

Audit Committee Meeting

June 2016



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; Vacant Position, Committee Members. Committee members subject to change at the June meeting.)

AGENDA

**June 17, 2016 – 8:00 a.m.
TRS East Building, 5th Floor, Boardroom**

1. Approve minutes of April 7, 2016 Audit Committee meeting
– Christopher Moss, Chair
2. Receive reports on the TRS Internal Audit Quality Assurance and Improvement Program (QAIP)
 - A. External Assessment – Benito Ybarra, TxDOT
 - B. Self-Assessment – Amy Barrett
3. Receive reports on Investment Audits and Compliance
 - A. State Auditor’s report on the Audit of Incentive Compensation at Selected Agencies – Michael Clayton, State Auditor’s Office
 - B. Internal Audit’s Testing of Performance Incentive Pay Calculations (Agreed-Upon Procedures) – Hugh Ohn
 - C. Quarterly Investment Compliance Testing (Agreed-Upon Procedures) – Hugh Ohn and Heather Traeger
4. Receive reports on TRS-ActiveCare Open Enrollment and Billing Issues and Status, including matters related to risk management, internal controls, and information security – Amy Barrett and Katrina Daniel; Greg Wood, Aetna; and Neil Masterson, EY
5. Receive reports on Employer Audits
 - A. Summary of Employer Audit Results – Dinah Arce and Art Mata
 - B. Audit of Manor Independent School District – Dinah Arce and Art Mata
 - C. Audit of Liberty Hill Independent School District – Dinah Arce and Art Mata
 - D. Audit of Beaumont Independent School District – Dinah Arce and Art Mata
 - E. Audit of Daingerfield-Lone Star Independent School District – Dinah Arce and Art Mata
6. Receive reports on outstanding recommendations
 - A. Status of prior employer audit recommendations – Barbie Pearson and Melody Austin
 - B. Status of prior audit and consulting recommendations – Amy Barrett
7. 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 – Christopher Moss, Heather Traeger and Amy Barrett

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
April 7, 2016**

The Audit Committee of the Board of Trustees of the Teacher Retirement System of Texas met on Thursday, April 7, 2016 in the boardroom located on the fifth floor of the East Building of TRS' offices located at 1000 Red River Street, Austin, Texas 78701. 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
Joe Colonna, Board Member

TRS Staff

Brian Guthrie, Executive Director
Amy Barrett, Chief Audit Executive
Hugh Ohn, Director, Investment Audit Services
Jan Engler, Director, Benefit Audits
Dinah Arce, Senior Auditor, Internal Audit
Cari Casey, Internal Audit Consultant, Internal Audit
Lih-Jen Lan, IT Audit manager, Internal Audit
Rodrigo Dominguez, Intern, Internal Audit
Britt Harris, Chief Investment Officer
Jerry Albright, Deputy Chief Investment Officer
Barbara Forsell, Senior Associate, Investment Operations
Barbie Pearson, Chief Benefit Officer
Adam Fambrough, Manager, Benefit Processing
Don Green, Chief Financial Officer
Chris Cutler, Chief Information Officer
Billy Lowe, Director of Information Systems Support & Development
Kyle Weigum, Director, Network Infrastructure and Support
Lance Rayborn, Manager, Voice and Data Services
Teresa Granger, SharePoint Administrator
Carolina de Onís, General Counsel
Dan Junell, Assistant General Counsel
Ronnie Bounds, Assistant General Counsel
Heather Traeger, Chief Compliance Office, Legal Department

TRS Staff (cont'd)

Lynn Lau, Assistant Secretary to the Board and Program Specialist
Katrina Daniel, Chief Health Care Officer
Yimei Zhao, Assistant Director of Finance, TRS Health & Insurance Benefits
Jay LeBlanc, Director, Risk Management & Strategic Planning
Rhonda Price, Senior Communications Specialist, Communications
Dan Herron, Communications Specialist, Communications

Other Attendees

Philip Mullins, Texas Retired Teachers Association
Ann Fickel, Texas Classroom Teachers Association
Ted Melina Raab, Texas American Federation of Teachers
Josh Sanderson, Association of Texas Professional Educators
Michael Clayton, State Auditor's Office
Benito Ybarra, Texas Department of Transportation
Greg Royal, Texas Department of Insurance
Byron Williams, Oregon State Treasury
Neill Masterson, EY
Lara Perlman, EY
Garrison Phillis, EY
Ron Franke, Myers and Stauffer, LC
Nick Arnold, Humana
Maggie Parker, Aetna
Brad Keoun, McGraw Center

Audit Committee Chair Christopher Moss called the meeting to order at 8:05 a.m. with a quorum of committee members present.

1. APPROVE THE PROPOSED MINUTES OF THE NOVEMBER 20, 2015 AUDIT COMMITTEE MEETING

On a motion by Ms. Nanette Sissney and seconded by Ms. Karen Charleston, the proposed minutes of the November 20, 2015 Audit Committee meeting were approved as presented.

Ms. Amy Barrett introduced three individuals who conducted the external peer review for the Internal Audit Department. She stated that all three are chief audit executives and introduced them as Mr. Bennie Ybarra from the Texas Department of Transportation, Mr. Greg Royal from the Texas Department of Insurance, and Mr. Byron Williams from the Oregon State Treasury. Ms. Barrett stated that the results of the peer review would be reported at the June Audit Committee meeting.

2. RECEIVE STATE AUDITOR'S OFFICE REPORTS

A. Audit of TRS' Comprehensive Annual Financial Report for Fiscal Year 2015

Mr. Michael Clayton, State Auditor's Office, presented the results of the audit of TRS' Comprehensive Annual Financial Report for Fiscal Year 2015. He stated that the results indicated that the financial statements were materially correct and prepared in accordance with Generally Accepted Accounting Principles; therefore, an unqualified opinion was issued. One

significant deficiency identified during the previous year's audit was reported again this year and it was recommended that management strengthen controls around the active member census data from employers to ensure that the information being provided to TRS is complete and accurate. Mr. Clayton stated that the finding should probably be addressed once the TRS Enterprise Application Modernization (TEAM) project is fully implemented.

B. Audit of Net Pension Liability Beginning of Year for Fiscal Year 2014

Mr. Clayton informed the Committee that new auditing guidance required auditors to audit the beginning balance of the net pension liability on the fiscal year 2014 Schedule of Pension Amounts by Employers that was required to be reported under governmental accounting standards. Because auditors had previously audited the ending balance only, they had to go back and test the beginning balance. He stated that an unqualified opinion was issued on the audit of the beginning balance of the 2014 employers' net pension liability. No issues were identified.

3. RECEIVE AN OVERVIEW OF THE TRS-ACTIVECARE ENROLLMENT AND BILLING READINESS REVIEW

Ms. Barrett informed the Committee that Internal Audit has partnered with the Health Insurance Benefits department to hire Ernst & Young (EY) to conduct an open enrollment and billing readiness review of WellSystems, the company subcontracted by Aetna to conduct the enrollment and billing services for the TRS-ActiveCare plan.

Mr. Neill Masterson, Ms. Lara Perlman, and Mr. Garrison Phillis, all with EY, gave an overview of the key areas tested during the readiness review, the process followed, and the reporting timeline.

Mr. Masterson stated that the team will be identifying the root cause for each of the major issues that occurred during the previous year's open enrollment process, reviewing and testing the remediation plans WellSystems and Aetna have implemented, and performing additional tests to determine whether other previously unknown issues need to be addressed.

Ms. Perlman informed the Committee that interviews will be held with five different school districts that experienced difficulties during the past enrollment period. The interviews will allow the team to better understand the issues from the schools' perspective and gain an end-to-end view of the entire enrollment process. Additionally, testing will be performed around third party administrator (TPA) file transfers and the MESA self-service online enrollment portal used by schools. Testing will include data integrity of the electronic files, user-friendliness of the MESA interface, usefulness of reporting provided by WellSystems, data vulnerability, and billing accuracy with special focus on the split billing arrangements.

Mr. Phillis stated that field work was underway and any findings will be validated with management and a final report will be issued with a presentation to the Audit Committee in June.

4. RECEIVE REPORTS ON INFORMATION TECHNOLOGY PROJECTS

A. Audit of SharePoint Governance and Security

Mr. Ron Franke, Meyers and Stauffer LC, presented the results of the SharePoint Governance and Security Audit which was completed in November 2015. He stated that TRS was transitioning from SharePoint 2010 to SharePoint 2013 in May 2015, and the audit focused on those sites that had already been transitioned to the new platform. The objectives of the audit were 1) determine whether TRS policies and procedures for the governance of the use of SharePoint were effective to ensure the consistent implementation of SharePoint, and the availability and confidentiality of the data contained on TRS SharePoint sites, and 2) determine whether the access controls were effective to ensure that only authorized individuals can access data contained on the SharePoint sites.

In regard to the first audit objective, Mr. Franke stated that the development and documentation of policies and procedures was significantly better than what they would have expected. He said TRS was well on track to implement the policies and procedures for the governance and use of SharePoint, particularly policies and procedures for ensuring the availability and confidentiality of data on the SharePoint sites. He recommended that TRS complete the written policies and procedures as planned, implement the planned periodic reviews, and continue efforts to implement a comprehensive set of tools and procedures for monitoring the SharePoint sites.

With regard to the second audit objective, Mr. Franke stated that TRS' policies, procedures and standards for access controls over SharePoint provided reasonable assurance that only authorized individuals could access data on the SharePoint sites. Testing found no instances of inappropriate levels of access or accounts belonging to individuals that should not have had access to the SharePoint sites tested. Mr. Franke said this was noteworthy, as they very seldom find no issues in this area at their audit clients. He reported that they did identify some areas for improvement and made three recommendations. First, TRS should ensure that documentation authorizing access to SharePoint be retained and readily available. Second, TRS should implement periodic reviews of SharePoint accounts that TRS already had planned to do. Third, TRS should consider strengthening security configuration settings as recommended in best practices. Mr. Franke noted that the third recommendation is a risk management decision that should be consistent with TRS' risk appetite.

Mr. Chris Cutler, TRS Chief Information Officer, provided management responses and stated that all improvements would be in place by August 2016. These improvements will include all policies and procedures being finalized and approved with yearly reviews thereafter, enhanced monitoring functions using new tools currently being reviewed, an improved process for standardizing and classifying requests and approvals for system access, and implementation of more complex password requirements.

Ms. Sissney asked if unauthorized and unsuccessful access attempts are being monitored. Mr. Cutler confirmed that the monitoring would be implemented within the August time frame as well. He also noted that TEAM would be using SharePoint as a platform for the reports repository. All internal reports generated from the TEAM application system will be stored, managed and audited through the SharePoint infrastructure, and therefore, being able to monitor SharePoint would continue to grow in importance.

B. Wireless Network Security Assessment (Agreed-Upon Procedures)

Mr. Franke presented the results of the agreed-upon-procedures testing conducted on the wireless network security at TRS. He stated that TRS Information Technology (IT) already had a very strong sense that the wireless network security was strong and they essentially verified what TRS IT already knew. No significant vulnerabilities or issues were identified during testing at either TRS facility location and no recommendations were made.

5. RECEIVE INTERNAL AUDIT REPORTS

A. Semi-Annual Testing of Investment Controls (External Public Markets and Public Strategic Partnership and Research) – Hugh Ohn

Mr. Hugh Ohn presented the results of the Semi-Annual Testing of Investment Controls. He stated that testing focused on controls related to the External Public Markets portfolio and the Public Strategic Partnership and Research portfolio and included the back office functions that provide support for those areas. Mr. Ohn reported that they identified one potential improvement related to the documentation of foreign travels. It was recommended that TRS improve the process to ensure that there are justifications for those foreign travels that exceed the specified travel limits (to be determined by management).

B. Quarterly Investment Testing (Agreed-Upon Procedures)

Mr. Ohn informed the Committee that no errors were identified during the quarterly investment compliance testing. No compliance exceptions or violations were identified. He noted that at management's request, testing this quarter included procedures related to budget transfers and expenditures, and no issues were found in this additional testing.

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

Ms. Barrett reported that several past audit recommendations had been implemented. Two items are indicated as orange, but adequate progress was being made in both areas. The recommendation involving GASB 72 and providing guidance on fair value standards for investments was also in progress. It should be fully implemented this summer. Updating the status of the Reporting Entity Audit Recommendations, she said that four of the five reporting entity audits had been closed. She stated that good progress was being made in following up on the issues identified and getting them implemented.

7. CONSIDER RECOMMENDATION TO THE BOARD OF TRUSTEES REGARDING REVISIONS TO THE AUDIT PLAN FOR FISCAL YEAR 2016

Ms. Barrett presented two proposed changes to the Audit Plan for fiscal year 2016. The first regarded changing the reporting frequency for the agreed-upon-procedures benefit testing. The proposed change would require the reporting to occur once per year rather than twice a year. The testing would cover the same period of time. The second proposed change regarded the addition of testing for the new executive performance incentive pay calculation. Ms. Barrett stated that this testing would be reported in July and would be similar to the regular incentive pay plan testing that already occurs.

Upon a motion by Ms. Palmer and seconded by Ms. Sissney, the Committee voted unanimously to recommend that the Board adopt the proposed revisions to the Audit Plan for fiscal year 2016, as presented by staff.

8. 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 stated that Internal Audit is on track to complete the audits in the Audit Plan. She advised the Committee of several projects that Internal Audit is helping to coordinate that are not included in the Audit Plan. These included an audit of the financial statement of the TRS London Office, the open enrollment and billing readiness review being performed at WellSystems and Aetna, and a possible investment fiduciary review that the State Auditor's Office may perform at TRS. She also reminded the Committee to take a look at the Chief Audit Executive's personal goals and status of these goals.

The meeting adjourned at 9:56 a.m.

Approved by the Audit Committee of the Board of Trustees of the Teacher Retirement System of Texas on the 17th day of June 2016.

Attested by:

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

TAB 2

TAB 2A

2016 Peer Review Results – Internal Audit Department

April 15, 2016



Overall Rating: Pass

Best Practices Identified

- Short/Long term internal audit strategic plan
- Communication of business objectives and associated risks as a result of audit work
- CAE performance evaluation
- Inclusion of staff in audit committee meetings
- Support for staff professional development

Recommendations

- Develop succession plan in consideration of potential retirements and critical skills required to sustain internal audit functions
- Balance between consulting, advisory and audit (direct assurance)
- Develop staffing plan that includes the potential for additional employer related audits
 - 15 of 1,360 (1%) conducted in last 2 years
 - potential for increase in EAR receivables
- Develop crosswalk between professional auditing standards and automated working paper templates

**REPORT ON THE
EXTERNAL QUALITY ASSURANCE REVIEW
OF THE TEACHER RETIREMENT SYSTEM
INTERNAL AUDIT DEPARTMENT**

April 2016



PERFORMED BY

Benito Ybarra, CIA, CISA, CFE
Chief Audit and Compliance Officer
Texas Department of Transportation

Greg Royal, CPA, CIA, CRMA, CGAP
Chief Audit Executive
Texas Department of Insurance

Byron Williams, CPA
Chief Audit Executive
Oregon State Treasury

PERFORMED IN ACCORDANCE WITH THE
STATE AGENCY INTERNAL AUDIT FORUM
PEER REVIEW POLICIES AND PROCEDURES

OVERALL OPINION

Based on the information received and evaluated during this external quality assurance review, it is our opinion that the Teacher Retirement System (TRS) Internal Audit Department receives a rating of “pass” and is in compliance with the Institute of Internal Auditors (IIA) *International Professional Practices Framework* and Code of Ethics, the United States Government Accountability Office (GAO) *Government Auditing Standards*, and the Texas Internal Audit Act (*Texas Government Code*, Chapter 2102). This opinion, which is the highest of the three possible ratings, means that policies, procedures, and practices are in place to implement the standards and requirements necessary for ensuring the independence, objectivity, and proficiency of the internal audit function.

We found that the Internal Audit Department is independent, objective, and able to render objective conclusions on the audit work performed. The staff members are qualified, proficient, and knowledgeable in the areas they audit. Individual audit projects are planned using risk assessment techniques; audit conclusions are supported in the working papers; and findings and recommendations are communicated appropriately.

The Internal Audit Department is well-managed. In addition, the Department has effective relationships with the Board of Trustees and is well-respected and supported by Executive Council management. Surveys and interviews conducted during the quality assurance review indicate that management considers Internal Audit a useful part of the agency and demonstrated a knowledge of the audit team’s mission.

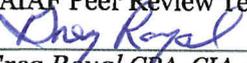
ACKNOWLEDGEMENTS

We appreciate the courtesy and cooperation extended to us by the Chief Audit Executive, Internal Audit staff, the Chairman of the Board of Trustees, the Audit Committee Chair, the Executive Director, and the executive managers who participated in the interview process. We would also like to thank each person who completed surveys for the quality assurance review. The feedback from the surveys and the interviews provided valuable information regarding the operations of the Internal Audit Department and its perceived value to the organization.



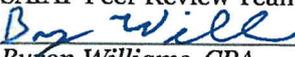
Benito Ybarra, CIA, CISA, CFE
Chief Audit and Compliance Officer
Texas Department of Transportation
SAIAF Peer Review Team Leader

04/15/16
Date



Greg Royal CPA, CIA, CRMA, CGAP
Chief Audit Executive
Texas Department of Insurance
SAIAF Peer Review Team Member

4/13/16
Date



Byron Williams, CPA
Chief Audit Executive
Oregon State Treasury
SAIAF Peer Review Team Member

4/11/16
Date

April 15, 2016

BACKGROUND

The Institute of Internal Auditors (IIA) *International Professional Practices Framework*, U.S. Government Accountability Office (GAO) *Government Auditing Standards*, and the Texas Internal Audit Act require that internal audit functions obtain external quality assurance reviews to assess compliance with standards and the Act and to appraise the quality of their operations. Government auditing standards require these reviews at least every three years. A periodic external quality assurance review, or peer review, of the internal audit function is an essential part of a comprehensive quality assurance program. This quality assurance review was performed in accordance with State Agency Internal Audit Forum (SAIAF) Peer Review guidelines.

The most recent quality assurance review for the Teacher Retirement System Internal Audit Department was performed in June 2013. The Internal Audit Department has addressed the recommendations made in the report on the previous quality assurance review.

OBJECTIVES, SCOPE, AND METHODOLOGY

The primary objective of the quality assurance review was to evaluate the Teacher Retirement System Internal Audit Department's compliance with auditing standards and the Texas Internal Auditing Act. Additional objectives included identifying best practices as well as areas where improvement may be needed. The review covered all completed audit and management assistance projects performed by the Teacher Retirement System Internal Audit Department from *September 1, 2012 through August 31, 2015*.

The work performed during the review included:

- Review, verification, and evaluation of the self-assessment prepared by the Internal Audit Department according to SAIAF guidelines.
- Review and evaluation of e-mailed surveys completed by management.
- Interviews with the Chief Audit Executive, Internal Audit Department staff, the Executive Director, executive managers, and Board members, including the Chairman of the Board of Trustees and the Chairman of the Audit Committee.
- Review and evaluation of audit working papers.
- Review of Internal Audit's policies and procedures, annual risk assessment, annual audit plan, and other relevant documents.

DETAILED RESULTS

The results of the quality assurance review for the Teacher Retirement System Internal Audit Department are presented in the order of the *Standards for the Professional Practice of Internal Auditing*. No significant weaknesses were identified during the review that would prevent the Department from fulfilling its responsibilities. The detailed results include identification of best practices as well as some opportunities for improvement that the Internal Audit Department may wish to consider.

IIA Code of Ethics

Internal Audit demonstrates its commitment to the IIA *Code of Ethics* by including it in the *Internal Audit Charter*, attending periodic ethics training classes, and practicing ethical behavior in the course of daily work. In addition, the Internal Audit Department administers the agency's hotline and works with executive management team members to ensure assignment, performance and reporting of investigations to help ensure organizational commitment to accountability and integrity.

Standard 1000: Purpose, Authority, and Responsibility

The purpose, authority, and responsibility of Internal Audit have been defined in a charter that is consistent with auditing standards. The current charter was signed by the Board and the Executive Director in *September 2014*. It defines the nature of audit and consulting services and grants the Internal Audit Department unrestricted access to agency records, property, and personnel.

Standard 1100: Independence and Objectivity

The Internal Audit Department is independent both in terms of the agency's organizational structure and the Department's practices. The Chief Audit Executive reports functionally to the Board of Trustees, which provides sufficient authority to promote independence and to ensure adequate consideration of audit results and action on audit issues and recommendations.

The charter helps ensure continued independence by specifying that internal auditors must remain free of operational and management responsibilities that could impair their ability to make independent reviews of all areas of the agency's operations. None of the internal auditors has had prior responsibility for any areas that the Department audits. In addition, auditors are required to disclose potential impairments to their independence and objectivity, based on audit work scheduled to be performed.

Recommendation:

Establish the appropriate balance between advisory/consulting engagements and assurance/audit engagements. Internal audit reports the activities associated with providing advisory/consulting services, and the trend indicates a consistent reliance by management for this level of service. TRS management indicated a continuing appetite for advisory/consulting engagements and appreciates the objective input received from internal audit; however, it is important for an appropriate balance to be established to assist in capacity management, resource planning and to account for potential impairments to audit staff objectivity.

CAE's Response:

We agree with this recommendation. While our audit plan is designed to achieve what we believe to be an appropriate balance between audit and consulting, obtaining specific input from stakeholders in this area and discussing any limitations would be beneficial to ensuring

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our work is of highest value. Therefore, we will meet with key stakeholders in June to have these discussions and agree on audit versus consulting allocation targets. Implementation date is June 20, 2016.

Standard 1200: Proficiency and Due Professional Care

The internal auditors individually and collectively possess the knowledge, skills, and abilities to perform their responsibilities. All full time staff have at least one relevant professional certification. Internal auditors are required by the Department's policies and procedures to enhance their knowledge, skills, and abilities by obtaining continuing professional education, consistent with their certifications and performance evaluations each year. The Department has hired contractors to assist in areas for which its expertise or resources have not been sufficient to satisfy the audit objectives.

Recommendation:

Develop a resource and succession plan in consideration of potential attrition and loss of critical skills required to sustain internal audit functions. In addition, there is an opportunity to realize an increase in revenue/receivables by increasing the focus on employer audits. During the last two fiscal years, the Department conducted 15 of 1,360 (1%) potential employer audits.

CAE's Response:

We agree with this recommendation. We have also identified the need for enhanced succession planning as part of our strategic plan and have taken steps to realign the department to enhance the subject matter expertise, hire staff auditors, and create a career path. In order to continue these efforts, we will develop a more formal plan for succession and for conducting additional employer audits and providing other services, if desired by key Stakeholders. Since employer audits constitute a relatively new program of the department, our focus has been on developing tools and educating employers. We are planning additional coverage in the future as the program becomes well-established and additional data is collected by TRS through its new benefits reporting application. Implementation of the formal succession plan and plan for additional employer audits will be implemented by August 31, 2016.

Standard 1300: Quality Assurance and Improvement Program

The Chief Audit Executive has implemented a quality assurance and improvement program to help ensure that Internal Audit adds value and improves the agency's operations and to provide assurance that the Department complies with *Standards* and the IIA Code of Ethics. The quality assurance program involves an evaluation of past peer review recommendations, review of working papers, policies, procedures and includes recommendations which require the approval of the Chief Audit Executive. In addition, the results of peer reviews are communicated to the Board of Trustees and Executive Management. Each audit report indicates that the work was performed in accordance with *Standards*.

Standard 2000: Managing the Internal Audit Activity

The Chief Audit Executive conducts an annual risk assessment that forms the basis for the Annual Audit Plan, which is approved by the Board of Trustees. Each internal audit report addresses risk and control issues within the agency. The Director has developed policies and procedures to guide the internal audit activity. The Director reports the Department's performance relative to the annual plan in an annual report submitted to the agency's Executive Director and Audit Committee Chair, and in an Annual Report on Internal Audit submitted to the Governor's Office, Legislative Budget Board, Sunset Advisory Commission, and the State Auditor.

Standard 2100: Nature of Work

Internal Audit evaluates risks related to the achievement of the agency's business objectives and tests activities to assess alignment with the agency's mission. The Department also contributes to the organization's risk management and governance processes through serving as non-voting representatives of TRS committees and workgroups such as the Risk Oversight Committee, TEAM Executive Steering Committee, and Fraud and Ethics Hotline Triage Team; and, by providing consulting and advisory services.

Standard 2200: Engagement Planning

During planning, internal auditors consider the business objectives of the activity being reviewed and the related contributing activities, risks and controls. Resources needed for each audit are considered during planning. Risk assessments are used to develop the objectives of each audit. Surveys and interviews conducted during this quality assurance review indicated that input is requested of the management team and the objectives of audits are clearly communicated to the client. An Audit Plan and an Audit Program are documented and approved for each audit. The scope of audits is adequately planned and documented in planning documents and audit reports.

Standard 2300: Performing the Engagement

Internal auditors evaluate and document sufficient, reliable, and relevant information to achieve their audit objectives. Results and conclusions are based on analysis, observation and testing of key activities and controls.

Audits are supervised by the Chief Audit Executive. The managers overseeing each project monitor the progress of the individual audits and ensure appropriate evidence is obtained and documented to provide assurance regarding the condition of the audited processes. In addition, the Chief Audit Executive attends planning meetings, approves control documents, and reviews working papers to ensure sufficiency of evidence and compliance with *Standards*.

Recommendation:

Develop and implement completion of a crosswalk between professional auditing standards and automated working paper templates. References to professional auditing standards were unavailable during reconciliation between working paper templates and professional auditing standards and we noted instances where steps related to the standards were not included in the working papers.

- PS 2210.A2 and GAGAS 6.28 require that auditors determine which laws, regulations and provisions of contracts are significant within the context of the audit, and to then design and perform procedures to detect instances of violations.
- GAGAS 6.13-6.15 requires the auditors to obtain an understanding of the nature and profile of the programs and the needs of potential users of the report. The need of potential users of the report was not found in the audit engagements.

The exclusion of these steps did not create a material impact to the conclusions reached in the audits reviewed; however, ensuring the completeness of the crosswalk can help reduce the risk of material omissions and further strengthen compliance with auditing standards.

CAE's Response:

We agree with this recommendation. Until a few years ago, we maintained a crosswalk of audit standards to steps performed in our work papers but removed them when we decided it was overly burdensome to maintain. This decision made sense at the time as our audit staff

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was experienced and understood the standards well. However, as we bring new staff into the audit function, ensuring that adequate documentation and understanding of the standards can be better facilitated with a crosswalk. Additionally, we do maintain a step in our work papers regarding considering state and federal laws during planning. However, we do not include the specific language in the step stated in the government auditing standards referenced above. We will incorporate the government auditing standards language and the crosswalk into our work paper template by August 31, 2016.

Standard 2400: Communicating Results

Audit results are communicated in a timely manner and provide management the opportunity to provide additional information and/or to start taking corrective action. Audit results are presented to management before they are finalized in a report, which helps ensure there is agreement about the areas for improvement and the recommended solutions.

Audit reports contain the audit objectives, results, conclusions, recommendations, and management's responses and action plans. The results of our surveys and interviews with management indicated that internal audit reports are accurate, objective, clear, concise, and complete. The Chief Audit Executive distributes internal audit reports to the Board of Trustees, Executive Management, which include management responses and actions of the activity being audited.

Standard 2500: Monitoring Progress

The agency has a system for monitoring the disposition of audit issues. Additionally, the Department verifies recommendations that have been implemented. The status of management's progress in implementing recommendations is reported during audit committee meetings, and the results are accessible to TRS management.

Standard 2600: Resolution of Senior Management's Acceptance of Risks

During the quality assurance review, no instances were identified of management accepting an inappropriate level of risk that would require the Chief Audit Executive to notify the Board.

BEST PRACTICES

TRS Internal Audit is a progressive department that is dedicated to continuous improvement. During the quality assurance review, we observed a number of practices that demonstrate outstanding commitment to the internal audit profession and in furthering the agency's mission. These leading practices include the following:

- The development and distribution of the Internal Audit short/long-term strategic plan is commendable. This strategic plan demonstrates an understanding of the agency's core mission and alignment with the leadership team's strategic outlook. There was evidence that strategies included in the plan were executed and in progress, as well; further demonstrating a commitment toward execution of the plan.
- The inclusion of business objectives and associated risks and controls in the final audit report helps provide focused assurance regarding the operating effectiveness and efficiency of audited activities. This alignment of business objectives to audit results further assists the organization in determining where limited resources should be invested.

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- The Chief Audit Executive's (CAE) performance evaluation process incorporates a mix of performance goal attainment, collaborative/constructive feedback from all levels of the organization and provides insight regarding the CAE's personality characteristics and leadership acumen.
- The Chief Audit Executive requires internal audit staff to attend audit committee meetings to provide information and further strengthen staff's organizational perspectives on risk management and the contributions they produce via assurance services.
- Professional development of staff is valued, as evidenced through support of external training and participation on internal task forces to strengthen and refine skills needed to audit.

REPORT DISTRIBUTION LIST

David Kelly, Chairman of the Board of Trustees

Christopher Moss, Chairman of the Audit Committee

Brian Guthrie, Executive Director

Amy Barrett, Chief Audit Executive

April 15, 2016



Internal Audit Department
of the Teacher Retirement System receives a rating of
"Pass"

In compliance with the Institute of Internal Auditors'
International Professional Practices Framework, Government Auditing
Standards, and the Texas Internal Auditing Act

This opinion is based on a quality assessment review conducted by members of the
Texas State Agency Internal Audit Forum (SAIAF) during the period of April 2016
The review was based on the methodology developed by the
Texas State Agency Internal Audit Forum.

A handwritten signature in blue ink, appearing to read "Benito Ybarra", written over a horizontal line.

Benito Ybarra, CIA, CISA, CFE
Chief Audit and Compliance Officer
Texas Department of Transportation

A handwritten signature in blue ink, appearing to read "Greg Royal", written over a horizontal line.

Greg Royal, CPA, CIA, CRMA, CGAP
Chief Audit Executive
Texas Department of Insurance

A handwritten signature in blue ink, appearing to read "Byron Williams", written over a horizontal line.

Byron Williams, CPA
Chief Audit Executive
Oregon State Treasury

TAB 2B

INTERNAL AUDIT QUALITY ASSURANCE SELF-ASSESSMENT

March 22, 2016

Teacher Retirement System Internal Audit Department

Business Objectives	<p>To determine whether Internal Audit (IA) function generally conforms with professional auditing standards, Texas Internal Auditing Act, auditor codes of ethics, and Internal Audit's Quality Assurance and Improvement Program (QAIP). (Professional audit standards consider Internal Audit function authority, independence, proficiency, quality assurance and improvement program, and how the audits are planned, performed, communicated, managed, and resolved.)</p>
Inherent Risks Without Controls	<ul style="list-style-type: none"> • Audits may not address significant organizational risks • Audit processes may be inefficient and ineffective • Assurance could be unreliable without effective quality control
Internal Audit Controls	<ul style="list-style-type: none"> • Internal Audit charter, organizational chart, board minutes • Job descriptions, resumes, training records, performance evaluations • Work papers, work programs, reports, quality control processes • Annual risk assessment, audit plan • IA policies and procedures • TRS Internal Audit Quality Assurance and Improvement Program
Tests Performed	<p>Conducted self-assessment to validate Internal Audit activities conform with applicable professional standards and state law using the self-assessment tool developed by the <i>State Agency Internal Audit Forum (SAIAF)</i>. These tests included steps to assess implementation of Internal Audit's QAIP.</p>
Best Practices	<ul style="list-style-type: none"> • Board approved TRS Internal Audit Charter • Achievement of professional requirements for annual training • Supervisory review of all audit working papers • Management involvement in annual audit planning • IA Strategic Plan alignment with TRS Strategic Plan
Results	<p>IA "generally conforms" with professional auditing standards, related codes of ethics, Texas state law, and Internal Audit's Quality Assurance and Improvement Program. Many best practices were identified. Opportunities for additional improvement were identified.</p>
Recommended Actions	<p>Update <i>TeamMate</i> (the electronic project work paper application) project templates to ensure documentation of:</p> <ul style="list-style-type: none"> • Opportunities for making improvements to risk management/control processes • Protocols to follow if fraud activities are suspected • Assessment of IA's ability to perform non-audit services • Various understandings between auditor and client, for agreed-upon procedures engagements and include the word "independent" in the report title of these engagements
Internal Audit Responses	<p>The Chief Audit Executive agrees with the recommendations and will ensure that the <i>TeamMate</i> project templates are updated by August 31, 2016.</p>

Legend of Results: **Red** - Does not conform **Yellow** - Partially conforms **Green** - Generally conforms

March 22, 2016

Audit Committee, Board of Trustees
Mr. Brian Guthrie, Executive Director

EXECUTIVE SUMMARY

We have completed the **Internal Audit Quality Assurance Self-Assessment** as included in the *Fiscal Year 2016 Audit Plan*. Annually, TRS Internal Audit staff conducts a self-assessment as an integral part of Internal Audit's Quality Assurance and Improvement Program (QAIP).

The objective of the self-assessment conducted in Fiscal Year 2016 was to determine whether the TRS Internal Audit department (Internal Audit) generally conforms with requirements of The Institute of Internal Auditors (IIA) *International Standards for the Professional Practice of Internal Auditing (Standards)*, the U.S. Government Accountability Office's (GAO) *Government Auditing Standards*, the IIA and GAO *Codes of Ethics*, the *Texas Internal Auditing Act*, and Internal Audit's QAIP.

CONCLUSION

Based on the results of the self-assessment, we concluded that TRS Internal Audit generally conforms with the IIA *International Standards for the Professional Practice of Internal Auditing*, the U.S. GAO's *Government Auditing Standards*, the IIA and GAO *Codes of Ethics*, the *Texas Internal Auditing Act*, and Internal Audit's QAIP.

We identified the following opportunities for improvement:

- Update TeamMate (the electronic project work paper application) project templates to ensure documentation of:
 - Opportunities for making improvements to the risk management and control processes
 - Protocols if fraud activities are suspected
 - Assessment of Internal Audit's ability to perform non-audit services
 - Various understandings between auditor and client, for agreed-upon procedures engagements and include the word "independent" in the report title of the report template for these engagements

Results of our procedures are presented in more detail in the **Detailed Results** section. The self-assessment objective, scope, methodology, and conclusion are described in **Appendix A**. The Internal Audit organization chart is found at **Appendix B**.

BACKGROUND

The Chief Audit Executive (CAE) is responsible for Internal Audit's QAIP, which covers all types of internal audit activities. The QAIP is designed to ensure that Internal Audit:

- Complies with professional auditing standards, codes of ethics, and state law
- Is monitored to ensure effective and efficient operations
- Provides unbiased and independent assurance activities
- Adds value and improves organizational operations
- Includes both periodic and ongoing internal assessments
- Includes an external quality assurance review (peer review) at least once every three years, the results of which are communicated to executive management and the TRS Board Audit Committee (Audit Committee)

INTERNAL ASSESSMENT

Ongoing Reviews of internal audit activities are conducted through:

- Supervision of engagements
- Regular, documented review of work papers during engagements by appropriate Internal Audit staff
- Consistent use of audit policies and procedures for each engagement to ensure compliance with applicable planning, fieldwork, and reporting standards
- Review and approval of all final reports and recommendations by the CAE
- Feedback from customer surveys on individual engagements
- Analyses of performance metrics established to improve effectiveness and efficiency

Periodic Reviews of internal audit activities are designed to assess conformance with professional auditing standards, codes of ethics, and state law, and the efficiency and effectiveness of the internal audit activity in meeting the needs of its various stakeholders.

Periodic reviews are conducted through:

- Routine independent customer surveys and participation in 360-surveys
- Regular activity and performance reporting to executive management and the Audit Committee
- Annual risk assessment for purpose of annual audit planning
- Annual self-assessment reviews to assess compliance with internal audit policies and auditing standards, achievement of internal audit performance metrics, and benchmarking of best practices

OVERALL CONCLUSION

After completing the self-assessment for Fiscal Year 2015, our conclusion is that the Teacher Retirement System of Texas (TRS) Internal Audit function generally conforms with *The Institute of Internal Auditor's (IIA) International Standards for the Professional Practice of Internal Auditing*, the U.S. Government Accountability Office's (GAO) *Government Auditing Standards*, the IIA and GAO Codes of Ethics, the Texas Internal Auditing Act, and Internal Audit's QAIP.

This conclusion is based on completion of a self-assessment using the *State Agency Internal Audit Forum (SAIAF) Master Peer Review Program*, and the review of a complete set of working papers of an assurance and a consulting project using the SAIAF Working Paper Review Tool in *TeamMate*¹. We identified opportunities to enhance our processes and documentation as described in the **Detailed Results** section of this report entitled "Opportunities for Improvement."

More detailed information regarding our self-assessment is found in the detailed results section. All of the standards and the individual conformance levels are detailed in **Appendix C**.

¹ Electronic project work paper application

DETAILED RESULTS

I. Positive Findings

Knowledge, skills, and other competencies, individually and collectively, are evidenced through the numerous professional certifications and attendance at professional lunch meetings, seminars and conferences. Also, IA has launched a data analytics project for Fiscal Year 2016 and beyond.

II. Opportunities for Improvement

A. The International Professional Practices Framework (IPPF) Standards on Planning and Performing Audits

The Institute of Internal Auditors (IIA) International Standards for the Professional Practice of Internal Auditing contain aspects of Engagement Planning. These standards require that:

- The auditor document opportunities for making improvements to the activity's risk management and control processes
- There be procedures to follow when an auditor believes that fraud may have occurred

While the risk assessment in each project implies that the auditor is seeking to provide management with opportunities for making improvements, the *TeamMate* template for audit projects could be improved by adding this specific step to the risk assessment process.

Also, while internal auditors currently seek the advice of the CAE when fraud activities may be suspected, there are no formal steps for internal auditors to follow when this situation occurs.

Opportunities for Improvement

The CAE should have language added to the *TeamMate* audit template that will:

- Direct auditors to ensure that they document opportunities for making significant improvements to the activity's risk management and control processes during the Planning Phase of an audit
- Direct auditors in the proper documentation and communication when fraud activities may be suspected

Chief Audit Executive's Response

The CAE agrees with the recommendations and will ensure that the *TeamMate* audit project template is updated to include steps for ensuring that 1) opportunities for making significant improvements to the activity's risk management and control processes and 2) steps for the proper documentation and communication for addressing suspected fraud activities. The recommendations will be implemented by August 31, 2016.

B. The U.S. Government Accountability Office's (GAO) Government Auditing Standards and GAO Standard on Independence and Objectivity

The U.S. Government Accountability Office's (GAO) Government Auditing Standards and GAO Standard on Independence and Objectivity, Standard 3.22, is establishes requirements for managing internal audit's independence and objectivity with all of its activities. This standard requires that the Chief Audit Executive (CAE) document threats to independence.

Internal Audit complies with this requirement by maintaining a memo documenting its threats to independence and its mitigations; however, the *TeamMate* file for each consulting engagement does not require an analysis for each engagement.

Opportunity for Improvement

The CAE should have the *TeamMate* consulting project template updated to include a step that specifically addresses whether the specific project is an allowable non-audit service under the GAO standards.

Chief Audit Executive's Response

The CAE agrees with the recommendation and will have the *TeamMate* consulting project template updated by August 31, 2016 to include a step to assess that TRS Internal Audit is able to perform the non-audit service.

C. The U.S. Government Accountability Office's (GAO) Government Auditing Standards and GAO Standards for Agreed-Upon Procedure Engagements

Although Internal Audit adheres to standards for planning, performing, and reporting on agreed-upon procedures engagements, an opportunity for improvement exists for Internal Audit to ensure that certain understandings with the client are documented, specifically:

- Establishing an understanding with the client on reporting
- Obtaining written acknowledgment about client's responsibility for the subject matter
- Obtaining affirmative acknowledgment from client about the procedures to be performed
- Obtaining acknowledgment about client's responsibility for the sufficiency of the procedures
- Listing the responsibilities of the practitioner
- Including any disclaimers expected to be included in the report, if applicable
- Involvement of specialists, if applicable
- Materiality is not a consideration for the engagement since all non-compliance violations are reported

Also, the final report should include the word "independent" in the title.

Opportunity for Improvement

The CAE should ensure that the *TeamMate* template for agreed-upon procedures engagements is updated to include the components enumerated above and that the report template is updated to include the word “independent” in the title.

Chief Audit Executive’s Response

The CAE agrees and will have the *TeamMate* template for agreed-upon procedures engagements updated to include the components enumerated above and the report title to include the word “independent.” The updates will be completed by August 31, 2016.

* * * *

We express our appreciation to the TRS Board of Trustees, Audit Committee of the Board, executive management, senior management, and staff who consistently support Internal Audit and audit activities.



Amy Barrett, CIA, CPA, CISA
Chief Audit Executive



Dinah G. Arce, CIA, CPA, CFE, CIDA
Senior Auditor

APPENDIX A

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

The self-assessment objective was to determine whether the Teacher Retirement System of Texas (TRS) Internal Audit generally conforms with *The IIA Standards for the Professional Practice of Internal Auditing*, the U.S. GAO's *Government Auditing Standards*, the IIA and GAO Codes of Ethics, the Texas Internal Auditing Act, and Internal Audit's QAIP.

Scope

The self-assessment review period was Fiscal Year 2015. We used *State Agency Internal Audit Forum* (SAIAF) procedures and steps that included the *International Standards for the Professional Practice of Internal Auditing*, *Generally Accepted Government Auditing Standards* (GAGAS), Texas Internal Auditing Act, and Internal Audit's QAIP requirements to conduct the annual TRS Internal Audit Quality Assurance Self-Assessment.

Methodology

We evaluated conformance with the following statutes and professional standards:

- *Texas Government Code* Chapter 2102 (Texas Internal Auditing Act)
- *International Standards for the Professional Practice of Internal Auditing* and the *Code of Ethics* of the Institute of Internal Auditors, Inc. (IIA)
- *Generally Accepted Government Auditing Standards* (GAGAS) developed by the U.S. Government Accountability Office (GAO) and the GAO Code of Ethics

During fieldwork, we performed the following procedures:

- Reviewed the most current TRS Internal Audit Charter, Annual Audit plan, TRS Internal Audit job descriptions, TRS Internal Audit certifications and continuing professional education hours, Request for Qualifications (RFQ) documentation, and follow-up documentation of the past audit recommendations
- Reviewed Fiscal Year 2015 audit and consulting projects
- Interviewed the Chief Audit Executive and other TRS Internal Audit Staff

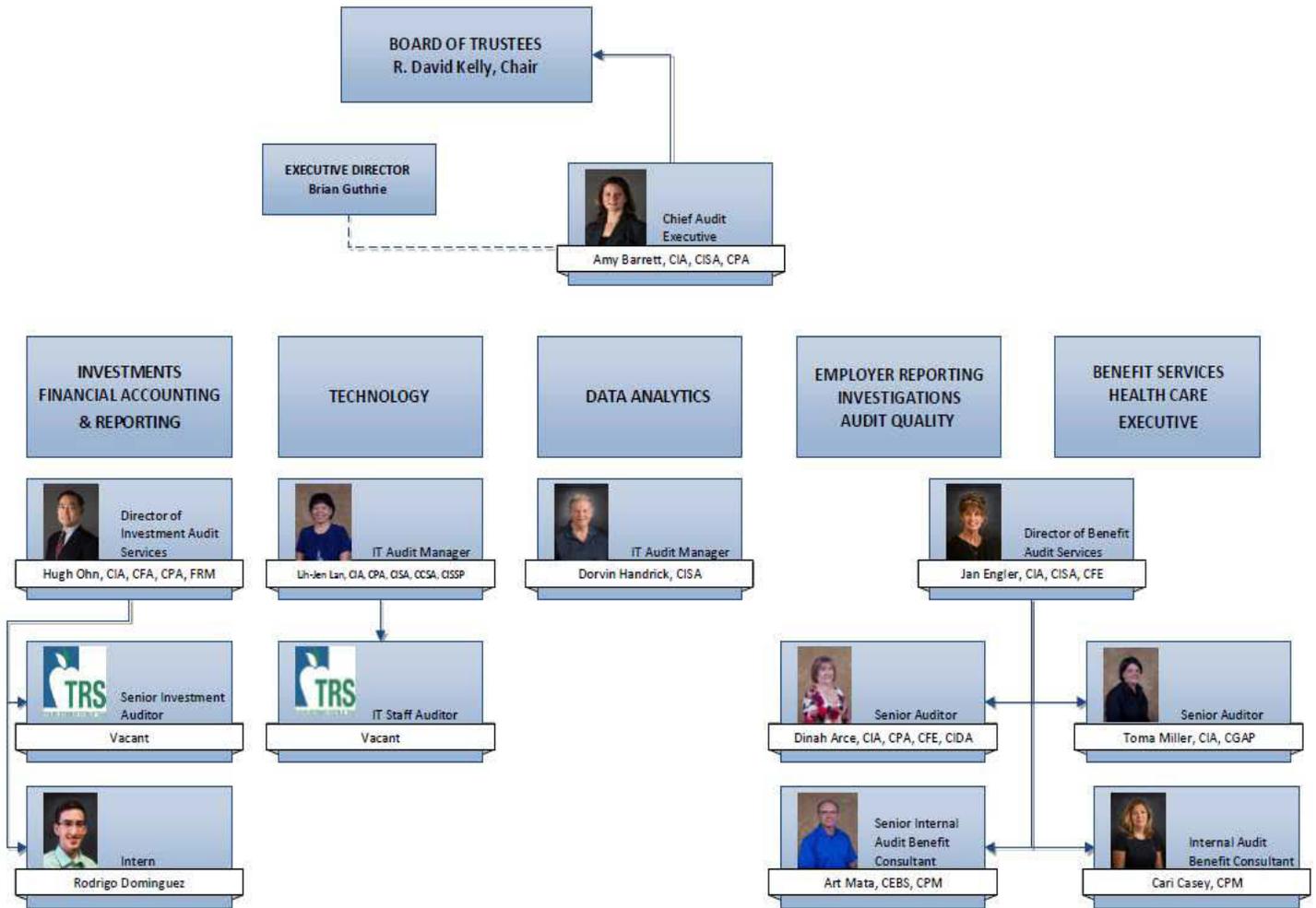
Conclusion

Our conclusion is that TRS Internal Audit generally conforms with the requirements of professional audit standards and related codes of ethics, the state law, and Internal Audit's QAIP.

APPENDIX B

TRS INTERNAL AUDIT ORGANIZATIONAL CHART

The following organization chart shows the Internal Audit function reports directly to the Board of Trustees, but administratively to the Executive Director. This facilitates an independent environment for the Internal Audit function to fulfill professional standards.



APPENDIX C

TRS 2015 SELF-ASSESSMENT

		Generally Conforms	Partially Conforms	Does Not Conform
OVERALL CONCLUSION		Pass		
IIA CODE OF ETHICS		Pass		
TEXAS INTERNAL AUDITING ACT		Pass		
IIA STANDARDS:				
AS 1000	Purpose, Authority, and Responsibility	Pass		
AS 1010	Recognition of the Definition of Internal Auditing, the Code of Ethics, and the <i>Standards</i> in the Internal Audit Charter	Pass		
AS 1100	Independence and Objectivity	Pass		
AS 1110	Organizational Independence	Pass		
AS 1120	Individual Objectivity	Pass		
AS 1130	Impairment to Independence and Objectivity	Pass		
AS 1200	Proficiency and Due Professional Care	Pass		
AS 1210	Proficiency	Pass		
AS 1220	Due Professional Care	Pass		
AS 1230	Continuing Professional Development	Pass		
AS 1300	Quality Assurance and Improvement Program	Pass		
AS 1310	Requirements of the Quality Assurance and Improvement Program	Pass		
AS 1311	Internal Assessments	Pass		
AS 1312	External Assessments	Pass		
AS 1320	Reporting on the Quality Assurance and Improvement Program	Pass		
AS 1321	Use of "Conforms with the <i>International Standards for the Professional Practice of Internal Auditing</i> "	Pass		

		Generally Conforms	Partially Conforms	Does Not Conform
AS 1322	Disclosure of Nonconformance	Pass		
PS 2000	Managing the Internal Audit Activity	Pass		
PS 2010	Planning	Pass		
PS 2020	Communication and Approval	Pass		
PS 2030	Resource Management	Pass		
PS 2040	Policies and Procedures	Pass		
PS 2050	Coordination	Pass		
PS 2060	Reporting to Senior Management and the Board	Pass		
PS 2100	Nature of Work	Pass		
PS 2110	Governance	Pass		
PS 2120	Risk Management	Pass		
PS 2130	Control	Pass		
PS 2200	Engagement Planning	Pass		
PS 2201	Planning Considerations	Pass Refer opportunity for improvement #1 in the final report		
PS 2210	Engagement Objectives	Pass Refer opportunity for improvement #1 in the final report		
PS 2220	Engagement Scope	Pass		
PS 2230	Engagement Resource Allocation	Pass		
PS 2240	Engagement Work Program	Pass		
PS 2300	Performing the Engagement	Pass		
PS 2310	Identifying Information	Pass		
PS 2320	Analysis and Evaluation	Pass		
PS 2330	Documenting Information	Pass		
PS 2340	Engagement Supervision	Pass		
PS 2400	Communicating Results	Pass		
PS 2410	Criteria for Communicating	Pass		
PS 2420	Quality of Communications	Pass		
PS 2421	Errors and Omissions	Pass		

		Generally Conforms	Partially Conforms	Does Not Conform
PS 2430	Use of "Conducted in Conformance with the <i>International Standards for the Professional Practice of Internal Auditing</i> "	Pass		
PS 2431	Engagement Disclosure of Nonconformance	Pass		
PS 2500	Monitoring Progress	Pass		
PS 2600	Resolution of Senior Management's Acceptance of Risks	Pass		
GOVERNMENT AUDITING STANDARDS:				
GAGAS 1.19 3.22 3.31 3.46 3.59 3.79-3.81 3.88	Independence and Objectivity	Pass Refer to opportunity for improvement #2 in the final report		
GAGAS 2.23 3.82-85 3.95-96 3.105	Quality Assurance and Improvement Program	Pass		
GAGAS 6.07 6.13 6.16 6.23 6.28 6.36-38 6.40-41 6.45-46 6.50-51	Engagement Planning	Pass		
GAGAS 6.53 6.60 6.66-67 6.69 6.83	Performing the Engagement	Pass		
GAGAS 7.04 7.09-7.13 7.14-7.19 7.21-7.23 7.27-7.31 7.32-7.44 8.04 A7.02	Communicating Results	Pass		

		Generally Conforms	Partially Conforms	Does Not Conform
GAGAS 5.64	Agreed Upon Procedures Engagements	<p align="center">Pass</p> <p>Refer to opportunity for improvement #3 in the final report</p>		

Definitions of conformance ranking system:

Generally Conforms –

Means the assessor has concluded that the relevant structures, policies, and procedures of the activity, as well as the processes by which they are applied, comply with the requirements of the individual Standard or element of the Code of Ethics in all material respects. For the sections and major categories, this means that there is general conformity to a majority of the individual Standards or elements of the Code of Ethics, and partial conformity to the others, within the section/category. There may be significant opportunities for improvement, but these should not represent situations where the activity has not implemented the Standards or the Code of Ethics, is not applying them effectively, or is not achieving their stated objectives.

Partially Conforms –

Means the assessor has concluded that the activity is making good–faith efforts to comply with the requirements of the individual Standard or element of the Code of Ethics, section and major category, but has fallen short of achieving some of the major objectives. This will usually represent some significant opportunities for improvement in effectively applying the Standards or Code of Ethics and/or achieving their objectives. Some of the deficiencies may be beyond the control of the activity and may result in recommendations to senior management or the Board of the organization.

Does Not Conform –

Means the assessor has concluded that the activity is not aware of, is not making good–faith efforts to comply with, or is failing to achieve many/all of the objectives of the individual Standard or element of the Code of Ethics, section and major category. These deficiencies will usually have a significant negative effect on the activity’s effectiveness and its potential to add value to the organization. They may also represent significant opportunities for improvement, including actions by senior management or the Board.

TAB 3

TAB 3A



An Audit Report on

**Incentive Compensation at the
Permanent School Fund,
General Land Office,
Employees Retirement System, and
Teacher Retirement System**

June 2016
Report No. 16-030



An Audit Report on

Incentive Compensation at the Permanent School Fund, General Land Office, Employees Retirement System, and Teacher Retirement System

SAO Report No. 16-030
June 2016

Overall Conclusion

The Permanent School Fund (PSF) of the Texas Education Agency and the General Land Office (GLO) calculated and paid incentive compensation awards in accordance with their policies and procedures for plan year 2015. GLO should strengthen controls over its incentive compensation plan by formally approving that plan prior to the start of the plan performance period. GLO also should retain documentation of management's review of plan calculations in accordance with its policies and procedures.

The Employees Retirement System (ERS) generally awarded and paid incentive compensation in accordance with its policies and procedures for plan year 2015. However, ERS overpaid an employee \$176.77 because it did not calculate that employee's award in accordance with its policies and procedures. Additionally, ERS should strengthen controls over its incentive compensation calculation and review process by developing formal calculation and review procedures. The ERS executive director, who was appointed on June 1, 2015, did not receive any incentive compensation for the 2015 performance period.

The Teacher Retirement System (TRS) generally awarded and paid incentive compensation in accordance with its policies and procedures for plan year 2015. However, TRS overpaid a total of \$2,236.00 to 9 employees because it input incorrect information into its calculation. TRS should strengthen controls over its incentive compensation calculation and review processes to prevent and detect errors and ensure that it records all incentive compensation payments correctly in its general ledger.

Auditors communicated other, less significant issues in writing separately to management of the PSF, GLO, ERS, and TRS.

Incentive Compensation for Plan Year 2015

The PSF, GLO, ERS, and TRS awarded a total of \$15,311,127 in incentive compensation to 253 employees through their incentive compensation plans for plan year 2015.

Specifically:

- The PSF awarded \$1,639,513 to 47 employees.
- GLO awarded \$299,655 to 5 employees.
- ERS awarded \$4,764,067 to 63 employees.
- TRS awarded \$8,607,892 to 138 employees.

Sources: The PSF, GLO, ERS, and TRS.

Table 1 presents a summary of the findings in this report and the related issue ratings. (See Appendix 2 for more information about the issue rating classifications and descriptions.)

Table 1

Summary of Chapters and Related Issue Ratings		
Chapter	Title	Issue Rating ^a
1	The PSF Calculated and Paid Plan Year 2015 Incentive Compensation in Accordance with Its Policies and Procedures	Low
2	GLO Calculated and Paid Plan Year 2015 Incentive Compensation in Accordance with Its Policies and Procedures	Low
3	ERS Generally Awarded and Paid Plan Year 2015 Incentive Compensation in Accordance with Its Policies and Procedures	Low
4	TRS Generally Awarded and Paid Plan Year 2015 Incentive Compensation in Accordance with Its Policies and Procedures	Low

^a A chapter is rated **Priority** if the issues identified present risks or effects that if not addressed could critically affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern and reduce risks to the audited entity.

A chapter is rated **High** if the issues identified present risks or effects that if not addressed could substantially affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern and reduce risks to the audited entity.

A chapter is rated **Medium** if the issues identified present risks or effects that if not addressed could moderately affect the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern and reduce risks to a more desirable level.

A chapter is rated **Low** if the audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

Summary of Management's Response

At the end of Chapters 2 through 4 in this report, auditors made recommendations to address the issues identified during this audit at GLO, ERS, and TRS; those agencies agreed with their respective recommendations.

Audit Objective and Scope

The objective of this audit was to determine whether the PSF, GLO, ERS, and TRS calculate and pay incentive compensation in accordance with policies and procedures.

The scope of this audit covered incentive compensation plan years ending August 31, 2015, at the PSF and ERS; June 30, 2015, at GLO; and September 30, 2015, at TRS.

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Detailed Results

Chapter 1

The PSF Calculated and Paid Plan Year 2015 Incentive Compensation in Accordance with Its Policies and Procedures

**Chapter 1
Rating:
Low ¹**

The Permanent School Fund (PSF) of the Texas Education Agency calculated and paid incentive compensation for its plan year ended August 31, 2015, in accordance with its policies and procedures. The commissioner of education formally approved the PSF incentive compensation plan before the beginning of the plan performance start date.

The PSF awarded a total of \$1,639,513 in incentive compensation to 47 employees. The PSF awarded the most incentive compensation to its chief investment officer, who was awarded \$143,551 payable during a three-year period. That \$143,551 represented 9 percent of the \$1,639,513 in total incentive compensation that the PSF awarded.

Gross of Fees and Net of Fees

Gross of fees indicates that the effect of fees has not been reflected in a return; net of fees indicates that the effect of fees has been reflected in a return.

Source: CFA Institute Web site at <http://www.cfapubs.org/doi/full/10.2469/ipmn.v2011.n1.1>

The PSF calculates incentive compensation based on an employee's achievement of goals related to total fund performance and the performance of the employee's assigned asset classes. Except for the performance of certain asset classes that are measured since their inception using an internal rate of return calculation, fund and asset class performance are calculated on a three-year rolling average performance period. The PSF calculates investment returns for its incentive compensation plan on a gross-of-fees-paid-to-external-manager basis (see text box for more information on gross of fees and net of fees). PSF awards incentive compensation if investment performance exceeds benchmarks. Total fund investment performance exceeded the target benchmark by 0.28 percent (28 basis points) for the three-year period from September 1, 2012, to August 31, 2015 (see text box for more information on basis points).

Basis Points

One basis point is 0.01 percent or one one-hundredth of a percentage point.

Source: Morningstar, Inc. Web site at http://www.morningstar.com/InvGlossary/basis_point_definition_what_is.aspx.

The PSF pays incentive compensation awards in installments over time. Specifically, for most employees, the PSF pays 50 percent of an incentive compensation award for the current plan year, 25 percent of that award in the next year, and 25 percent of that award in the

¹ Chapter 1 is rated Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/function(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

third year. As a result, payments to employees may consist of partial awards from three years.

Table 2 shows the positions eligible to earn incentive compensation in the PSF plan and the incentive compensation payment awards for each position for plan year 2015.

Table 2

PSF Incentive Compensation Awards for Plan Year 2015	
Eligible Position	Incentive Compensation Award or Award Range
Chief Investment Officer	\$143,551
Deputy Chief Investment Officer and Director of Fixed Income	\$105,837
Deputy Executive Administrator	\$80,551
Director of Equities	\$110,851
Director of Global Risk Control Strategies	\$94,897
Director of Private Markets	\$106,295
Portfolio Manager I - IV	\$27,922 to \$80,777
Risk Manager	\$27,165
Investment Analyst I - IV	\$14,240 to \$41,612
Risk Analyst	\$6,421
Director of Finance	\$25,366
Director of Investment Operations	\$32,264
Director of Legal and Compliance	\$25,859
Director of Operational Due Diligence	\$19,422
Accountant I - VII	\$10,564
Attorney I - VI	\$7,914
Director of Investment Technology	\$14,450
Financial Analyst I - IV	\$1,873 to \$9,382
Program Specialist I - VII	\$1,125 to \$4,276
Systems Analyst I - VI	\$3,162 to \$5,153
Executive Assistant I - III	Position was vacant
Staff Services Officer I - V	\$651

Source: The PSF.

GLO Calculated and Paid Plan Year 2015 Incentive Compensation in Accordance with Its Policies and Procedures

Chapter 2
Rating:
Low ²

The General Land Office (GLO) calculated and paid incentive compensation for its plan year ended June 30, 2015, in accordance with its policies and procedures. However:

- The land commissioner and the chief clerk did not formally approve the incentive compensation plan until July 9, 2014, which was after the performance period began. Obtaining formal approval of the incentive compensation plan prior to the beginning of the performance period could help ensure that the plan aligns with the intent of executive management.
- GLO did not retain documentation of one manager's review and approval of the incentive award calculation spreadsheet in accordance with its policies and procedures. Management review provides additional assurance that the incentive awards are calculated and paid in accordance with plan policies and procedures.

GLO awarded a total of \$299,655 in incentive compensation to 5 employees. GLO awarded the most incentive compensation to its chief investment officer, who was awarded \$211,815 payable during a two-year period. That \$211,815 represented 71 percent of the \$299,655 in total incentive compensation that GLO awarded.

The GLO incentive compensation plan compares investment performance of the total fund with a target benchmark on a one-year, three-year, and five-year basis. GLO calculates incentive compensation based on an employee's achievement of goals in investment performance (60 percent) and a qualitative component (40 percent) that is tied to employee job performance during the performance period. GLO calculates investment returns for its incentive compensation plan on a gross-of-fees-paid-to-external-manager basis. GLO awards incentive compensation for exceeding one-year, three-year, or five-year investment performance benchmarks. If the one-year total fund return is negative but outperforms the benchmark, the payment of incentive compensation awarded for the current performance period is deferred and payable on December 1 of the following year, regardless of performance results. Total fund investment performance:

² Chapter 2 is rated Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

- Exceeded the target benchmark by 5.99 percent (599 basis points) for the five-year period from July 1, 2010, to June 30, 2015.
- Exceeded the target benchmark by 4.63 percent (463 basis points) for the three-year period from July 1, 2012, to June 30, 2015.
- Exceeded the target benchmark by 2.37 percent (237 basis points) for the one-year period from July 1, 2014, to June 30, 2015.

GLO pays incentive compensation awards in installments over time. Specifically, it pays 50 percent of the award on December 1 following the end of the performance period, and it pays the remaining 50 percent on the anniversary of the first payment. As a result, payments to employees may consist of partial awards from two years.

Table 3 shows the positions eligible to earn incentive compensation in the GLO plan and the incentive compensation payment awards for each position for plan year 2015.

Table 3

GLO Incentive Compensation Awards for Plan Year 2015	
Eligible Position	Incentive Compensation Award or Award Range
Deputy Commissioner of Funds Management	\$211,815
Real Assets Portfolio Manager	\$56,040
Senior Financial Analyst	\$645 to \$20,002
Program Specialist	\$11,153
^a GLO changed the Deputy Commissioner of Funds Management title to Chief Investment Officer after the adoption of the plan	

Source: GLO.

Recommendations

GLO should:

- Formally approve the incentive compensation plan prior to the start of the plan performance period.
- Retain documentation of management’s review of plan calculations in accordance with its policies and procedures.

Management's Response

Recommendation: Formally approve the incentive compensation plan prior to the start of the plan performance period.

Management's Response: We agree with the finding. The FY2016 plan was approved prior to the start of the plan performance period.

Recommendation: Retain documentation of management's review of plan calculations in accordance with its policies and procedures.

Management's Response: We agree with the finding. The documentation will be retained per the policies and procedures.

Title of Responsible Person: Director of Budget and Planning

ERS Generally Awarded and Paid Plan Year 2015 Incentive Compensation in Accordance with Its Policies and Procedures

Chapter 3
Rating:
Low ³

The Employees Retirement System (ERS) generally calculated and paid incentive compensation for its plan year ended August 31, 2015, in accordance with its policies and procedures. However:

- ERS incorrectly calculated the proration for one employee, which resulted in an overpayment of \$176.77. For incentive calculations, ERS employee promotions are prorated effective as of the date of the promotion. The overpayment occurred because ERS used the wrong promotion date for the proration calculation, and subsequent reviews did not identify the error.
- ERS does not have written policies and procedures regarding the incentive compensation calculation and review process. That increases the risk of inaccurate award payouts due to mistakes in the calculation and review process.

ERS awarded a total of \$4,764,067 in incentive compensation to 63 employees. ERS awarded the most incentive compensation to its chief investment officer, who was awarded \$382,777 payable over a three-year period. That \$382,777 represented 8 percent of the \$4,764,067 in total incentive compensation that ERS awarded. The ERS executive director, who was appointed on June 1, 2015, did not receive any incentive compensation for the 2015 performance period.

ERS awards incentive compensation based on a combination of investment performance and qualitative performance. All investment performance goals are measured against benchmarks, except for securities lending, which requires fixed income staff to have positive earnings for one-year and three-year periods to earn incentive compensation. The qualitative performance component assesses if ERS employees exceeded the applicable job performance standards. The ERS incentive compensation plan allows the ERS executive director to exercise discretion in plan-related matters. The following is an excerpt of plan section 7.1.

³ Chapter 3 is rated Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

7.1 The Plan shall be administered by the Board, as it relates to participation of the Executive Director, and by the Executive Director, as it relates to participation of other ERS employees, in accordance with the terms hereof, as amended from time to time. In administering the Plan, the Board or Executive Director, with input from ERS senior management, shall have discretionary authority to interpret the Plan document and to administer the Plan in accordance with its terms.

For plan year 2015, the executive director used his discretion to reduce the qualitative performance assessments for all but one employee that participated in the plan.

ERS calculates the investment performance component of incentive compensation based on total trust fund performance and individual assigned goals. ERS awards incentive compensation for exceeding one-year, three-year, or five-year investment performance benchmarks, depending on an employee's length of service. ERS employees earn awards if the fund performance is negative for the year but exceeds the benchmark performance; however, award payment is deferred until the next plan year in which the one-year total trust performance is positive. ERS calculates total trust fund performance returns for its incentive compensation plan on a net-of-fees-paid-to-external-managers basis. The total fund investment performance:

- Exceeded the target benchmark by 0.38 percent (38 basis points) for the five-year period from September 1, 2010, to August 31, 2015.
- Exceeded the target benchmark by 0.49 percent (49 basis points) for the three-year period from September 1, 2012, to August 31, 2015.
- Exceeded the target benchmark by 1.32 percent (132 basis points) for the one-year period from September 1, 2014, to August 31, 2015.

In conducting the audit at ERS, State Auditor's Office auditors relied on ERS internal audit report number 2016-01, *Incentive Compensation Plan*, released on December 7, 2015. The State Auditor's Office conducted procedures to confirm that the ERS internal audit department was qualified and that the internal audit work on which the State Auditor's Office relied was sufficient.

ERS pays incentive compensation awards in installments over time. Specifically, for most employees, ERS pays 50 percent of an incentive compensation award for the current plan year, 25 percent of that award in

the next year, and 25 percent of that award in the third year. As a result, payments to employees may consist of partial awards from three years. ERS pays investment operations team members in two installments of 50 percent each, as directed by the previous executive director.

Table 4 shows the positions eligible to earn incentive compensation in the ERS plan and the incentive compensation payment awards for each position for plan year 2015.

Table 4

ERS Incentive Compensation Awards for Plan Year 2015	
Eligible Position	Incentive Compensation Award or Award Range
Investment Analyst I - II	\$2,193 to \$17,564
Investment Analyst III - IV	\$2,948 to \$60,783
Portfolio Manager I - V	\$14,083 to \$199,435
Supervising Portfolio Manager	\$111,390 to \$122,224
Trader I - II	\$40,660
Chief Trader I - II	\$82,169 to \$107,665
Asset Class Portfolio Managers/Directors	\$134,650 to \$202,005
Risk Management and Applied Research	\$121,133
Financial Analyst I-IV	\$1,781 to \$23,998
Investment Administrative Support	Opted out of incentive compensation for plan year 2015
Director of Investment Services	\$130,044
Chief of Staff	Position was vacant
Deputy Chief Investment Officer	\$172,010
Investments and Securities, Paralegal	Position was vacant
Investments and Securities, Attorney	\$73,552 to \$102,479
General Counsel and Chief Compliance Officer	\$127,598
Chief Investment Officer	\$382,777
Executive Director	Did not receive incentive compensation for plan year 2015

Source: ERS.

Recommendations

ERS should:

- Strengthen its payment review process to ensure that it identifies calculation errors.

- Develop written policies and procedures for its incentive compensation calculation and review process.

Management's Response

ERS management agrees with both recommendations. An initial draft of the Incentive Compensation Plan's process procedures has been completed. ERS staff will continue the review and improvement process of the plan procedures and expect to have a finalized document by August 31, 2016. The Director of Human Resources is the responsible staff for implementation.

TRS Generally Awarded and Paid Plan Year 2015 Incentive Compensation in Accordance with Its Policies and Procedures

Chapter 4
Rating:
Low ⁴

The Teacher Retirement System (TRS) generally calculated and paid incentive compensation for its plan year ended September 30, 2015, in accordance with its policies and procedures. However, TRS overpaid a total of \$2,236 to 9 employees because it input incorrect information into its calculation. Specifically, to calculate the performance of one portfolio, TRS used a performance target that differed from the performance target documented in its incentive compensation plan. That overstated the performance of the employees assigned to that portfolio and resulted in the overpayments. TRS did not detect the error during its reviews.

TRS awarded a total of \$8,607,892 in incentive compensation to 138 employees. TRS awarded the most incentive compensation to its chief investment officer, who was awarded \$329,708 payable over a 2-year period. That \$329,708 represented 4 percent of the \$8,607,892 in total incentive compensation that TRS awarded.

Auditors relied on the work of the TRS internal audit department as part of this audit. Specifically, auditors reviewed the TRS internal audit report *Quarterly Investment Testing of compliance with the requirements of the Investment Policy Statement (IPS), Securities Lending Policy (SLP), Employee Ethics Policy, Code of Ethics for Contractors, Performance Incentive Pay Plan, and Procedures for Wire Transfers for the Quarter ended September 30, 2015*, released on November 10, 2015. The State Auditor's Office conducted procedures to confirm that the TRS internal audit department was qualified and that the internal audit work on which the State Auditor's Office relied was sufficient.

TRS changed one incentive compensation award amount for plan year 2014. (TRS made that change after the State Auditor's Office had audited incentive compensation for plan year 2014.). That change resulted in TRS paying an additional \$22,453 to one employee, and TRS incorrectly recorded \$5,613 of that amount as a one-time merit payment (rather than incentive compensation) in its general ledger. TRS paid the additional compensation to an employee who retired during the 2015 plan performance period.

The employee who received the award discussed above was the only individual affected by a change that TRS made to its incentive compensation

⁴ Chapter 4 is rated Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

plan prior to the start of the 2015 plan performance period. That change allowed qualified employees who retire to receive incentive compensation that they have earned but that has not been paid by their retirement date. As discussed above, TRS paid \$5,613 to the employee as a one-time merit payment in February 2015, and it paid the remaining \$16,840 in February 2016 as incentive compensation.

The TRS incentive compensation plan is based on a combination of investment performance and qualitative performance. The investment performance component compares investment performance with benchmarks (50 percent) and the performance of peer groups (30 percent). The qualitative performance component (20 percent) assesses performance in a variety of areas such as interpersonal relationship skills, accountability, and effective teamwork.

The TRS incentive compensation plan measures investment performance of the total fund and of an employee's individual assigned asset classes on both a one-year (33 percent) and three-year (67 percent) basis. If investment performance exceeds the benchmarks or the performance of other large public funds, that triggers the awarding of incentive compensation. TRS calculates investment returns for its incentive compensation plan on a net-of-fees-paid-to-external-managers basis. TRS employees may earn incentive compensation in years in which the total fund return is negative if that return exceeds the benchmark return. However, TRS defers the payment of those awards until the total fund has a positive return in a subsequent year. The total fund investment performance:

- Exceeded the benchmark by 62 basis points for the three-year period from October 1, 2012, to September 30, 2015.
- Exceeded the benchmark by 46 basis points for the one-year period from October 1, 2014, to September 30, 2015.

TRS pays incentive compensation awards in installments over time. Specifically, it pays 50 percent of an award on February 1 following the end of the performance period, and it pays the remaining 50 percent on the anniversary of the first payment. As a result, payments to employees may consist of partial awards from two years.

Table 5 shows the positions eligible to earn incentive compensation in the TRS plan and the incentive compensation payment awards for each position for plan year 2015.

Table 5

TRS Incentive Compensation Awards for Plan Year 2015	
Eligible Positions	Incentive Compensation Award or Award Range
Chief Investment Officer	\$329,708
Deputy Chief Investment Officer	\$210,174
Senior Managing Director	\$164,655 to \$256,806
Managing Director	\$159,109 to \$160,669
Senior Director	\$120,405 to \$176,000
Director	\$45,740 to \$151,319
Senior Investment Manager	\$64,545 to \$122,763
Investment Manager	\$14,750 to \$89,850
Senior Associate	\$31,159 to \$51,807
Associate	\$3,119 to \$36,721
Senior Analyst	\$4,029 to \$20,775
Analyst	\$1,460 to \$10,978
Junior Analyst	Position was vacant
Administrative Assistants	\$1,067 to \$1,891

Source: TRS.

Recommendations

TRS should:

- Strengthen controls over the incentive compensation calculation and review processes to prevent and detect calculation input errors.
- Record all incentive compensation payments correctly in its general ledger.

Management's Response

TRS is in agreement with the findings of the State Auditor's Office. We are constantly striving to improve processes, procedures, and internal controls related to incentive compensation payments. In fact, the changes made in plan year 2015 were the most comprehensive undertaken by the agency to date and provided additional checks and balances that had not been in place before. However, there are still several manual spreadsheet processes being used that increase the potential for human error. To that end, TRS is currently

seeking a technology solution that will minimize manual processes and we expect to have the necessary software implemented this year so that it can be used to calculate the results of the 2016 incentive compensation plan year.

Title of Responsible Person: Chief Financial Officer

Appendices

Appendix 1

Objective, Scope, and Methodology

Objective

The objective of this audit was to determine whether the Permanent School Fund (PSF) of the Texas Education Agency, the General Land Office (GLO), the Employees Retirement System (ERS), and the Teacher Retirement System (TRS) calculate and pay incentive compensation in accordance with their policies and procedures.

Scope

The scope of this audit covered incentive compensation plan years ending August 31, 2015, at the PSF and ERS; June 30, 2015, at GLO; and September 30, 2015, at TRS.

Methodology

The audit methodology included collecting information and documentation from the audited agencies; reviewing incentive compensation plans, policies, and procedures, and other guidance related to incentive compensation; and analyzing and evaluating data and the results of tests.

Auditors tested sample items to determine whether selected recipients were eligible to receive incentive compensation payments, payment calculation data inputs were correct, payment calculations were correct based on the terms of the incentive compensation plans, and payment amounts distributed to recipients matched amounts calculated for each recipient.

Auditors reviewed calculations, personnel files, payroll data, and externally reported fund performance results to determine whether the audited agencies calculated and paid incentive compensation in accordance with their policies and procedures. Auditors also tested access controls over the spreadsheets and data that the audited agencies used to calculate incentive compensation.

Auditors tested access controls for key calculation data inputs and conducted procedures to determine whether auditors could rely on the work that ERS and TRS internal auditors conducted.

Data Reliability and Completeness

Auditors assessed the reliability of the incentive compensation award data used in this audit by tracing the data to supporting documentation and reviewing access to the data. Auditors verified the completeness of the incentive compensation award data by comparing information in the incentive compensation award calculation spreadsheets the audited agencies used to the data in Uniform Statewide Payroll/Personnel System. Auditors determined that the incentive compensation award data was sufficiently reliable for the purposes of this audit.

Auditors also determined that the investment performance data obtained from custodians was sufficiently reliable for the purposes of this audit.

Sampling Methodology

Auditors selected samples of incentive compensation awards for testing using professional judgment at the PSF, ERS, and TRS. Auditors tested the entire population of incentive compensation awards at GLO.

Information collected and reviewed included the following:

- Incentive compensation plan documentation at the PSF, GLO, ERS, and TRS.
- Incentive compensation payment calculation spreadsheets for incentive compensation plan years ending August 31, 2015, at the PSF and ERS; June 30, 2015, at GLO; and September 30, 2015, at TRS.
- Incentive compensation recipients' personnel files.
- Payroll data related to incentive compensation recipients.
- Investment performance reports from custodian banks.
- Agency internal audit documents.

Procedures and tests conducted included the following:

- Interviewed management and key personnel at the PSF, GLO, ERS, and TRS.
- Tested and recalculated incentive compensation awards for recipients of incentive compensation for incentive compensation plan years ending August 31, 2015, at the PSF and ERS; June 30, 2015, at GLO; and September 30, 2015 at TRS.

- Verified that incentive compensation award payments matched award calculations.
- Reviewed and tested compliance with the audited agencies' policies and procedures.
- Reviewed ERS and TRS internal auditors' education, professional certification, and continuing education to determine whether they complied with *Government Auditing Standards*, Sections 6.40 and 6.41.
- Examined, on a test basis, ERS and TRS internal auditors' work to determine whether it could be used as audit evidence.

Criteria used included the following:

- *Texas Education Agency Permanent School Fund Division Performance Incentive Pay Plan*, effective September 1, 2014.
- *General Land Office Performance Incentive Pay Plan*, effective July 1, 2014.
- *Employees Retirement System of Texas Incentive Compensation Plan for Key Investment Professionals and Leadership Employees*, effective September 1, 2014.
- *Teacher Retirement System of Texas Performance Incentive Pay Plan*, effective October 1, 2014.
- TRS and ERS board of trustees meeting minutes.
- Section 44, Article III, Texas Constitution and related statutes.
- Rider 13, page III-34, and Rider 22, pages III-9 and III-10, General Appropriations Act (83rd Legislature).
- Texas attorney general opinions related to incentive compensation.
- *Government Auditing Standards*, 2011 Revision, Section 6.41.
- *Teacher Retirement System of Texas Performance Incentive Calculation and Verification* procedures document, revised April 23, 2015.

Project Information

Audit fieldwork was conducted from February 2016 through April 2016. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a

reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The following members of the State Auditor's staff performed the audit:

- Benjamin Nathaniel Keyfitz, CPA (Project Manager)
- Yue Zhang, MPA (Assistant Project Manager)
- Doug Stearns
- Dennis Ray Bushnell, CPA (Quality Control Reviewer)
- Michael Owen Clayton, CPA, CISA, CFE, CIDA (Audit Manager)

Issue Rating Classifications and Descriptions

Auditors used professional judgement and rated the audit findings identified in this report. Those issue ratings are summarized in the report chapters/sub-chapters. The issue ratings were determined based on the degree of risk or effect of the findings in relation to the audit objective(s).

In determining the ratings of audit findings, auditors considered factors such as financial impact; potential failure to meet program/function objectives; violation of state statute(s), rules, regulations, and other requirements or criteria; and the inadequacy of the design and/or operating effectiveness of internal controls. In addition, evidence of potential fraud, waste, or abuse; significant control environment issues; and little to no corrective action for issues previously identified could increase the ratings for audit findings. Auditors also identified and considered other factors when appropriate.

Table 6 provides a description of the issue ratings presented in this report.

Table 6

Summary of Issue Ratings	
Issue Rating	Description of Rating
Low	The audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited <u>or</u> the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.
Medium	Issues identified present risks or effects that if not addressed could <u>moderately affect</u> the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern(s) and reduce risks to a more desirable level.
High	Issues identified present risks or effects that if not addressed could <u>substantially affect</u> the audited entity's ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern(s) and reduce risks to the audited entity.
Priority	Issues identified present risks or effects that if not addressed could <u>critically affect</u> the audited entity's ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern(s) and reduce risks to the audited entity.

Related State Auditor's Office Work

Related State Auditor's Office Work		
Number	Product Name	Release Date
15-032	An Audit Report on Incentive Compensation at Selected Agencies	May 2015
14-033	An Audit Report on Incentive Compensation at the Teacher Retirement System, the Permanent School Fund, the General Land Office, and the Employees Retirement System	May 2014
13-033	An Audit Report on Incentive Compensation at the Teacher Retirement System, the Permanent School Fund, and the Employees Retirement System	April 2013

Copies of this report have been distributed to the following:

Legislative Audit Committee

The Honorable Dan Patrick, Lieutenant Governor, Joint Chair
The Honorable Joe Straus III, Speaker of the House, Joint Chair
The Honorable Jane Nelson, Senate Finance Committee
The Honorable Robert Nichols, Member, Texas Senate
The Honorable John Otto, House Appropriations Committee
The Honorable Dennis Bonnen, House Ways and Means Committee

Office of the Governor

The Honorable Greg Abbott, Governor

Employees Retirement System

Members of the Employees Retirement System Board of Trustees
Mr. I. Craig Hester, Chair
Mr. Doug Danzeiser, Vice Chair
Ms. Ilesa Daniels
Ms. Cydney Donnell
Mr. Brian D. Ragland
Mr. Frederick E. Rowe Jr.
Mr. Porter Wilson, Executive Director

General Land Office

The Honorable George P. Bush, Land Commissioner and Chairman of the
School Land Board
Members of the School Land Board
Mr. Gilbert Burciaga
Mr. David S. Herrmann

Permanent School Fund

Members of the State Board of Education
Ms. Donna Bahorich, Chair
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Mr. Ruben Cortez, Jr., Secretary
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Ms. Erika Beltran
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Mr. Tom Maynard
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Mr. Ken Mercer
Ms. Geraldine Miller
Ms. Marisa B. Perez
Mr. Marty Rowley
Mr. Mike Morath, Commissioner of Education

Teacher Retirement System

Members of the Teacher Retirement System Board of Trustees

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Mr. Christopher Moss

Ms. Anita Smith Palmer

Ms. Dolores Ramirez

Mr. Brian Guthrie, Executive Director



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TAB 3B

TESTING OF PERFORMANCE INCENTIVE PAY CALCULATIONS

Plan Year Covering October 1, 2014 through September 30, 2015

TRS Internal Audit Department

Business Objectives	To accurately calculate and award performance incentive compensation amounts in accordance with the Performance Incentive Pay Plan		
Business Risks	<u>Participant Eligibility</u> <ul style="list-style-type: none"> Ineligible employees included in the calculation Wrong salary amount used Incorrect job classification used Incorrect proration percentage used for partial plan year participants 	<u>Three Award Components</u> <ul style="list-style-type: none"> Incorrect investment performance or benchmarks used Wrong peer group or incorrect peer performance used Qualitative scores not supported by employee performance appraisal 	<u>Calculation Worksheets</u> <ul style="list-style-type: none"> Incorrect formulas included in the worksheets Mathematical errors included Manual entries or overrides included Access or edits by unauthorized staff
Management Assertions	Only eligible employees and their correct classifications and salaries are used for incentive pay calculations	Correct award percentages of alpha, peer group performance, and qualitative scores are used for calculations	Calculation worksheets are free from mathematical errors and protected from unauthorized access
Agreed-upon Procedures	<ul style="list-style-type: none"> Compare eligible participants provided by Human Resources to the people included in the calculations, including employee name, participation date, salary, and proration percentage Verify existence of personnel action forms for employees with status changes during the year 	<ul style="list-style-type: none"> Verify whether investment performance results for profit centers and peer group were prepared by independent parties Trace investment performance and alpha targets to source data Compare qualitative scores used in the calculation to the information provided by IMD 	<ul style="list-style-type: none"> Verify whether calculation worksheets include correct formulas, without any manual entries or overrides Verify whether individual tabs correctly support the master calculation worksheet Compare the people authorized to access calculation worksheets to their roles
Test Results	All participants' information matched and personnel action forms existed to support employee status changes	No exceptions related to three award components are noted; however, there are <ul style="list-style-type: none"> No procedures for Investment Accounting's comparison of investment returns and No policy requiring performance appraisals for employees transferring from IMD. 	Calculation worksheets include correct formulas and only authorized people have access. However, State Auditors identified a data entry error for investment performance target, which resulted in overpayment of \$2,236.
Management Comment	None	<ul style="list-style-type: none"> Procedures will be updated Policy will be updated to include close-out evaluation 	Agree – TRS is seeking a technology solution to minimize manual processes

Legend of Test Results: **Red** - Significant to TRS **Orange** - Significant to Business Objectives
Yellow - Other Reportable Exception **Green** - Positive Test Result/No Exception

May 11, 2016

Don Green, Chief Financial Officer

Subject: Report on Independent Testing of Performance Incentive Pay

We have completed the **Testing of Performance Incentive Pay Calculations** as included in the *Fiscal Year 2016 Audit Plan*.

We performed the procedures listed below that were agreed to by management of the Investment Accounting Department and the Human Resources Department. These procedures include testing of participant's eligibility as well as accurate calculations of award amounts in accordance with the Performance Incentive Pay Plan ("Plan") effective for the period from October 1, 2014 through September 30, 2015.

This agreed-upon procedures engagement was performed in accordance with generally accepted government auditing standards contained in the *Government Auditing Standards* issued by the Comptroller General of the United States.

The sufficiency of the agreed-upon procedures performed is solely the responsibility of management of the departments specified in this report. Consequently, we make no representations regarding the sufficiency of the procedures described in **Appendix A** either for the purpose for which this report has been requested or for any other purpose.

Our testing procedures and results are included in **Appendix A**.

Internal Controls

We were not engaged to and did not perform an examination of the internal controls nor the operating effectiveness pertaining to the subject areas tested. Accordingly, we do not express an opinion on the suitability of the design of internal controls nor the operating effectiveness of the subject areas tested.

Had we performed additional procedures, or had we made an examination of the system of internal controls, other matters might have come to our attention that would have been reported to you. This report relates only to the procedures specified in **Appendix A** and does not extend to the internal controls.

This report is intended solely for information and use by TRS management, the Board of Trustees, and legislative oversight agencies, and is not intended to be and should not be used by anyone other than those specified parties. However, this report is a matter of public record and its distribution is not limited, except as protected by statute.

* * * * *

We express our appreciation to management and key personnel of the Investment Accounting, Human Resources, Investment Management Division, and State Street Bank for their cooperation and professionalism shown to us during this testing.



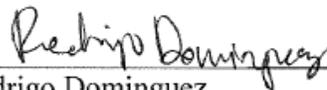
Amy Barrett, CIA, CPA, CISA
Chief Audit Executive



Hugh Ohn, CIA, CPA, CFA, FRM
Director of Investment Audit Services



Lih-Jen Lan, CIA, CPA, CISA, CCSA, CISSP
IT Audit Manager



Rodrigo Dominguez
Internal Audit Intern

APPENDIX A
AGREED-UPON PROCEDURES AND RESULTS
(Testing of Performance Incentive Pay Calculations)

No	Test Area	Test Procedure	Test Result	Management Comment
1	<u>Participant Eligibility</u> (List of Eligible Participants)	Obtain from Human Resources (HR) a final list of eligible participants for the 2014-2015 Plan Year.	Obtained the list from Human Resources which is responsible for keeping records of eligible participants.	No response required
2	<u>Participant Eligibility</u> (Confirmation of Eligible Participants)	Verify whether the employees included in the final list of eligible participants were confirmed by IMD Director of Professional Development.	The Director of Professional Development confirmed the completeness of the final list.	No response required
3	<u>Participant Eligibility</u> (Participant Status Changes)	Select the sample employees with status changes (e.g., added, promoted, or transferred) and verify existence of personnel action form (PAF) to provide support for the status change.	No exceptions noted.	No response required
4	<u>Participant Eligibility</u> (Hire Date and Participation Date)	Compare the HR participant list to the information used in the calculation worksheet for each employee for the hire date and participation date. Ensure that: (a) all eligible participants are included in the calculation worksheet and (b) ineligible participants are not included in the calculation worksheet.	All eligible participants are included in the calculation worksheet and each participant's hire date and participation date matched.	No response required
5	<u>Participant Eligibility</u> (Proration by Participation Date)	Check if the proration percentage (shown in the Proration column) is correct for each participant (e.g., 100%, 75%, 50%, or 25%) based on each person's participation date.	The correct proration percentage was used for each participant.	No response required
6	<u>Participant Eligibility</u> (Proration among Profit Centers)	For the participants who worked for more than one profit center, verify whether those proration percentages among profit centers are correct per information provided by HR.	The correct proration percentages were used.	No response required
7	<u>Participant Eligibility</u> (Reasonableness Checks on Position and Department)	Scan the participant's Incentive Level and Department columns of the calculation worksheet to see if each participant's incentive compensation position and his/her department (profit center) appear to be correct (based on Investment Audit Team's general knowledge of IMD staff and movement).	Each participant's position and assigned department appear to be correct.	No response required

No	Test Area	Test Procedure	Test Result	Management Comment
8	<u>Participant Eligibility</u> (Salary Information)	Compare each participant's salary information (included in the Salary column of the calculation worksheet) to information provided by HR to check whether they match.	Salary information matched for each participant.	No response required
9	<u>Participant Eligibility</u> (Maximum Award Opportunity)	Compare each participant's maximum award opportunity (MAO) information (included in the MAO columns of the master worksheet) to the information provided by HR.	MAO information (i.e., percentages and amounts) matched.	No response required
10	<u>Participant Eligibility</u> (Terminated Employees)	Obtain from HR a list of the participants who were terminated during the current plan year and check whether any terminated employees are included in the calculation worksheet or Current Year Payout tab.	No terminated employees were included in the calculation worksheet or payout tab.	No response required
11	<u>Three Award Components</u> (Investment Return Information)	Obtain investment performance information as of September 30, 2015 from State Street, broken down by IMD profit centers.	Obtained information from State Street independently.	No response required
12	<u>Three Award Components</u> (State Street's Investment Return Calculations)	Contact appropriate State Street representative to obtain information about internal controls established to ensure accurate and complete calculations of investment performance for incentive compensation purpose. If considered necessary, obtain evidence that these controls were followed.	Met with State Street representatives and obtained information about their quality control on investment return calculations, including checklist completed.	No response required
13	<u>Three Award Components</u> (Review of Profit Center Returns Prepared for Incentive Compensation Purposes)	Contact IMD and Investment Accounting to obtain information about review and reconciliation of investment returns prepared by State Street for incentive compensation purposes.	Contacted the IMD and Investment Accounting and learned that IMD Management Committee review profit center returns. In addition, Investment Accounting compares profit center returns to Pure View reports, although this comparison is not specified in the policies or procedures.	Performance Incentive Calculation and Verification Procedures will be updated to reflect the investment return comparisons performed by Investment Accounting.
14	<u>Three Award Components</u> (Review of Investment Returns)	Verify whether IMD Investment Management Committee (IMC), Investment Operations, and/or Investment Accounting reviews and confirms State Street's investment	IMC members were given the opportunities to review investment performance information for	No response required

No	Test Area	Test Procedure	Test Result	Management Comment
		performance information for reasonableness.	reasonableness and none of the members expressed concerns about performance information.	
15	<u>Three Award Components</u> (Alpha by Profit Center)	Trace the following investment performance numbers for sample IMD profit centers (for both one-year's and three-years'): a. Actual performance numbers to State Street's investment return summary b. Alpha target numbers to Addendum A of the Plan document Verify whether alphas for sample profit centers are correctly calculated.	Based on the investment returns prepared by State Street, alphas for sample profit centers were correctly calculated. However, State Auditor's Office identified a data entry error for the 3-year performance target for Private Equity SPN, which resulted in incorrect payment amount of \$2,236.	TRS is currently seeking a technology solution that will minimize manual processes involved in the calculation.
16	<u>Three Award Components</u> (Performance Allocation among Profit Centers)	Trace each profit center performance allocation percentage to the Addendum A of the Plan to verify if correct allocation percentages are used in the calculation.	Correct allocation percentages were used.	No responses required
17	<u>Three Award Components</u> (Internal Public Markets staff's Performance Attribution)	Trace performance results for each portfolio manager and sector manager to the performance summary prepared by Investment Operations (and previously tested by Internal Audit as part of Quarterly Compliance Testing).	Correct outperformance or underperformance numbers were used for Internal Public Markets managers.	No response required
18	<u>Three Award Components</u> (Benchmark Alpha)	Trace each participant's alpha from benchmarks used in the calculation worksheet to the information in the Passive Portion Calculation tab to verify if the correct earned-percentage of the appropriate profit center was used for each participant's award percentage.	Correct earned percentage for benchmark alpha was used for each participant.	No response required
19	<u>Three Award Components</u> (Peer Group Performance)	Trace Peer Group median performance numbers (for both one-year and three years) of Total Trust, Private Equity, and Real Assets to the Trust Universe Composite Services (TUCS) report.	Peer Group performance information is supported in the TUCS report.	No response required
20	<u>Three Award Components</u> (Peer Group Alpha Targets)	Trace alpha target numbers of the Total Trust, Trade Management Group, Private Equity, and Real Assets to the Addendum B of the Plan	Alpha targets as well as the performance allocation percentages among profit centers	No response required

No	Test Area	Test Procedure	Test Result	Management Comment
		document. Also, Trace the performance allocation percentages among profit centers to the Addendum B of the Plan to determine whether they match.	matched information included in the Plan.	
21	<u>Three Award Components</u> (Peer Group Alpha)	Verify if excess returns from the Peer Group alpha targets are accurately calculated for each profit center.	Peer Group excess returns were accurately calculated.	No responses required
22	<u>Three Award Components</u> (Peer Group Earned Percentages)	Trace Peer Group earned percentage of each participant to Peer Group Performance tab to determine whether correct earned percentage number of the appropriate profit center was used in the calculation.	Correct Peer Group earned percentages were used for each participant.	No response required
23	<u>Three Award Components</u> (Qualitative Award)	Obtain information on the Qualitative Award for each participant from IMD Professional Development and compare it with the percentage used in the calculation worksheet.	Information supporting qualitative award existed.	No response required
24	<u>Three Award Components</u> (Qualitative Award)	Trace qualitative earned percentage of each participant to the supporting Qualitative Earned tab to determine whether they agree.	Qualitative award information matched. However, Currently there is no policy to require close-out performance evaluations when IMD employees transfer to other TRS departments during the Plan Year.	Human Resources will include a requirement for close-out evaluation of transfer employees as part of policy updates.
25	<u>Three Award Components</u> (Weight Used for Each of Three Component)	Verify if the percentage of MAO earned for each participant is correctly calculated (by using the weights of 50% for passive award, 30% for peer group award, and 20% for qualitative award).	Correct MAO earned percentages were used in the calculation.	No response required
26	<u>Three Award Components</u> (Total Award Amount)	Verify if the total incentive award amount for each participant is correctly calculated for the current year (by multiplying Maximum Potential Award amount by the percentage of the MAO earned).	Total award amount was correctly calculated for each participant.	No response required
27	<u>Three Award Components</u> (Deferred Amounts from Prior year)	Obtain from HR prior year's payment information (i.e., 50% of the award amount) for each participant. Compare each participant's remaining payout amount with prior year's payment amount to verify if they match, excluding terminated employees.	Each amount matched.	No response required

No	Test Area	Test Procedure	Test Result	Management Comment
28	<u>Three Award Components</u> (Current Year Payout Amounts)	Verify whether the current year payout amount is correctly calculated for each active participant (by adding the 50% of the current year's award amount to the prior year's deferred amount).	Current year's payout amount was correctly calculated for each active participant.	No response required
29	<u>Three Award Components</u> (IMD Review of Award Amounts)	Confirm that Investment Accounting sent the preliminary award amounts to IMD (e.g., IMC members) to review preliminary results before finalizing them.	Confirmed that preliminary award amounts were sent to IMD for review.	No response required
30	<u>Calculation Worksheets</u> (Preparation of Source Data)	Verify whether information included in the calculation worksheets has been separately prepared and reviewed by responsible groups, such as HR, State Street, IMD and Investment Accounting.	Preparers and reviewers signed on the confirmation checklist.	No response required
31	<u>Calculation Worksheets</u> (Links between Calculation Worksheet and Supporting Tabs)	Check if individual tabs included in the calculation worksheet correctly support the master calculation worksheet for the current plan year.	All links and formulas were correct.	No response required
32	<u>Calculation Worksheets</u> (Any Use of Overrides in Cells)	Check if the cells used in the calculation worksheet only contain formulas, without any typed-in numbers or overrides.	No inappropriate typed-in entries or overrides were included in the cells.	No response required
33	Calculation Worksheets (Access to IT Folders)	Contact Help Desk to obtain the list of people authorized to access to the PIP SharePoint and verify if only authorized people have access. For example, none of the IMD employees covered by the PIP should have right to edit the calculation worksheets.	IT access levels of authorized people were appropriate.	No response required

TAB 3C

QUARTERLY INVESTMENT COMPLIANCE TESTING
INVESTMENT POLICY STATEMENT (IPS), SECURITIES LENDING POLICY (SLP), PERFORMANCE INCENTIVE PAY (PIP) PLAN, WIRE
TRANSFER PROCEDURES, AND EMPLOYEE ETHICS POLICY
 CALENDAR QUARTER ENDED MARCH 31, 2016, EXCEPT AS NOTED

Business Objectives	1. <u>Board Reports</u> All required information is reported to the TRS Board of Trustees	2. <u>Investment Selection and Approval</u> Investments made are within delegated limits and established selection criteria	3. <u>Other (IPS, SLP, wire transfers, other reporting)</u> Risk limits are followed for other investment programs and activities	4. <u>Ethics Policies</u> Ethics filing and reporting requirements are met
Business Risks	Board is not informed of key investment decisions and critical information	Approvals and fundings exceed delegated limits	Risks exceed Board-established tolerances or management policies and procedures	Ethics policy requirements are not performed or filed
Management Assertions	All required information is reported to the Board	Approvals and fundings are within delegated limits and made for qualified managers	Programs are within risk limits and activities follow established policies and procedures	Ethics policies and requirements are being followed
Agreed-Upon Procedures	<ul style="list-style-type: none"> Compare Board reports to IPS requirements Vouch sample information included in Board reports to supporting documentation 	<ul style="list-style-type: none"> Vouch Internal Investment Committee (IIC) approved investments to supporting documentation Verify approval limits of new investments Obtain evidence that Placement Agent Questionnaires (PAQs) were received prior to investing 	<ul style="list-style-type: none"> Validate SLP compliance Test accuracy of Internal Public Markets PIP calculations for the quarter ended 12/31/2015. Test supporting documentation for wire transfers Obtain senior management disclosures about known compliance violations 	<ul style="list-style-type: none"> Obtain evidence that Key Employees acknowledged their Key Employee status
Test Results	<ul style="list-style-type: none"> All reporting requirements were met Documentation provided support for the reports tested 	<ul style="list-style-type: none"> All investments tested were in compliance with approval limits PAQs were obtained for all investments tested 	<ul style="list-style-type: none"> All requirements of the IPS, SLP, PIP, and wire transfer procedures tested were met Chief Compliance Officer disclosed one external manager's trade with an unauthorized counterparty 	<ul style="list-style-type: none"> All ethics filing and training requirements tested were met
Management Responses	N/A	N/A	Trade was transferred to an authorized counterparty. Resulted in no financial loss or gain to TRS.	N/A

Legend: **Red** - Significant to TRS **Orange** - Significant to Business Objectives **Yellow** - Other Reportable Exception **Green** - Positive Test Result/ No Exception



June 1, 2016

Carolina de Onis, TRS General Counsel

We have completed the **Quarterly Investment Compliance Testing** for the quarter ended March 31, 2016, as included in the *Fiscal Year 2016 Audit Plan*. This scope of this engagement included the requirements of the Investment Policy Statement (IPS), Securities Lending Policy (SLP), Employee Ethics Policy, Wire Transfer Procedures, and Performance Incentive Pay (PIP) Plan.

We performed the procedures that were agreed to by the TRS Legal Services division. These procedures include tests that supplement the current compliance monitoring procedures performed by State Street and the Chief Compliance Officer.

This agreed-upon procedures engagement was performed in accordance with generally accepted government auditing standards contained in the *Government Auditing Standards* issued by the Comptroller General of the United States.

The sufficiency of the agreed-upon procedures performed is solely the responsibility of the specified users of the report. Consequently, we make no representations regarding the sufficiency of the procedures described in **Appendix A** either for the purpose for which this report has been requested or for any other purpose.

Our testing procedures and results are included in **Appendix A**.

Internal Control Structure

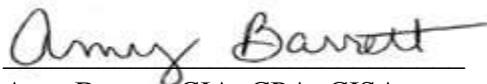
We were not engaged to and did not perform an examination of the internal controls nor the operating effectiveness pertaining to the subject areas tested. Accordingly, we do not express an opinion on the suitability of the design of internal controls nor the operating effectiveness of the subject areas tested.

Had we performed additional procedures, or had we made an examination of the system of internal control, other matters might have come to our attention that would have been reported to you. This report relates only to the procedures specified in **Appendix A** and does not extend to the internal control structure.

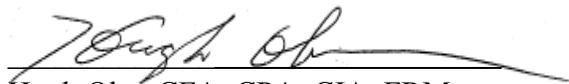
This report is intended solely for information and use by TRS management, the Board of Trustees, and oversight agencies, and is not intended to be and should not be used by anyone other than those specified parties. However, this report is a matter of public record and its distribution is not limited.

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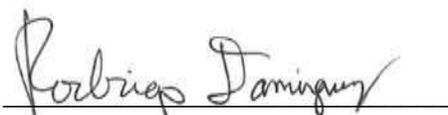
We express our appreciation to management and key personnel of the Investment Management Division, Investment Accounting, and Legal Services for their cooperation and professionalism shown to us during this quarterly testing.



Amy Barrett, CIA, CPA, CISA
Chief Audit Executive



Hugh Ohn, CFA, CPA, CIA, FRM
Director of Investment Audit Services



Rodrigo Dominguez
Internal Audit Intern

APPENDIX A
AGREED-UPON PROCEDURES AND RESULTS

STEP #	OBJ. #	TEST PURPOSE	TEST DESCRIPTION	TEST RESULT	MANAGEMENT RESPONSE
1	1	IPS Article 1.7a - 1.7o – Obtain evidence that all requirements were reported to Board of Trustees. Quarterly reporting requirements include investment performance, asset class exposures, and external investments under consideration. Semi-annual reports include outstanding derivatives, leverage, and liquidity positions, and risk limits	<ul style="list-style-type: none"> • Obtain information reported to the Board of Trustees and compare it to reporting requirements per Investment Policy Statement (IPS) • Vouch sample information reported to the Board of Trustees to supporting documentation 	<ul style="list-style-type: none"> • Information reported to Board of Trustees complied with IPS requirements. • Documentation provided support for the information included in Board reports 	No response required
2	2	IPS Article 2.6 – Verify that Investment Management Division (IMD) evaluated hedge fund classification	<ul style="list-style-type: none"> • Select a sample of approved investments in hedge funds and external managers • Obtain analysis indicating whether each investment is hedge fund or not. If analysis is unavailable, inconclusive, or erroneous, report that result • For any analysis requiring Board approval of classification, obtain Board minutes to test whether approval was obtained 	Approved hedge fund tested had analysis indicating whether investment was a hedge fund or not. No Board approval was required.	No response required
3	2	IPS Article 2.7 a – Verify that the Internal Investment Committee (IIC) approve investments in the External Public Markets (EPU) portfolio in accordance with relevant guidelines	Select a sample of EPU investments and verify whether IIC approval was obtained	IIC approval was obtained on the investment tested.	No response required

STEP #	OBJ. #	TEST PURPOSE	TEST DESCRIPTION	TEST RESULT	MANAGEMENT RESPONSE
4	2	IPS Article 2.7 g – Verify funds added to previously approved investments for purposes of rebalancing or adjusting risk did not exceed 2% of associated portfolios	<ul style="list-style-type: none"> • Inquire with Managing Director of EPU whether portfolios were adjusted for the purposes of rebalancing or adjusting risks • If funds added, did such additional investments or allocations exceed 2% of Hedge Fund Portfolio, External Manager Portfolio, or Other Absolute Return Portfolio (as appropriate) per investment on a monthly basis • Obtain documentation from IMD staff supporting rebalancing analytics. Report on exceptions. 	Funds added to previously approved investments or purposes of rebalancing or adjusting risk did not exceed 2% of associated portfolios.	No response required
5	3	IPS Article 10.3 d – Obtain evidence of IMD’s examination of requirements of its securities lending agent	Obtain monthly securities lending review reports for the quarter to test whether the securities lending agent is an organization rated A- or better by a Nationally Recognized Statistical Rating Organization (NRSRO)	The rating for State Street was A- or better per Moody’s, Fitch, and Standard and Poor’s.	No response required
6	2	IPS Article 10.9 – Verify leverage used meets requirements	<ul style="list-style-type: none"> • Obtain leverage report provided to the TRS Board and compare reported leverage uses to leverage use allowed by the IPS • Inquire whether any risk parameters were exceeded and if so, was the limit caused by leverage 	Leverage was used only as authorized and no risk parameters were exceeded.	No response required
7	2	IPS Article 12 - Obtain evidence of existence of placement agent questionnaire (PAQ) for each new investment selected for testing and test for inclusion in summary report to the Board	<ul style="list-style-type: none"> • For each investment selected for testing, verify that IMD obtained responses to the questionnaire • Determine that IMD compiled responses to the questionnaires and reported all results to the Board at least semi-annually 	<ul style="list-style-type: none"> • The hedge fund tested has a completed questionnaire. • A summary of responses to the placement agent questionnaires was reported to the Board. 	No response required
8	2	IPS Appendix B – Obtain evidence that investments approved are within policy limits	<ul style="list-style-type: none"> • Select sample of approved investments and obtain tear sheet for each, observe the approved amounts are within authorized limits <ul style="list-style-type: none"> a) Initial allocation – .50% b) Additional or follow-on – 1% c) Total Manager Limits – 3% 	NA – no new EPU investments were approved during the quarter.	No response required

STEP #	OBJ. #	TEST PURPOSE	TEST DESCRIPTION	TEST RESULT	MANAGEMENT RESPONSE
			d) Total limit each manager organization – 6% <ul style="list-style-type: none"> • Obtain documentation from IMD staff that supports the calculations of the authorized limits • Inquire if any “Special Investment Opportunities” were made for the quarter 		
9	3	Quarterly Compliance Certification – Obtain evidence that all known compliance violations have been reported by IMD managers and Investment Legal staff	Confirm with the Chief Compliance Officer that she has received compliance certification from IMD management, Investment Legal staff, and CIO regarding any known compliance violations occurred during the testing period	Obtained confirmation from the Chief Compliance Officer. One compliance exception related to an external manager’s currency forward trade with a non-ISDA counterparty was identified. This violation was caused by the manager’s failure to code legacy rules restricting eligible TRS counterparties into its new Account Broker System.	The trade was transferred to an ISDA-counterparty before settlement and the IMD confirmed that the manager’s system has been re-coded. This violation resulted in no financial loss or gain to TRS.
10	3	Wire Transfers – Obtain evidence that TRS Investment Accounting’s record of processed investment funding was complete	Obtain wire transfer reports for testing period, select sample of wire transfers, and test that supporting documentation, including manager authorizations, exists for each wire transfer	All wire transfers tested were properly authorized and correct amounts were wired.	No response required
11	3	Securities Lending Policy – Obtain evidence that IMD reviews the securities lending program and performance of lender	Obtain evidence for the following securities lending policy requirements: <ul style="list-style-type: none"> a) Cash collateral received from borrowers is invested in either securities that qualify as “first tier securities” within Rule 2a-7 under the Investment Company Act of 1940, or Moody’s A3 or Standard & Poor’s A- or greater. b) The fair market value of the cash collateral investments portfolio must not decline by more than .0035 percent per 1 basis point change in interest rates. c) The maximum market value of securities on loan at any one time shall not exceed 30% of 	<ul style="list-style-type: none"> a) Cash collateral received from borrowers was invested in authorized securities. b) Testing of the interest rate sensitivity of the cash collateral investment pool indicated that the portfolio fair market value would not decline by more than .0035 percent per a 1 basis point change in interest rates. c) During the quarter, the market value of TRS securities on loan did not exceed 30% of the market value of the total TRS portfolio. 	No response required

STEP #	OBJ. #	TEST PURPOSE	TEST DESCRIPTION	TEST RESULT	MANAGEMENT RESPONSE
			the market value of the total TRS investment portfolio.		
12	3	Performance Incentive Pay Plan (PIP) – Verify that investment performance results used in quarterly Internal Public Markets (IPM) portfolio matches data from TRS financial applications and custodian bank and that the excess return calculations for individual portfolio managers and sector managers are correct	Trace quarterly IPM individual component calculation spreadsheet to TRS financial performance application data and TRS custodian bank data. Test whether employee assignments were approved by Senior Director in TRS IPM prior to quarter start by obtaining approval email from Senior Director in TRS IPM to Investment Operations Performance Analyst. If any assignment changes are included in the approval, compare the approved changes to the assignments in the quarterly IPM individual component calculation spreadsheet. Test whether formulas in the quarterly IPM individual component calculation spreadsheet are correct by recalculating investment return totals by portfolio manager and sector manager, and comparing total investment returns to returns provided by the TRS Custodian Bank.	There were no data, employee assignment, or formula errors included in the quarterly IPM individual component calculation spreadsheet. Thus, excess return calculations for individual portfolio managers and sector managers for the IPM portfolio were correct for the quarter ended December 31, 2015.	No response required
13	4	Employee Ethics Policy – Verify that Key Employees acknowledged their Key Employee status through the annual Ethics Compliance Statement.	Obtain evidence that the sample TRS Key Employees submitted their Key Employee Status Acknowledgment forms to Legal Services for 2016.	All sampled Key Employee Acknowledgment forms were filed with TRS Legal for 2016.	No response required

Note: Testing procedures for the Investment Policy Statement (IPS), Securities Lending Policy (SLP), Employee Ethics Policy, and Wire Transfer Procedures were performed for the quarter ended March 31, 2016. Compliance certifications obtained by the Chief Compliance Office were for the quarter ending April 30, 2016. Testing procedures for the Performance Incentive Pay Plan were for the quarter ended December 31, 2015.

TAB 4

TRS-ACTIVECARE OPEN ENROLLMENT AND BILLING ISSUES AND STATUS

June 2016

TRS Internal Audit Department

Objective	Assess preparedness for TRS-ActiveCare open enrollment
Business Risks	<ul style="list-style-type: none"> • Incorrect enrollment of employees or dependents • Delayed access to care • Incorrect billing to school districts • Data vulnerability
Procedures	<p>Readiness Review</p> <ul style="list-style-type: none"> • Interviews with school districts • Onsite visit to vendor • Walk-through of key processes • Interviews with vendor management and staff • Testing of implemented controls
Issues & Remediation Status	<p>Remediation Implemented; Testing Complete</p> <ul style="list-style-type: none"> • Incorrect enrollment of dependents • Duplicate enrollments • Billing discrepancies (significantly reduced) • Delayed responses to Benefit Administrators <p>Remediation Implemented or in Progress; Additional Testing Needed</p> <ul style="list-style-type: none"> • Ineffective discrepancy reports • Delayed processing of enrollment transactions and files during open enrollment • Urgent updates overwritten by subsequent file transfers • MESA, the web-based enrollment portal used by employees and Benefit Administrators, is not user friendly • Lack of reporting and search capabilities within MESA • Insufficient training for Benefit Administrators prior to open enrollment • Benefit Administrators unable to access or navigate the Aetna enrollment portal to verify benefit coverage • Delayed or incorrect processing of split premium arrangements • Delayed processing of coverage, receipt of insurance cards due to inefficient end date for open enrollment period • Insufficient time for employees to review coverage options prior to open enrollment • Lack of timely communication to Benefit Administrators regarding the reason for transaction denials in MESA • Inaccurate enrollment of dependents due to confusing enrollment process within MESA • Lack of defined and documented change management process for key system changes and updates <p>Remediation in progress; Additional Testing Needed</p> <ul style="list-style-type: none"> • Data vulnerability issues
Management Actions	<p>Aetna and TRS have identified and are addressing 17 action items over various timeframes in the following areas:</p> <ul style="list-style-type: none"> • Enrollment discrepancy reporting • Resource capacity • Training • Communication • Data processing • Data vulnerabilities <p>If those actions, including interim solutions, are implemented successfully, TRS management believes that TRS-ActiveCare is prepared for the next open enrollment, recognizing that the process will not be flawless, but should be significantly improved.</p>

Legend of Results:



Red - Significant Impact to TRS
 Yellow - Moderate Impact to Business Objectives



Orange - Significant Impact to Business Objectives
 Green - No Issue

TAB 5

TAB 5A

SUMMARY OF AUDITS OF FOUR INDEPENDENT SCHOOL DISTRICTS

June 2016

TRS Internal Audit Department

Audit Objectives	<p>To determine the following:</p> <ul style="list-style-type: none"> • Completeness and accuracy of reports submitted to TRS by the Reporting Entity (RE) for the test month • TRS membership eligibility of contract workers performing services for the Reporting Entity • Accuracy of census data information (name, date of birth, gender, amount of salary, year of entry, years of service)
Risks	<ul style="list-style-type: none"> • Eligible members are not included and/or ineligible employees are incorrectly included in reports • Ineligible compensation included in salary reported to TRS • Incorrect calculations of contributions and surcharges • Inaccurate actuarial data because census data provided to TRS is not correct
Tests	<ul style="list-style-type: none"> • Compare reports submitted to TRS with source documentation of Reporting Entity to confirm: <ul style="list-style-type: none"> ○ Eligibility of TRS membership and eligible compensation ○ Accuracy and completeness of contributions and surcharges ○ Accuracy and completeness of Employment After Retirement Area 1 and 2 Reports • Review contracts/invoices of contract workers to determine if eligible for TRS membership • Determine accuracy of census data reported to TRS
Results	<p>Positive Findings: Promptness in responding to questions/document requests; well-organized records</p> <ul style="list-style-type: none"> • Testing results of reports submitted to TRS (tested 120 active members, 146 retirees) <ul style="list-style-type: none"> ○ Regular Payroll Report: Improperly included ineligible compensations for two employees; improperly excluded eligible compensation for one employee; improperly excluded and did not pay contributions on one employee (member contribution, RE contribution, and TRS-Care contribution); unable to determine whether four employees not reported to TRS were eligible for TRS membership. ○ New Member Report: Improperly excluded and did not pay contributions on one new member; unable to determine the completeness and accuracy of one New Member Report. ○ Federal Fund/Private Grant Report and Federal Fund TRS-Care Report: Incorrectly calculated and underpaid contributions on two members. ○ Statutory Minimum Report: Improperly excluded and did not pay contributions on five members; incorrectly calculated and overpaid on 22 members; incorrectly calculated and underpaid on four members. ○ Non-OASDI Report: Improperly excluded and did not pay contributions on one employee; incorrectly calculated and overpaid contributions on 14 members; incorrectly calculated and underpaid contributions on 20 members. ○ Pension Surcharge Report: Improperly excluded and did not pay surcharges on 16 retirees; improperly included and paid surcharge on one retiree. ○ TRS-Care Surcharge Report: Improperly excluded and did not pay surcharges on three retirees. ○ EAR Area 1 and 2 Reports: Improperly excluded 70 retirees from Employment After Retirement Reports; improperly included one retiree in Employment After Retirement Report; improperly reported one retiree in Employment After Retirement Report; improperly used job classification for reporting Employment After Retirement; did not always maintain documentation of hours worked by retirees. • Tested contract workers to determine TRS eligibility and referred one contract to TRS Legal Services for review and determination for TRS eligibility. • Census data testing: Salaries for two members were inaccurate. • Verification of Report Totals: Some report totals per TRAQS reports submitted to TRS did not agree with the REs' supporting documentation.
Recommended Actions	<p>Combined recommended actions:</p> <ul style="list-style-type: none"> • Work with TRS Reporting and Query System (TRAQS) coaches to correct reports by agreed-upon deadlines • Ensure personnel are trained and knowledgeable of <i>TRS Laws and Rules</i> by reading and studying reporting information and self-audit tools provided on the TRS website • Maintain documentation of hours worked by all TRS retirees who have returned to work
Management Responses	<p>Each Reporting Entity agreed with the recommendations and will:</p> <ul style="list-style-type: none"> • Work with TRS Reporting and Query System (TRAQS) coaches to correct reports by agreed-upon deadlines • Ensure personnel are trained and knowledgeable of <i>TRS Laws and Rules</i> by reading and studying reporting information and self-audit tools provided on the TRS website • Maintain documentation of hours worked by all TRS retirees who have returned to work

TAB 5B

AUDIT OF MANOR INDEPENDENT SCHOOL DISTRICT

January 15, 2016

TRS Internal Audit Department

Audit Objectives	<p>To determine the following:</p> <ul style="list-style-type: none"> • Completeness and accuracy of reports submitted to TRS by the Reporting Entity (RE) for the test month • TRS membership eligibility of contract workers performing services for the Reporting Entity • Accuracy of census data information (name, date of birth, gender, amount of salary, year of entry, years of service)
Risks	<ul style="list-style-type: none"> • Eligible members not included and/or ineligible employees are incorrectly included in reports • Ineligible compensation included in salary reported to TRS • Incorrect calculations of contributions and surcharges • Inaccurate actuarial data because census data provided to TRS is not correct
Tests	<ul style="list-style-type: none"> • Compare reports submitted to TRS with source documentation of Reporting Entity to confirm: <ul style="list-style-type: none"> ○ Eligibility of TRS membership and eligible compensation ○ Accuracy and completeness of contributions and surcharges ○ Accuracy and completeness of Employment After Retirement Area 1 and 2 Reports • Review contracts/invoices of contract workers to determine if eligible for TRS membership • Determine accuracy of census data reported to TRS
Results	<ul style="list-style-type: none"> • Positive Finding: <ul style="list-style-type: none"> ○ Manor ISD officials were prompt in responding to questions and providing supporting documentation ○ Personnel files were well organized • Test Results (Tested 30 of the 1,197 members reported to TRS, five of the 122 employees not reported to TRS, four of the seven independent contract workers, all 27 retirees): <ul style="list-style-type: none"> Member Contributions <ul style="list-style-type: none"> ○ One \$200 car allowance improperly included and \$211.70 benefit pay improperly included ○ One \$1,250 bilingual education stipend improperly excluded ○ Unable to determine whether four employees not reported to TRS are eligible for TRS membership because supporting documentation for hours worked is not maintained ○ Four independent contract workers tested who performed services for the RE from the list provided were properly excluded from the Regular Payroll Report Employer Contributions and Surcharges <ul style="list-style-type: none"> ○ See related issues above ○ Incorrectly calculated contributions for two members for federal fund pension and TRS-Care reimbursement contributions ○ Statutory Minimum and Non-OASDI Reports used the incorrect Years of Experience Credit (Salary Step) table resulting in inaccurate contributions ○ Retirees incorrectly classified as substitutes but working in permanently open positions ○ Incorrectly excluded and did not pay surcharges for nine retirees working more than half-time Other Results <ul style="list-style-type: none"> ○ Inaccurate census data information on the two employees whose compensation was incorrectly reported ○ Report totals for federal fund pension and TRS-Care reimbursement contributions per the TRAQS reports did not agree with the RE supporting documentation. Although the totals per the TRAQS EAR pension surcharge, TRS-Care surcharge, and the Area 1 and 2 Reports agreed to the RE supporting documentation, the reports themselves were inaccurate and incomplete ○ Supporting documentation for the time worked by retirees is not consistently maintained ○ Retirees on Area 1 and 2 Reports not properly classified ○ Inaccurate and incomplete Area 1 and 2 Reports ○ The Chief Financial Officer informed us that there are inaccuracies in Manor ISD's official records and these inaccuracies are being tested by other auditors. Additionally, we were informed that there were inaccurate salaries on four other employees
Recommended Actions	<p>We recommend that the Manor ISD officials:</p> <ul style="list-style-type: none"> • Work with TRAQS coaches to correct reports by March 2016 • Ensure personnel are knowledgeable of TRS Rules and Laws • Maintain sufficient and accurate records of time worked for all substitutes and retirees
Management Responses	<p>Manor ISD officials concur with the recommendations and will work to adjust the reports by March 2016. Finance and Human Resource staff recently attended training with their TRS TRAQS coach and are imparting this knowledge to all staff. Manor ISD officials are also working to refine a process that when fully implemented will ensure the accuracy of time worked for substitutes and retirees.</p>

January 15, 2016

Mr. Roy Knight
Acting Superintendent of Schools
Manor Independent School District
P.O. Box 359
Manor, TX 78653

AUDIT REPORT OF MANOR INDEPENDENT SCHOOL DISTRICT

EXECUTIVE SUMMARY

We have completed the audit of eligibility and contributions, as included in the *Fiscal Year 2016 Audit Plan*. Our audit objectives were to determine the following¹:

- Completeness and accuracy of the reports submitted to TRS by the Reporting Entity² for the test month
- Eligibility of contract workers performing services for the Reporting Entity for TRS membership
- Accuracy of census data information (name, date of birth, gender, amount of salary, year of entry, years of service)

During the audit, we observed the following:

- Manor ISD officials were prompt in responding to questions and providing supporting documentation
- Personnel files were well organized

Based on our audit results:

- All but one report were incomplete and inaccurate and for that one report we were unable to determine the completeness and accuracy
- Of the list of contract workers provided to TRS, no contract workers performing services for the Reporting Entity were eligible for membership; therefore, they were properly excluded from the Regular Payroll Report
- Census data information reported to TRS was inaccurate for two employees' salaries in our sample. Additionally, management disclosed inaccurate salaries for four other employees
- We were unable to conclude if four employees not reported to TRS were eligible for TRS membership because supporting documentation for work as a substitute was not maintained

¹ Assuming the completeness and accuracy of the official records maintained by the Reporting Entity

² A Reporting Entity (RE) is an employer, as defined in Texas Government Code, Title 8, Subtitle C, Chapter 821.001.

- All amounts of contributions made to TRS per the TRAQS reports agreed with the Reporting Entity detailed supporting documentation, with the exception of the Federal Fund Reports for TRS pension fund reimbursement and TRS-Care reimbursement. Also, the amount reported for surcharges was incomplete
- Time records are not maintained for employed retirees

Refer to Appendix B for detailed results of testing.

BACKGROUND

PROJECT BACKGROUND

The Annual Audit Plan approved by the TRS Board of Trustees includes audits of reporting entities in order to confirm member eligibility and accuracy of contributions and fees. The type of information submitted by reporting entities to TRS includes:

- Regular Payroll Reports of positions, salary/hourly rate, contract dates, position codes
- Contributions
- Surcharges
- Census data
- Lump sum payments

In reaction to new requirements of the Governmental Accounting Standards Board, the American Institute of Certified Public Accountants (AICPA) issued a white paper indicating that reporting entities' census data should be audited. As a result, we have included testing of census data (name, date of birth, gender, amount of salary, year of entry, and years of service) in the scope of this audit. Separately, the State Auditor's Office is performing audits of reporting entities' census data as part of the audit of TRS Comprehensive Annual Financial Statements.

The population of reporting entities from which the sample was selected for testing included all Texas public schools. These were selected based on criteria including the following:

- Frequency of adjustments and corrections to reports
- Complaints about the Reporting Entity
- Warrant holds
- Weaknesses in finance area reported by the Legislative Budget Board (LBB), the State Auditor's Office (SAO), or the Texas Education Agency (TEA)
- No audit history of census data by TRS or the SAO within last five years

The Manor ISD was chosen for audit using a consistent risk assessment methodology that included the variables listed above.

REPORTING ENTITY BACKGROUND³

Originally established in the late 1880's, the Manor community was a hub for the Central Texas cotton industry and has grown to be a hub for the high-tech industry, with Samsung and Applied Materials within its boundaries and Dell and Freescale Semiconductors in close proximity.

Manor Independent School District (MISD) is a rapidly growing, diverse district that encompasses approximately 100 square miles and includes addresses in Austin, Manor, and Elgin, Texas. It serves over 8,600 students at two high schools, two middle schools, eight elementary schools, and one alternative academy.

The MISD is made up of a unique blend of rural and urban features with its diverse population. Its primary focus offers exciting opportunities and demonstrates what is possible when educating 21st century students.

This fall, the MISD opened a new workforce training center — the first of its kind in Central Texas — for students to earn college credit and a job certificate. In partnership with Austin Community College, Manor High School juniors and seniors can earn certifications to work as nursing assistants, medical assistants and computer technicians. Certification programs are also offered in heating and air conditioning, electrical pre-apprenticeship and mechatronics. In most of those programs, students will also earn college credit.

MISD's mission statement is to provide College and Career Readiness programs and professional, career-oriented higher education to students from diverse backgrounds. MISD proudly offers access and opportunity to motivated students who desire to enrich their lives in a personalized and supportive environment. MISD provides caring and effective teaching and engaged staff who are passionate, knowledgeable, and dedicated to student achievement. They build on these strengths to prepare students for successful careers, advanced education, and lifelong learning.

³ Information obtained from the ISD website and other internet sources.

RESULTS AND RECOMMENDATIONS

OVERALL RESULTS

Positive Findings

During the audit, we observed the following:

- Manor ISD officials were prompt in responding to questions and providing supporting documentation
- Personnel files were well organized

Other Findings

We tested:

- Thirty of the population of 1,197 members reported to TRS in the Regular Payroll Report for the test month of May 2015
- Four retirees who performed services in May 2015
- Five employees paid in the test month who were not reported to TRS in the Regular Payroll Report
- Four contract workers paid for the test month for services performed

With the exception of the superintendent’s salary, we did not test whether salary amounts included in the reporting entity’s payroll register were complete, accurate, and authorized.

We did not test the eligibility to receive an annuity of those retirees who have returned to work.

We concluded the following about the completeness and accuracy of the reports submitted to TRS:

NAME OF REPORT	COMPLETE?	ACCURATE?
Regular Payroll Report - Member Contributions to Pension Fund - Member Contributions to TRS-Care - Reporting Entity Contributions to TRS-Care	No	No
Reporting Entity Payment for New Member Report	Unable to Determine	Unable to Determine
Federal Fund/Private Grant Report	No	No
Federal Fund TRS-Care Report	No	No
Statutory Minimum Report	No	No
Reporting Entity Payment for Non-OASDI Members Report	No	No
Reporting Entity Pension Surcharge for Reported Retirees Report	No	No
Reporting Entity TRS-Care Surcharge for Reported Retirees Report	No	No
Reporting Entity Employment After Retirement (EAR) Report	No	No

See the table at **Appendix B** for detailed results of testing.

During our audit, the Chief Financial Officer informed us that there are some inaccuracies in Manor ISD’s official records and these inaccuracies are being tested by other auditors. As a result of this information, we concluded that reports submitted to TRS are either incomplete or inaccurate or we are unable to conclude on the completeness or accuracy of the reports.

RECOMMENDATION

The Manor ISD officials should work with the TRS Reporting and Query System (TRAQs) coaches to correct the reports and ensure that corrections are completed by March 2016.

The Manor ISD officials should ensure that personnel are knowledgeable of TRS Rules and Laws by reading and studying the reporting information and using the self-audit tools provided on the TRS website.

Sufficient and accurate records should be maintained for time worked for all substitutes and retirees.

MANAGEMENT RESPONSES

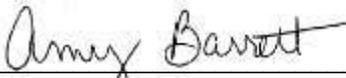
We concur with the recommendations made by Internal Audit. We will work with the TRS TRAQs coach to adjust the reports. We are working diligently and plan to have the adjustments complete by March 2016.

Finance and Human Resources staff recently attended a one-one-one training session with our TRS TRAQs coach and was provided valuable information. We are imparting this knowledge to all staff and will collaboratively ensure the accuracy of reports submitted to TRS.

We are working to refine a process that when fully implemented will ensure the accuracy of time worked for substitutes and retirees.

* * * * *

We appreciate Manor ISD management and staff for their cooperation, courtesy, and professionalism extended to us during this audit.



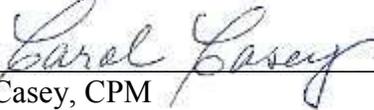
Amy Barrett, CIA, CPA, CISA
Chief Audit Executive



Art Mata, CEBS, CPM
Senior Internal Audit Consultant



Dinah G. Arce, CIA, CPA, CFE, CIDA
Senior Auditor



Carol Casey, CPM
Internal Audit Consultant

cc: Manor ISD Board of Trustees
Mr. Kevin Brackmeyer, Superintendent

APPENDIX A

AUDIT OBJECTIVE, SCOPE, METHODOLOGY, AND CONCLUSION

We conducted this audit in accordance with generally accepted government auditing standards contained in the *Government Auditing Standards* issued by the Comptroller General of the United States and the *International Standards for the Professional Practice of Internal Auditing* issued by the Institute of Internal Auditors, Inc.

These standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our audit findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

AUDIT OBJECTIVE

Our audit objectives were to determine the following⁴:

- Completeness and accuracy of the reports submitted to TRS by the Reporting Entity for the test month
- Eligibility of contract workers performing services for the Reporting Entity for the test month for TRS membership
- Accuracy of census data information (name, date of birth, gender, amount of salary, year of entry, years of service)

Specifically, we performed tests to determine whether the following was complete and accurate:

- Eligible members
- Member contributions
- Employer contributions and surcharges
- Census data of eligible members

SCOPE

Payroll data was selected from the month of May 2015. We selected:

- Thirty sample items from TRS Regular Payroll Report for the test month
- Four retirees on the payroll
- Five sample items from the Reporting Entity payroll register for employees that were not reported to TRS
- Four contract workers paid for the test month for services performed

With the exception of the superintendent's salary, we did not test whether salary amounts included in the reporting entity's payroll register were complete, accurate, and authorized.

We did not test the eligibility to receive an annuity of those retirees who have returned to work.

⁴ Assuming the completeness and accuracy of the official records maintained by the RE

METHODOLOGY

We specifically performed the procedures below.

- 1. To determine completeness and accuracy of reporting eligible members:**
 - Compare the Regular Payroll Report and detail records submitted to TRS with position title on the Reporting Entity's payroll register
 - Confirm eligibility through contract agreements, personnel files, third-party agreements, time reports, job descriptions, and compensation information
 - Determine if the payroll register contains employees who have not been reported to TRS but are eligible for membership in TRS

- 2. To determine that member contributions are reported and are accurate:**
 - Recalculate member contributions and compare to the TRS Regular Payroll Report

- 3. To determine that employer contributions/surcharges are reported and are accurate:**
 - Obtain the reports of employer contributions and surcharges remitted to TRS on the Regular Payroll Report.
 - Review detail supporting records for the employer calculations and recalculate employer contributions for the following:
 - New member contributions
 - Federal Fund/Private Grants contributions
 - Employment After Retirement surcharges
 - Statutory Minimum contributions
 - Non-OASDI contributions

- 4. To determine accuracy of census data of eligible members:**
 - Pull supporting documentation for each item in sample to confirm date of birth, hire date/years of service, eligible compensation, gender, and dates of termination/retirement

CONCLUSION

During the audit, we observed the following:

- Manor ISD officials were prompt in responding to questions and providing supporting documentation
- Personnel files were well organized

Based on our audit results:

- All but one report were incomplete and inaccurate and for that one report we were unable to determine the completeness and accuracy
- Of the list of contract workers provided to TRS, no contract workers performing services for the Reporting Entity were eligible for membership; therefore, they were properly excluded from the Regular Payroll Report

- Census data information reported to TRS was inaccurate for two employees' salaries in our sample. Additionally, management disclosed inaccurate salaries of four other employees
- We were unable to conclude if four employees not reported to TRS were eligible for TRS membership because supporting documentation for work as a substitute was not maintained
- All amounts of contributions made to TRS per the TRAQS reports agreed with the Reporting Entity detailed supporting documentation, with the exception of the Federal Fund Reports for TRS pension fund reimbursement and TRS-Care reimbursement Also, the amount reported for surcharges was incomplete
- Time records are not maintained for employed retirees

See the table at **Appendix B** for detailed testing results.

APPENDIX B

MANOR ISD DETAIL OF ADJUSTMENTS TO REPORTS

Population, sampling and overview of test results:

Test month: May 2015

SECTION 1 - MEMBER AND REPORTING ENTITY CONTRIBUTIONS

Tested 30 of 1,197 total members reported in the TRS Regular Payroll Report for the test month

Test results:

1. All but one report were incomplete and inaccurate and we were unable to determine the completeness and accuracy of the New Member Report. The Chief Financial Officer informed us that there are some inaccuracies in Manor ISD's official records and these inaccuracies are being tested by other auditors. As a result, TRS concluded that reports submitted to TRS are either incomplete or inaccurate or we are unable to conclude.
2. Ineligible compensation was incorrectly included on two employees.
3. Eligible compensation incorrectly excluded on one employee.
4. Statutory Minimum and Non-OASDI Reports were inaccurate because the incorrect Years of Experience Credit (Salary Step) table was used.

Tested five of the 122 employees not reported to TRS in the Regular Payroll Report for the test month

Test results:

1. Unable to conclude if four of the five employees not reported to TRS were TRS eligible because supporting documentation for hours worked is not maintained.

Tested four of the seven independent contract workers during the test month to determine TRS eligibility

Test results: No exceptions

SECTION 2 - EMPLOYMENT AFTER RETIREMENT SURCHARGES

Tested four of the 27 retirees that worked in the test month in a position other than a substitute to confirm if worked less than the 84 hour limit for May 2015.

Test results:

1. All four retirees tested did not exceed the 84 hour limit for May 2015.

Tested all 9 retirees (retired after 9/1/05) that worked in excess of 84 hours in test month in a position other than a substitute to determine if surcharges were owed

1. Nine retirees worked more than half-time and surcharges were not paid for these employees.

SECTION 3 - EMPLOYMENT AFTER RETIREMENT AREA 1 AND 2 REPORTS

Tested all 27 retirees that worked in the test month to determine if correctly included in the Employment After Retirement Area 1 and 2 Reports

Test results:

1. 15 of the 27 retirees that worked in the test month were incorrectly excluded from the Area 1 and 2 Reports.
2. Two retirees were incorrectly included in the Area 2 Report rather than the Area 1 Report.
3. Incorrect position classifications were used in reporting.
4. Retirees incorrectly classified as substitute are working in permanently open positions.

OTHER RESULTS

Tested all TRS TRAQS report totals to the RE supporting documentation

Test results:

1. The report totals per the TRAQS reports submitted to TRS for the federal fund TRS pension fund and TRS-Care reimbursement did not agree with the RE supporting documentation. Although the EAR pension surcharges, TRS-Care surcharges and the Area 1 and 2 Reports did agree with the RE supporting documentation, the reports were inaccurate and incomplete.
2. Records of time worked by retirees is not maintained.
3. Census data information was incorrect for two member's salaries.
4. Management disclosed inaccurate salaries of four other employees outside of our sample.

SECTION 1

ERROR #	REGULAR PAYROLL REPORT - ELIGIBILITY TESTING	REPORT TOTAL	UNDER STATED	OVER STATED	REVISED REPORT TOTAL	% ERROR
	Includes the following contributions: - member contributions to pension fund - member contributions to TRS-Care - Reporting Entity contributions to TRS-Care					
Member Contributions to Pension Fund						
1	Incorrectly excluded and did not pay contributions on eligible extra pay of \$1,250 for one member		\$ 83.75			
2	Incorrectly included ineligible compensation of \$200.00 on one member and \$211.70 on another member			\$ 27.58		
	TOTAL	\$ 301,624.89	\$ 83.75	\$ 27.58	\$ 301,681.06	0%
Member Contributions to TRS-Care						
1	Incorrectly excluded and did not pay contributions on eligible extra pay of \$1,250 for one member		\$ 8.13			
2	Incorrectly included ineligible compensation of \$200.00 on one member and \$211.70 on another member			\$ 2.68		
	TOTAL	\$ 29,262.09	\$ 8.13	\$ 2.68	\$ 29,267.54	0%
RE Contributions to TRS-Care						
1	Incorrectly excluded and did not pay contributions on eligible extra pay of \$1,250 for one member		\$ 6.88			
2	Incorrectly included ineligible compensation of \$200.00 on one member and \$211.70 on another member			\$ 2.26		
	TOTAL	\$ 24,760.23	\$ 6.88	\$ 2.26	\$ 24,764.85	0%

ERROR #	NEW MEMBER REPORT	REPORT TOTAL	UNDER STATED	OVER STATED	REPORT TOTAL	% ERROR
1	Unable to determine the completeness and accuracy					
TOTAL		\$ 2,850.38	\$ -	\$ -	\$ 2,850.38	0%

ERROR #	FEDERAL FUND/PRIVATE GRANT REIMBURSEMENT TO STATE REPORT	REPORT TOTAL	UNDER STATED	OVER STATED	REPORT TOTAL	% ERROR
1	Incorrectly calculated and underpaid on two members		\$ 10.15			
TOTAL		\$ 15,048.34	\$ 10.15	\$ -	\$ 15,058.49	0%

ERROR #	FEDERAL FUND REIMBURSEMENT TO TRS-CARE	REPORT TOTAL	UNDER STATED	OVER STATED	REPORT TOTAL	% ERROR
1	Incorrectly calculated and underpaid on two members		\$ 45.69			
TOTAL		\$ 3,604.67	\$ 45.69	\$ -	\$ 3,650.36	1%

ERROR #	STATUTORY MINIMUM REPORT	REPORT TOTAL	UNDER STATED	OVER STATED	REPORT TOTAL	% ERROR
1	Incorrectly excluded and did not pay contributions on one member		\$ 58.05			
2	Incorrectly overpaid contributions on one member			\$ 12.72		
3	Incorrectly calculated and underpaid contributions on one member		\$ 48.24			
4	Incorrectly calculated and overpaid on 17 members			\$ 635.86		
TOTAL		\$ 77,441.52	\$ 106.29	\$ 648.58	\$ 76,899.23	-1%

ERROR #	NON-OASDI REPORT	REPORT TOTAL	UNDER STATED	OVER STATED	REPORT TOTAL	% ERROR
1	Incorrectly calculated and underpaid on 18 members		\$ 150.88			
2	Incorrectly calculated and overpaid on three members			\$ 25.90		
TOTAL		\$ 49,064.96	\$ 150.88	\$ 25.90	\$ 49,189.94	0%

SECTION 2

ERROR #	PENSION SURCHARGE FOR RETIREES REPORT	TOTAL REPORTED	UNDER STATED	OVER STATED	REPORT TOTAL	% ERROR
1	Incorrectly excluded and did not pay contributions on nine members		\$ 7,328.70			
TOTAL		\$ -	\$ 7,328.70	\$ -	\$ 7,328.70	100%

ERROR #	TRS-CARE SURCHARGE FOR RETIREES REPORT	REPORT TOTAL	UNDER STATED	OVER STATED	REPORT TOTAL	% ERROR
1	Incorrectly excluded and did not pay contributions on two members		\$ 1,938.00			
TOTAL		\$ -	\$ 1,938.00	\$ -	\$ 1,938.00	100%

SECTION 3

ERROR #	EMPLOYMENT AFTER RETIREMENT AREA 1 AND 2 REPORT	REPORT TOTAL	UNDER STATED	OVER STATED	REPORT TOTAL	% ERROR
1	Incorrectly excluded 13 retirees from Area 1 (this includes two retirees reported in Area 2 rather than Area 1 as noted in #2 below)					
2	Incorrectly included two retirees on Area 2 rather than the Area 1 Report.					
3	Incorrectly excluded four retirees from Area 2					
4	MISD did not properly classify the retirees using proper position codes					
GRAND TOTALS		\$ 503,657.08	\$ 9,678.47	\$ 707.00	\$ 512,628.55	2%

TAB 5C

AUDIT OF LIBERTY HILL INDEPENDENT SCHOOL DISTRICT

February 5, 2016

TRS Internal Audit Department

Audit Objectives	<p>To determine the following:</p> <ul style="list-style-type: none">• Completeness and accuracy of reports submitted to TRS by the Reporting Entity (RE) for the test month• TRS membership eligibility of contract workers performing services for the Reporting Entity• Accuracy of census data information (name, date of birth, gender, amount of salary, year of entry, years of service)
Risks	<ul style="list-style-type: none">• Eligible members not included and/or ineligible employees are incorrectly included in reports• Ineligible compensation included in salary reported to TRS• Incorrect calculations of contributions and surcharges• Inaccurate actuarial data because census data provided to TRS is not correct
Tests	<ul style="list-style-type: none">• Compare reports submitted to TRS with source documentation of Reporting Entity to confirm:<ul style="list-style-type: none">○ Eligibility of TRS membership and eligible compensation○ Accuracy and completeness of contributions and surcharges○ Accuracy and completeness of Employment After Retirement (EAR) Area 1 and 2 Reports• Review contracts/invoices of contract workers to determine if eligible for TRS membership• Determine accuracy of census data reported to TRS
Results	<ul style="list-style-type: none">• Positive Finding:<ul style="list-style-type: none">○ School officials were prompt in responding to questions and providing supporting documentation○ Personnel files were well organized• Test Results (Tested 30 of the 429 members reported to TRS, four of the seven independent contract workers, all six retirees): Member Contributions<ul style="list-style-type: none">○ No exceptionsEmployer Contributions and Surcharges<ul style="list-style-type: none">○ Incorrectly calculated and underpaid Statutory Minimum Contribution and Non-OASDI contribution on two members○ Incorrectly calculated and overpaid Statutory Minimum Contribution and Non-OASDI contribution on two members○ Improperly excluded one retiree from the EAR Area 1 Report○ Improperly included and paid surcharge on one retireeOther Results<ul style="list-style-type: none">○ A contract for one independent contract worker was referred to TRS Legal Services for determination of TRS eligibility○ Census data information reported to TRS was complete and accurate○ Record of time worked by retirees is not consistently maintained○ All report totals per TRAQS reports submitted to TRS agreed with the RE supporting documentation with the exception of the EAR Area 1 and 2 and the TRS-Care Surcharge Reports
Recommended Actions	<p>We recommend that the Reporting Official:</p> <ul style="list-style-type: none">• Work with TRAQS coaches to correct reports by March 31, 2016• Ensure personnel are knowledgeable of TRS Rules and Laws• Maintain sufficient and accurate records of time worked for all substitutes and retirees
Management Responses	<p>Liberty Hill ISD officials concur with the recommendations made by Internal Audit and will:</p> <ul style="list-style-type: none">• Work with the TRS TRAQS coach to adjust the reports by March 2016• Provide training and the necessary resources to staff to ensure the accuracy of reports submitted to TRS• Will develop and implement a process to ensure the accuracy of time worked for substitutes and retirees

February 5, 2016

Dr. Robert Hart
Superintendent of Schools
Liberty Hill Independent School District
301 Forrest Street
Liberty Hill, TX 78642

AUDIT REPORT OF LIBERTY HILL INDEPENDENT SCHOOL DISTRICT

EXECUTIVE SUMMARY

We have completed the audit of eligibility and contributions, as included in the *Fiscal Year 2016 Audit Plan*. Our audit objectives were to determine the following¹:

- Completeness and accuracy of the reports submitted to TRS by the Reporting Entity² for the test month
- Eligibility of contract workers performing services for the Reporting Entity for TRS membership
- Accuracy of census data information (name, date of birth, gender, amount of salary, year of entry, years of service)

During the audit, we observed the following:

- School officials were prompt in responding to questions and providing supporting documentation
- Personnel files were well organized

Based on our audit results, some reports were incomplete and inaccurate, one contract for an independent contract worker was referred to TRS Legal for determination for TRS eligibility, and census data was accurate.

Refer to Appendix B for detailed results of testing.

¹ Assuming the completeness and accuracy of the official records maintained by the RE

² A Reporting Entity (RE) is an employer, as defined in Texas Government Code, Title 8, Subtitle C, Chapter 821.001.

BACKGROUND

PROJECT BACKGROUND

The Annual Audit Plan approved by the TRS Board of Trustees includes audits of reporting entities in order to confirm member eligibility and accuracy of contributions and fees. The type of information submitted by reporting entities to TRS includes:

- Regular Payroll Reports of positions, salary/hourly rate, contract dates, position codes
- Contributions
- Surcharges
- Census data
- Lump sum payments

In response to new requirements of the Governmental Accounting Standards Board, the American Institute of Certified Public Accountants (AICPA) issued a white paper indicating that reporting entities' census data should be audited. As a result, we have included testing of census data (name, date of birth, gender, amount of salary, year of entry, and years of service) in the scope of this audit. Separately, the Texas State Auditor's Office is performing audits of reporting entities' census data as part of the audit of TRS Comprehensive Annual Financial Statements.

The population of reporting entities from which the sample was selected for testing included all Texas public schools. These were selected based on criteria including the following:

- Frequency of adjustments and corrections to reports
- Complaints about the Reporting Entity
- Warrant Holds
- Weaknesses in finance area reported by the Legislative Budget Board (LBB), the State Auditor's Office (SAO), or the Texas Education Agency (TEA)
- No audit history of census data by TRS or the SAO within last five years

The Liberty Hill ISD was chosen for audit using a consistent risk assessment methodology that included the variables listed above.

REPORTING ENTITY BACKGROUND³

Liberty Hill is a rural community in the Texas Hill Country, 30 miles northwest of Austin. The 100 square miles of the school district is located entirely within western Williamson County, one of the fastest growing counties in the state as well as the nation. Administration, faculty, and staff are committed to excellence in all programs to improve student outcomes and enhance the school experience for all students. The mission of the Liberty Hill ISD is to develop successful, contributing, responsible citizens.

³ Information obtained from the ISD website and other internet sources.

RESULTS AND RECOMMENDATIONS

OVERALL RESULTS

Positive Findings

During the audit, we observed the following:

- School officials were prompt in responding to questions and providing supporting documentation
- Personnel files were well organized

Other Findings

We tested:

- Thirty of the population of 429 members reported to TRS in the Regular Payroll Report for the test month
- All six of the retirees who performed services in the test month

With the exception of the superintendent's salary, we did not test whether salary amounts included in the reporting entity's payroll register were complete, accurate, and authorized.

We did not test the eligibility to receive an annuity of those retirees who have returned to work.

We concluded the following about the completeness and accuracy of the reports submitted to TRS:

NAME OF REPORT	COMPLETE?	ACCURATE?
Regular Payroll Report	Yes	Yes
- Member Contributions to Pension Fund		
- Member Contributions to TRS-Care		
- Reporting Entity Contributions to TRS-Care		
Reporting Entity Payment for New Member Report	Yes	Yes
Federal Fund/Private Grant Report	Yes	Yes
Federal Fund TRS-Care Report	Yes	Yes
Statutory Minimum Report	Yes	No
Reporting Entity Payment for Non-OASDI Members Report	Yes	No
Reporting Entity Employment After Retirement (EAR) Area 1 and 2 Report	No	No
Reporting Entity Pension Surcharge for Reported Retirees Report	No	No
Reporting Entity TRS-Care Surcharge for Reported Retirees Report	Yes	Yes

See the table at **Appendix B** for detailed results of testing.

RECOMMENDATION

The Reporting Official should work with the TRS Reporting and Query System (TRAQs) coaches to correct the reports and ensure that corrections are completed by March 2016.

The Reporting Official should ensure that personnel are knowledgeable of TRS Rules and Laws by reading and studying the reporting information and using the self-audit tools provided on the TRS website.

Sufficient and accurate records should be maintained for time worked for all substitutes and retirees.

MANAGEMENT RESPONSES

We concur with the recommendations made by Internal Audit. We will work with the TRS TRAQs coach to adjust the reports. We plan to have the adjustments complete by March 6, 2016.

We will provide training and the necessary resources to staff to ensure the accuracy of reports submitted to TRS.

We will develop and implement a process to ensure the accuracy of time worked for substitutes and retirees.

* * * * *

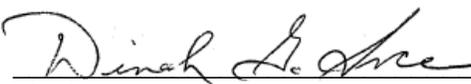
We appreciate Liberty Hill ISD management and staff for their cooperation, courtesy, and professionalism extended to us during this audit.



Amy Barrett, CIA, CPA, CISA
Chief Audit Executive



Jan Engler, CIA, CISA, CFE
Director of Benefit Audits



Dinah G. Arce, CIA, CPA, CFE, CIDA
Senior Auditor



Art Mata, CEBS, CPM
Senior Internal Audit Consultant



Carol Casey, CPM
Internal Audit Consultant

cc: Liberty Hill ISD Board of Trustees

APPENDIX A

AUDIT OBJECTIVE, SCOPE, METHODOLOGY, AND CONCLUSION

We conducted this audit in accordance with generally accepted government auditing standards contained in the *Government Auditing Standards* issued by the Comptroller General of the United States and the *International Standards for the Professional Practice of Internal Auditing* issued by the Institute of Internal Auditors, Inc.

These standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our audit findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

AUDIT OBJECTIVE

Our audit objectives were to determine the following⁴:

- Completeness and accuracy of the reports submitted to TRS by the Reporting Entity for the test month
- Eligibility of contract workers performing services for the Reporting Entity for the test month for TRS membership
- Accuracy of census data information (name, date of birth, gender, amount of salary, year of entry, years of service)

Specifically, we performed tests to determine whether the following was complete and accurate:

- Eligible members
- Member contributions
- Employer contributions and surcharges
- Census data of eligible members

SCOPE

Payroll data was selected from the month of August 2015. We selected:

- Thirty sample items from TRS Regular Payroll Report for the test month
- All six retirees on the payroll
- Four contract workers paid for the test month for services performed

With the exception of the superintendent's salary, we did not test whether salary amounts included in the reporting entity's payroll register were complete, accurate, and authorized.

We did not test the eligibility to receive an annuity of those retirees who have returned to work.

⁴ Assuming the completeness and accuracy of the official records maintained by the RE.

METHODOLOGY

We specifically performed the procedures below.

- 1. To determine completeness and accuracy of reporting eligible members:**
 - Compare the Regular Payroll Report and detail records submitted to TRS with position title on the Reporting Entity's payroll register
 - Confirm eligibility through contract agreements, personnel files, third-party agreements, time reports, job descriptions, and compensation information
 - Determine if the payroll register contains employees who have not been reported to TRS but are eligible for membership in TRS
- 2. To determine that member contributions are reported and are accurate:**
 - Recalculate member contributions and compare to the TRS Regular Payroll Report
- 3. To determine that employer contributions/surcharges are reported and are accurate:**
 - Obtain the reports of employer contributions and surcharges remitted to TRS on the Regular Payroll Report
 - Review detail supporting records for the employer calculations and recalculate employer contributions for the following:
 - New Member contributions
 - Federal Fund/Private Grant contributions
 - Employment After Retirement surcharges
 - Statutory Minimum contributions
 - Non-OASDI contributions
- 4. To determine accuracy of census data of eligible members:**
 - Pull supporting documentation for each item in sample to confirm date of birth, hire date/years of service, eligible compensation, gender, and dates of termination/retirement

CONCLUSION

See the table at **Appendix B** for detailed testing results.

APPENDIX B
LIBERTY HILL ISD
DETAIL OF ADJUSTMENTS TO REPORTS

POPULATION, SAMPLE, TESTING:

- Test month: August 2015

SECTION 1 - ELIGIBILITY TESTING AND EMPLOYER CONTRIBUTIONS (See details below)

- Tested 30 of 429 total members reported in the TRS Regular Payroll Report for the test month to determine eligibility and completeness and accuracy of member and Reporting Entity (RE) contributions.
- Tested four of the seven independent contract workers during the test month to determine TRS eligibility.

SECTION 2 - EMPLOYMENT AFTER RETIREMENT (See details below)

- Tested all six of the retirees that worked in the test month in a position other than a substitute to determine if worked more than the 84 hour limit for the test month.
- Tested the time worked for all six retirees that worked in the test month.

SECTION 3 - OTHER TESTS AND RESULTS

- Tested census data information on all 30 sample items.
Test Results - Census data information for the 30 sample items was correct.
- Tested all TRAQS Reports submitted to TRS and verified totals reported to the RE detailed supporting documentation.
Test Results - All report totals per TRAQS reports submitted to TRS agreed with the RE supporting documentation; however, as mentioned below, the Reporting Entity did not provide detail backup for the Area 1 and 2 and the TRS-Care Surcharge Reports.

SECTION 1 - ELIGIBILITY TESTING

REGULAR PAYROLL REPORT - ELIGIBILITY TESTING

Includes the following contributions: member contributions to pension fund, member contributions to TRS-Care, Reporting Entity contributions to TRS-Care

	REPORT TOTAL	UNDER STATED	OVER STATED	REVISED REPORT TOTAL	% ERROR
Member Contributions to Pension Fund					
no exceptions					
TOTAL	\$ 97,187.27	\$ -	\$ -	\$ 97,187.27	0%
Member Contributions to TRS-Care					
no exceptions					
TOTAL	\$ 9,428.55	\$ -	\$ -	\$ 9,428.55	0%
RE Contributions to TRS-Care					
no exceptions					
TOTAL	\$ 7,978.02	\$ -	\$ -	\$ 7,978.02	0%
Referred one contract of an independent contract worker to TRS Legal Services for review and determination for TRS eligibility					

NEW MEMBER REPORT	REPORT TOTAL	UNDER STATED	OVER STATED	REVISED REPORT TOTAL	% ERROR
no exceptions					
TOTAL	\$ 372.83	\$ -	\$ -	\$ 372.83	0%

FEDERAL FUNDS REIMBURSEMENT TO PENSION FUND	REPORT TOTAL	UNDER STATED	OVER STATED	REVISED REPORT TOTAL	% ERROR
no exceptions					
TOTAL	\$ 1,598.03	\$ -	\$ -	\$ 1,598.03	0%

FEDERAL FUNDS REIMBURSEMENT TO TRS-CARE	REPORT TOTAL	UNDER STATED	OVER STATED	REVISED REPORT TOTAL	% ERROR
no exceptions					
TOTAL	\$ 235.00	\$ -	\$ -	\$ 235.00	0%

STATUTORY MINIMUM REPORT	REPORT TOTAL	UNDER STATED	OVER STATED	REVISED REPORT TOTAL	% ERROR
Improperly calculated and underpaid on two members		\$ 33.48			
Improperly calculated and overpaid on two members			\$ 18.84		
TOTAL	\$ 14,720.41	\$ 33.48	\$ 18.84	\$ 14,735.05	0.10%

NON-OASDI REPORT	REPORT TOTAL	UNDER STATED	OVER STATED	REVISED REPORT TOTAL	% ERROR
Improperly calculated and underpaid on two members		\$ 4.15			
Improperly calculated and overpaid on two members			\$ 7.39		
TOTAL	\$ 18,415.24	\$ 4.15	\$ 7.39	\$ 18,412.00	-0.02%

SECTION 2 - EMPLOYMENT AFTER RETIREMENT

EMPLOYMENT AFTER RETIREMENT AREA 1 AND 2 REPORT	REPORT TOTAL			REVISED REPORT TOTAL	% ERROR
Improperly excluded one retiree from Area 1 Report					
Record of time worked by retirees is not consistently maintained					

PENSION SURCHARGE FOR RETIREES REPORT	TOTAL REPORTED	UNDER STATED	OVER STATED	REVISED REPORT TOTAL	% ERROR
Improperly included and paid surcharge on one retiree			\$ 217.95		
TOTAL	\$ 217.95	\$ -	\$ 217.95	\$ -	-100%

TRS-CARE SURCHARGE FOR RETIREES REPORT	REPORT TOTAL	UNDER STATED	OVER STATED	REVISED REPORT TOTAL	% ERROR
No exceptions					
TOTAL	\$ -	\$ -	\$ -	\$ -	0.00%

GRAND TOTALS	\$ 150,153.30	\$ 37.63	\$ 244.18	\$ 149,946.75	-0.1%
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TAB 5D

AUDIT OF BEAUMONT INDEPENDENT SCHOOL DISTRICT

March 4, 2016

TRS Internal Audit Department

Audit Objectives	<p>To determine the following:</p> <ul style="list-style-type: none"> • Completeness and accuracy of reports submitted to TRS by the Reporting Entity (RE) for the test month • TRS membership eligibility of contract workers performing services for the Reporting Entity • Accuracy of census data information (name, date of birth, gender, amount of salary, year of entry, years of service)
Risks	<ul style="list-style-type: none"> • Eligible members not included and/or ineligible employees are incorrectly included in reports • Ineligible compensation included in salary reported to TRS • Incorrect calculations of contributions and surcharges • Inaccurate actuarial data because census data provided to TRS is not correct
Tests	<ul style="list-style-type: none"> • Compare reports submitted to TRS with source documentation of Reporting Entity to confirm: <ul style="list-style-type: none"> ○ Eligibility of TRS membership and eligible compensation ○ Accuracy and completeness of contributions and surcharges ○ Accuracy and completeness of Employment After Retirement (EAR) Area 1 and 2 Reports • Review contracts/invoices of contract workers to determine if eligible for TRS membership • Determine accuracy of census data reported to TRS
Results	<ul style="list-style-type: none"> • Positive Finding: <ul style="list-style-type: none"> ○ School officials were prompt in responding to questions and providing supporting documentation • Test Results (Tested 30 of the 2,373 members reported to TRS, five of the 123 vendor/independent contractor payments, all 90 retirees): <ul style="list-style-type: none"> Member Contributions <ul style="list-style-type: none"> ○ No exceptions Employer Contributions and Surcharges <ul style="list-style-type: none"> ○ New Member Report - Improperly excluded and did not pay contributions on one new member ○ Statutory Minimum Report - Improperly excluded and did not pay contributions for four employees ○ Non-OASDI Report - Improperly calculated contributions for eight employees ○ Employment After Retirement Report - Improperly excluded 15 retired members in Area 1 ○ Employment After Retirement Report - Improperly excluded 36 retired members in Area 2 ○ Employment After Retirement Report - Improperly included one retired member in Area 1 ○ Pension Surcharge Report - Improperly excluded and did not pay surcharges on six retirees ○ TRS-Care Surcharge Report - Improperly excluded and did not pay surcharges on one retiree Other Results: <ul style="list-style-type: none"> ○ No independent contract workers were eligible for TRS membership and were, therefore, properly excluded from the Regular Payroll Report ○ Census data information reported to TRS was complete and accurate ○ All report totals per TRAQS reports submitted to TRS agreed with the RE supporting documentation with the exception of the Federal Fund/Private Grant and TRS-Care Federal Grant reports
Recommended Actions	<p>We recommend that the Reporting Official:</p> <ul style="list-style-type: none"> • Work with TRAQS coaches to correct reports by June 2016 • Ensure personnel are knowledgeable of <i>TRS Rules and Laws</i> • Maintain sufficient and accurate records of time worked for all substitutes and retirees
Management Responses	<p>Beaumont ISD officials concur with the recommendations made by Internal Audit and will:</p> <ul style="list-style-type: none"> • Work with the TRS TRAQS coach to adjust the reports by June 2016 • Provide training and the necessary resources to staff to ensure the accuracy of reports submitted to TRS • Will develop and implement a process to ensure the accuracy of time worked for substitutes and retirees



March 4, 2016

Dr. John W. Frossard
Superintendent of Schools
Beaumont Independent School District
3395 Harrison Ave.
Beaumont, TX 77706

AUDIT REPORT OF BEAUMONT INDEPENDENT SCHOOL DISTRICT

EXECUTIVE SUMMARY

We have completed the audit of eligibility and contributions, as included in the *Fiscal Year 2016 Audit Plan*. Our audit objectives were to determine the following¹:

- Completeness and accuracy of the reports submitted to TRS by the Reporting Entity² for the test month
- Eligibility of contract workers performing services for the Reporting Entity for TRS membership
- Accuracy of census data information (name, date of birth, gender, amount of salary, year of entry, years of service)

During the audit, we observed the following:

- School officials were prompt in responding to questions and providing supporting documentation.

Based on our audit results, some reports submitted to TRS were incomplete and inaccurate, no independent contract workers were eligible for TRS membership and were therefore properly excluded from the Regular Payroll Report, and census data was accurate. In addition, all report totals per TRAQS reports submitted to TRS agreed with the Reporting Entity supporting documentation with the exception of the Federal Fund/Private Grant and TRS-Care Federal Grant reports.

Refer to Appendix B for detailed results of testing.

¹ Assuming the completeness and accuracy of the official records maintained by the Reporting Entity.

² A Reporting Entity (RE) is an employer, as defined in Texas Government Code, Title 8, Subtitle C, Chapter 821.001.

BACKGROUND

PROJECT BACKGROUND

The Annual Audit Plan approved by the TRS Board of Trustees includes audits of reporting entities in order to confirm member eligibility and accuracy of contributions and surcharges. The type of information submitted by reporting entities to TRS includes:

- Regular Payroll Reports of positions, salary/hourly rate, contract dates, position codes
- Contributions
- Surcharges
- Census data
- Lump sum payments

In response to new requirements of the Governmental Accounting Standards Board, the American Institute of Certified Public Accountants (AICPA) issued a white paper indicating that reporting entities' census data should be audited. As a result, we have included testing of census data (name, date of birth, gender, amount of salary, year of entry, and years of service) in the scope of this audit. Separately, the Texas State Auditor's Office is performing audits of reporting entities' census data as part of the audit of *TRS Comprehensive Annual Financial Statements*.

The population of reporting entities from which the sample was selected for testing included all Texas public schools. These were selected based on criteria including the following:

- Frequency of adjustments and corrections to reports
- Complaints about the Reporting Entity
- Warrant Holds
- Weaknesses in finance area reported by the Legislative Budget Board (LBB), the Texas State Auditor's Office (SAO), and the Texas Education Agency (TEA)
- No audit history of census data by TRS within the last five years or the SAO within the current fiscal year

Beaumont ISD was chosen for audit using a consistent risk assessment methodology that included the variables listed above.

REPORTING ENTITY BACKGROUND³

Beaumont is a city in and county seat of Jefferson County, Texas, United States, within the Beaumont–Port Arthur Metropolitan Statistical Area. Located on the Neches River and about 90 miles from Houston, the city had a population of 118,296 at the 2010 census, making it the twenty-fourth most populous city in the state of Texas.

Beaumont Independent School District was established in 1983 through the merger of the former Beaumont School District (founded in 1883) with South Park Public Schools (founded in 1891). The citywide district encompasses 153.34 square miles in Jefferson County in Southeast Texas.

³ Information obtained from the ISD website and other internet sources.

STUDENTS

Enrollment

High School.....	5,040
Middle School.....	3,799
Elementary School.....	<u>10,389</u>

TOTAL 19,228

RESULTS AND RECOMMENDATIONS

OVERALL RESULTS

Positive Findings

During the audit, we observed the following:

- School officials were prompt in responding to questions and providing supporting documentation

Other Findings

We tested:

- Thirty of the population of 2,373 members reported to TRS in the Regular Payroll Report for the test month
- All 90 retirees who performed services in the test month

With the exception of the superintendent's salary, we did not test whether salary amounts included in the reporting entity's payroll register were complete, accurate, and authorized.

We did not test the eligibility to receive an annuity for those retirees who have returned to work.

We concluded the following about the completeness and accuracy of the reports submitted to TRS:

NAME OF REPORT	COMPLETE?	ACCURATE?
Regular Payroll Report - Member Contributions to Pension Fund - Member Contributions to TRS-Care - Reporting Entity Contributions to TRS-Care	Yes	Yes
Reporting Entity Contributions for New Member Report	No	No
Reporting Entity Contributions for Federal Fund/Private Grant Report	Unable to Determine*	Unable to Determine*
Reporting Entity Contributions for Federal Grant TRS-Care Report	Unable to Determine*	Unable to Determine*
Reporting Entity Contributions for Statutory Minimum Report	No	No
Reporting Entity Contributions for Non-OASDI Members Report	Yes	No
Reporting Entity Employment After Retirement (EAR) Area 1 and 2 Report	No	No
Reporting Entity Employment After Retirement Pension Surcharge for Reported Retirees Report	No	No
Reporting Entity Employment After Retirement TRS-Care Surcharge for Reported Retirees Report	No	No

*Although the detail for the sample of 30 tested was complete and accurate, the totals reported to TRS in TRAQS did not agree with the totals per the RE supporting documentation. Therefore, we were unable to conclude on the completeness and accuracy of the report.

See the table at **Appendix B** for detailed results of testing.

RECOMMENDATION

The Reporting Official should work with the TRS Reporting and Query System (TRAQs) coaches to correct the reports and ensure that corrections are completed by June 2016.

The Reporting Official should ensure that personnel are knowledgeable of *TRS Rules and Laws* by reading and studying the reporting information and using the self-audit tools provided on the TRS website.

MANAGEMENT RESPONSES

We concur with the recommendations made by Internal Audit. We will work with the TRS TRAQs coach to adjust the reports. We plan to have the adjustments complete by June 2016.

We will provide training and the necessary resources to staff to ensure the accuracy of reports submitted to TRS.

* * * * *

We appreciate Beaumont ISD management and staff for their cooperation, courtesy, and professionalism extended to us during this audit.



Amy Barrett, CIA, CPA, CISA
Chief Audit Executive



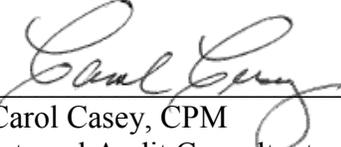
Jan Engler, CIA, CISA, CFE
Director of Benefit Audits



Dinah G. Arce, CIA, CPA, CFE, CIDA
Senior Auditor



Art Mata, CEBS, CPM
Senior Internal Audit Consultant



Carol Casey, CPM
Internal Audit Consultant

cc: Beaumont ISD Board of Trustees

APPENDIX A

AUDIT OBJECTIVE, SCOPE, METHODOLOGY, AND CONCLUSION

We conducted this audit in accordance with generally accepted government auditing standards contained in the *Government Auditing Standards* issued by the Comptroller General of the United States and the *International Standards for the Professional Practice of Internal Auditing* issued by the Institute of Internal Auditors, Inc.

These standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our audit findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

AUDIT OBJECTIVE

Our audit objectives were to determine the following⁴:

- Completeness and accuracy of the reports submitted to TRS by the Reporting Entity for the test month
- Eligibility of contract workers performing services for the Reporting Entity for the test month for TRS membership
- Accuracy of census data information (name, date of birth, gender, amount of salary, year of entry, years of service)

Specifically, we performed tests to determine whether the following was complete and accurate:

- Eligible members
- Member contributions
- Employer contributions and surcharges
- Census data of eligible members

SCOPE

Payroll data was selected from the month of October 2015. We selected:

- Thirty sample items from TRS Regular Payroll Report for the test month
- All 90 retirees on the payroll
- Five contract workers paid for the test month for services performed
- Five employees paid during the test month who were not reported to TRS in the TRS Regular Payroll Report

With the exception of the superintendent's salary, we did not test whether salary amounts included in the reporting entity's payroll register were complete, accurate, and authorized.

We did not test the eligibility to receive an annuity for those retirees who have returned to work.

⁴ Assuming the completeness and accuracy of the official records maintained by the RE.

METHODOLOGY

We specifically performed the procedures below.

- 1. To determine completeness and accuracy of reporting eligible members:**
 - Compare the Regular Payroll Report and detail records submitted to TRS with position title on the Reporting Entity's payroll register
 - Confirm eligibility through contract agreements, personnel files, third-party agreements, time reports, job descriptions, and compensation information
 - Determine if the payroll register contains employees who have not been reported to TRS but are eligible for membership in TRS

- 2. To determine that member contributions are reported and are accurate:**
 - Recalculate member contributions and compare to the TRS Regular Payroll Report

- 3. To determine that employer contributions/surcharges are reported and are accurate:**
 - Obtain the reports of employer contributions and surcharges remitted to TRS on the Regular Payroll Report
 - Compare report totals per TRAQS to the report totals per the RE supporting documentation
 - Review detail supporting records for the employer calculations and recalculate employer contributions for the following:
 - New Member contributions
 - Federal Fund/Private Grant contributions
 - Employment After Retirement Pension and TRS-Care Surcharges
 - Statutory Minimum contributions
 - Non-OASDI contributions

- 4. To determine accuracy of census data of eligible members:**
 - Pull supporting documentation for each item in sample to confirm date of birth, hire date/years of service, eligible compensation, gender, and dates of termination/retirement

CONCLUSION

During the audit, we observed that the school officials were prompt in responding to questions and providing supporting documentation.

Based on our audit results, some reports submitted to TRS were incomplete and inaccurate, no independent contract workers were eligible for TRS membership and were therefore properly excluded from the Regular Payroll Report, and census data was accurate. In addition, all report totals per TRAQS reports submitted to TRS agreed with the Reporting Entity supporting documentation with the exception of the Federal Fund/Private Grant and TRS-Care Federal Grant reports. See the table at **Appendix B** for detailed testing results.

APPENDIX B
BEAUMONT ISD
DETAIL OF ADJUSTMENTS TO REPORTS

POPULATION, SAMPLE, TESTING:

- Test month: October 2015

SECTION 1 - ELIGIBILITY TESTING AND EMPLOYER CONTRIBUTIONS (See details below)

- Tested 30 of 2,373 total members reported in the TRS Regular Payroll Report for the test month to determine eligibility and completeness and accuracy of member and Reporting Entity RE contributions
- Tested five of the 123 vendor/independent contract payments during the test month to determine TRS eligibility

SECTION 2 - EMPLOYMENT AFTER RETIREMENT (See details below)

- Tested time worked for four of the 90 retirees that worked in the test month in a position other than a substitute
- Tested the 90 retirees to determine the accuracy and completeness of the Area 1 and Area 2 reports for the test month

SECTION 3 - OTHER TESTS AND RESULTS

- Tested census data information on all 30 sample items
Test Results - Census data information for the 30 sample items was correct

- Tested all TRAQS Reports submitted to TRS and verified totals reported to the RE detailed supporting documentation
Test Results - All report totals per TRAQS reports submitted to TRS agreed with the RE supporting documentation with the exception of Federal Fund/Private Grant and TRS-Care Federal Grant

SECTION 1 - ELIGIBILITY TESTING

REGULAR PAYROLL REPORT - ELIGIBILITY TESTING

Includes the following contributions: member contributions to pension fund, member contributions to TRS-Care, Reporting Entity contributions to TRS-Care

	REPORT TOTAL	UNDER STATED	OVER STATED	REVISED REPORT TOTAL	% ERROR
Member Contributions to Pension Fund					
No exceptions					
TOTAL	\$ 588,438.12	\$ -	\$ -	\$ 588,438.12	0%
Member Contributions to TRS-Care					
No exceptions					
TOTAL	\$ 53,123.76	\$ -	\$ -	\$ 53,123.76	0%
RE Contributions to TRS-Care					
No exceptions					
TOTAL	\$ 44,949.26	\$ -	\$ -	\$ 44,949.26	0%

Independent contract workers were not eligible for TRS membership and were therefore properly excluded from the Regular Payroll Report.

	REPORT TOTAL	UNDER STATED	OVER STATED	REVISED REPORT TOTAL	% ERROR
NEW MEMBER REPORT					
Improperly excluded and did not pay contributions on one new member		\$ 106.71			
TOTAL	\$ 22,714.08	\$ 106.71	\$ -	\$ 22,820.79	0%

	REPORT TOTAL	UNDER STATED	OVER STATED	REVISED REPORT TOTAL	% ERROR
FEDERAL FUND/PRIVATE GRANT REPORT					
No exceptions					
TOTAL	\$ 42,249.17	\$ -	\$ -	\$ 42,249.17	0%

	REPORT TOTAL	UNDER STATED	OVER STATED	REVISED REPORT TOTAL	% ERROR
FEDERAL GRANT TRS-CARE REPORT					
No exceptions					
TOTAL	\$ 6,539.36	\$ -	\$ -	\$ 6,539.36	0%

STATUTORY MINIMUM REPORT	REPORT TOTAL	UNDER STATED	OVER STATED	REVISED REPORT TOTAL	% ERROR
Improperly excluded and did not pay contributions for four employees		\$ 1,878.72			
TOTAL	\$ 47,758.99	\$ 1,878.72	\$ -	\$ 49,637.71	3.93%

NON-OASDI REPORT	REPORT TOTAL	UNDER STATED	OVER STATED	REVISED REPORT TOTAL	% ERROR
Improperly calculated contributions for eight employees			\$ 420.09		
TOTAL	\$ 117,348.77	\$ -	\$ 420.09	\$ 116,928.68	-0.36%

SECTION 2 - EMPLOYMENT AFTER RETIREMENT

EMPLOYMENT AFTER RETIREMENT AREA 1 AND 2 REPORT

Improperly excluded 15 retired members in Area 1					
Improperly excluded 36 retired members in Area 2					
Improperly included one retired member in Area 1					

PENSION SURCHARGE FOR RETIREES REPORT	TOTAL REPORTED	UNDER STATED	OVER STATED	REVISED REPORT TOTAL	% ERROR
Improperly excluded and did not pay surcharges on six retirees		\$ 1,233.79			
TOTAL	\$ 7,033.07	\$ 1,233.79	\$ -	\$ 8,266.86	18%

TRS-CARE SURCHARGE FOR RETIREES REPORT	REPORT TOTAL	UNDER STATED	OVER STATED	REVISED REPORT TOTAL	% ERROR
Improperly excluded and did not pay surcharges on one retiree		\$ 294.00			
TOTAL	\$ 4,962.00	\$ 294.00	\$ -	\$ 5,256.00	0.00%

GRAND TOTALS	\$ 935,116.58	\$ 3,513.22	\$ 420.09	\$ 938,209.71	0.3%
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TAB 5E

AUDIT OF DAINGERFIELD-LONE STAR INDEPENDENT SCHOOL DISTRICT

May 13, 2016

TRS Internal Audit Department

Audit Objectives	<p>To determine the following:</p> <ul style="list-style-type: none"> • Completeness and accuracy of reports submitted to TRS by the Reporting Entity (RE) for the test month • TRS membership eligibility of contract workers performing services for the Reporting Entity • Accuracy of census data information (name, date of birth, gender, amount of salary, year of entry, years of service)
Risks	<ul style="list-style-type: none"> • Eligible members not included and/or ineligible employees are incorrectly included in reports • Ineligible compensation included in salary reported to TRS • Incorrect calculations of contributions and surcharges • Inaccurate actuarial data because census data provided to TRS is not correct
Tests	<ul style="list-style-type: none"> • Compare reports submitted to TRS with source documentation of Reporting Entity to confirm: <ul style="list-style-type: none"> ○ Eligibility of TRS membership and eligible compensation ○ Accuracy and completeness of contributions and surcharges ○ Accuracy and completeness of Employment After Retirement Area 1 and 2 Reports • Review contracts/invoices of contract workers to determine if eligible for TRS membership • Determine accuracy of census data reported to TRS
Results	<ul style="list-style-type: none"> • Positive Finding: <ul style="list-style-type: none"> ○ School officials were prompt in responding to questions and providing supporting documentation ○ Personnel files were well organized • Test Results (Test month – January 2016, Tested 30 of the 181 members reported to TRS, five of the 205 payments to vendors/independent contract workers, five employees not reported, and 23 retirees that worked in the test month.): <ul style="list-style-type: none"> Member Contributions <ul style="list-style-type: none"> ○ No exceptions for the 30 sampled; however, one of the five employees not reported to TRS was determined to be eligible and therefore was improperly excluded and did not pay pension or TRS-Care contributions Employer Contributions and Surcharges <ul style="list-style-type: none"> ○ Regular Payroll Report – Improperly excluded and did not pay TRS-Care contribution for one employee not reported to TRS who was determined to be eligible ○ New Member Report – No exceptions ○ Federal Fund/Private Grant Report – No exceptions ○ Federal Fund TRS-Care Report – No exceptions ○ Statutory Minimum Report – Improperly calculated and overpaid contributions on two employees and improperly calculated and underpaid contributions on one employee ○ Non-OASDI Report – Improperly calculated and overpaid contributions on one employee and improperly excluded and did not pay contributions on one employee (one of the five employees not reported to TRS as mentioned above) ○ Area 1 and 2 Reports – Improperly excluded one retiree from the EAR Area 1 Report and improperly excluded two retirees from the Area 2 Report ○ TRS Pension Surcharge Report – Improperly underpaid surcharge on one retiree ○ TRS-Care Surcharge Report – No exceptions Other Results <ul style="list-style-type: none"> ○ No vendor/independent contract workers were eligible for TRS membership and were therefore properly excluded from the TRS Regular Payroll Report ○ Census data information reported to TRS was complete and accurate ○ All report totals per TRAQS reports submitted to TRS agreed with the RE supporting documentation with the exception of the EAR Area 2 Report
Recommended Actions	<p>We recommend that the Reporting Official:</p> <ul style="list-style-type: none"> • Work with TRAQS coaches to correct reports by July 2016 • Ensure personnel are knowledgeable of TRS Rules and Laws • Maintain sufficient and accurate records of time worked for all substitutes and retirees
Management Responses	<p>Daingerfield-Lone Star ISD officials concur with the recommendations made by Internal Audit and will:</p> <ul style="list-style-type: none"> • Work with the TRS TRAQS coach to adjust the reports by July 2016 • Provide training and the necessary resources to staff to ensure the accuracy of reports submitted to TRS • Will develop and implement a process to ensure the accuracy of time worked for substitutes and retirees

May 13, 2016

Ms. Sandra Quarles
Superintendent of Schools
Daingerfield-Lone Star Independent School District
200 Tiger Drive
Daingerfield, TX 75638

AUDIT REPORT OF DAINGERFIELD-LONE STAR INDEPENDENT SCHOOL DISTRICT

EXECUTIVE SUMMARY

We have completed the audit of eligibility and contributions, as included in the *Fiscal Year 2016 Audit Plan*. Our audit objectives were to determine the following¹:

- Completeness and accuracy of the reports submitted to TRS by the Reporting Entity² for the test month
- Eligibility of contract workers performing services for the Reporting Entity for TRS membership
- Accuracy of census data information (name, date of birth, gender, amount of salary, year of entry, years of service)

During the audit, we observed the following:

- School officials were prompt in responding to questions and providing supporting documentation
- Personnel files were well organized

Based on our audit results, some reports were incomplete and inaccurate, no independent contract workers were eligible for TRS membership and were therefore properly excluded from the Regular Payroll Report, and census data was accurate. The totals reported to TRS in TRAQS for Area 2 Report did not agree with the totals per the RE supporting documentation. One employee not reported to TRS was deemed eligible for TRS participation.

Refer to Appendix B for detailed results of testing.

¹ Assuming the completeness and accuracy of the official records maintained by the Reporting Entity.

² A Reporting Entity (RE) is an employer, as defined in Texas Government Code, Title 8, Subtitle C, Chapter 821.001.

BACKGROUND

PROJECT BACKGROUND

The Annual Audit Plan approved by the TRS Board of Trustees includes audits of reporting entities in order to confirm member eligibility and accuracy of contributions and fees. The type of information submitted by reporting entities to TRS includes:

- Regular Payroll Reports of positions, salary/hourly rate, contract dates, position codes
- Contributions
- Surcharges
- Census data
- Lump sum payments

In response to new requirements of the Governmental Accounting Standards Board, the American Institute of Certified Public Accountants (AICPA) issued a white paper indicating that reporting entities' census data should be audited. As a result, we have included testing of census data (name, date of birth, gender, amount of salary, year of entry, and years of service) in the scope of this audit. Separately, the State Auditor's Office is performing audits of reporting entities' census data as part of the audit of TRS Comprehensive Annual Financial Statements.

The population of reporting entities from which the sample was selected for testing included all Texas public schools. These were selected based on criteria including the following:

- Frequency of adjustments and corrections to reports
- Complaints about the Reporting Entity
- Warrant Holds
- Weaknesses in finance area reported by the Legislative Budget Board (LBB), the Texas State Auditor's Office (SAO), and the Texas Education Agency (TEA)
- No audit history of census data by TRS within the last five years or the SAO within the current fiscal year

The Daingerfield-Lone Star ISD was chosen for audit using a consistent risk assessment methodology that included the variables listed above.

REPORTING ENTITY BACKGROUND³

The Daingerfield-Lone Star ISD (DLSISD) is located in Morris County in North East Texas. In 1880 this school was operating under the name of "The Jefferson District High School." The Daingerfield Independent School District was incorporated in 1902 and the Texas Conference of the Methodist Episcopal Church South, transferred their Daingerfield school properties to the Independent School District in 1906.

Over 1,000 students on four campuses are served by 196 teachers and staff, with 35% of the teachers have more than 20 years of experience. The House Bill (HB) 5 Community and Student Engagement Rating for 2014-2015 rated three of the four schools as "exemplary." The 2015

³ Unaudited information obtained from the ISD website and other internet sources.

State of Texas Assessments of Academic Readiness (STAAR) statistics reveal that students achieved a 73% combined score.

High school students are given the opportunity to remain on campus and participate in dual credit classes in conjunction with Northeast Texas Community College. Over the past several years the high school math team has competed in numerous competitions and taken first and second place at the state level, including:

- 2013 and 2015 – 2nd place State Calculator
- 2012 and 2014 – 1st place State Calculator
- 2011 and 2012 – 1st place State Number Sense

The DLSISD website includes detailed strategies and timelines for the district’s achievement of performance goals for “No Child Left Behind.” The vision of the District shall be to graduate independent, successful, lifelong learners through educational excellence, community involvement, and good citizenship.

RESULTS AND RECOMMENDATIONS

OVERALL RESULTS

Positive Findings

During the audit, we observed the following:

- School officials were prompt in responding to questions and providing supporting documentation
- Personnel files were well organized

Other Findings

We tested:

- Thirty of the population of 181 members reported to TRS in the Regular Payroll Report for the test month
- Twenty three retirees who performed services in the test month
- Five employees paid in the test month who were not reported to TRS in the Regular Payroll Report
- Five vendors/independent contract workers paid during the test month

With the exception of the superintendent’s salary, we did not test whether salary amounts included in the reporting entity’s payroll register were complete, accurate, and authorized.

We did not test the eligibility to receive an annuity of those retirees who have returned to work.

We concluded the following about the completeness and accuracy of the reports submitted to TRS:

NAME OF REPORT	COMPLETE?	ACCURATE?
Regular Payroll Report - Member Contributions to Pension Fund - Member Contributions to TRS-Care - Reporting Entity Contributions to TRS-Care	No	No
Reporting Entity Contribution for New Member Report	Yes	Yes
Reporting Entity Contribution for Federal Fund/Private Grant Report	Yes	Yes
Reporting Entity Contribution for Federal Grant TRS-Care Report	Yes	Yes
Reporting Entity Contribution for Statutory Minimum Report	Yes	No
Reporting Entity Contribution for Non-OASDI Members Report	No	No
Reporting Entity Employment After Retirement (EAR) Area 1 and 2 Report	No	No
Reporting Entity Pension Surcharge Report	No	No
Reporting Entity TRS-Care Surcharge Report	Yes	Yes

The totals reported to TRS in TRAQS for Area 2 Report did not agree with the totals per the RE supporting documentation.

See the table at **Appendix B** for detailed results of testing.

RECOMMENDATION

The Reporting Official should work with the TRS Reporting and Query System (TRAQs) coaches to correct the reports and ensure that corrections are completed by July 2016.

The Reporting Official should ensure that personnel are knowledgeable of TRS Rules and Laws by reading and studying the reporting information and using the self-audit tools provided on the TRS website.

Sufficient and accurate supporting records should be maintained for Employment After Retirement reports.

MANAGEMENT RESPONSES

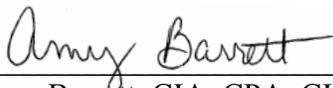
We concur with the recommendations made by Internal Audit. We will work with the TRS TRAQs coach to adjust the reports. We plan to have the adjustments complete by July 2016.

We will provide training and the necessary resources to staff to ensure the accuracy of reports submitted to TRS.

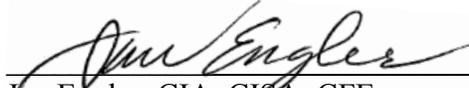
We will develop and implement a process to ensure supporting documentation is maintained for all TRAQs reports.

* * * * *

We appreciate Daingerfield-Lone Star ISD management and staff for their cooperation, courtesy, and professionalism extended to us during this audit.



Amy Barrett, CIA, CPA, CISA
Chief Audit Executive



Jan Engler, CIA, CISA, CFE
Director of Benefit Audits



Dinah G. Arce, CIA, CPA, CFE, CIDA
Senior Auditor



Art Mata, CEBS, CPM
Senior Internal Audit Consultant



Carol Casey, CPM
Internal Audit Consultant

cc: Daingerfield-Lone Star ISD Board of Trustees

APPENDIX A

AUDIT OBJECTIVE, SCOPE, METHODOLOGY, AND CONCLUSION

We conducted this audit in accordance with generally accepted government auditing standards contained in the *Government Auditing Standards* issued by the Comptroller General of the United States and the *International Standards for the Professional Practice of Internal Auditing* issued by the Institute of Internal Auditors, Inc.

These standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our audit findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

AUDIT OBJECTIVE

Our audit objectives were to determine the following⁴:

- Completeness and accuracy of the reports submitted to TRS by the Reporting Entity for the test month
- Eligibility of contract workers performing services for the Reporting Entity for the test month for TRS membership
- Accuracy of census data information (name, date of birth, gender, amount of salary, year of entry, years of service)

Specifically, we performed tests to determine whether the following was complete and accurate:

- Eligible members
- Member contributions
- Employer contributions and surcharges
- Census data of eligible members

SCOPE

Payroll data was selected from the month of January 2016. We selected:

- Thirty sample items from TRS Regular Payroll Report for the test month
- Twenty-three retirees on the payroll
- Five sample items from the Reporting Entity payroll register for employees that were not reported to TRS
- Five sample items of the 205 vendor/independent contract workers paid for the test month for services performed

With the exception of the superintendent's salary, we did not test whether salary amounts included in the reporting entity's payroll register were complete, accurate, and authorized.

We did not test the eligibility to receive an annuity of those retirees who have returned to work.

⁴ Assuming the completeness and accuracy of the official records maintained by the RE

METHODOLOGY

We specifically performed the procedures below.

- 1. To determine completeness and accuracy of reporting eligible members:**
 - Compare the Regular Payroll Report and detail records submitted to TRS with position title on the Reporting Entity's payroll register
 - Confirm eligibility through contract agreements, personnel files, third-party agreements, time reports, job descriptions, and compensation information
 - Determine if the payroll register contains employees who have not been reported to TRS but are eligible for membership in TRS

- 2. To determine that member contributions are reported and are accurate:**
 - Recalculate member contributions and compare to the TRS Regular Payroll Report

- 3. To determine that employer contributions/surcharges are reported and are accurate:**
 - Obtain the reports of employer contributions and surcharges remitted to TRS on the Regular Payroll Report.
 - Review detail supporting records for the employer calculations and recalculate employer contributions for the following:
 - New member contributions
 - Federal Fund/Private Grant contributions
 - Employment After Retirement surcharges
 - Statutory Minimum contributions
 - Non-OASDI contributions

- 4. To determine accuracy of census data of eligible members:**
 - Pull supporting documentation for each item in sample to confirm date of birth, hire date/years of service, eligible compensation, gender, and dates of termination/retirement

CONCLUSION

See the table at **Appendix B** for detailed testing results.

APPENDIX B

Daingerfield-Lone Star ISD DETAIL OF ADJUSTMENTS TO REPORTS

POPULATION, SAMPLE, TESTING:

- Test Month = January 2016

SECTION 1 - ELIGIBILITY TESTING AND EMPLOYER CONTRIBUTIONS (See details below)

- Tested 30 of 181 total members reported in the TRS Regular Payroll Report for the test month to determine eligibility and completeness and accuracy of member and Reporting Entity (RE) contributions.
- Tested five of the 205 vendor/independent contractor payments during the test month to determine TRS eligibility.
- Tested five of the employees not reported to TRS to determine TRS eligibility.

SECTION 2 - EMPLOYMENT AFTER RETIREMENT (See details below)

- Tested all 23 of the retirees that worked in the test month in a position other than a substitute to determine if worked more than the 84 hour limit for the test month.

SECTION 3 - OTHER TESTS AND RESULTS

- Tested census data information on all 30 sample items.
Test Results - Census data information for the 30 sample items was correct.
- Tested all TRAQS Reports submitted to TRS and verified reported totals to the totals per the RE detailed supporting documentation.
Test Results - All report totals per TRAQS reports submitted to TRS agreed with the RE supporting documentation except for Area 2 of EAR report.

SECTION 1 - ELIGIBILITY TESTING

REGULAR PAYROLL REPORT - ELIGIBILITY TESTING

Includes the following contributions: member contributions to pension fund, member contributions to TRS-Care, Reporting Entity contributions to TRS-Care

	REPORT TOTAL	UNDER STATED	OVER STATED	REVISED REPORT TOTAL	% ERROR
Member Contributions to Pension Fund					
No exceptions for the 30 sampled; however, one of the five employees not reported to TRS was determined to be eligible and therefore was improperly excluded and did not pay contributions.		\$ 63.91			
TOTAL	\$ 38,339.86	\$ 63.91	\$ -	\$ 38,403.77	0%

Member Contributions to TRS-Care

No exceptions for the 30 sampled; however, one of the five employees not reported to TRS was determined to be eligible and therefore was improperly excluded and did not pay contributions.		\$ 5.77			
TOTAL	\$ 3,461.36	\$ 5.77	\$ -	\$ 3,467.13	0%

RE Contributions to TRS-Care

No exceptions for the 30 sampled; however, one of the five employees not reported to TRS was determined to be eligible and therefore was improperly excluded and did not pay contributions.		\$ 4.88			
TOTAL	\$ 2,928.78	\$ 4.88	\$ -	\$ 2,933.66	0%

No vendor/contract workers tested were eligible for TRS membership and were therefore correctly excluded from the TRS Regular Payroll Report

NEW MEMBER REPORT	REPORT TOTAL	UNDER STATED	OVER STATED	REVISED REPORT TOTAL	% ERROR
No exceptions					
TOTAL	\$ 197.75	\$ -	\$ -	\$ 197.75	0%

FEDERAL FUNDS REIMBURSEMENT TO PENSION FUND	REPORT TOTAL	UNDER STATED	OVER STATED	REVISED REPORT TOTAL	% ERROR
No exceptions					
TOTAL	\$ 2,654.65	\$ -	\$ -	\$ 2,654.65	0%

FEDERAL FUNDS REIMBURSEMENT TO TRS-CARE	REPORT TOTAL	UNDER STATED	OVER STATED	REVISED REPORT TOTAL	% ERROR
No exceptions					
TOTAL	\$ 390.39	\$ -	\$ -	\$ 390.39	0%

STATUTORY MINIMUM REPORT	REPORT TOTAL	UNDER STATED	OVER STATED	REVISED REPORT TOTAL	% ERROR
Improperly calculated and overpaid contributions on two employees.			\$ 8.86		
Improperly calculated and underpaid contributions on one employee.		\$ 14.11			
TOTAL	\$ 2,403.01	\$ 14.11	\$ 8.86	\$ 2,408.26	0.22%

NON-OASDI REPORT	REPORT TOTAL	UNDER STATED	OVER STATED	REVISED REPORT TOTAL	% ERROR
Improperly calculated and overpaid contributions on one employee.			\$ 3.11		
Improperly excluded and did not pay contributions on one employee (one of the five employees not reported to TRS determined to be eligible, as mentioned above).		\$ 13.31			
TOTAL	\$ 7,455.74	\$ 13.31	\$ 3.11	\$ 7,465.94	0.14%

SECTION 2 - EMPLOYMENT AFTER RETIREMENT

EMPLOYMENT AFTER RETIREMENT AREA 1 AND 2 REPORT	REPORT TOTAL	UNDER STATED	OVER STATED	REVISED REPORT TOTAL	% ERROR
Improperly excluded one retiree from Area 1 Report.					
Improperly excluded two retirees from Area 2 Report.					

PENSION SURCHARGE FOR RETIREES REPORT	TOTAL REPORTED	UNDER STATED	OVER STATED	REVISED REPORT TOTAL	% ERROR
Improperly underpaid surcharge on one retiree.		\$ 26.14			
TOTAL	\$ 1,215.85	\$ 26.14	\$ -	\$ 1,241.99	2%

TRS-CARE SURCHARGE FOR RETIREES REPORT	REPORT TOTAL	UNDER STATED	OVER STATED	REVISED REPORT TOTAL	% ERROR
No exceptions					
TOTAL	\$ 1,083.00	\$ -	\$ -	\$ 1,083.00	0.00%

GRAND TOTALS	\$ 60,130.39	\$ 128.12	\$ 11.97	\$ 60,246.54	0.2%
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TAB 6

TAB 6A

**TRS Internal Audit
Status of Reporting Entity Audit Recommendations – May 2016**

	Audit Project #	Audit Report Date	Reporting Entity (RE)	Status
1	15-401 A	4/29/2015	Santa Maria ISD	Closed
2	15-401 B	5/21/2015	College Station ISD	Closed
3	15-401 C	5/21/2015	Presidio ISD	Closed
4	15-401 D	5/21/2015	El Paso ISD	Closed
5	15-401 E	10/29/2015	Northside ISD	Closed

Status Definitions:

- Under Legal Services Review – TRS Benefits team has requested Legal Services review before taking any further action
- In Progress – TRS Benefits team is working with RE on corrections/adjustments
- Closed – TRS Benefits team has resolved all RE audit findings
- No Audit Findings – the audit resulted in no audit findings

TAB 6B

TRS Internal Audit Summary of Audit Recommendations Status – May 2016

Project	Recommendation	Status	Issue Type	Estimated Date	Revised / Actual Date
14-401 Purchasing and Contract Administration					
	TRS' Contract Administration Manual should have a monitoring component to ensure compliance with the revised Contract Administration Manual and a method for follow-up and/or escalation of non-compliance.	In Progress	Other Reportable	9/2015	6/2016
	The Purchasing Department should update written procedures to match current and new processes.	Implemented	Other Reportable	10/2015	4/2016
15-301 FY 2015 Overall IMD Internal Control Opinion					
	Provide clear guidelines for acceptable accounting and valuation standards for Private Equity investments	Implemented	Other Reportable	9/2015	5/2016
15-402 Actuarial Data Controls					
	Include the required active and retired actuarial data file layouts in the contractual agreement with actuary	In Progress	Other Reportable	9/2016	

Significant to Business Objectives

	<ul style="list-style-type: none"> Past <i>original</i> estimated completion date No management action plan <u>or</u> No progress on management action plan
	<ul style="list-style-type: none"> Past <i>original</i> estimated completion date Progress on management action plan
	<ul style="list-style-type: none"> <i>Original</i> estimated completion date has not changed Progress on management action plan
	Satisfactory implementation of management action plan <u>or</u> Acceptance of risk by management
	Implementation of management action plan pending Internal Audit validation

Other Reportable

	<ul style="list-style-type: none"> Past <i>original</i> <u>or</u> first <i>revised</i> estimated completion date No management action plan <u>or</u> No progress on management action plan
	<ul style="list-style-type: none"> Past <i>original</i> <u>or</u> first <i>revised</i> estimated completion date Progress on management action plan
	<ul style="list-style-type: none"> Within <i>original</i> <u>or</u> first <i>revised</i> estimated completion date Progress on management action plan
	Satisfactory implementation of management action plan <u>or</u> Acceptance of risk by management

**TRS Internal Audit
Summary of Audit Recommendations Status – May 2016**

Project	Recommendation	Status	Issue Type	Estimated Date	Revised / Actual Date
15-501 Records Management Audit					
	Require Certification for Terminating Employee and Contract Workers	Implemented	Significant	12/2015	3/2016
	Develop a plan to perform routine enterprise-wide departmental records retention assessments	Implemented	Significant	10/2015	9/2015
	Develop a plan to provide well-defined guidelines for users of electronic records systems and increase records management awareness	Implemented	Significant	10/2015	9/2015
16-301 Overall IMD Opinion Audit					
	Improve the travel process to ensure justification for excess lodging expenses for foreign travel	In Progress	Other Reportable	8/2016	

**TRS Internal Audit
Summary of Audit Recommendations Status – May 2016**

State Auditor’s Office (SAO) Audit Recommendations

Project	Recommendation	Status	Issue Type	Estimated Date	Revised / Actual Date
15-035 SAO Audit of Employer Pension Liability Allocation Schedules					
	Establish verification process of reporting entities and verify payment of contributions - Step 3 – implement new Pension Line of Business	Implemented	Significant	9/2016	5/2016
15-305 SAO Audit of Fiscal Year 2014 Comprehensive Annual Financial Report					
	Strengthen controls over census data	In Progress	Significant	8/2016	9/2016

TAB 7

Teacher Retirement System of Texas
June 2016 Audit Committee Agenda Items Mapped to TRS Stoplight Report

403(b)	Accounting & Reporting <i>Agenda Items 3A & 3B</i>	Budget	Business Continuity	Communications & External Relations
Credit	Customer Service	Employer Reporting <i>Agenda Items 5 A-E</i>	Ethics & Fraud Prevention	Facilities Management & Planning
Governmental / Association Relations & Legislation	Health Care Plans Administration <i>Agenda Item 4</i>	Information Security & Confidentiality	Investment Accounting <i>Agenda Items 3A-C</i>	Investment Operations
Legacy Information Systems	Liquidity / Leverage	Market	Open Government <i>Agenda Items 2, 6 & 7</i>	Pension Benefit Administration
Pension Funding	Purchasing & Contracts	Records Management	Regulatory, Compliance & Litigation <i>Agenda Item 3C</i>	Talent Continuity
TEAM Program	TRS-ActiveCare Affordability	TRS-Care Funding		

Fiscal Year 2016 Audit Plan Status As of May 2016

Title and Project #	Type	Status
Executive and Finance		
Actuarial Data Controls (15-402)	Audit	Complete
State Auditor's Office (SAO) Financial (CAFR) Audit Coordination	Advisory	Complete
Internal Ethics and Fraud Hotline Administration	Advisory	Ongoing
Meetings Participation	Advisory	Ongoing
Special Requests and Emerging Issues	Audit/Consulting/Advisory	
• Innovation Best Ideas (16-605) - Board Chair Request	Consulting	Complete
Testing of Executive Performance Incentive Pay Calculations	Agreed-Upon Procedures	
TEAM Program		
TEAM Program Internal Controls Assessment	Advisory	In Progress
TEAM Security and Access Controls Assessment	Advisory	In Progress
TEAM Independent Program Assessment (IPA) Vendor Support	Advisory	Ongoing
TEAM Committees and TEAM Projects Participation	Advisory	Ongoing
Pension Benefits		
Benefits Testing for State Auditor's Office (SAO) Audit of Comprehensive Annual Financial Report (CAFR) (16-100)	Audit	Complete
Annual Benefits Testing (16-101)	Agreed-Upon Procedures	
Reporting Entity Audits (6-8) and Investigations (16-401)	Audit	In Progress (Completed 5 REs)
TRS Reporting Entity Website Audit Information	Advisory	Complete
Benefits Data Analysis Pilot Project	Advisory	
Health Care		
Health Care Audit Risk Assessment Follow Up	Consulting	Complete
Open Enrollment and Billing Readiness Review	Consulting	In Progress
Health Care Vendor Selection Observation	Advisory	Complete
Health Care Vendor Update Meetings	Advisory	Ongoing

Fiscal Year 2016 Audit Plan Status As of May 2016

Title and Project #	Type	Status
Information Technology		
SharePoint Governance and Security Audit (16-501)	Audit	Complete
Wireless Network Security Assessment (16-502)	Agreed-Up On Procedures	Complete
Data Protection Project	Advisory	In Progress
Disaster Recovery, Network Penetration Tests; Security Risk Assessment Review	Advisory	Ongoing
Investment Management		
Overall Internal Control Opinion on Investment Activities (16-301)	Audit	In Progress
Quarterly Investment Compliance, Incentive Pay, Ethics Policies and Budget Testing (16-302)	Agreed-Up On Procedures	Complete 3rd QTR
Annual Incentive Compensation Plan Testing (16-303)	Agreed-Up On Procedures	Complete
Coordination of SAO Audit of Incentive Pay	Advisory	Complete
Investments Data Analysis Pilot Project	Advisory	In Progress
Investment Committees Attendance	Advisory	Ongoing
Coordinate the TRICOT Financial Audit	Advisory	In Progress
Internal Audit Department		
Annual Internal Audit Report (16-603)	Audit	Complete
Data Analytic Development Project	Advisory	In Progress
Quarterly Audit Recommendations Follow-up	Audit	Ongoing
External Quality Assurance Review	Audit	Complete
Internal Quality Assurance Review (16-602)	Advisory	Complete
Fiscal Year 2017 Audit Plan	Advisory	
Internal Audit Vendor Request for Qualifications (RFQ)	Advisory	Complete
Audit Committee Meetings Preparation	Advisory	Ongoing

Internal Audit Advisory Services¹
Fiscal Year 2016 – 3rd Quarter

BENEFIT SERVICES
<p>Participated in the TEAM Program</p> <ul style="list-style-type: none"> • Executive Steering Committee • Organizational Change Management Advisory Group • Business Procedures and Training • Core Management Team (CMT) Prioritization Review Meetings • Monthly meetings with TEAM Program Manager and vendor personnel • Independent Program Assessment (IPA) Vendor Coordination and Support • Reporting Entity Outreach (REO) Core Team • TRS Website Redesign Committee
HEALTH INSURANCE BENEFITS (HIB)
<ul style="list-style-type: none"> • Attended the Health Plan Administrator (HPA) and Pharmacy Benefit Manager (PBM) Vendor Quarterly Update Meetings • Participated (non-voting) in the HIB Claims Audit Vendor selection process • Coordinated Health Care Risk Assessment Follow-Up project • Participated in and coordinated selection and engagement of a vendor to conduct the Open Enrollment and Billing Readiness Review • Piloting TRS-ActiveCare eligibility audit
INVESTMENT MANAGEMENT DIVISION (IMD)
<ul style="list-style-type: none"> • Attended Internal Investment Committee (IIC) meetings • Participated in Proxy Voting Committee meeting • Participated in Securities Lending monitoring calls • Participated in Performance Incentive Pay Procedures Working Group meetings
FINANCIAL SERVICES
<ul style="list-style-type: none"> • Coordinated hiring of an external audit firm for financial statement audit of London Office • Participated in GASB 72 (Fair Value Standards) Implementation Working Group meetings • Provided input into update of Fraud, Waste, and Abuse Policy
EXECUTIVE
<ul style="list-style-type: none"> • Facilitated SAO's Quarterly Update Meetings • Administered and facilitated Hot Line Calls • Participated in the Risk Oversight Committee • Participated in Safety Committee Quarterly Committee Meetings
INFORMATION TECHNOLOGY (IT)
<ul style="list-style-type: none"> • Participated in TEAM Enterprise Security Team meetings • Participated in TRUST Report Repository Meetings • Participated in TRUST General Ledger Testing Meetings • Participated in the Enterprise Risk Management (ERM) Data Protection Project • SharePoint Governance and Security Advisory Services • Observed the mainframe recovery test

¹ Advisory Services (non-audit services) - The scope of work performed does not constitute an audit under Generally Accepted Government Auditing Standards (GAGAS).

Internal Audit Goals and Performance Measures - Fiscal Year 2016
3rd Quarter Ending May 2016

Target Performance	Activity	Status
Goal 1: Enhance Effectiveness of Internal Audit Organization		
1. Spend a minimum of 75% of total available department hours (excludes uncontrollable leave) for professional staff on direct assurance, consulting, and advisory services.	Achieved 80% for the 3 rd quarter of fiscal year 2016.	On Task
2. Complete an independent external assessment and report the results of the Quality Assurance and Improvement Program.	The external assessment was completed in April 2016.	Achieved
Goal 2: Develop and Implement Internal Audit Annual Audit Plan based on Formal Risk Assessment		
3. Prepare an annual audit plan based on a documented risk assessment and obtain input from trustees and staff.	Audit planning and risk assessment is scheduled for the 4 th quarter.	On Task
4. Execute 80% of audit and agreed-upon procedures projects (80% allows for flexibility due to changes in TRS business practices and special requests).	Planned assurance and agreed-upon procedures projects are on schedule and assigned to staff.	On Task
5. Update a formal reporting entity risk assessment to identify reporting entities for audit.	The update of the reporting entity risk assessment is in progress.	Achieved
Goal 3: Enhance Internal Audit Staff Skills and Knowledge in Emerging Risks and Controls with Emphasis on Information Technology, Investment, and Health Care		
6. Enhance staff knowledge of services provided to the Investment Management Division by visiting one TRS asset manager or service provider.	Amy Barrett and Hugh Ohn visited Aon Hewitt in April 2016	Achieved
7. Engage a service provider for developing data analytics capabilities.	Engaged a firm to develop data analytics capabilities and proposed a roadmap for Internal Audit	Achieved
Goal 4: Deliver Value-Added Consulting and Advisory Activities		
8. Facilitate coordination of TEAM Independent Program Assessment (IPA) vendor by coordinating meetings with Executive Director, Executive Steering Committee (ESC) and Core Management Team (CMT), quarterly presentations to the TRS Board of Trustees, and other contractual activities.	Coordination and support of IPA vendor is ongoing.	On Task

Internal Audit Goals and Performance Measures - Fiscal Year 2016
3rd Quarter Ending May 2016

Target Performance	Activity	Status
9. Facilitate timely completion and success of State Auditor’s Office (SAO) audits in fiscal year 2016 by effectively providing audit support, coordinating meetings, reserving facilities and gathering schedule and documentation requests.	Internal Audit staff has provided support and coordination for the following SAO audits: <ul style="list-style-type: none"> • Audit of FY 2015 Comprehensive Annual Financial Report (CAFR) • Audit of Benefits Proportionality at the Office of the Comptroller of Public Accounts, the Teacher Retirement System, and the Employees Retirement System • Audit of Incentive Compensation at Selected Agencies 	On Task
Goal 5: Enhance Participation in Professional and Peer Organizations		
10. Participate in professional organizations (APPFA, IIA, ISACA, ACFE, SAIAP, CFA Institute) through monthly chapter meetings and participate in leadership roles in at least one professional organization.	The CAE is secretary for APPFA and IT Audit Manager is the web administrator for APPFA. One audit manager is on the Board of Governors for the Austin Chapter of the IIA. Participation in professional organizations is ongoing.	On Task
11. Support staff in obtaining additional certifications such as the CFA, CPA, and CIA certifications and have all staff obtain a minimum of 40 continuing professional education hours.	Staff attended professional development training this quarter.	On Task

Legend: Target Status

	Target not achieved
	Behind in achieving target or partially complete
	On task to achieve target
	Achieved target



Update on CAE Performance Goals

	TRS Strategic Plan	CAE Goals	Key Performance Indicators	Status
1	Objective G2.O1: Implement modern pension and benefit information systems that allow TRS staff to serve our members and deliver accurate benefits effectively and timely by August 2017.	TEAM: Participate actively in TEAM program and oversight vendor coordination; facilitate identification, communication, and resolution of risks early prior to going live; gather information for the automation best ideas board presentation	Ongoing participation in bi-weekly Executive Steering Committee (ESC) meetings	Ongoing: Chief Audit Executive (CAE) attends and participates in ESC meetings
Regular meetings with oversight, project management, implementation vendor, and change management (OCM) staff to assess program status			Ongoing: CAE meets monthly with Bridgepoint, Provaliant, and HPE separately from management. CAE meets periodically with OCM staff	
Increased dialog and meetings between oversight vendor and project management staff to discuss risks identified and solutions proposed			Complete: Provaliant established a process for Bridgepoint to communicate and vet risks and recommendations to project management team prior to the Core Management Team.	
Initiation of advisory activities for TEAM relating to security and internal controls			In progress: Internal Audit (IA) staff are mapping business controls from the old system to the new and identifying tests of key controls. IA staff is participating in the security team meetings where controls are mapped to industry standards	
Increased requests for TEAM participation and audit staff input into TEAM activities			Ongoing: Audit staff have responded to requests regarding system access and security protocols.	
Presentation of automation best ideas to Trustees at February retreat	Complete: Automation best ideas gathered and presented to Trustees at February retreat			



Update on CAE Performance Goals

	TRS Strategic Plan	CAE Goals	Key Performance Indicators	Status
2	<p>Strategy G1.02.S1: Establish and implement an effective investment governance structure.</p> <p>Tactic G1.02.S1.T4: Perform regular audit and compliance activities.</p>	<p>Investment, Benefits, Health Care, and IT Assurance: Identify and audit key risks related to investments and other areas to provide assurance to the board and executive management</p>	Completion of annual audit plan, especially completion of overall investment opinion, investment compliance, and incentive pay projects	In progress: Annual audit plan is on track to be completed. Investment incentive pay project is complete.
			Enterprise Risk Management (ERM) Stoplight Report risks considered in development of the annual audit plan	Complete: Annual audit plan is mapped to the ERM stoplight report and shared with the Risk Oversight Committee (ROC)
			Subject matter expert used to supplement investment audit projects	In progress: Protiviti provided staff augmentation resources for the investment area. EY is assisting in identifying data analytics opportunities.
			Active participation in the Executive Council (EC) and Risk Oversight Committee meetings with input on governance, risk, and control matters	Ongoing: CAE participates in monthly EC and quarterly ROC meetings
			Staff auditor observation of internal investment meetings including Internal Investment Committee (IIC), Securities Lending, Proxy Voting, and London Office Operations	Ongoing: IA staff attended IIC meetings and meetings on the setup of the London Office. IA is coordinating the hiring of financial auditor for the London Office.
			Staff auditor participation in quarterly health care vendor updates	Ongoing: IA staff attend all quarterly meetings with health care vendors. IA coordinated and participated in the Open Enrollment Readiness Review
			Staff auditor observation of hot site/co-location testing	Complete: IA staff observed the hot site/colocation testing



Update on CAE Performance Goals

	TRS Strategic Plan	CAE Goals	Key Performance Indicators	Status
3	<p>Strategy G2.O2.S2: Provide and maintain accurate, timely and consistent information to participants, reporting entities and other stakeholders in line with customer service benchmarks.</p> <p>Tactic G2.O2.S2.T4: Conduct and publish independent review and audits in accordance with best practices</p>	<p>Employer Audits: Increase efficiency and volume of employer audits and coordinate with Benefits, Health Care, and Legal staff to identify systemic issues requiring additional employer training and timely resolution</p>	<p>6 – 8 employer audits completed (double of prior year)</p> <p>Testing at employers of TRS-ActiveCare eligibility and premiums paid (new for FY16)</p> <p>TRS staff outside of audit participated in employer audits as requested and provided results prior to issuing reports</p> <p>Audit webpage relating to employer audits updated</p> <p>Overview to trustees on employer audit steps provided at February meeting</p>	<p>In progress: IA has completed 5 employer audits and plans to complete 2 more prior to year-end.</p> <p>In progress: IA has completed a pilot audit of TRS-ActiveCare eligibility at one school district and is preparing to launch a second pilot audit in September once the TRS-ActiveCare open enrollment period ends.</p> <p>Complete: Staff from Benefit Reporting attend all Reporting Entity audit exit conferences and receive test worksheets prior to audit completion</p> <p>Complete: The webpage with employer audit information was updated and a new webpage was created to assist financial auditors of Reporting Entities requesting information from TRS</p> <p>Complete: A joint presentation with Benefit Reporting on conducting employer audits was made at the February board meeting</p>



Update on CAE Performance Goals

	TR Strategic Plan	CAE Goals	Key Performance Indicators	Status
4	G1.O2.S1.T4 Perform regular audit and compliance activities G2.O2.S2.T4 Conduct and publish independent review and audits in accordance with best practices	CAFR and SAO Audits: Facilitate State Auditor's Office (SAO) audits to minimize disruption to TRS staff and ensure sufficient communication of requests and findings	Concerns about audit process raised to internal audit are addressed	Complete: All concerns raised to Internal Audit have been provided to the SAO
			SharePoint used to gather schedule requests (new process)	Complete: IA staff used SharePoint for uploading documents required by the SAO
			Recommendations from TRS for improving SAO CAFR process from prior year implemented in current year	Complete: All recommendations from the prior year were implemented in the current year
			Debriefing meeting held after audit to gather lists of improvements for next year	Complete: Debrief meeting held after the audit and a list of improvements identified
			Audit recommendations made by SAO are tracked quarterly with status reported to the Risk Oversight Committee (ROC) and Audit Committee (AC)	Ongoing: Audit recommendations are tracked and reported to the ROC and AC
5	G1.O2.S1.T4 Perform regular audit and compliance activities G2.O2.S2.T4 Conduct and publish independent review and audits in accordance with best practices	Expertise: Engage third party expertise to address critical risks in complex areas by issuing a request for qualifications (RFQ) and utilizing expertise in selected projects	Audit Services RFQ issued in September	Complete: RFQ issued
			Subject matter expertise outside of internal audit used in vendor evaluation and selection process	Complete: TRS staff in Investments, IT, and Health Care areas participated in vendor evaluation and selection
			Vendors selected by December 31, 2015	Complete: Vendors selected and contracts are in place for three vendors
			Vendors used in conducting projects requiring specific expertise or tools	Complete: Vendors completed the WiFi security assessment, Health Care Risk Assessment (HCRA) Follow Up, and TRS-ActiveCare Readiness Review with assistance from Internal Audit.



Update on CAE Performance Goals

	TRS Strategic Plan	CAE Goals	Key Performance Indicators	Status
6	G1.O2.S1.T4 Perform regular audit and compliance activities G2.O2.S2.T4 Conduct and publish independent review and audits in accordance with best practices	Data Analysis Capabilities: Improve data analysis capabilities identified by EY in year one of the data analytics roadmap for Internal Audit to improve the quality of audit results	Data analysis vision statement created and mapped to audit strategic plan and TRS Core Values	Complete: Data analysis vision statement was created and mapped
			EY provides other data analytics training	Complete: EY provided the Excel training for data analysis to IA staff
			Staff attends data analysis training	Ongoing: IA staff are preparing internal training for other staff on data analysis techniques
			Two data analysis projects identified and completed (internal advisory)	In progress: In process of selecting and piloting analysis projects. Due to staff leave and turnover, projects may not complete until FY17.
7	Objective G4.O2: Develop an effective recruitment / retention strategy and a competitive total rewards package	Workforce Planning: Plan for the future by hiring staff, transitioning benefits testing from senior to junior staff, and reorganizing benefits team	One staff hired from Benefit Services	Complete: Cari Casey was hired from Benefit Services effective October 1
			Organizational changes made to better align audit teams to TRS departments	Complete: Jan Engler was promoted to Director of Pension Services and four staff were moved to report to her. An intern was hired as full time auditor to assist with investment audits and a senior investment auditor was hired effective June 1. In progress: Requests have been submitted to hire two more staff, especially with significant IT and benefits experience
			Responsibilities of retiring auditor smoothly transitioned to other auditors	Complete: CAE ensured Karen Morris' responsibilities were smoothly transitioned to other staff



Update on CAE Performance Goals

	TRS Strategic Plan	CAE Goals	Key Performance Indicators	Status
8	G1.O2.S1.T4 Perform regular audit and compliance activities	Governance: Orient new audit committee members to enhance understanding of audit's role in the governance structure	New audit committee member orientation provided to new trustees	In progress: Orientation materials have been prepared and orientation meetings are in process of being scheduled by executives
	G2.O2.S2.T4 Conduct and publish independent review and audits in accordance with best practices		External quality assessment review (QAR) of audit compliance with standards completed and communicated to trustees with no significant compliance deficiencies	Complete: The external QAR took place in April with a report to the audit committee in June. Internal Audit achieved full compliance with auditing standards

Internal Audit Staff Quarterly Accomplishments

- Toma Miller participated in the onsite Aetna/Wellsystems Readiness Review in Tampa, Florida
- Toma Miller attended the State and Local Government Benefits Associations (SALGBA) Conference in San Antonio
- Hugh Ohn, Dinah Arce, Cari Casey, and Amy Barrett, attended the Association of Public Pension Fund Auditors (APPFA) semi-annual conference in Chicago
- Amy Barrett presented on GASB 67 and 68 and the auditing implications at the Association of Government Accountants in Austin
- Anandhi Mani joined Internal Audit as a Senior Investment Auditor effective June 1, 2016. She majored in Accounting and received a bachelor-equivalent degree from the University of London Examinations and Assessment Council, and holds CPA and CIA certifications. Her previous work experience includes work at the Texas Attorney General's Office, Travis County District Attorney's Office, and Deloitte.
- Rodrigo Dominguez joined Internal Audit as an Auditor effective June 15, 2016. He has been an intern for TRS Internal Audit since June 1, 2015. He received a Bachelor of Economics from The University of Texas at Austin. His work experience includes accounts payable student associate at the University of Texas at Austin's Office of Accounting and usher at the Frank Erwin Center.

PROTIVITI FLASH REPORT

Brace Yourself: OCR's Phase 2 HIPAA Audits Have Begun

March 31, 2016

For the last two years, the industry has been waiting to see what would come from the Phase 2 HIPAA audits that the Office for Civil Rights (OCR) promised. The wait is finally over.

While some organizations took advantage of the time they had to bring their HIPAA compliance practices up to par, others waited with measured skepticism. Regardless of which category an organization falls into, it should be taking action today to make sure it is ready, from a compliance standpoint, for what is coming based on a recent announcement from the OCR.

During this year's National HIPAA Summit on March 21, OCR Director Jocelyn Samuels notified the attendees that the Phase 2 HIPAA audits were starting that day, albeit in the form of verification emails to ensure they have accurate contact information from select organizations for their next steps. This was shortly followed by an email blast providing the same information.

Here's what is now known; however, this information may be subject to change as the OCR finalizes the program:

OCR Update	What It Means to You
Emails are being sent to obtain and verify contact information to identify covered entities and business associates of various types to be included in potential auditee pools. The OCR has made it clear that failure to respond to this or any other OCR communication will not exclude an organization from the audit pool.	These emails are coming from hhs.gov, so organizations should check their spam and other filters to ensure they receive these without a problem. Organizations also should validate that the OCR has the appropriate contact person or department so that they can respond to the OCR's requests in a timely manner.
The OCR will send out a questionnaire to gather data about the size, type and operations of the organization. This will be sent to covered entities and business associates alike; however, in the questionnaire to covered entities they will request a list of all of the organization's business associates.	Covered entities need to make sure that a comprehensive list of their business associates is in place and up-to-date. This should not just be a list of "key" relationships, or only ones for which valid contracts are in place – the OCR wants to know about all business associates.
Most audits are planned to be "desk audits" where the OCR will request documentation that the organization will submit electronically to the OCR's new audit portal for review by an OCR auditor. The organization will only have 10 business days to submit any requested documentation. The OCR has noted that the auditor may have the ability to follow up proactively with the organization with questions, but it is not clear whether the auditee may initiate such conversations.	It is still important that the organization's documentation and evidence stands on its own, as that may be the one opportunity to explain key practices. Organizations should review their documentation and determine if evidence (1) is readily available so that it can be submitted within the deadline, and (2) can be easily understood by an independent third party such as an OCR-designated auditor. Consider the use of a supporting narrative that describes the process the organization took and the correlation to its supporting evidence. This may be most critical for supporting/describing risk analysis efforts if the information is split across multiple documents.

OCR Update	What It Means to You
The OCR is still planning to perform some “onsite” audits that will cover a broader scope. The OCR mentioned that some organizations that have had a “desk audit” may subsequently be selected for an onsite audit as well.	While the focus of “desk audits” will be narrower, it will still be important to ensure the organization’s overall compliance program is functioning, as additional audit activity may occur.
The updated audit protocols will be ready “very shortly,” according to OCR Director Samuels. These protocols essentially will be the OCR’s game plan for how it is going to audit during these efforts and reflect an updated version of the protocols currently available on the HHS website.	Don’t delay and wait for these to be finalized; however, once the updated protocols are published, organizations will need to review them in detail and ensure their evidence, documentation, practices, etc., continue to align with the OCR’s expectations.

The OCR has stated that those organizations currently going through an OCR investigation will not be immediately subject to the Phase 2 audits. This does not mean, however, that these organizations have an indefinite free pass. These audits are here to stay, are just getting started, and the OCR’s scrutiny will only continue to increase.

For more information on these upcoming audits, see the OCR’s updates at www.hhs.gov/hipaa/for-professionals/compliance-enforcement/audit/index.html.

About Protiviti

Protiviti (www.protiviti.com) is a global consulting firm that helps companies solve problems in finance, technology, operations, governance, risk and internal audit, and has served more than 60 percent of *Fortune* 1000® and 35 percent of *Fortune* Global 500® companies. Protiviti and our independently owned Member Firms serve clients through a network of more than 70 locations in over 20 countries. We also work with smaller, growing companies, including those looking to go public, as well as with government agencies.

Ranked 57 on the [2016 Fortune 100 Best Companies to Work For®](#) list, Protiviti is a wholly owned subsidiary of Robert Half (NYSE: RHI). Founded in 1948, Robert Half is a member of the S&P 500 index.

Protiviti assists a wide variety of organizations with their HIPAA compliance programs and has been helping clients address HIPAA since its inception. HIPAA is not new to us. We are recognized as a HIPAA thought leader in the healthcare industry and have published numerous articles and publications on HIPAA’s key requirements and challenges. We also present regularly on HIPAA at local, regional and national conferences.

Protiviti assists healthcare organizations across the entire lifecycle of their HIPAA compliance programs. We would be happy to discuss the impact the OCR’s Phase 2 HIPAA audits will have on you and your organization.

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