

Audit Committee Meeting

March 2014



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

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

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

AGENDA

**March 27, 2014 –9:45 a.m.
TRS East Building, 5th Floor, Boardroom**

1. Approve minutes of December 13, 2013 Audit Committee meeting – Mr. Christopher Moss, Chair
2. Receive Comptroller of Public Accounts report on the Post-Payment Audit of Teacher Retirement System of Texas – Ms. Janie Duarte
3. Receive report on Follow-up Audit of Telephone Counseling Center Performance Measures – Ms. Jan Engler, Mr. Tom Guerin; Mr. Ron Franke and Mr. Michael Dean, Myers and Stauffer LC
4. Receive Internal Audit reports
 - A. Report on Observation of TRS-ActiveCare Vendor Selection Process – Ms. Jan Engler
 - B. Second Quarter Test Results of Investment Controls (Internal Public Markets, Trading, Control Environment) – Mr. Hugh Ohn
 - C. Quarterly Investment Testing (Agreed-Upon Procedures) – Mr. Hugh Ohn
 - D. Semi-Annual Testing of Benefit Payments (Agreed-Upon Procedures) – Ms. Amy Barrett
5. Receive report on the status of prior audit and consulting recommendations – Ms. Amy Barrett
6. Discuss or consider Internal Audit administrative reports and matters related to governance, risk management, internal control, compliance violations, fraud, regulatory reviews or investigations, fraud risk areas, audits for the annual internal audit plan, or auditors' ability to perform duties – Mr. Christopher Moss and Ms. 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
December 13, 2013**

The Audit Committee of the Teacher Retirement System of Texas met on Friday, December 13, 2013 in the 5th floor Board room. 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
Todd Barth, Board Member
Joe Colonna, Board Member
Dolores Ramirez, Board Member

TRS Staff

Brian Guthrie, Executive Director
Ken Welch, Deputy Director
Amy Barrett, Chief Audit Executive
Hugh Ohn, Director, Investment Audit Services
Karen Morris, Director, Pension Audit Services
Jan Engler, Manager, Internal Audit
Dinah Arce, Senior Auditor, Internal Audit
Toma Miller, Auditor, Internal Audit
Amy Morgan, Chief Information Officer
T.A. Miller, Deputy Information Officer
Britt Harris, Chief Investment Officer
Jerry Albright, Deputy Chief Investment Officer
Sylvia Bell, Director, Administrative Center, Investment Division
Carolina de Onis, General Counsel
Clarke Howard, Assistant General Counsel
Angela Vogeli, Assistant General Counsel
Beckie Smith, Assistant General Counsel
Lynn Lau, Assistant Secretary to the Board and Program Specialist, Legal Department
Betsey Jones, Director, Health Care Policy and Administration
Bob Jordan, Director, TRS Health and Insurance Benefits
Edward Esquivel, Assistant Director, TRS Health and Insurance Benefits
Don Green, Chief Financial Officer
Jamie Michels, Manager, General Accounting
Cindy Haley, Team Leader, Financial Reporting, General Accounting

Scot Leith, Manager, Director of Investment and Benefit Accounting
Art Mata, Benefit Accounting Consultant, Benefit Accounting
Marianne Woods Wiley, Chief Benefit Officer
Mike Rehling, Manager, Benefit Processing
Adam Fambrough, Assistant Manager, Benefit Processing
Jimmie Savage, Manager, Member Data Services
Tom Guerin, Manager, Benefit Counseling
Barbie Pearson, Assistant Manager, Benefit Counseling
Howard Goldman, Director, Communications
Jay LeBlanc, Director, Risk Management & Strategic Planning

Other Attendees

Philip Mullins, Retiree
Greg Adams, State Auditor's Office
Angelica Ramirez, State Auditor's Office
Susan Haseley, Protiviti Inc.
Rene Hernandez, Protiviti Inc.

Audit Committee Chair Christopher Moss called the meeting to order at 8:40 a.m. with a quorum of committee members present.

1. APPROVE MINUTES OF SEPTEMBER 13, 2013 AUDIT COMMITTEE MEETING

On a motion by Ms. Nanette Sissney, and seconded by Mr. David Corpus, the proposed minutes of the September 13, 2013 Audit Committee meeting were approved as presented.

2. RECEIVE STATE AUDITOR'S OFFICE REPORT ON AUDIT OF TRS' FISCAL YEAR 2013 COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR)

Mr. Greg Adams, State Auditor's Office (SAO) Project Manager, stated that his office performed an independent audit of TRS' Fiscal Year 2013 CAFR and issued an unqualified opinion. Mr. Adams stated that no material misstatements were found in the audit and no material weaknesses were identified. Additionally, he stated that no evidence was found of fraud, abuse, or noncompliance with laws or regulations, contracts or grant agreements during the course of the audit.

3. RECEIVE REPORT ON A PLAN TO CONDUCT A HEALTH CARE RISK ASSESSMENT AND DEVELOP A MODEL THREE-YEAR AUDIT PLAN

Ms. Susan Haseley, Protiviti Inc., gave an overview of this consulting project. She stated that Protiviti will be working closely with Internal Audit and Health and Insurance Benefits staff to conduct a risk assessment of TRS' health care programs. The scope of the risk assessment will be comprehensive, and will cover health care benefit administration, financial and operational processes, as well as regulatory compliance and related technology and privacy risks. The goal of the risk assessment will be to identify priorities in terms of risk and to develop a customized risk model and audit universe for Internal Audit to use in developing a three-year audit plan for the health care programs. The results of this project will be reported at the June 2014 Audit Committee meeting.

4. RECEIVE INTERNAL AUDIT PENSION BENEFITS REPORTS

A. Cost of Living Adjustment (COLA) Payment Process

Mr. Art Mata gave an overview of the process used by TRS to implement the legislatively directed COLA provided to eligible annuitants beginning September 1, 2013. He stated that a committee of TRS staff was formed from individuals across the agency to ensure that all implications of the COLA were considered and addressed in a timely manner. Great care was given to ensure that all special payment situations were evaluated for proper application of the COLA. Mr. Mata reported that the cost of the COLA was \$9.5 million and increased the monthly pension payment to approximately 184,000 retirees. All increases were accurately implemented on time and no additional full-time employees or funding were needed in order to implement this change.

B. Audit of Cost of Living Adjustment (COLA)

Ms. Amy Barrett reported the results of the COLA audit. She stated that the audit looked at three main areas: interpretation and application of the legislative mandate, programming changes and quality assurance testing that occurred, and the manual payment calculation process. No issues were identified regarding the first two areas of focus and two recommendations were made regarding manual and special payment processes.

C. Special Service Buy Back Legislative Changes

Mr. Adam Fambrough gave an overview of legislative changes made in 2011 that impacted the cost for members to purchase special service credits. He stated that the price to purchase withdrawn, out-of-state, developmental, and unreported service increased as of September 1, 2013. He stated that the implementation included revision of TRS administrative rules and departmental procedures and forms, updated actuarial tables, internal system program changes, staff training, and communications to members.

D. Special Service Buy Back Audit

Ms. Jan Engler reported the results of the special service buy back audit. She stated that the audit objectives were to determine the following: eligibility for service credit was in accordance with TRS Laws and Rules, Special Service Buy Back (SSBB) billing was accurate and used calculation methods, tables, and implementation dates in compliance with current legislation; and SSBB payments were accurately applied to member accounts. Ms. Engler indicated that key process controls were working as management intended and the audit did not result in any findings.

5. RECEIVE INTERNAL AUDIT INVESTMENT MANAGEMENT DIVISION REPORTS

A. Overview of Internal Control Framework for Expressing an Opinion on Investment Controls

Ms. Barrett gave a brief overview of the control framework being used by Internal Audit to give an overall opinion regarding controls within the Investment Management Division (IMD). She stated that the auditors will be using the control framework developed by the Committee of Sponsoring Organizations (COSO) which lays out 17 control principles that should be evaluated in an organization. She stated that by using this framework in the audit process, Internal Audit will be able to provide a more holistic assurance of the controls in place within IMD. She stated that quarterly reports will be each issued for each quarter's control tests and reported to the Audit Committee.

B. First Quarter Interim Test Results of Investment Controls

Mr. Hugh Ohn reviewed the results of control testing related to securities lending and commission sharing arrangements (CSA). He stated that although the audit primarily focused on controls in place within IMD, some controls at State Street, TRS' custodian and asset manager, in regards to securities lending were also reviewed. Mr. Ohn stated the audit results indicated that controls tested for securities lending and commission sharing arrangements are working effectively. He stated two recommendations were made: first, to implement a regular reasonableness review of securities lending income; and, second, to consider other options for long-term solutions to address revenue shortfall projections for the CSA program. He reported that management agreed with these recommendations.

C. Quarterly Investment Testing

Mr. Ohn reported that the quarterly investment testing identified one issue which IMD had already self-reported to the board in the transparency report. The issue was in regards to an emerging manager allocation limit being exceeded beyond authorized limits. He stated that IMD has put steps in place to prevent this going forward. No other issues were identified.

6. RECEIVE REPORTS ON THE FISCAL YEAR 2013 INTERNAL AUDIT ANNUAL REPORT AND STATUS OF PRIOR AUDIT AND CONSULTING RECOMMENDATIONS

A. Fiscal Year 2013 Internal Audit Annual Report

Ms. Barrett gave an overview of the Internal Audit Annual Report issued in accordance with the Texas Internal Auditing Act with copies given to the State Auditor's Office, Legislative Budget Board, Sunset Advisory Commission, and the Governor's Office.

B. Status of Prior Audit and Consulting Recommendations

Ms. Barrett gave a brief overview of the outstanding audit recommendations. She stated that several have been implemented. There were currently no outstanding past due recommendations.

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

Ms. Barrett reviewed several standard administrative reports. She indicated that Internal Audit is on target to accomplish all projects on the annual audit plan.

Ms. Barrett also briefly reviewed a consulting project performed by students from the University of Texas at Austin and coordinated by internal auditor Dinah Arce. The project looked at TRS policies surrounding cloud computing and mobile devices. The students surveyed other organizations, researched best practices, and presented their results and suggestions for improvement to Information Technology management. She stated the project was very successful and the students did a great job.

The Committee was given an overview of organizational changes within Internal Audit. Ms. Barrett stated that staff has been realigned to allow for better focus on specific areas within the agency in order to develop subject matter experts and enhance the depth of the assurance and consulting services that Internal Audit can provide.

Ms. Barrett also took a moment to recognize internal auditor Karen Morris for her 30 plus years of state service and informed the Committee that she was recently promoted to Director of Pension Audit Services.

The meeting adjourned at 9:51 a.m.

Approved by:

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

TAB 2

S U S A N

C O M B S

TEXAS COMPTROLLER *of* PUBLIC ACCOUNTS

P.O. Box 13528 • AUSTIN, TX 78711-3528



November 26, 2013

Mr. Brian K. Guthrie
Executive Director
Teacher Retirement System of Texas
1000 Red River Street
Austin, TX 78701-2627

Dear Mr. Guthrie:

We have completed a post-payment audit of certain payroll, purchase, and travel transactions of the Teacher Retirement System of Texas (System). We also completed a limited review of refunded revenue, return of retirement benefits, employee benefits, and retirement benefits transactions. A draft of this report was sent to the Chief Financial Officer, Don Green, on Nov. 4, 2013. Responses to the draft report are included within this final report.

We would like to thank your staff, especially Janie Duarte, Kevin Hoban, and Janet Bray for their responsiveness and cooperation in assisting us with this audit.

Our purpose was to determine whether the System's expenditures complied with certain state laws and rules concerning expenditures and with the processing requirements of the Uniform Statewide Accounting System (USAS) and the Uniform Statewide Payroll/Personnel System (USPS). The System is responsible for ensuring that its staff is knowledgeable in these areas.

The System must submit to the Texas Comptroller of Public Accounts (Comptroller's office) a corrective action plan that addresses the instances of errors detailed within this report. The plan must provide for appropriate improvements in the control structure related to the System's payment process and show expected dates of implementation. The corrective action plan must be completed and signed by management and the System's internal auditor. An electronic copy of the corrective action plan is available upon request. Our office must receive the completed plan by Jan. 6, 2014.

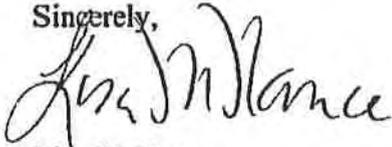
We intend for this report to be used by the System's management and certain state officials and agencies as listed in Tex. Gov't Code Ann. § 403.071 (Vernon 2013). However, the audit report is a public record and its distribution is not limited.

We would like to request input from you or your designee on the quality of the audit process and the service provided by the audit staff conducting the audit. Please use the website at <https://fm.x.cpa.state.tx.us/fm/survey/audit/> to provide feedback on the post-payment audit process. We have attached a copy of the document for your convenience. We greatly appreciate your feedback.

Mr. Brian K. Guthrie
November 26, 2013
Page 2

Thank you for your cooperation. If we can be of any further assistance, please contact Derik Montique at derik.montique@cpa.state.tx.us or call 512-305-9761. The System may inquire about and register for training related to the findings through the Fiscal Management Training Center website at <https://fm.x.cpa.state.tx.fmx/training/index.php>.

Sincerely,



Lisa M. Nance
Manager, Statewide Fiscal Services

Enclosure

cc: R. David Kelly, Chairman, Teacher Retirement System of Texas, Board of Trustees
Don Green, Chief Fiscal Officer, Teacher Retirement System of Texas
Amy Barrett, Chief Audit Executive, Teacher Retirement System of Texas
Derik Montique, Auditor, Statewide Fiscal Services

Audit Scope

A sample of the payroll, purchase, and travel transactions and a limited review of refunded revenue, return of retirement benefits, employee benefits, and retirement benefits that processed through USAS and USPS during the period beginning March 1, 2012 through Feb. 28, 2013 was audited to determine compliance with applicable state laws. The appendices to this report include schedules of the errors identified.

We believe the audit provides a reasonable basis for the findings set forth in the attached report. The System should implement the recommendations listed in the Detailed Findings of this report. It is the System's responsibility to seek refunds for all overpayments, unless the System determines it is not cost effective to do so. If necessary, the Comptroller's office may take the actions set forth in Tex. Gov't Code Ann. Sec. 403.071(h) (Vernon 2013) to ensure that the System's documents comply in the future. The System must ensure that the findings discussed in this report are resolved.

Texas Law requires the Comptroller's office to properly audit claims submitted for payment through the Comptroller's office. All payment transactions are subject to audit regardless of amount or materiality.

Payroll transactions and deductions

Payroll transactions were audited for compliance with the General Appropriations Act (GAA), the *Texas Payroll/Personnel Resource (Payroll Resource)*, and other pertinent statutes.

The audit identified:

- Underpayment of longevity pay.

A limited sample of voluntary contributions was also audited.

- No issues were identified.

Purchase transactions

Purchase transactions were audited for compliance with the GAA, *eXpendit, State of Texas Procurement Manual*, and other pertinent statutes.

The audit identified:

- Freight not on purchase order.

Travel transactions

Travel transactions were audited for compliance with the GAA, *Textravel*, and other pertinent statutes.

- No issues were identified.

Refund of revenue transactions

The audit included a limited review of the System's transactions relating to refund payments. The review consisted of verifying that the provided documentation reconciled with the payment amount in the sample.

- No errors were identified.

Return of retirement benefits, employee benefits, and retirement benefits transactions

The audit included a limited review of the System's transactions relating to return of retirement benefits, employee benefits, and retirement benefits. The review consisted of verifying that the payments did not exceed authorized amounts, and that the payments were in compliance with *eXpendit*, and other pertinent statutes. The review of these payments did not include an investigation of the System's procedures for making or monitoring the payments; therefore, we are not offering an opinion on those procedures.

- No errors were identified.

Prompt payment and payment scheduling issues

We audited the System's compliance with the prompt payment law and scheduling rules.

The audit identified:

- Interest loss to treasury for 46 travel and five purchase transactions.
- Interest overpaid for five purchase transactions.
- Interest not paid for four purchase and two travel transactions.

Fixed assets

The audit included a limited review of nine fixed assets acquired by expenditures during our audit period to test for accurate reporting in the State Property Accounting system (SPA) and to verify existence of the asset. The System reported one missing asset during the audit period.

EXECUTIVE SUMMARY

The audit identified:

- All assets reviewed were located; however, some assets were not properly recorded in SPA.

Direct deposit authorization forms

A review was conducted of the System's procedure to comply with the federal mandate to properly identify and handle payments involving the movement of funds internationally.

The audit identified:

- Two employees were set-up using outdated direct deposit forms.

The forms do not adhere to the National Automated Clearing House Association rules requiring the identification of a direct deposit payment if it is an International Automated Clearing House transaction.

Prior post-payment audit and current audit recurring errors

A prior post-payment audit of the System's payroll, purchase and travel transactions was concluded on Dec. 11, 2009.

During the current audit, we noted one recurring error:

- Prompt payment and payment scheduling

Contact

Derik Montique, MBA, CFE
(512) 305-9761

Contributing auditors

Anna Calzada
Valerie Davis, MBA, CTPM
Steve Tamez
Chris Conyers, MBA

LONGEVITY UNDERPAYMENT

Finding

During the audit, we identified one employee that noted prior state employment on the job application that was not included in his calculation of state service. As a result of the audit, the additional prior state service was verified, resulting in additional state service credit and longevity underpayment. The total amount of longevity underpayment was \$5,160.00. The System's payroll department procedures include obtaining prior state service verifications whenever an employee notes previous state employment on the job application or any other applicable form. The System stated that not obtaining the additional prior state employment was due to an oversight.

When an agency hires an employee, the agency must research if the employee has previous state employment. If there is prior state employment, the agency must: confirm the amount of lifetime service credit, and compute the correct amount of longevity pay entitlement. See Texas Comptroller of Public Accounts, *Payroll Resource – Non-Salary Payments – Longevity Pay*, <https://fm.xcpa.state.tx.us/fm/pubs/paypol>.

We provided the System with the schedule and calculation of the incorrect longevity payment. The schedule is not included with this report due to confidentiality issues.

Recommendation/Requirement

The System must ensure that prior state service is properly verified and documented for its employees. The System should verify all personnel files to ensure that properly completed prior state verification forms are obtained for its employees.

Agency Response

The System agrees with the audit recommendations. Compliance with Texas Government Code and the Texas Payroll/Personnel Resource (Payroll Resource) is very important to the System.

Currently, the System uses information provided by the employee on their application during the hiring process to prepare the human resources form PER 1A-1B. Information on the PER 1A-1B is used by payroll to submit verification to each state agency and/or institution of higher education identified by the new employee. Responses from agencies are then compared to the prior state service information on the PER 1A-1B to ensure accurate longevity pay coding in USPS and accurate payment processing. Additionally, the Payroll Team discusses the importance of disclosing all prior state service, including higher education service, to the new employee during New Employee Orientation.

DETAILED FINDINGS – PAYROLL

In addition to the steps listed above, the System is reviewing human resource and payroll processes to determine if additional controls for verifying state service would be appropriate.

The System processed compensation to the employee for the \$5,160.00 longevity underpayment.

FREIGHT NOT ON PURCHASE ORDER

Finding

We identified two transactions where the System paid freight charges even though they were not included on the original purchase order (PO). Freight charges not specifically identified on the original PO should not be paid by the System. The System stated that it was due to oversight.

A purchase agreement and/or purchase order is a contract entered into by the state and a vendor. The System may pay only the contracted amount as shown on the purchase agreement. If freight charges are not included in the purchase agreement, then the charges are not owed by the System and should not be paid.

Recommendation/Requirement

The System should document all freight terms on each PO. In situations where the final amount of freight cannot be determined, estimates may be used. In those instances, the System should document the limit that may not be exceeded for any freight amount. If it is determined that the upper limit for a freight amount will be exceeded, the vendor should obtain approval for the higher amount. Any approvals for higher amounts should be documented prior to receiving the invoice.

Agency Response

The System agrees with the audit recommendations. Compliance with the Texas Procurement procedures is very important to the System. The System will review internal procedures to reinforce the need to include freight terms on each purchase order and to verify freight terms prior to payment authorization.

DETAILED FINDINGS – PROMPT PAYMENT AND SCHEDULING

PROMPT PAYMENT AND PAYMENT SCHEDULING ISSUES

Prompt Payment

According to the prompt payment law, Tex. Gov't Code Ann. § 2251.021 (a) (Vernon 2008), a governmental entity's payment is overdue on the 31st day after the later of:

- the date the governmental entity receives the goods under the contract;
- the date the performance of the service under the contract is completed; or
- the date the governmental entity receives an invoice for the goods or service.

The Comptroller's office computes and automatically pays any interest due under the prompt payment law when the Comptroller's office is responsible for paying the principal amount on behalf of the agency. Tex. Gov't Code Ann. § 2251.026 (Vernon 2008). During the audit period, the System paid vendors \$3,066.41 for prompt payment interest.

In our sample, we identified four purchase and two travel transactions that were paid late where interest was not paid to the vendors and five purchase transactions where interest was overpaid. According to the System, interest was not paid due to oversights made when processing the payments.

Scheduling

Tex. Gov't Code Ann. Sec. 2155.382(d) (Vernon 2008) authorizes the Comptroller to allow or require state agencies to schedule payments that the Comptroller will make to a vendor. The Comptroller must prescribe the circumstances under which advance scheduling of payments is allowed or required; however, the Comptroller must require advance scheduling of payments when it is advantageous to the state.

We identified 46 travel and five purchase transactions that the System paid early, resulting in interest loss to the state treasury. The System stated that it was not aware that direct-billed travel transactions should be scheduled.

Recommendation/Requirement

The System must review its procedures to ensure that it submits payment information for processing as well as releasing the payment in a timely manner to avoid incurring interest liabilities. In addition, the System must verify that proper due dates are entered to ensure that if interest is due, it is paid correctly to the vendors.

To minimize the loss of earned interest to the state treasury, the System must schedule all payments that are greater than \$5,000.00 for the latest possible distribution and in accordance with its purchasing agreements as described in the Comptroller's *Prompt Payment and Scheduling Guide*. The System can pay according to the terms on the invoice only if those terms are included in the purchase agreement.

DETAILED FINDINGS – PROMPT PAYMENT AND SCHEDULING

Agency Response

Compliance with Tex. Gov't Code Ann. §2251.021 (a) (Vernon 2008), and Tex. Gov't Code Ann. §2251.026 (Vernon 2008), and Tex. Gov't Ann. §2155.382(d) (Vernon 2008) is very important to the System. The System's accounting procedure manual includes detailed expenditure processing policies and procedures to pay all vendors 30 days from the date the goods and services are received, or the date the invoice is received, whichever is later. If the invoice is less than \$5,000, the system is authorized to pay earlier than 30 days per Comptroller guidelines. In addition, pursuant to Texas Government Code 660.019 and System accounting procedures, employee travel reimbursements are not required to be scheduled and are allowed to be paid within 45 days. Late payment interest amounts, number of days late and documented late payment reasons are monitored by the System. The System's accounting procedure manual is available electronically to all staff and detailed expenditure processing is provided to System accounting staff including prompt paying processing, post payment audit results and the Comptroller's most common post payment audit errors.

A state agency may request the Comptroller of Public Accounts (Comptroller's office) to pay a claim against the agency only by submitting the appropriate payment voucher to the Comptroller's office. TEX. GOV'T CODE ANN. §§ 404.046, 404.069 (Vernon 2013), §§ 2103.003, 2103.0035, 2103.004 (Vernon 2008). State law prohibits the Comptroller's office from paying a claim against a state agency unless the Comptroller's office audits the corresponding voucher. TEX. GOV'T CODE ANN. § 403.071(a), § 403.078 (Vernon 2013) § 2103.004(a)(3) (Vernon 2008).

State law allows the Comptroller's office to audit a payment voucher before or after the Comptroller's office makes a payment in response to that voucher. TEX. GOV'T CODE ANN. § 403.071(g)-(h) (Vernon 2013), TEX. GOV'T CODE ANN. § 2155.325 (Vernon 2008). In addition, state law authorizes the Comptroller's office to conduct pre-payment or post-payment audits on a sample basis. TEX. GOV'T CODE ANN. §§ 403.011(a)(13), 403.079 (Vernon 2013), TEX. GOV'T CODE ANN. § 2155.324 (Vernon 2008).

The Expenditure Audit section of the Comptroller's office Statewide Fiscal Services conducts these audits.

Audit objectives

The primary objectives of a post-payment audit are to:

- Ensure that payments are documented so that a proper audit can be conducted.
- Ensure that payment vouchers are processed according to the requirements of the Uniform Statewide Accounting and/or the Uniform Statewide Payroll/Personnel System.
- Verify that payments are made in accordance with certain applicable state laws.
- Verify that assets are in their intended location and are properly recorded in the State Property Accounting (SPA) system.
- Verify that the voucher signature cards and systems security during the audit period were consistent with applicable laws, rules, and other requirements.

Methodology

The expenditure audit section uses generally recognized sampling techniques to conduct a post-payment audit. The computer audit menu system software is used to generate a stratified random sample of payment vouchers for the audit, with a confidence level of 95 percent. The vouchers are audited in detail, and the results of the audit are projected to estimate the amount of claims that were unsubstantiated or improperly paid. Limited samples are also utilized where applicable.

Field Work

Each auditor in the expenditure audit section is required to approach the field work phase of each audit with an appropriate level of professional skepticism based upon the results of the initial planning procedures. If an auditor suspects during an audit that fraud, defalcations, or intentional misstatement of the facts has occurred, then the auditor will meet with his or her supervisor or Statewide Fiscal Services manager, or both, to decide what course of action or additional procedures would be appropriate.

Reporting

Each auditor audits the payment vouchers included in a sample according to established policies and procedures. The audit findings are reported to the audited agency in the form of a report.

The audit report discloses the total dollar amount of any unsubstantiated payments or overpayments noted in the sample. In addition, the report shows the result of projecting those payments to the appropriate population. Finally, the report includes recommendations and requirements for the audited agency.

Each auditor discusses the management issues noted during the audit at the exit and communicates details of these issues to the chief fiscal officer.

TAB 3

Summary of Audit On Call Center Performance Measures Recommendations Status

March 2014

Project	Recommendation	Status	Estimated Date	Revised / Actual Date
13-102 Audit of Call Center Performance Measures				
	Investigate the feasibility of calculating and reporting the Average Speed of Answer (ASA) measure based on a data source without known problems. If such a data source cannot be identified, disclose in all performance measure reports the known issues with the accuracy of the reported results.	Implemented	1/2013	1/2013
	Continue to work with Siemens to identify and correct the causes of errors in OpenScape Contact Center affecting the ASA measure.	Implemented	5/2013	10/2013
	Given the history of problems with OpenScape Contact Center, assess whether there are additional analytical procedures that could be performed such as running management reports more frequently prior to and following an OpenScape Contact Center upgrade as an additional "early warning mechanism" to identify possible errors introduced into the software.	Implemented	5/2013	5/2013
	Evaluate the suitability of measuring service level as a tool for managing Telephone Counseling Center performance.	Implemented	5/2013	12/2013

Significant to Business Objectives

	Past <i>original</i> estimated completion date No management action plan <u>or</u> No progress on management action plan
	Past <i>original</i> estimated completion date Progress on management action plan
	<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

	Past <i>original</i> <u>or</u> first revised estimated completion date No management action plan <u>or</u> No progress on management action plan
	Past <i>original</i> <u>or</u> first revised estimated completion date Progress on management action plan
	Within <i>original</i> <u>or</u> first revised estimated completion date Progress on management action plan
	Satisfactory implementation of management action plan or Acceptance of risk by management

**Independent Accountant's Report
On a Follow-up Audit of Call Center Performance Measures
For the Teacher Retirement of Texas**

For the Period January 14, 2013 through January 31, 2014





*To the Audit Committee, Board of Trustees and Executive Director of the Teacher Retirement System of Texas
Austin, Texas*

Myers and Stauffer LC has completed the Follow-up Audit on Call Center Performance Measures on behalf of TRS Internal Audit, as included in the Internal Audit *Fiscal Year 2014 Audit Plan*. This audit was performed under the master contract K201300145 with the Teacher Retirement System of Texas (TRS), Engagement Release Order #3, effective January 2, 2013. Our audit covered the period of January 14, 2013 to January 31, 2014.

We conducted this audit in accordance with the performance audit provisions of *Generally Accepted Government Auditing Standards (December 2011 revision)* 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. *Government Auditing 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. Because there were no findings identified, management responses from TRS are not included in this report; however, TRS management was provided the opportunity to review and provide feedback on a draft of this report.

This report is intended solely for the information and use of TRS management and its Board and is not intended to be, and should not be, used by anyone other than the specified party.

If we can be of any assistance to you, or if you have any questions concerning this report, please contact us.

Sincerely,

Myers and Stauffer LC

Myers and Stauffer LC
Austin, Texas
March 5, 2014

TABLE OF CONTENTS

EXECUTIVE SUMMARY	1
BACKGROUND	2
AUDIT RESULTS	3
TABLE OF IMPLEMENTATION STATUS.....	3
APPENDIX A: AUDIT OBJECTIVE, SCOPE, AND METHODOLOGY.....	5
APPENDIX B: SUMMARY REPORT FOR AUDIT OF CALL CENTER PERFORMANCE MEASURES.....	7

EXECUTIVE SUMMARY

We have completed the **Follow-up Audit on Call Center Performance Measures**, as included in the TRS Internal Audit *Fiscal Year 2014 Audit Plan*.

The audit objective was to verify management's implementation actions taken to address the audit recommendations in the report on Call Center Performance Measures in FY 2013 and to answer the following *questions* for each of four recommendations in two follow-up areas:¹

1. Did management responses fully address the original audit recommendations?
2. Were management responses implemented?
3. Is the implementation current?

We concluded:

1. Management responses fully addressed all four audit recommendations
2. Management implemented actions for all four management responses
3. Management actions are current for all four management responses

Overall, management fully implemented all four audit recommendations². These audit recommendations were as follows:

- Investigate the feasibility of calculating and reporting the Average Speed of Answer (ASA) measure based on a data source without known problems. If such a data source cannot be identified, disclose in all performance measure reports the known issues with the accuracy of the reported results.
- Continue to work with Siemens to identify and correct the causes of errors in OpenScape Contact Center affecting the ASA measure.
- Given the history of problems with OpenScape Contact Center, assess whether there are additional analytical procedures that could be performed such as running management reports more frequently prior to and following an OpenScape Contact Center upgrade as an additional "early warning mechanism" to identify possible errors introduced into the software.
- Evaluate the suitability of measuring service level as a tool for managing Telephone Counseling Center performance.

Results of our procedures are presented in more detail in the **Audit Results** section (page 3-4). The audit objective, scope, and methodology are described in **Appendix A** (page 5-6). **Appendix B** is the Summary Report of Audit on Call Center Performance Measures (page 7).

¹ The summary report of FY 2013 Audit of Call Center Performance Measures is attached as Appendix B.

² "Yes" to all three questions.

BACKGROUND

In January 2013, Myers and Stauffer LC (MSLC) on behalf of TRS Internal Audit issued an audit report on Call Center Performance Measures.

The audit objectives were to:

- Determine whether the calculation of the key performance measure for Average Speed of Answer (ASA) is in accordance with the methodology presented in the TRS Strategic Plan or a reasonable approximation of that methodology. Provide recommendations for enhancements to improve controls and increase accuracy of the ASA performance measure.
- Determine whether Telephone Counseling Center governance is effective in managing speed of answer by benchmarking current call center processes, data collected, and call center software functionality with industry practice and the available functionality of the existing software. Provide recommendations for enhancements to decrease ASA or otherwise improve management of TCC operations related to ASA.

TRS Internal Audit outsourced this assurance audit project with MSLC. MSLC provided the expertise in performance measure evaluation, data analysis, and call center operations.

Results of the FY 2013 audit indicated issues with the accuracy of information produced by the OpenScape Contact Center application made ASA figures reported based on information from OpenScape Contact Center unreliable during fiscal year 2012 and September 2012. The audit also indicated that while Telephone Counseling Center governance is effective in managing ASA, service level is a more commonly used measure for measuring call center wait times. The project team made four recommendations related to two areas for TRS management action to (a) work with Siemens to address the issues with the accuracy of information produced by OpenScape or implement compensating controls, and (b) evaluate the suitability of service level as a tool for managing Telephone Counseling Center performance. See Appendix B, Summary Report of Audit on Call Center Performance Measures, page 7.

Management agreed with the recommendations and has implemented actions to address them. Management reports status of these actions to Internal Audit through an internal tracking system. Internal Audit provides management status updates in the quarterly reports to the Audit Committee.

The objective of this follow-up audit was to verify the implementation actions taken by management in addressing significant risks noted in the FY 2013 audit report.

AUDIT RESULTS

OVERALL RESULTS

Based on the audit fieldwork results, management fully implemented all four recommendations that are included in the audit scope of this follow-up project. The in-scope recommendations in this project were for TRS management to:

- Investigate the feasibility of calculating and reporting the ASA measure based on a data source without known problems. If such a data source cannot be identified, disclose in all performance measure reports the known issues with the accuracy of the reported results.
- Continue to work with Siemens to identify and correct the causes of errors in OpenScape Contact Center affecting the ASA measure.
- Given the history of problems with OpenScape Contact Center, assess whether there are additional analytical procedures that could be performed such as running management reports more frequently prior to and following an OpenScape Contact Center upgrade as an additional “early warning mechanism” to identify possible errors introduced into the software.
- Evaluate the suitability of measuring service level as a tool for managing Telephone Counseling Center performance.

The table below provides details on management’s implementation status of in-scope audit recommendations from the Audit on Call Center Performance Measures.

Table of Implementation Status

#	Original Recommendation	Implementation Status (As determined by Follow-up Audit)		
		Management Response Fully Addressed Recommendation	Management Response Fully Implemented	Implementation is Current
1	Investigate the feasibility of calculating and reporting the ASA measure based on a data source without known problems. If such a data source cannot be identified, disclose in all performance measure reports the known issues with the accuracy of the reported results.	Yes	Yes	Yes
2	Continue to work with Siemens to identify and correct the causes of errors in OpenScape Contact Center affecting the ASA measure.	Yes	Yes	Yes

#	Original Recommendation	Implementation Status (As determined by Follow-up Audit)		
		Management Response Fully Addressed Recommendation	Management Response Fully Implemented	Implementation is Current
3	Given the history of problems with OpenScape Contact Center, assess whether there are additional analytical procedures that could be performed such as running management reports more frequently prior to and following an OpenScape Contact Center upgrade as an additional “early warning mechanism” to identify possible errors introduced into the software.	Yes	Yes	Yes
4	Evaluate the suitability of measuring service level as a tool for managing Telephone Counseling Center performance.	Yes	Yes	Yes

CONCLUSION

Our procedures determined that:

1. Management responses fully addressed all four audit recommendations
2. Management implemented actions for all four management responses
3. Management actions are current for all four management responses

We therefore concluded that TRS management has:

- Resolved the issues with information accuracy produced by the Siemens software application that made reported ASA figures unreliable during fiscal year 2012 and September 2012, and
- Completed evaluation of service level as a more suitable measure for managing Telephone Counseling Center performance than the Average Speed of Answer.

APPENDIX A

AUDIT OBJECTIVE, SCOPE, AND METHODOLOGY

We conducted this performance 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

The audit objective was to verify management's implementation actions taken to address the audit recommendations in the FY 2013 Audit of Call Center Performance Measures and to answer the following *questions* for all four of the follow-up areas:

1. Did management responses fully address the original audit recommendations?
2. Were management responses implemented?
3. Is the implementation current?

The implementation is considered current if the processes put in place to address and compensate for accuracy issues with ASA reporting were being performed as of January 2014, the latest month covered by MSLC fieldwork, and if TRS had completed its assessment of the suitability of service level as a measure as of January 2014.

Results of the FY 2013 audit indicated issues with the accuracy of information produced by the OpenScope Contact Center application made ASA figures reported, based on information from OpenScope Contact Center, unreliable during fiscal year 2012 and September 2012. The audit also indicated that while Telephone Counseling Center governance is effective in managing ASA, service level is a more commonly used measure for measuring call center wait times.

SCOPE

The scope of the follow-up audit included audit recommendations related to two significant areas reported in the FY 2013 Audit of Call Center Performance Measures that was presented to the Audit Committee in April 2013.

- Issues with the accuracy of information produced by the OpenScope Contact Center application made ASA figures reported based on information from OpenScope Contact Center unreliable during fiscal year 2012 and September 2012.
- While Telephone Counseling Center governance is effective in managing ASA, service level is a more commonly used measure for measuring call center wait times.

Four recommendations related to these two areas were included in the audit scope:

- Investigate the feasibility of calculating and reporting the ASA measure based on a data source without known problems. If such a data source cannot be identified, disclose in all performance measure reports the known issues with the accuracy of the reported results.
- Continue to work with Siemens to identify and correct the causes of errors in OpenScape Contact Center affecting the ASA measure.
- Given the history of problems with OpenScape Contact Center, assess whether there are additional analytical procedures that could be performed such as running management reports more frequently prior to and following an OpenScape Contact Center upgrade as an additional “early warning mechanism” to identify possible errors introduced into the software.
- Evaluate the suitability of measuring service level as a tool for managing Telephone Counseling Center performance.

The audit scope included the period from the previous audit completion date of January 14, 2013 to January 31, 2014.

METHODOLOGY

The audit methodology included obtaining information on management’s implementation actions on each in-scope significant issue. To determine the implementation status, the auditor conducted interviews with Benefit Counseling and Information Technology personnel, reviewed reports and other documentation, and performed tests on reports of Average Speed of Answer (ASA) data for the months of October 2013, November 2013, and January 2014. We examined Board Summary Reports of ASA statistics, internal spreadsheets used by TRS to monitor the accuracy and reasonableness of ASA data, and system documentation related to OpenScape software releases intended to correct the information accuracy issues identified in the previous audit report. We also examined documentation of the analysis TRS performed on the suitability of Service Level to replace the ASA measure, as well as their follow-up actions to implement it as a replacement measure.

APPENDIX B

Summary Report for Audit of Call Center Performance Measures

Telephone Counseling Center Performance Measures Audit March 2013

Outsourced Audit for TRS Internal Audit Department by Myers and Stauffer, LC

Audit Objectives	Determine whether the calculation of the Average Speed of Answer (ASA) performance measure is in accordance with the methodology presented in the TRS Strategic Plan or a reasonable approximation of that methodology.	Determine whether Telephone Counseling Center (TCC) governance is effective in managing speed of answer by benchmarking current call center processes, data collected, and call center software functionality with industry practice and the available functionality of the existing software.
Audit Scope	<ul style="list-style-type: none"> TRS's TCC and related applications supporting the ASA performance measurement Siemens Communications, Inc. (Siemens) who provides the application that supports performance measurement of the ASA Activities and calculations from September 1, 2011 - September 30, 2012 	
Audit Methodology	<ul style="list-style-type: none"> Interviews with TRS management and staff and Siemens employees Review of policies and procedures for the ASA measure Analysis of Siemens application data Recalculation of selected ASA measure data Examination of industry best practices for managing call centers Observation of TCC management processes 	
Results	Issues with information accuracy produced by Siemens application made reported ASA figures unreliable during fiscal year 2012 and September 2012.	Telephone Counseling Center governance is effective in managing ASA. Service level is a more commonly used measure for call center wait times.
Recommended Actions	<ul style="list-style-type: none"> Investigate using a data source without known problems, or disclose issues with accuracy in reported data Continue working with Siemens to correct causes of errors affecting ASA data Assess running additional analytical procedures prior to and after upgrades to help identify any introduced errors 	<ul style="list-style-type: none"> Evaluate service level as a more suitable performance measure. If so: <ul style="list-style-type: none"> Coordinate with entities to change from ASA measure to service level measure Identify realistic service level measure performance goal considering resources & client needs
Management Responses	Management agrees and has incorporated disclosure statements on TCC reports and other reports as applicable. We continue to work with Siemens to correct errors affecting ASA data and we will run pre- and post-upgrade reports to identify errors.	Management agrees and will analyze the suitability of service level as a performance measurement tool. If service level is an appropriate measure, we will coordinate with the necessary entities to move from the ASA to the service level measure.

Legend of Results: Red - Significant to TRS Orange - Significant to Audit Objectives
Yellow - Other Reportable Issue Green - Positive Finding or No Issue

Project 13-102

TAB 4

TAB 4A

TEACHER RETIREMENT SYSTEM of TEXAS
Internal Audit Department Memorandum

TO: Bob Jordan

CC: Betsey Jones
Amy Barrett
John Dobrich

FROM: Jan Engler

SUBJECT: Internal Audit Observation of Health Plan Administrator (HPA) & Pharmacy Benefits Manager (PBM) Proposal Evaluation and Vender Selection Process

DATE: February 25, 2014

The *Fiscal Year 2014 Internal Audit Annual Audit Plan* includes advisory services for the Health & Insurance Benefits Department (HIB).

This memo provides confirmation that I participated as an independent, non-voting member of the HPA and PBM proposal evaluation team from October 2013 through February 2014. During that time, I observed the following:

- The TRS Purchasing Department facilitated the proposal evaluations according to their procedures and Texas procurement laws, while *Gabriel, Roeder, Smith, and Company* (GRS) provided expert assistance during the proposal evaluation process.
- The proposal evaluation team members examined the responding vendor proposals and then met several times to discuss the results of their work.
- The four voting team members completed written evaluations using weighted scorecards developed by consensus with input from TRS Purchasing and GRS.
- Team members and others involved in the process signed Non-Disclosure Forms prior to receiving any vendor proposals for review.
- Team members and others involved in the process were notified that the vendors being evaluated were placed on the TRS material, non-public watch list during the evaluation period and selection period.

Please let me know if you have any questions or need additional information.

TAB 4B

SECOND QUARTER TEST RESULTS OF INVESTMENT CONTROLS

March 5, 2014

TRS Internal Audit Department

Business Objectives	Internal Public Markets: Generate alpha (“returns in excess of benchmark returns”) within risk guidelines	Trading: Efficiently and effectively execute trade orders initiated by portfolio managers	Control Environment: Establish the set of standards, processes, and structures for internal control to work
Business Risks	<ul style="list-style-type: none"> Consistent underperformance Allocation risk (relative to index, sector, or region) Security selection risk Exceeding risk limits Unauthorized trades Improper or illegal trading Lack of resources/expertise 	<ul style="list-style-type: none"> Unauthorized or rogue trades Human errors or mistakes Trading with unauthorized brokers or preferential treatment of certain brokers Paying higher price or commission than the market or peers 	<ul style="list-style-type: none"> Low level of integrity and ethics Ineffective Board oversight Lack of organizational structure or authority Insufficient resources or staff competence Lack of accountability or performance incentive
Management Controls	<ul style="list-style-type: none"> Performance monitoring Portfolio rebalancing Portfolio risk (e.g., tracking error) monitoring Approval before trade Compliance monitoring Access to external research 	<ul style="list-style-type: none"> Segregation of duties Automated trade order and execution systems List of approved brokers Trading volume analysis Independent analysis of execution quality 	<ul style="list-style-type: none"> Ethics policy TRS Core Values and IMD Culture Statement Board approval of policies Organizational units and committees established Staff development program Performance incentive plan
Controls Tested	<ul style="list-style-type: none"> Performance monitoring Portfolio rebalancing Access to external research Portfolio manager's approval for trade 	<ul style="list-style-type: none"> Segregation of duties Trade automation Post trade analysis Independent report on execution quality 	<ul style="list-style-type: none"> Disclosure of personal financial information Board approval of policies IMD continuing education Incentive pay calculations
Results	Management controls are operating effectively to achieve business objective.	Management controls are operating effectively to achieve business objective.	Management controls are operating effectively to achieve business objective. Procurement controls will be tested in Q4.
Recommended Actions	None	None	None
Management Responses	N/A	N/A	N/A

Legend of Results: Red - Significant to TRS Orange - Significant to Business Objectives
Yellow - Other Reportable Issue Green - Positive Finding or No Issue

MEMORANDUM

TO: Audit Committee Members, TRS Board of Trustees
Brian Guthrie, Executive Director

FROM: Amy Barrett, Chief Audit Executive
Hugh Ohn, Director of Investment Audit Services

SUBJECT: **Second Quarter Test Results of Investment Controls**

DATE: March 5, 2014

The purpose of this memo is to report the interim results of Internal Audit's tests of Investment Management Division (IMD) controls for the second quarter of fiscal year 2014. The results of these tests are considered interim since they will be used to express the overall opinion on IMD controls at the end of the fiscal year 2014. For the second quarter of fiscal year 2014, we tested controls related to the following three areas: (a) Internal Public Markets; (b) Trading; and (c) Control Environment.

OVERVIEW

Internal Public Markets (IPM)

The actively-managed internal public equity portfolios are managed by the Internal Public Markets (IPM) group of the Investment Management Division (IMD). According to the Investment Policy Statement ("Policy"), "the primary objectives of the Public Markets Portfolios are to manage publicly-traded, marketable securities and related instruments in accordance with the risk parameters established by the permitted asset allocation ranges of this Policy, to meet or exceed the performance of the Policy Benchmark, as allocated to the Public Markets Portfolios."

The IPM group, which is led by the Senior Managing Director, is divided into three subgroups: (a) Quant Research; (b) Fundamental Research; and (c) Portfolio Management. The Quant Research team builds systematic equity portfolios for the Trust to generate alpha, to collect risk premium, and to create a factor exposure. The Quant Research team also manages five portfolios, including Global Best Idea (GBI) Quant Strategic, GBI Quant Dynamic, GBI Quant Macro Distance, Low Vol with Overlay (co-managed with the Risk group) and U.S. High Quality. The Fundamental Research team, which includes all sector analysts, provides research support by sector, industry, and region to the portfolio managers. The Portfolio Management team includes portfolio managers who approve or disapprove analyst's recommendations before placing trade orders. The IPM group consists of 27 FTEs (Full Time Equivalents).

On a day-to-day basis, the primary IPM portfolios which are called the GBI Flagship portfolio, is managed against the MSCI All Country World Index (ACWI). This index includes approximately 2,500 securities across large, mid, and small cap size companies, growth and value styles, and industry/sector segments in 45 developed and emerging market countries.

Second Quarter Investment Control Test Results March 5, 2014 Memorandum

As of December 31, 2013, the portfolios managed by the IPM consisted of GBI Flagship (which included GBI Quant and GBI U.S. REIT Long Short portfolios), GBI U.S. Quality and GBI Gold. The market value of these portfolios was approximately \$23.4 billion. According to State Street's PureView report, one-year and three-year returns of the largest GBI Flagship portfolio (with the market value of \$12.1 billion) were 23.1% and 10.1%, respectively, outperforming its benchmark by 31 basis points and 33 basis points, respectively.

Trading

The Trading group provides global execution across multiple asset classes including equities, futures, forwards, and foreign currencies. For example, its objective for equity trades is to efficiently and effectively execute the buy or sell orders initiated by IPM portfolio managers. After portfolio managers enter trade orders into Bloomberg, a trader is assigned to execute them. While monitoring the market prices as well as future direction of the market, the trader uses electronic algorithms or works with an outside broker to execute these orders. During the execution, the trader tries to achieve the best execution while minimizing a market impact resulting from our orders.

Execution results of the trades are monitored by both portfolio managers and an independent organization (i.e., ITG). Portfolio managers monitor the Trading group and the brokers' execution results from a performance perspective. An independent organization evaluates both overall TRS' and individual trader's execution as compared to the peer group on a quarterly basis.

In addition to executing trades for actively-managed internal TRS portfolios, the Trading group also manages passive equity portfolios. The notional amount of trades executed by the Trading group for all IMD profit centers was approximately \$249.2 billion in 2013.

Control Environment

As part of the control tests for this quarter, we tested several elements of the control environment, mostly related to the IMD, to assess their effectiveness. The control environment is the set of standards, processes, and structures that provide the basis for carrying out internal control across the organization. The Board of Trustees and senior management establish the tone at the top regarding the importance of internal control including expected standards of conduct. Management reinforces expectations at the various levels of the organization.

The control environment is one of the five components of internal control framework issued by the Committee of Sponsoring Organization (COSO) of the Treadway Commission. According to the COSO, the control environment includes the following principles:¹

1. The organization demonstrates a commitment to integrity and ethical values.
2. The Board of Trustees demonstrates independence from management and exercises oversight of the development and performance of internal control

¹ Excerpt from *Internal Control – Integrated Framework, Framework and Appendices*, Committee of Sponsoring Organizations of the Treadway Commission, 2013, page. 31

Second Quarter Investment Control Test Results
March 5, 2014 Memorandum

3. Management establishes, with board oversight, structures, and reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives.
4. The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.
5. The organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives.

Results of our tests of these principles indicate that overall both TRS (including the Board of Trustees) and IMD are maintaining an effective control environment. The following table summarizes the TRS and/or IMD controls we assessed (including any deficiencies identified) for the five control environment principles:

No	COSO Control Environment Principle	Examples of Controls Tested	Control Deficiencies Identified
1	Organization's commitment to integrity and ethical values	<ul style="list-style-type: none"> • Ethics policy (including annual ethics training and compliance certification) • TRS Core Values and IMD Culture Statement • Disclosure of personal financial information 	None
2	The Board of Trustee's independence and oversight	<ul style="list-style-type: none"> • Appointment of TRS Board members and establishment of Board committees • Board approval of investments-related policies • Use of investment consultants 	None
3	Management's establishment of structures, reporting lines, authorities, and responsibilities	<ul style="list-style-type: none"> • TRS and IMD organization charts • Internal Investment Committee (IIC) and Investment Management Committee (IMC) • Delegated investing authority of IMD 	None *
4	Organization's commitment to attract, develop, and retain competent individuals	<ul style="list-style-type: none"> • IMD Career Path/Model • Criminal background checks on employees • IMD's requirement for annual continuing education • Performance incentive pay 	None
5	Organization's holding individuals accountable for their responsibilities	<ul style="list-style-type: none"> • Annual goal-setting and evaluation • Performance appraisal ("360 Evaluation") 	None

* Procurement controls will be tested in Q4.

FINDINGS AND RECOMMENDED ACTIONS

No significant issues and recommendations were identified.

TAB 4C

QUARTERLY INVESTMENT TESTING
INVESTMENT POLICY STATEMENT (IPS), SECURITIES LENDING POLICY (SLP), WIRE TRANSFER PROCEDURES
CALENDAR QUARTER ENDED DECEMBER 31, 2013, EXCEPT AS NOTED

Business Objectives	<p>1. <u>Board Reports</u> All required information is reported to the TRS Board of Trustees</p>	<p>2. <u>Investment Selection and Approval</u> Investments made are within delegated limits and established selection criteria</p>	<p>3. <u>Other (IPS, SLP, wire transfers, other reporting)</u> Risk limits are followed for other investment programs and activities</p>	<p>4. <u>Monitoring by Investment Compliance Specialist</u> Investment activities comply with IPS (for the three months ended January 31, 2014)</p>
Business Risks	Board is not informed of key investment decisions and critical information	Approvals and fundings exceed delegated limits	Risks exceed Board established tolerances	Noncompliance is undetected or not timely resolved
Management Assertions	All required reports are made to the Board	Approvals and fundings are within limits and made for qualified managers	Programs are within risk limits	Investment activities comply with investment policies (proxy, securities lending, IPS)
Agreed-Upon Procedures	<ul style="list-style-type: none"> Compare Board reports to IPS requirements 	<ul style="list-style-type: none"> Vouch Internal Investment Committee (IIC) approved investments to supporting documentation Verify approval limits of new investments 	<ul style="list-style-type: none"> Validate IMD obtained reporting requirements of new managers/funds and summarized results Obtain senior management disclosures about known compliance violations Test supporting documentation for wire transfers 	Perform various compliance checks and monitor State Street's daily compliance reports
Test Results	<ul style="list-style-type: none"> All reporting requirements met Documentation provides support for information tested 	<ul style="list-style-type: none"> All supporting documentation exists All newly approved investments were within authorized limits 	<ul style="list-style-type: none"> All other requirements of the IPS, SLP, wire transfer procedures, etc. are met 	<ul style="list-style-type: none"> All investment policy requirements met, except for purchase of a newly-added Sudan-restricted security by two external managers
Management Responses	None	None	None	Upon TRS' instruction, the managers divested the security. Investment Compliance and IMD are streamlining the distribution process. In addition, TRS will work with the State agencies responsible for developing the lists to receive preliminary lists in advance.

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

March 5, 2014

Carolina de Onis, TRS Legal Counsel

We have completed the **Quarterly Investment Testing** of compliance with the requirements of the Investment Policy Statement (IPS), Securities Lending Policy (SLP), and procedures for wire transfers as included in the *Fiscal Year 2014 Audit Plan*.

We performed the procedures listed below 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 Senior Investment Compliance Specialist.

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 below 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**. The monitoring results of the Investment Compliance Specialist are included in this report in **Appendix B**.

Internal Control Structure

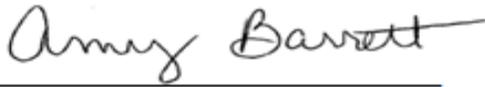
We were not engaged to and did not perform an examination of the internal controls nor the operating effectiveness pertaining to the subject areas tested. Accordingly, we do not express an opinion on the suitability of the design of internal controls nor the operating effectiveness of the subject areas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

* * * * *

We express our appreciation to management and key personnel of the Investment Management Division and Investment Accounting 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

APPENDIX A

AGREED-UPON PROCEDURES AND RESULTS

STEP #	OBJ. #	TEST PURPOSE	TEST DESCRIPTION	TEST RESULT	MANAGEMENT RESPONSE
1	1	IPS Article 1.7 - Verify that all requirements were reported to Board of Trustees	Obtain copies of all reports required to be reported to Board of Trustees and compare to reporting requirements per Investment Policy Statement (IPS)	Reports required to be reported to Board of Trustees complied with IPS.	No response required
2	4	IPS Article 1.8 – Obtain evidence that TRS complied with Chapters 806 and 807 of the Government Code relating to prohibitions on investments in Sudan and Iran, respectively.	<ul style="list-style-type: none"> • Ensure that responsible staff have updated Sudan/Iran restricted lists • Determine whether TRS complied with the following requirements: (a) to notify the Comptroller’s Office and the Pension Review Board regarding holdings of restricted company securities; (b) to divest holdings; and (c) to file annual report of Sudan/Iran investment activity to the Legislature and the Attorney General 	<ul style="list-style-type: none"> • Investment Compliance staff updated Sudan/Iran restricted lists. • TRS complied with the annual report requirements. 	No response required
3	2	IPS Article 3.3f – Obtain evidence of existence of IMD’s prudent underwriting objectives for advisor’s due diligence	Select sample of Private Market investments approved during testing period, obtain evidence of existence of advisor’s report stating investment opportunity meets prudent underwriting standards and merits inclusion within respective portfolios	For selected private markets approved investments for the quarter, verified that the prudence letter from the advisor was included in the Internal Investment Committee (IIC) materials.	No response required
4	2	IPS Article 7 – Obtain evidence that new investments in emerging managers meet requirements	Test sample of approved investments to verify: <ul style="list-style-type: none"> • Each is independent private investment management firm with less than \$2 billion • Each has a performance track record as a firm of less than 5 years, or both • TRS commitment did not exceed 40% of fund size 	<ul style="list-style-type: none"> • Investments tested are independent private investment management firms with less than \$2 billion, or • Have a performance track record as a firm that is no more than 5 years or both. • TRS commitment not exceeding 40% of fund size. 	No response required

STEP #	OBJ. #	TEST PURPOSE	TEST DESCRIPTION	TEST RESULT	MANAGEMENT RESPONSE
5	2	IPS Article 12 - Verify existence of placement agent questionnaire for each new investment selected for testing and test for inclusion in summary report to 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 Board at least semi-annually 	Each investment tested had a completed questionnaire and was included in the summary report to the Board	No response required
6	2	IPS Appendix B – Verify 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 <ol style="list-style-type: none"> a) Initial allocation – .50% b) Additional or follow-on – 1% c) Total Manager Limits – 3% d) Total limit each manager organization – 6% • Obtain documentation from IMD staff that supports the calculations of the authorized limits • Inquire if any “Special Investment Opportunities” were made for the quarter, and if so: <ol style="list-style-type: none"> a) Obtain documentation that the Special Investment Opportunity was either a distressed situation or market dislocation b) Obtain documentation that the CIO notified the Executive Director (ED) of each Special Investment Opportunity c) Obtain documentation that CIO and ED requested comments from chairman of appropriate board committee and TRS consultants and advisers d) Verify Special Investment 	For the sample selected for testing, no manager or partner organization exceeded the authorized limits and documentation existed for IMD staff calculations of authorized limits. There were no Special Investment Opportunities.	No response required

STEP #	OBJ. #	TEST PURPOSE	TEST DESCRIPTION	TEST RESULT	MANAGEMENT RESPONSE
			<p>Opportunity did not exceed \$1 billion.</p> <p>e) Verify that no further investment in a special Investment Opportunity was made until Board reauthorized CIO's authority to designate a Special Investment Opportunity</p>		
7	4	Compliance Report of Senior Investment Compliance Specialist (SICS) – Verify with SICS that all other policy requirements were met	Obtain the investment compliance report from the SICS of other non-compliance issues as a result of the custodian's monitoring procedures	Obtained the investment compliance report. Refer to Appendix B.	Refer to Appendix B
8	3	Quarterly Disclosures – Verify all known compliance violations have been reported	Send request for disclosure to IMD management, Legal Investment staff, and CIO requesting disclosure of any known compliance violations during testing period	Obtained all disclosures from IMD management, Legal Investment staff, and CIO of any known compliance violations during testing period.	No response required
9	3	Test authorizations of wire transfers – Verify wire transfers are authorized and properly supported	Obtain wire transfer reports for testing period, select sample of wire transfers, verify that supporting documentation exists for each	All wire transfers tested were properly authorized and correct amounts were wired.	No response required

Note: Testing procedures for the Investment Policy Statement (IPS), Securities Lending Policy (SLP), and wire transfers are for the activity for the quarter ending December 31, 2013.

APPENDIX B

COMPLIANCE WITH INVESTMENT AND RELATED POLICIES As of and for the three months ended January 31, 2014

Policy	Compliance Exceptions	Reportable Exceptions	Management Responses
Investment Policy Statement (IPS)	Yes	Two external managers purchased a stock newly added to the Sudan Restricted Companies List.	Upon TRS' instruction, the managers divested the stocks. In addition, Investment Compliance and IMD are streamlining the process for distributing new restricted company lists to external managers on a timely basis. However, because the relevant statutes contemplate instantaneous compliance, there remains a possibility for future compliance issues in implementing the restricted lists across TRS' global portfolio. To help alleviate this issue, we will try to work with the relevant State agencies to receive preliminary lists prior to receipt of the final lists.
Securities Lending Policy (SLP)	No	None	N/A
Proxy Voting Policy	No	None	N/A

- Unsatisfactory progress is being made or there have been significant delays in resolving issue.
- Timely or satisfactory progress is being made toward resolving issue.
- No exception or satisfactorily resolved issue.

TAB 4D

SEMI-ANNUAL TESTING OF BENEFIT PAYMENTS

JULY 2013 – DECEMBER 2013

TRS Internal Audit Department

Business Objectives	To deliver retirement and related benefits authorized by law for members and their beneficiaries.		
Business Risks	Fraud / Errors Benefit payments could be incorrect or fraudulent in these areas: <ul style="list-style-type: none"> • Payments to recent retirees • Benefit payments with an expiration date 	Eligibility TRS members could retire with full benefits without meeting Rule of 80 or minimum requirements	Manual Voucher Payments Manual voucher payments could be processed incorrectly or without proper authorization
Management Assertions	All benefit payments are valid	All retirees who received annuity benefit payments are eligible	All manually processed voucher payments are valid
Agreed-upon Procedures	Matched benefit payments to supporting documents in two areas: 1. Recent retiree benefit recalculations 2. Benefit payment expiration dates	3. Recalculated Rule of 80 or minimum requirements for all new normal-age service retirements during the testing period	4. Matched 60 randomly selected manually processed voucher payments to supporting documentation
Test Results	No Exceptions	No Exceptions	No Exceptions
Management Responses	N/A	N/A	N/A

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

February 28, 2014

Mr. Don Green, Chief Financial Officer
Ms. Marianne Woods Wiley, Chief Benefit Officer
Ms. Betsey Jones, Director, Health Care Policy and Administration

We have completed the first testing period for the **Semi-Annual Testing of Benefit Payments** as included in the *Fiscal Year 2014 Audit Plan*.

We performed the procedures listed below that were agreed to by management of Benefit Services, Health and Insurance Benefits, and the Financial Division. These procedures included four data-mining tests designed to identify anomalies in benefit payments during the current testing period and possible deviations from management's benefit processing controls.

For this testing period, the tests performed included testing gross payment amounts made to recent retirees, manual benefit payments, normal age retirement criteria, and expiry date testing for five or ten year guaranteed period payments, disability retirement payment calculations for retirees with less than 10 years of service, and expiration dates greater than 50 years. There were no exceptions noted as a result of the test procedures performed. The detailed procedures and results of our testing are explained in **Appendix A**.

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 below either for the purpose for which this report has been requested or for any other purpose.

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 above 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.

* * * * *

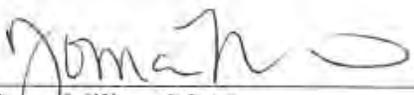
We express our appreciation to management and key personnel of Information Technology, Benefit Services, Health and Insurance Benefits, and the Financial Division for their cooperation and professionalism shown to us during the testing.



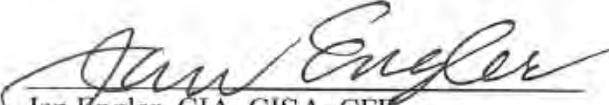
Amy Barrett, CIA, CPA, CISA
Chief Audit Executive



Dorvin Handrick, CISA, CDP
Senior IT Auditor



Tom Miller, CGAP
Internal Auditor



Jan Engler, CIA, CISA, CFE
Internal Audit Manager

APPENDIX A

AGREED UPON PROCEDURES AND RESULTS

1. Test Purpose: Test that gross annuity payments to recent retirees (June 2013 or later retirements) from July to December 2013 are calculated accurately.

Test Description: Query the *July to December 2013 Benefit Payments Data File* for all gross annuity payments that were related to recent member retirements and randomly select three service retirement sample items and two disability retirement sample items from each month for a total of 30 sample items. Recalculate the gross payment amount as follows: The annuitant's standard annuity payment is first recalculated based on the member's number of years of service and the average salary amount at the time of retirement and agreed to the supporting documentation in the *TRS Imaging System*. If applicable, recalculate the gross annuity payment amount using the annuity payment option adjustment factor(s) selected by the member per the supporting documentation in the *TRS Imaging System*.

Test Result: All 30 gross annuity payments to recent retirees from July to December 2013 were recalculated and traced to supporting documentation. No exceptions were noted.

2. Test Purpose: Test that the expiration date to stop the annuity payment timely is properly recorded in the system.

Test Description: Test the expiration date accuracy for a sample of annuity payments from July to December 2013 for the three groups described below. Agree the recorded expiration date to the auditor's calculation based on the imaged documents maintained in the *TRS Imaging System*. Each test is described as follows:

- a. Expiration date of guaranteed-period annuity options retirement
 - i.) For guaranteed-period (5-year and 10-year) annuity options that TRS is paying the beneficiary because the retiree was deceased before the guaranteed period ended, obtain all records with an expiration date that is greater than the retirement date plus the guaranteed period. Agree these records to supporting documentation indicating the expiration date.
 - ii.) Obtain all records where the payment status is active but there is no expiration date. Trace these records to the supporting documentation.

b. Expiration date of disability retirement with less than 10 years of service

The disabled retiree with less than 10 years of service should receive a standard benefit amount of \$150 per month for the shortest period of the retiree's disability period, retiree's life, or total number of creditable service months.

- i.) Obtain all records with a retiree death date but payment status is still active. Trace to the supporting documentation.
- ii.) Obtain all records that the gross payment amount is not the standard amount of \$150 and report differences.
- iii.) Obtain all records where the expiration date has expired but the payment status is still active. Trace to the supporting documentation.
- iv.) Obtain all records where the member was not the payee. Trace to the supporting documentation.
- v.) Obtain all records where the expiration date is greater than the retirement date plus years of member service. Select five random samples from each monthly data file to test by adding the number of creditable service months, based on the imaged documents in the TRS *Imaging System*, to the retirement date and comparing that number with the expiration date in the retirement system. Agree sample items to supporting documentation.

c. Expiration date is longer than 50 years from the date of current payment record.

Obtain items from all payment records with an expiration date that is more than 50 years from each data file from July to December 2013 that have not been previously tested. Recalculate and agree the recorded expiration date to the supporting documentation.

Test Results:

a. Expiration date of guaranteed-period annuity options retirement

- i.) No exceptions were noted where the expiration date was greater than the retirement date plus the guaranteed period.
- ii.) All 32 unique sample items of records, with an active payment status but no expiration date, were traced to the supporting documentation. No exceptions were noted.

b. Expiration date of disability retirement with less than 10 years of service

No exceptions were noted.

c. Expiration date is beyond 50 years from current payment records

The recalculated expiration date for the two records identified agreed to the recorded expiration date in the supporting documentation. No exceptions were noted.

3. Test Purpose: Test for normal-age service retirement benefits from July to December 2013 that do not meet the Rule of 80 with at least five years of service or the minimum retirement age of 65 with at least five years of service.

Test Description: Query the *July to December 2013 Benefit Payments Data File* for all payments that were related to normal-age service retirement benefits since June 2013. All proportionate retirements, early age retirements, and disability retirements are excluded. The annuitant's retirement age is calculated based on the year and month of the member's retirement date and birth date in the annuity system records. All records were recalculated by the auditor according to the stated criteria using the automated audit software.

Test Result: All normal-age service retirement benefits met the requirements of Rule of 80 with at least five years of service or with the minimum retirement age of 65 and at least five years of service. No exceptions were noted.

4. Test Purpose: Test that manual voucher payments are properly authorized and supported.

Test Description: Select a random sample of 10 manual voucher payments per month from the *July to December 2013 Benefit Payments Data File*. Trace and agree these manual voucher payments to the supporting documents maintained in the *TRS Imaging System*.

Test Results: We randomly selected 60 manual voucher payments to test. These test samples included 22 premium refunds, six annuity pop-ups, 12 qualified domestic relations order (QDRO) related payments, three payments re-issued due to returned payments, eight retiree requests to re-issue payment, six payments re-issued due to retiree/beneficiary death, and three other related manual payments. All payments were traced and agreed to the supporting documents. No exceptions were noted.

TAB 5

**TRS Internal Audit
Summary of Audit Recommendations Status
March 2014**

Project	Recommendation	Status	Issue Type	Estimated Date	Revised / Actual Date
12-403 Audit of Compensation, Payroll and Position Control					
	Develop and implement a written procedures manual for payroll	In Progress	Other Reportable	4/2013	10/2014
13-201 Health Care Administration Audit					
	Formalize procedures for non-financial contract monitoring – staff guidance	In Progress	Other Reportable	3/2014	
	Formalize procedures for non-financial contract monitoring – minor contract requirement modifications	In Progress	Other Reportable	9/2014	
	Strengthen internal processes and procedures related to plan enrollment and coverage changes	In Progress	Other Reportable	3/2014	
13-102 Telephone Counseling Center Performance Measures Audit (Outsourced Audit conducted by Myers and Stauffer LC)*					
	Address Average Speed to Answer (ASA) reliability issues	Implemented	Significant	5/2013	8/2013
	Evaluate service level as a more suitable measure	Implemented	Other Reportable	12/2013	12/2013

*See Tab 3 for Myers and Stauffer LC report on the Follow-up Audit of Telephone Counseling Center Performance Measures

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
March 2014**

Project	Recommendation	Status	Issue Type	Estimated Date	Revised / Actual Date
13-602 Fraud Risk Identification and Prevention Audit					
	Benefit Accounting - Improve system access reviews to ensure access privileges remain current with job duties	Implemented	Significant	12/2013	12/2013
	Benefit Processing - Improve system access reviews to ensure access privileges remain current with job duties and are appropriately balanced between the need for cross-training staff and the need for restricted access to limit opportunity for fraud	Implemented	Significant	12/2013	9/2013
14-301 Investment Management Division Controls (Broken down by each quarter tests)					
1 st QTR	Include reasonableness checks on securities lending income as part of Investment Accounting's monitoring activities	Implemented	Other Reportable	1/2014	2/2014
1 st QTR	Consider other funding options to address long-term CSA revenue shortfall projections	In Progress	Other Reportable	7/2014	
14-404 Audit Of Cost of Living Adjustment (COLA)					
	Strengthen management controls in special payment processes	Implemented	Other Reportable	11/2013	10/2013
	Verify the COLA eligibility for each of the 804.005 payees	In Progress	Other Reportable	6/2014	

TAB 6

Teacher Retirement System of Texas
March 2014 Audit Committee Agenda Items Mapped to TRS Stoplight Report

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

Status of Fiscal Year 2014 Planned Assurance, Consulting, and Advisory Services as of February 2014

Title	Type	Status
Executive		
Electronic Records	Audit	
Fraud Investigation Procedures Development	Advisory	In Progress
Internal Ethics and Fraud Hotline Administration	Advisory	Ongoing
University of Texas Students' Project – Best Practices for Social Media	Consulting (Added)	In Progress
Meetings Participation	Advisory	Ongoing
Special Requests	Advisory	Ongoing
Finance		
Purchasing and Contract Administration	Audit	
GASB 67 and 68 Implementation Status	Advisory	In Progress
State Auditor's Office (SAO) Financial Audit Coordination	Advisory	Complete
Meetings Participation	Advisory	Ongoing
Special Requests and Surprise Inspections	Advisory	In Progress
TEAM Program		
TEAM Independent Program Assessment (IPA) Vendor Support	Advisory	Ongoing
TEAM Committees Participation	Advisory	Ongoing
Pension Benefits		
Cost of Living Adjustment (COLA) Calculation	Audit	Complete
Refunds, Inactive and Escheated Accounts	Audit	
Special Service Buy Back Process	Audit	Complete
Telephone Counseling Center Follow-up	Audit	In Progress
Benefits Payment Testing for SAO Financial Audit	Audit	Complete
Semi-annual Benefits Testing	Agreed-Upon Procedures	1 of 2 Complete
Employer Reporting		
TRS Employer Reporting Controls	Advisory	
Employer Self-Audit Program	Advisory	In Progress
Employer Reviews/Special Projects	Various	In Progress

Status of Fiscal Year 2014 Planned Assurance, Consulting, and Advisory Services as of February 2014

Title	Type	Status
Health Care Benefits		
Health Care Governance, Risk Management, and Reporting	Consulting	
Health Care Vendor Update Meetings	Advisory	Ongoing
Health Care Vendor and Auditor Selection Observation	Advisory	Complete
Information Technology		
Identity and Access Management, and Contractor Onboarding Process	Audit	In Progress
Information Technology (IT) Security Program Follow-up	Audit	
Emerging IT Risks: Cloud Computing and Mobile Device Security	Consulting	
University of Texas Students' Project – Best Practices and Policies for Cloud Computing and Mobile Devices	Consulting (Added)	Complete
Co-Location/Disaster Recovery Planning	Consulting	In Progress
Network Penetration Test; Security Risk Assessment Review	Advisory	
Technology Committee Meetings Attendance	Advisory	Ongoing
Investment Management		
Overall Internal Control Opinion on Investment Activities (includes periodic status reports)	Audit	In Progress
Quarterly Investment Testing	Agreed-Upon Procedures	1st, 2nd Quarters Complete
Private Strategic Partner Network (SPN) Fee Calculations	Consulting	
Incentive Compensation Plan Review	Advisory	Complete
Investment Committees Attendance	Advisory	Ongoing
Internal Audit Department		
Internal Quality Assurance Review	Advisory	In Progress
External Quality Assurance Reviews	Advisory	In Progress
Annual Internal Audit Report	Audit	Complete
Quarterly Audit Recommendations Follow-up	Audit	Ongoing
Fiscal Year 2015 Audit Plan	Advisory	
Health Care Audit Risk Assessment, Model 3Year Audit Plan Project	Consulting	In Progress
Audit Committee Meetings Preparation	Advisory	Ongoing
Internal Audit Strategic Plan	Advisory	In Progress

Fiscal Year 2014 Internal Audit Advisory Services¹ December 2013 – February 2014

BENEFIT SERVICES
TEAM PROJECT <ul style="list-style-type: none"> • Executive Steering Committee Participation • Budget Committee Participation • Data Management Project Participation • Reporting Entity Outreach Core Team Meeting Participation • Organizational Change Management Advisory Group Participation • Monthly meetings with TEAM Project Manager • Core Management Team: Standing Prioritization Review Meeting • Independent Program Assessment Vendor Coordination and Support • Assistance to TRS Project Management Office with identification of internal controls in the Line of Business commitments and Financial System Replacement requirements
HEALTH BENEFITS
<ul style="list-style-type: none"> • Health Plan Administrator (HPA) and Pharmacy Benefit Manager (PBM) Vendor Quarterly Update Meeting Participation • TRS-ActiveCare Request for Proposal (RFP) Meeting Participation (Non-voting) • Health Care Risk Assessment Consulting Project Coordination • Data analysis and testing of duplicate TRS-Care Premium Refunds per management request
INVESTMENTS
<ul style="list-style-type: none"> • Internal Investment Committee (IIC) Attendance • Monthly Meetings with Deputy CIO and Director of Operations
FINANCIAL SERVICES
<ul style="list-style-type: none"> • Coordination of State Auditor’s Office on the Audit of TRS’ Fiscal Year 2013 Comprehensive Annual Financial Report • Surprise Inspections of General Accounting, Security and Receiving areas • Financial System Replacement (FSR) Weekly Meetings Participation
EXECUTIVE
<ul style="list-style-type: none"> • State Auditor’s Office Quarterly Update Meetings Coordination and Support • Hot Line Call Facilitation • Executive Requests • Social Media Advisory Committee Participation • Internal Investigations Procedures’ Input
INFORMATION TECHNOLOGY
<ul style="list-style-type: none"> • Enterprise Security Project Team Participation • Co-Location Consulting Project Coordination

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 2014
2nd Quarter Ending February 28, 2014**

Target Performance	Activity	Status
Goal 1: Enhance Effectiveness of Internal Audit Organization		
1. Update the Internal Audit Strategic Plan, 2012-2016, and align with TRS mission and core values.	Internal Audit Strategic Plan for 2015-2019 will be finalized this fiscal year. Assigned staff are working on various components of the draft plan.	On Task
2. Spend a minimum of 75% of total available department hours (excludes uncontrollable leave) for professional staff on direct assurance, consulting, and advisory services.	Achieved 76% for the second quarter	On Task
3. Develop and implement transition plan for the transfer of the investment compliance function from Internal Audit to Legal Services.	The investment compliance function transferred to Legal Services effective September 1, 2013. Internal Audit management provided assistance as needed during the first quarter.	Achieved
Goal 2: Develop and Implement Internal Audit Annual Audit Plan based on Formal Risk Assessment		
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. Complete internal self-assessment and report annually on Quality Assurance and Improvement Program.	The internal self-assessment is in progress.	On Task
Goal 3: Enhance Internal Audit Staff Skills and Knowledge in Emerging Risks and Controls with Emphasis on Information Technology, Investment and Health Care		
6. Obtain internal audit staff training and implement COSO Internal Control 2013 Integrated Framework in the Investment Management Division overall internal control opinion audit during fiscal year 2014.	The CAE and two internal audit directors received training on the COSO Internal Control 2013 Integrated Framework. This framework is being implemented in the IMD overall internal control opinion that is currently in progress.	On Task
7. Enhance staff knowledge of investment due diligence key processes by visiting one TRS asset manager.	Open – to be scheduled	On Task

**Internal Audit Goals and Performance Measures - Fiscal Year 2014
2nd Quarter Ending February 28, 2014**

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
9. Facilitate timely completion and success of State Auditor's Office (SAO) audits in fiscal year 2014 by effectively providing audit support, coordinating meetings, reserving facilities and gathering schedule and documentation requests.	State Auditor's Office Report on the Audit of Fiscal Year 2013 Comprehensive Annual Report (CAFR) was reported to the Audit Committee in December 2013	Achieved
10. Coordinate with Legal Services and executive management on the development of framework for ethics and fraud investigations and implement in fiscal year 2014.	Internal Audit has provided input into the draft internal investigations procedures; the CAE will participate in a committee to review and update the TRS fraud policy.	On Task
11. Coordinate with Benefit Accounting and executive management on the development of employer self-audit program and implement in fiscal year 2014.	Continuation of project that began in fiscal year 2013; staff is currently working with Benefit Accounting management	On Task
Goal 5: Enhance Participation in Professional and Peer Organizations		
12. Participate in at least two quality assurance reviews of internal audit departments in state agencies and public pension funds.	The CAE led a quality assurance review of the Employees Retirement System of Texas internal audit function. An audit manager is leading a quality assurance review at the Office of the Attorney General internal audit function.	On Task
13. Participate in professional organizations (APPFA, IIA, ISACA, ACFE, SAIAP, CFA Institute) through monthly chapter meetings and engage in leadership roles in at least two of the professional organizations.	Participation in professional organizations is ongoing. The CAE is secretary for APPFA, and one audit manager is on the Board of Governors for the Austin Chapter of the IIA.	On Task

Legend: Target Status

-  Target not achieved
-  Behind in achieving target
-  On task to achieve target
-  Achieved target

Teachers Retirement System of Texas
Internal Ethics and Fraud Investigations
Incident Report Activity Summary
1/1/2010 (inception) through 2/28/2014

Time Period	Number of Calls Per Ethics and Fraud Hotline	Status
1/01/2010 – 8/31/2010	1	Resolved
9/01/2010 – 8/31/2011	2	Resolved
9/01/2011 – 11/30/2011	0	N/A
12/01/2011 – 3/31/2012	1	Resolved
4/01/2012 – 5/31/2012	0	N/A
6/01/2012 – 8/31/2012	0	N/A
9/01/2012 – 11/30/2012	1	Resolved
12/01/2012 – 3/31/2013	0	N/A
4/01/2013 – 5/31/2013	0	N/A
6/01/2013 – 8/31/2013	0	N/A
9/01/2013 – 11/30/2013	0	N/A
12/01/2013 – 2/28/2014	0	N/A

Time Period	Internal Investigations that Internal Audit Provided Assistance	Status
6/01/2013 – 8/31/2013	1	Resolved

Resolved – fully investigated by the Triage Team and all actions agreed to by the Triage Team have occurred.

Per the TRS Fraud and Ethics Hotline Procedures:

- The Audit Committee Chair will be kept apprised of the status of investigations and will be notified of any suspected fraud in accordance with TRS's Fraud, Waste, and Abuse Prevention Policy.
- The Audit Committee will be provided with statistics quarterly regarding calls received, their disposition, and those resulting in identification of fraud and notification to the State Auditor's Office hotline.
- The Audit Committee may instruct Internal Audit to perform an audit of matters relating to issues identified with the allegation in accordance with the Audit Committee Charter.
- Internal Audit will consider results of hotline calls and actions by the Triage Team in developing the annual audit plan or amendments to that plan.

SEC STRATEGIC PLAN FOR 2014-2018

OVERVIEW

For questions on the note below, please contact Katherine Kimmel at (202) 547-3035.

Below is a high-level summary of key points from the Securities and Exchange Commission's (SEC or Commission) Strategic Plan for 2014-2018. The Strategic Plan was prepared in accordance with the Government Performance and Results Modernization Act of 2010. The plan details the Commission's environment, resources, strategic goals, and initiatives for fiscal years 2014 through 2018.

Please find the report in its entirety [here](#).

OUTLOOK

A. DISPERSED & COMPLEX MARKETS

- Sophisticated technology brings new risks of accidental or intentional disruptions capable of spreading across markets, international borders, and institutional firewalls
- Market structure has become highly fragmented as trading volume is dispersed among many highly automated trading centers that compete for order flow of securities

B. AGENCY'S JURISDICTION

- Dodd-Frank Act (Dodd-Frank) and JOBS Act have increased the Commission's regulatory responsibility for hedge fund advisers and other private funds, clearing houses, rating agencies, municipal advisers, and crowdfunding portals
- The Commission, with the CFTC, is now responsible for the entire swaps market

C. GLOBALLY INTERCONNECTED MARKETS

- SEC plans to engage and coordinate appropriately with foreign regulators, both bilaterally and multilaterally, on enforcement strategies and swaps regulations
- Combat fraud and identify global risks that could impact U.S. securities markets

D. CONTINUING RISKS

- Budgetary constraints
- Legislative and regulatory changes
- Regulatory changes may unintentionally hamper beneficial market behavior
- Investors may consider regulations a substitute for care and diligence
- Over/underb regulation may undermine the competitiveness of U.S. capital markets or chill innovation, entrepreneurship, and prudent riskb taking

RESOURCES

- Pursuant to Dodd-Frank and beginning in FY 2012, registration fee collections are no longer offsetting collections, and currently, only transaction fees are offsetting collections

STRATEGIC GOAL 1: EFFECTIVE REGULATORY ENVIRONMENT

A. PROMOTE HIGH-QUALITY DISCLOSURE & PREVENT ABUSE

- Improve the quality and usefulness of disclosure by focusing on registrants' financial condition, operations, risk management, and executive compensation
- Engage in rulemaking mandated by Congress
- Analyze new products and instruments (exchange traded products and market innovations)
- Consider requiring mutual funds to provide additional information
- Strengthen proxy infrastructure (proxy voting and shareholder-company communications)
- Modernize beneficial ownership reporting and disclosure obligations relating to the use of equity swaps and other derivative instruments
- Analyze regulatory structures for investment advisers and broker-dealers (BDs) providing personalized investment advice
- Modernize the regulatory treatment and valuation of certain portfolio holdings of registered investment companies using derivatives
- Promote high-quality accounting standards by strengthening the independence of the Financial Accounting Standards Board (FASB)
- Foster high-quality audits through the oversight of the accounting profession and the Public Company Accounting Oversight Board (PCAOB)
- Enhance regulation of BDs, clearing agencies, and other major market participants by evaluating regulatory structures related to financial responsibility, customer protection, and governance
- Monitor disclosures related to asset-backed securities
- Revise rules and forms to improve registration and disclosure requirements
- Issue joint rules concerning credit-risk retention in securitized transactions
- Strengthen oversight of municipal advisors

B. PROMOTE FAIR & EFFICIENT CAPITAL MARKETS

- Foster a fair and efficient market structure
 - Review the impact of algorithmic and other automated trading on the markets and, if warranted, develop appropriate policy response
 - Strengthen incentives for investors to display trading interest (increasing price discovery)
 - Enhance the post-trade transparency of alternative trading systems (including dark pools)
 - Review equity and options market structure
- Oversee the system of self-regulation, focusing on conflicts of interest
- Enhance the technological resilience of securities markets
 - Continue work on rulemaking proposal to require securities markets, clearing agencies, and plan processors to assure that their systems have adequate levels of capacity, integrity, resiliency, availability, and security to maintain their operational capability

- Reduce reliance on credit ratings references in SEC rules by inserting appropriate substitutes as required by Dodd-Frank
- Enhance oversight of derivatives by working with the CFTC to harmonize futures and securities laws for economically equivalent instruments
- Help prevent market manipulation
 - Review recent changes to the regulation of short sales
 - Enhance transparency of trading activities
 - Update and enhance anti-manipulation rules
 - Update and enhance anti-manipulation rules that address issuer repurchases and timely public notice of dividends and other distributions
- Improve transparency and oversight of small capitalization securities
- Consider implementing further money market funds reforms
- Enhance the market structure for fixed income securities
 - Initiatives will be aimed at promoting transparency, developing new mechanisms to facilitate the provision of liquidity, and improving the execution quality of investor orders
- Consider streamlining the process for introducing new exchange-traded funds to the market
- Enhance the safety and efficiency of securities clearance and settlement practices through rules covering clearing agencies and transfer agents and harmonize such practices
- The SEC has an indicator in place to measure the percentage and number of market outages at SROs and electronic communications networks that are corrected within targeted timeframes

C. ADOPT & ADMINISTER REGULATIONS & RULES

- Improve agency-wide coordination of the rulemaking process
- Enhance the process for no-action, interpretive, and exemptive regulatory requests
- Respond accurately and timely to informal guidance requests from market participants

D. ENGAGE WITH STAKEHOLDERS

- The Chair of the SEC will continue to participate actively in the Financial Stability Oversight Committee (FSOC)
- Collaborate with other authorities, domestic and foreign, on enforcement and market oversight matters by sharing data, information, and expertise on regulatory issues
- Conduct technical assistance programs with emerging and recently-emerged markets to help reduce regulatory arbitrage and promote cross-border enforcement and supervisory assistance
- Facilitate input from stakeholders in rulemaking initiatives
- Coordinate closely with the Investor Advisory Committee

STRATEGIC GOAL 2: FOSTER & ENFORCE COMPLIANCE

A. DETECT & DETER VIOLATIONS

- Enhance surveillance and risk assessment capabilities by seeking access to data and insights from registrants, self-regulatory organizations (SROs), commercial vendors, and other sources

- Improve management of tips, complaints, and referrals
- Build upon the establishment and successes of the Office of the Whistleblower
- Bolster the expertise of the SEC staff through additional training and certifications
- Build upon Enforcement’s Cooperation Program through cooperation agreements, deferred prosecution agreements, and non-prosecution agreements to encourage violation reporting
- Enhance sharing, cooperation, and joint initiatives both within the agency and with other regulators, such as FINRA, state regulators, the CFTC, and international counterparts
- The SEC has an indicator to examine investigations in which requests for access to information were granted by the SEC to other authorities, such as SROs or other state, federal, and foreign enforcement authorities

B. PROSECUTE VIOLATIONS

- Continue utilizing specialty groups within the enforcement program
- Enhance timeliness of distributions to wronged investors
- Enhance communications among SEC divisions and offices and the enforcement program
- Review approach for enforcement penalties and broaden the range of enforcement sanctions

STRATEGIC GOAL 3: FACILITATE INVESTOR ACCESS TO INFORMATION

A. HIGH-QUALITY DISCLOSURE MATERIALS

- Update disclosure and reporting requirements to reflect the informational needs of investors
- Evaluate the effectiveness of filing review programs for reporting entities
- Design and implement new disclosure regimes for specialized categories of issuers so that investors in these products have relevant and useful information to make informed decisions
- Design and implement enhancements to EDGAR and SEC.gov

B. EDUCATE INVESTORS

- Use feedback from individual investors to improve investor education resources
- Inform rulemaking with investors’ views and address Investor Advisory Committee input
- Expand collaborative partnerships to shape educational initiatives
- Promote investor awareness through Investor Alerts and other educational materials

STRATEGIC GOAL 4: ENHANCE COMMISSION’S PERFORMANCE

- Promote a results-oriented work environment
- Encourage a collaborative environment across divisions and offices
- Maximize the use of agency resources by continually improving agency operations and controls

PROGRAM EVALUATION

- The SEC publishes an Annual Performance Report, consults with outside groups, and benefits from GAO and Office of Inspector General oversight

SEC Charges 23 Firms With Short Selling Violations in Crackdown on Potential Manipulation in Advance of Stock Offerings

FOR IMMEDIATE RELEASE
2013-182

Washington D.C., Sept. 17, 2013 — The Securities and Exchange Commission today announced enforcement actions against 23 firms for short selling violations as the agency increases its focus on preventing firms from improperly participating in public stock offerings after selling short those same stocks. Such violations typically result in illicit profits for the firms.

The enforcement actions are being settled by 22 of the 23 firms charged, resulting in more than \$14.4 million in monetary sanctions.

The SEC's Rule 105 of Regulation M prohibits the short sale of an equity security during a restricted period – generally five business days before a public offering – and the purchase of that same security through the offering. The rule applies regardless of the trader's intent, and promotes offering prices that are set by natural forces of supply and demand rather than manipulative activity. The rule therefore helps prevent short selling that can reduce offering proceeds received by companies by artificially depressing the market price shortly before the company prices its public offering.

The firms charged in these cases allegedly bought offered shares from an underwriter, broker, or dealer participating in a follow-on public offering after having sold short the same security during the restricted period.

"The benchmark of an effective enforcement program is zero tolerance for any securities law violations, including violations that do not require manipulative intent," said Andrew J. Ceresney, Co-Director of the SEC's Division of Enforcement. "Through this new program of streamlined investigations and resolutions of Rule 105 violations, we are sending the clear message that firms must pay the price for violations while also conserving agency resources."

"This coordination between the enforcement and examination programs reaffirms that market participants must be in compliance with Rule 105 to preserve and protect the independent pricing mechanisms of the securities markets," said Andrew Bowden, Director of the SEC's National Exam Program.

In a [litigated administrative proceeding against G-2 Trading LLC](#), the SEC's Division of Enforcement is alleging that the firm violated Rule 105 in connection with transactions in the securities of three companies, resulting in profits of more than \$13,000. The Enforcement Division is seeking full disgorgement of the trading profits, prejudgment interest, penalties, and other relief as appropriate and in the public interest.

The SEC charged the following firms in this series of settled enforcement actions:

- [Blackthorn Investment Group](#) – Agreed to pay disgorgement of \$244,378.24, prejudgment interest of \$15,829.74, and a penalty of \$260,000.00.
- [Claritas Investments Ltd.](#) – Agreed to pay disgorgement of \$73,883.00, prejudgment interest of \$5,936.67, and a penalty of \$65,000.00.
- [Credentia Group](#) – Agreed to pay disgorgement of \$4,091.00, prejudgment interest of \$113.38, and a penalty of \$65,000.00.
- [D.E. Shaw & Co.](#) – Agreed to pay disgorgement of \$447,794.00, prejudgment interest of \$18,192.37, and a penalty of \$201,506.00.
- [Deerfield Management Company](#) – Agreed to pay disgorgement of \$1,273,707.00, prejudgment interest of \$19,035.00, and a penalty of \$609,482.00.
- [Hudson Bay Capital Management](#) – Agreed to pay disgorgement of \$665,674.96, prejudgment interest of \$11,661.31, and a penalty of \$272,118.00.
- [JGP Global Gestão de Recursos](#) – Agreed to pay disgorgement of \$2,537,114.00, prejudgment interest of \$129,310.00, and a penalty of \$514,000.00.
- [M.S. Junior, Swiss Capital Holdings, and Michael A. Stango](#) – Agreed to collectively pay disgorgement of \$247,039.00, prejudgment interest of \$15,565.77, and a penalty of \$165,332.00.
- [Manikay Partners](#) – Agreed to pay disgorgement of \$1,657,000.00, prejudgment interest of \$214,841.31, and a penalty of \$679,950.00.
- [Meru Capital Group](#) – Agreed to pay disgorgement of \$262,616.00, prejudgment interest of \$4,600.51, and a penalty of \$131,296.98.00.
- [Merus Capital Partners](#) – Agreed to pay disgorgement of \$8,402.00, prejudgment interest of \$63.65, and a penalty of \$65,000.00.
- [Ontario Teachers' Pension Plan Board](#) – Agreed to pay disgorgement of \$144,898.00, prejudgment interest of \$11,642.90, and a penalty of \$68,295.
- [Pan Capital AB](#) – Agreed to pay disgorgement of \$424,593.00, prejudgment interest of \$17,249.80, and a penalty of \$220,655.00.
- [PEAK6 Capital Management](#) – Agreed to pay disgorgement of \$58,321.00, prejudgment interest of \$8,896.89, and a penalty of \$65,000.00.
- [Philadelphia Financial Management of San Francisco](#) – Agreed to pay disgorgement of \$137,524.38, prejudgment interest of \$16,919.26, and a penalty of \$65,000.00.

- [Polo Capital International Gestão de Recursos a/k/a Polo Capital Management](#) – Agreed to pay disgorgement of \$191,833.00, prejudgment interest of \$14,887.51, and a penalty of \$76,000.00.
- [Soundpost Partners](#) – Agreed to pay disgorgement of \$45,135.00, prejudgment interest of \$3,180.85, and a penalty of \$65,000.00.
- [Southpoint Capital Advisors](#) – Agreed to pay disgorgement of \$346,568.00, prejudgment interest of \$17,695.76, and a penalty of \$170,494.00.
- [Talkot Capital](#) – Agreed to pay disgorgement of \$17,640.00, prejudgment interest of \$1,897.68, and a penalty of \$65,000.00.
- [Vollero Beach Capital Partners](#) – Agreed to pay disgorgement of \$594,292, prejudgment interest of \$55.171, and a penalty of \$214,964.
- [War Chest Capital Partners](#) – Agreed to pay disgorgement of \$187,036.17, prejudgment interest of \$10,533.18, and a penalty of \$130,000.00.
- [Western Standard](#) – Agreed to pay disgorgement of \$44,980.30, prejudgment interest of \$1,827.40, and a penalty of \$65,000.00.

The SEC's investigations were conducted by Conway T. Dodge, Anita B. Bandy, Lauren B. Poper, Christina M. Adams, Allen A. Flood, Kevin J. Gershfeld, Wendy Kong, Mary S. Brady, Ian S. Karpel, Kimberly L. Frederick, and J. Lee Robinson. The SEC's litigation will be led by James A. Kidney. The SEC appreciates the ongoing assistance of the Financial Industry Regulatory Authority.

###

CYBERSECURITY: KEEPING IP UNDER LOCK AND KEY

Your organization's valuable intellectual property (IP) — its trade secrets, patents, and customer lists — is more susceptible to cyberattack today than it was yesterday. And it will be even more vulnerable tomorrow. In fact, a recent study by the Ponemon Institute found that the number of successful cyberattacks on companies more than doubled over a two-year period, and the resulting financial impact increased nearly 40 percent.

Technology is changing rapidly, and so are the means by which the perpetrators of cybercrimes carry out their nefarious activities. Increased global connectivity and a greater reliance on third-party organizations also heighten the risk of IP exposure.

This issue of *Tone at the Top* explores how audit committees, management, and internal auditors can work to reduce IP exposures and better protect their organizations from crippling cyberattacks.

Valuable Assets

Intellectual property is a fairly generic term that encompasses most of an organization's important

product- and service-related data, the intangible assets that give a company its edge. A confidential client database is a good example, as are marketing plans, customer transaction information, and beta test results. The list goes on.



There was a time when this type of information would be stored, quite literally, under lock and key. However, today's high-tech business environment requires digital storage, remote accessibility, and quick and easy transferability. Keeping IP safe is increasingly difficult because, as business has moved to the digital space, so have criminals.

"From a threat vector standpoint, your phone is probably your biggest risk," says Jeff Spivey, president of Security Risk Management Inc. and board vice president for ISACA, which sets international IT audit and control standards.

"There is malware out there that allows hackers to use your mobile phone to monitor your email, access your passwords, IP, and even remotely operate your phone camera," says Spivey, who will be speaking on cybersecurity at The IIA's [General Audit Management Conference](#) in March.

Invisible Threat

The first step to boosting cybersecurity is to identify the threat. The four main types are: nuisance hackers, state-sponsored attackers, criminal attackers, and “hacktivists,” who may be pursuing agendas related to the environment or human rights.

Common modes of attack include the introduction of a malicious program such as a Trojan, worm, virus, or spyware; password phishing; and denial-of-service attacks intended to crash websites. The results can be devastating, including financial losses, IP theft, reputational damage, fraud, and legal exposure.

Six Steps to Protect IP

Robert Smallwood, IT security consultant and author of *Safeguarding Critical E-documents*, recommends the following six steps for protecting IP:

1. Identify confidential e-documents (document types and categories).
2. Determine where they are created, who needs access to them, and when.
3. Develop information governance (IG) policies to manage and control access to sensitive documents.
4. Enforce IG policies with electronic document security (EDS) technologies, which may include information rights management, data loss prevention, digital signature technology document analytics, or encryption.
5. Test and audit your IG program.
6. Refine policies and continue to evaluate deploying new cybersecurity and EDS technologies.

Most insidious are the so-called “zero-day” attacks, in which hackers break into a database, copy or modify data, and then leave undetected, says Marc Vael, chief audit executive for Smals, which provides IT infrastructure for Belgium’s social services and health care system. Under such an attack, it can be months or even years before the breach is detected, long after the damage has been done.

Holistic Effort

Keeping IP safe from criminals requires all [three lines of defense](#) — IT management, risk management, and internal audit — to stay current on relevant technology and share knowledge to prevent blindspots and silos. David Brand, managing director in charge of IT Audit at consulting firm Protiviti, warns against putting too much of the responsibility on IT managers. Cybersecurity, he says, should be a top risk management concern and a regular part of internal audit plans.

“There is a tendency for organizations to think of cybersecurity as an IT issue, but it is really up to executive management to tell IT what needs to be protected, where that intellectual property resides, and who should have access to it,” Brand says. “Cybersecurity risk is the same as any other kind of risk. It’s just that the asset is electronic instead of physical. You need a good system of internal controls.”

The audit committee’s responsibilities can include setting expectations and accountability for management and assessing the adequacy of resources, funding, and focus for cybersecurity activities. It’s important that audit committees communicate expectations regarding security and risk mitigation.

The Weakest Link

Not all threats are external. As with any risk mitigation effort, people are the weakest link. Vael recommends regular and ongoing employee training from the bottom to the top of the organization. “The biggest issue is understanding,” Vael says. “Explain to me, in my language, the risks involved, what is expected, and what that implies.”

Board Communications

The data generated by boards of directors is as vulnerable to cyberattack as any of the organization's IP. Indeed, according to the Thomson Reuters 2013 Board Governance Survey, more than 75 percent of organizations utilize unsecure, personal email accounts to distribute board documents, and almost 50 percent do not ensure board communications are encrypted. But 52 percent of organizations now use a board portal to share sensitive board information.

As part of the IT audit, Vael recommends an annual evaluation of the organization's ability to maintain and secure its IT applications, assets, and infrastructure — something he calls “e-skills.”

Finally, as more organizations outsource IT functions or move infrastructure and applications to the cloud, Vael urges directors and executives to hold management accountable for doing due diligence on third-party solution providers to ensure that they comply with the organization's policies, practices, and culture when it comes to IP protection and cybersecurity.

“People tend to focus on the tangible stuff — processes and procedures, organizational structures,” Vael says. “What's missing is the cultural component.”

Internal auditors also should verify that the company updates employee training programs as needed so they include requirements for protecting and securely disposing of confidential material, and ensure that new employees have adequate training that includes careful explanation of the information security policy and code of conduct.

Indeed, it is employees who, unfortunately, represent the weakest link in the cyberprotection chain. Organizations can go a long way toward protecting their cyber-IP by doing everything they can to remove the threat from within.

Questions Boards Should Ask



- Which information assets are most critical, and what is the value at stake in the event of a breach?
- Does the board/audit committee spend enough time working to understand the risks and key controls needed to protect the organization from cyberattack?
- Has an inventory of IP been performed, including where it resides and who has access to it?
- Does the organization devote adequate resources and funding to address cybersecurity?
- Has protection of IP been included in the companywide risk assessment?
- Are there formal procedures to be followed in the event of a breach, and have those procedures been tested?
- What is internal audit's assessment of the organization's ability to secure its IP?

Quick Poll Question

How confident are you that your organization's controls can prevent a significant cybersecurity threat?

Visit www.theiia.org/goto/quickpoll to answer the question and see how others are responding.

Background and High-Level Summary of SLGEP Efforts

In June 2012, the GASB issued two new standards that will substantially change the accounting and financial reporting of public employee pension plans and the state and local governments that participate in such plans. GASB Statement No. 67, *Financial Reporting for Pension Plans*, revises existing guidance for the financial reports of most governmental pension plans. GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. GASB Statement No. 67 is effective for financial statements for periods beginning after June 15, 2013. GASB Statement No. 68 is effective for financial statements for fiscal years beginning after June 15, 2014.

There are numerous accounting and auditing issues facing governmental plans (both cost-sharing and agent) and participating employers that the SLGEP has been working very diligently to address. During this process, the SLGEP has had many discussions internally with representatives of the Auditing Standards Board, as well as with other key stakeholders including actuaries, plans, governmental employers, and the GASB. The remainder of this *GAQC Alert* discusses the status of the SLGEP efforts, guidance issued to date, and other additional guidance expected.

Whitepapers Released Relevant to Cost-Sharing Plans, Participating Employers, and Auditors

With the implementation of GASB Statement No. 68, employers will be required to recognize a liability as employees earn their pension benefits (that is, as they provide services to the government). For the first time, employers participating in cost-sharing plans will recognize their proportionate share of the collective pension amounts for all benefits provided through the plan. The SLGEP has released one whitepaper which addresses numerous issues from the employer and employer auditor perspective that will arise from the implementation of GASB Statement No. 68. These issues need to be addressed by employers sooner rather than later and will involve close coordination between employers and cost-sharing plans. In a separate whitepaper, the SLGEP has addressed responsibilities of the plan and its auditor regarding the completeness and accuracy of all census data underlying certain financial statement elements of the plan. Each of these papers is discussed in more detail below:

Whitepaper on Employer and Related Auditor Issues. This whitepaper titled, *Governmental Employer Participation in Cost-Sharing Multiple-Employer Plans: Issues Related to Information for Employer Reporting*, addresses issues related to how employers participating in cost-sharing plans obtain all necessary information to properly recognize and disclose pension amounts in their financial statements and how their auditors obtain sufficient appropriate evidence to support their opinions on employer financial statements. It should be of interest to cost-sharing plans, participating employers, and their auditors. In the whitepaper, the SLGEP recommends that cost-sharing plans calculate and disclose in two schedules each employer's allocation percentage and pension amounts. The SLGEP further recommends the plans engage their auditors to obtain reasonable assurance and report on the schedules in accordance with AU-C section 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*. The employer and employer auditor have their own responsibilities with regard to the information provided by the plan, as further discussed in the whitepaper, but the plan auditor's report on the schedules provides evidence that the pension amounts allocated to the employer and included in the employer's financial statements are not materially misstated. Most importantly, the whitepaper concludes that if a cost-sharing plan issues financial statements, but does not prepare the above described schedules or if it does prepare the above described schedules but does not engage its auditor to opine on them as recommended by the SLGEP, it is unlikely that employer auditors will be able to accumulate sufficient appropriate audit evidence necessary to provide unmodified opinions on opinion units of the government financial reporting entity that have material allocated pension amounts. It is important to emphasize that unaudited information provided by the plan to its employers to support allocations or pension amounts would not be sufficient appropriate audit evidence for their auditors to base their opinions. Read the whitepaper for much more detail.

Whitepaper on Plan Census Data Issues. The whitepaper titled, *Single-Employer and Cost-Sharing Multiple-Employer Plans: Issues Associated with Testing Census Data in an Audit of Financial Statements*, addresses the role of census data in single-employer and cost-sharing plan financial statements and the plan auditor's responsibility for such census data. It should be of primary interest to cost-sharing plans and their auditors. However, participating employers may also wish to review the whitepaper as it could have ramifications for them. In the whitepaper, the SLGEP addresses the responsibility of the cost-sharing plan to obtain all necessary information and the plan auditors to obtain sufficient appropriate evidence regarding the completeness and accuracy of all census data underlying certain financial statement elements of the plan. From an audit perspective, the whitepaper describes the plan auditor's responsibility to identify and assess the risks of material misstatement of these elements. For this purpose, the plan auditor should:

1. Obtain an understanding of the processes and controls used by the plan's management to support the completeness and accuracy of census data provided to the actuary.
2. Consider the likelihood of misstatement and whether the potential misstatement is of such a magnitude that it could result in a material misstatement of the total pension liability, contribution revenue, or contributions receivable.

The nature, timing, and extent of substantive procedures to be performed over the census data and the underlying payroll records of employers will depend on the assessed risk of material misstatement of the relevant elements and whether management has effective processes to determine the completeness and accuracy of census data provided to the actuary. Note that in order to obtain sufficient appropriate audit evidence the whitepaper explains that it is necessary to select a representative group of contributing employers each year on a rotating basis for testing underlying payroll records of employees who are potentially eligible for participation in a cost-sharing plan. A risk-based approach for selecting the employers to test each year is also described. [Read the whitepaper for more detail.](#)

Expected Issuance of Related Auditing Interpretations

In addition to the above described whitepapers, the SLGEP, working with the AICPA Audit and Attest Standards Team, is currently developing a series of auditing interpretations that will address specific questions pertaining to both the auditors of the cost-sharing plans and employers. These interpretations will support certain of the conclusions reached in the SLGEP whitepapers and include interpretations of AU-C 500, *Audit Evidence*, AU-C 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, and AU-C 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*. The clearance process for these interpretations is currently underway and they are expected to be released no later than late March. A future *GAQC Alert* will announce the issuance of these interpretations.

Internal Audit Staff Quarterly Accomplishments

- Internal Audit is once again hosting three students from the University of Texas at Austin who are working on a consulting project for their graduate audit class project. Dinah Arce is project lead and assists the students in their research of best practices and policies on Social Media. The students have met with Howard Goldman, Director of Communications, and some of his staff. They will present the results of their research to the Communications and Internal Audit staff in April 2014.
- Dinah Arce received the TRS Core Value ethics award as part of TRS February Core Values Campaign.
- Nick Ballard joined Internal Audit as a Senior Investment Auditor effective March 1, 2014. He has a MBA from the University of Texas at Austin and has passed level I and II of the Chartered Financial Analyst (CFA) exam. His work experience includes finance division team lead and investment analyst at the Texas Pension Review Board, and senior auditor at the State Auditor's Office.