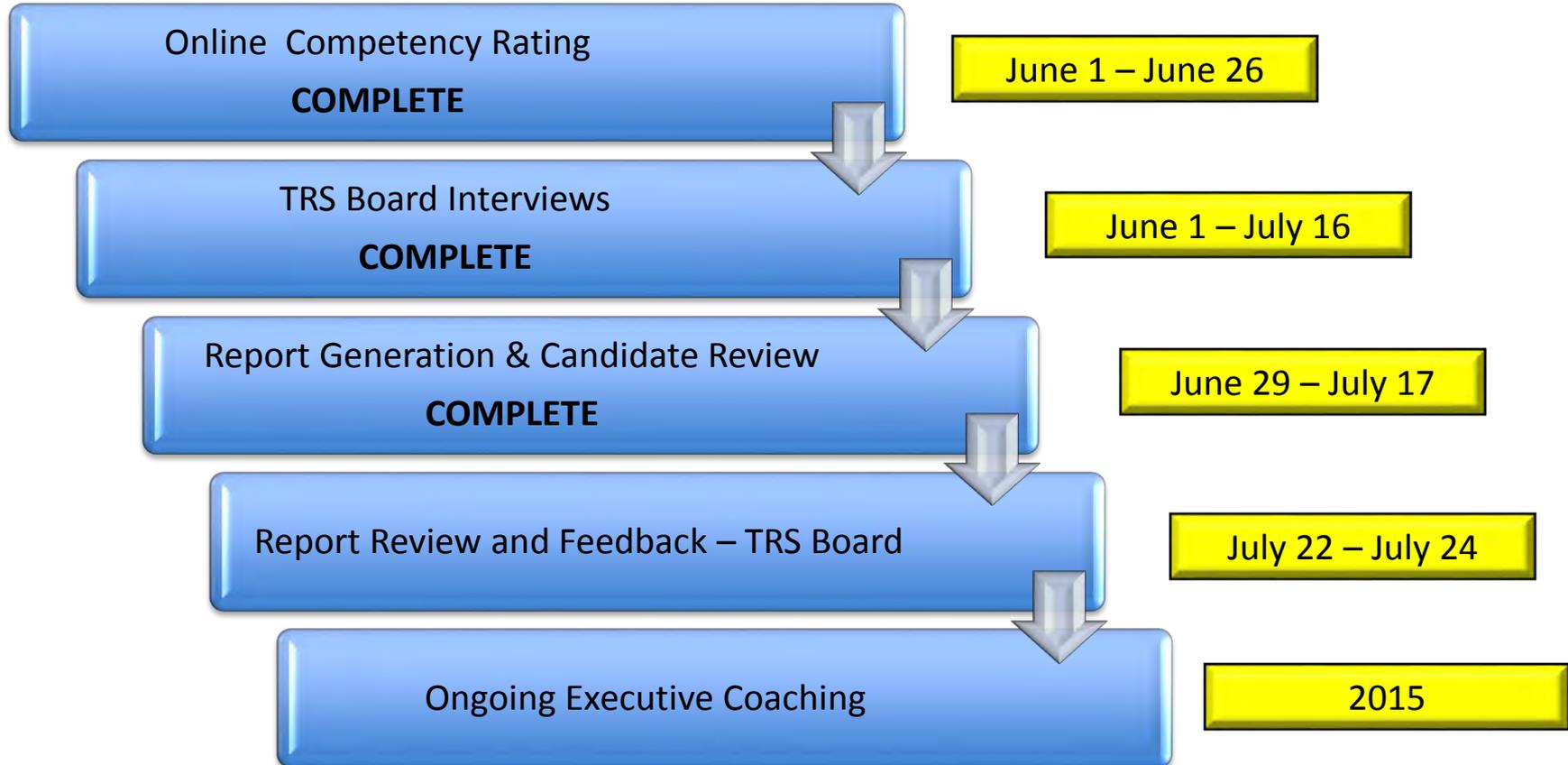
Teacher Retirement System of Texas

July 2015

TRS Leadership Assessment Process

- **Process was initiated with TRS in 2013**
- **Participants:**
 - Brian Guthrie – Executive Director
 - Britt Harris – Chief Investment Officer
 - Amy Barrett – Chief Audit Officer
- **Customized for TRS:**
 - Competency descriptions reflect TRS Agency specifics
 - Phone interviews with TRS Board members
- **Key Outcomes:**
 - Executives continue to develop and increase in competency
 - 2015 is highest performance year to date
 - Executives scores are among the highest in FCG data base of comparable leadership positions
 - Executive coaching for development

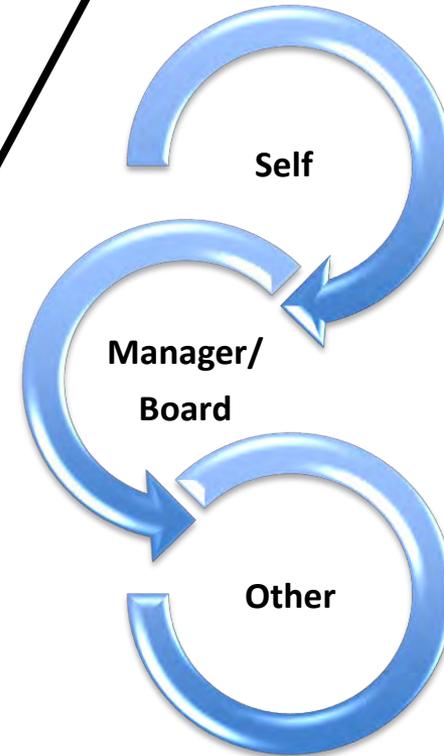
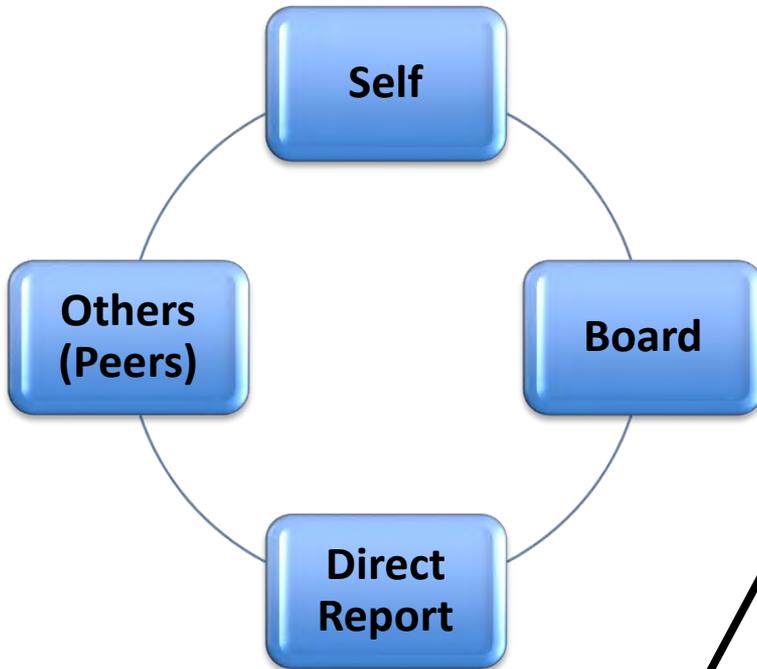
TRS Leadership Assessment: Process Steps & Timeline



TRS Leadership Assessments - Input

Competency

Online 360 Degree Assessment



Contribution

Interview and Manager based

TRS Leadership Rating Scales - Input

Scale	Competency <i>"Candidate demonstrates this behavior..."</i>	Contribution <i>"On this goal candidate..."</i>
5	To a very great extent	Far exceeded expectations
4	To a great extent	Exceeded expectations
3	To some extent	Met expectations
2	To a little extent	Partially met expectations
1	Not at all	Did not meet expectations

TRS Leadership Contribution Sample, Not real executive data

Contribution Goal – Brian	Score
Sustain a financially sound pension trust fund. Continue trust fund earnings growth. Maintain an effective working relationship with legislative stakeholders on trust issues.	Board: 4.38 Self: 4.50

Contribution Goal – Britt	Score
Effectively manage investment risks for the Investment Management Division <ul style="list-style-type: none">• No significant risk violations in the performance year.• Maintain a transparent and high quality risk management approach as assessed by the risk committee.• Monitor and manage risks with a high level of quality.• No significant risk findings from audits.	Board: 4.13 Manager: 5.00 Self: 4.00

TRS Sample Competencies: Three Hats of Leadership – Executive Director

Leads the Agency

**Broader firm wide
impact**

1. Client Focus
2. Servant Leadership
3. Builds Agency Talent
4. Strategic Thinking
5. Effective Decision Making
6. Drives Agency Vision

Leads the Team

**Tactical team
management**

1. Develops Others
2. Effective Collaboration
3. Conflict Resolution
4. Provides Direction
5. Priority Setting

Leads the Self

Personal effectiveness

1. Ethical and Value Centered Leadership
2. Integrity and Trust
3. Learning Agility
4. Listens Actively
5. Self Awareness

TRS Leadership Assessments – Output Sample

Not real executive data

Name	Competency			Contribution
Brian Guthrie	Leads Self	Leads Team	Leads Agency	Performance Goals
Overall Avg	4.08	4.18	4.08	4.08
Self Evaluation	4.12	4.60	4.30	3.83
Board Evaluation	4.20	4.30	4.23	4.08
Direct Reports Evaluation	4.08	3.92	3.97	n/a
Other Evaluation	3.90	3.90	3.80	n/a

Leadership Personality – Output Sample



Questions & Comments

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