

# **Audit Committee Meeting**

**November 2015**



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

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

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

**AGENDA**

**November 20, 2015 – 8:00 a.m.  
TRS East Building, 5<sup>th</sup> Floor, Boardroom**

1. Approve minutes of September 25, 2015 Audit Committee meeting  
– Christopher Moss, Chair
2. Receive State Auditor’s Office report on audit of Benefits Proportionality at the Office of the Comptroller of Public Accounts, the Teacher Retirement System, and the Employees Retirement System –Angelica Ramirez and Hillary Eckford, State Auditor’s Office
3. Receive Internal Audit reports
  - A. Audit of Actuarial Data Controls – Karen Morris and Dorvin Handrick
  - B. Audit of Northside Independent School District – Dinah Arce and Art Mata
  - C. Quarterly Investment Testing (Agreed-Upon Procedures) – Nick Ballard
4. Receive reports on the Fiscal Year 2015 Internal Audit Annual Report and status of prior audit and consulting recommendations
  - A. Fiscal Year 2015 Internal Audit Annual Report – Amy Barrett and Dinah Arce
  - B. Status of prior audit and consulting recommendations – Amy Barrett
5. Discuss or consider Internal Audit administrative reports and matters related to governance, risk management, internal control, compliance violations, fraud, regulatory reviews or investigations, new and outstanding complaints, fraud risk areas, audits for the annual internal audit plan, or auditors' ability to perform duties – Christopher Moss and Amy Barrett

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

**TAB 1**



**TEACHER RETIREMENT SYSTEM OF TEXAS  
AUDIT COMMITTEE MEETING  
September 25, 2015**

The Audit Committee of the Teacher Retirement System of Texas met on Friday, September 25, 2015 in the 5<sup>th</sup> 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  
Dolores Ramirez, Board Member  
Joe Colonna, Board Member

**TRS Staff**

Brian Guthrie, Executive Director  
Ken Welch, Deputy Director  
Amy Barrett, Chief Audit Executive  
Karen Morris, Director, Pension Audit Services  
Hugh Ohn, Director, Investment Audit Services  
Jan Engler, Audit Manager, Internal Audit  
Dinah Arce, Senior Auditor, Internal Audit  
Lih-Jen Lan, Information Technology Audit Manager, Internal Audit  
Dorvin Handrick, Information Technology Audit Manager, Internal Audit  
Toma Miller, Senior Auditor, Internal Audit  
Nick Ballard, Senior Investment Auditor, Internal Audit  
Britt Harris, Chief Investment Officer  
Sylvia Bell, Director, Operations Group, Investment Division  
Barbie Pearson, Chief Benefit Officer  
Cari Casey, Team Leader, Data Management, Benefit Services  
Don Green, Chief Financial Officer  
Jimmie Savage, Records Management Officer  
Mark Browning, Records Retention Analyst  
Jamie Pierce, Director, General Accounting  
Cindy Haley, Team Leader, Financial Reporting, General Accounting  
Gloria Nichols, Senior Financial Analyst, General Accounting  
Scot Leith, Director, Investment Accounting  
Chris Cutler, Chief Information Officer  
Cedric Robertson, Information Security, Information Technology

**TRS Staff (cont'd)**

Carolina de Onis, General Counsel  
Dan Junell, Assistant General Counsel  
Heather Traeger, Chief Compliance & Ethics Officer  
Ronnie Bounds, Assistant General Counsel  
Lynn Lau, Assistant Secretary to the Board and Program Specialist  
John Dobrich, Procurement, Legal  
Katrina Daniel, Chief Health Care Officer  
Bob Jordan, Director, TRS Health & Insurance Benefits  
Edward Esquivel, Assistant Director, TRS Health & Insurance Benefits  
Yimei Zhao, Assistant Director of Finance, TRS Health & Insurance Benefits  
Jay LeBlanc, Director, Risk Management & Strategic Planning  
Howard Goldman, Director, Communications  
Dan Herron, Communications Specialist, Communications

**Other Attendees**

Philip Mullins, Texas State Employees Union  
Ann Fickel, Texas Classroom Teachers Association  
Ted Melina Raab, Texas American Federation of Teachers  
John Corey, Texas State Teachers Association  
Josh Sanderson, Association of Texas Public Educators  
Steven Huff, Reinhart Boerner Van Deuren s.c.  
Angelica Ramirez, State Auditor's Office  
Michael Clayton, State Auditor's Office  
Sally Reaves, Sagebrush Solutions  
Rene Hernandez, Protiviti  
Tricia Callahan, Protiviti  
Soo Lee, Protiviti

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

**1. APPROVE THE PROPOSED MINUTES OF THE JULY 24, 2015 AUDIT COMMITTEE MEETING**

On a motion by Ms. Anita Palmer, and seconded by Ms. Nanette Sissney, the proposed minutes of the July 24, 2015 Audit Committee meeting were approved as presented.

**2. RECEIVE STATE AUDITOR'S OFFICE REPORTS**

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

Mr. Michael Clayton, State Auditor's Office, informed the committee that field work has begun on the annual financial statement audit. He stated that the purpose of the audit is to issue an opinion on TRS' fiscal year 2015 financial statements in accordance with auditing standards generally accepted in the United States of America and standards applicable to financial audits contained in the Governmental Auditing Standards issued by the Comptroller General of the

United States. He added that an evaluation has been completed and it was determined that the auditors conducting the audit are independent as required.

Mr. Clayton advised the committee that three separate reports will be issued as part of the audit. The first is the Independent Auditor's Report for which the expected issuance date is November 16, 2015. The second report is on internal controls and compliance with other matters which includes any control weaknesses identified during the audit. The last report is issued to the Legislative Audit Committee and is required for any work performed by the State Auditor's Office. He stated that the last two reports will be issued at some point in November following the official audit report.

Mr. Clayton stated that the financial statement audit now includes an evaluation of the controls in place to ensure that census data reported by employers is accurate. He stated that accuracy is now very important as employers must report their share of the overall pension liability on their financial statements.

### **B. Audit of TRS' Fiscal Year 2014 Employer Pension Liability Allocation Schedules**

Mr. Clayton presented the results of the Audit of TRS' Fiscal Year 2014 Employer Pension Liability Allocation Schedules. He stated that the State Auditor's Office issued an unqualified opinion. He noted that one finding was identified where six charter schools were not included in the schedules, but that ultimately the omission did not affect the schedule as a whole because those schools were small. This was reported to management and will be followed up on during the planned review of the schedule for fiscal year 2015.

### **3. RECEIVE INDEPENDENT AUDIT REPORT ON TRS-ACTIVECARE SERVICE PROVIDERS**

Ms. Sally Reaves, Sagebrush Solutions, presented the results of the independent audit of TRS-ActiveCare service providers. She stated that the audit scope included a review of services provided during fiscal year 2013 and 2014 for vendors Blue Cross Blue Shield of Texas, ESI, First Care, Allegian, and Scott & White, with the main emphasis being on medical claims processing.

She stated that testing found that the two self-insured plans administered by Blue Cross Blue Shield of Texas and ESI satisfied all of the metrics and contractual requirements for processing accuracy and timeliness and all of the metrics for customer service. A recommendation was made to Blue Cross Blue Shield of Texas regarding its copayment assessment process and system edits. It was recommended that ESI review its procedures to ensure they contain adequate steps to assist participants in obtaining urgent and medically necessary medication under extraordinary circumstances.

The three fully insured HMO plans administered by First Care, Allegian, and Scott & White met or exceeded generally observed industry standards for processing claims. Additionally, First Care and Scott & White exceeded industry standards for reported financial and payment accuracy rates. Allegian came in just below industry standards for financial accuracy. This resulted in a recommendation that Allegian take action to improve its claim adjudication accuracy.

#### **4. RECEIVE INTERNAL AUDIT REPORTS**

##### **A. Audit of Information Technology Controls at Third-Party Investment Service Providers**

Mr. Hugh Ohn stated that internal audit partnered with Protiviti to conduct this audit. He stated that the primary audit objective was to determine whether the information technology (IT) controls at two selected third-party service providers that host critical Investment Management Division (IMD) systems are designed to achieve IMD business objectives. The secondary objective was to design or develop a monitoring tool that could be used by IMD and the Information Technology (IT) Department to monitor IT systems controls at these third-party service providers.

Mr. Rene Hernandez and Ms. Tricia Callahan, Protiviti, provided an overview of the audit process that was used to evaluate the vendors' IT controls.

Mr. Ohn then presented the results of the audit. He stated that the overall results show that the IT controls were designed effectively to accomplish IMD business objectives and no significant control weaknesses were identified. He stated that two recommendations were made during the audit.

The first recommendation was to enhance TRS' oversight of the service providers by having IMD refine the IMD contract management checklist and log to ensure that TRS contracts include the latest standard data security language in all contracts, new or amended. The second recommendation was that TRS request Service Organization Control (SOC) two reports from all key third-party service providers in order to obtain independent assurance that IT security controls are in place and operating effectively. Mr. Ohn stated that management has agreed with these recommendations and plans to quickly implement them.

##### **B. Fourth Quarter Test Results of Investment Controls (Real Assets)**

Mr. Nick Ballard presented the results of this audit. He stated that management controls at IMD are operating effectively for the real assets portfolio. He noted that testing found staff's due diligence to be thorough and that staff conducted portfolio reviews on an ongoing basis to assess investment performance.

Mr. Ballard indicated that two issues identified previously during testing of the private equities portfolio were also identified during the real assets testing. The first was in regards to inconsistencies in the documentation of staff's due diligence and monitoring. He stated that since the issue was first reported to the committee in March, management has drafted and implemented team due diligence and monitoring guidelines that were put into effect in June 2015. Since these guidelines provide clear guidance on expected documentation practices for these analyses going forward, no further action was recommended on this item.

Mr. Ballard stated that the second issue identified during previous testing and also applicable to real assets was related to investment accounting. He stated that auditors previously recommended that the Investment Accounting Department provide clear guidance on acceptable accounting and valuation standards for private markets assets. Investment Accounting is

currently working to implement this recommendation which will also be applicable to real assets. As a result, he states, no further recommendation is being made.

### **C. Overall Opinion on Investment Management Division Internal Controls**

Mr. Ohn gave an overview of the process used to evaluate and express an overall opinion on IMD internal controls. He explained that the opinion was based on the results of 29 separate audits and tests performed during the previous three fiscal years. The projects focused on the five components of the internal controls framework issued by the Committee of Sponsoring Organizations (COSO). These five components include: the control environment, risk assessment, control activities, the information and communication process for identifying, obtaining, producing, and sharing information within the organization, and monitoring activities.

Mr. Ohn stated that the overall results of testing indicated that IMD controls are effective and provide reasonable assurance that risks are being mitigated and managed to meet IMD business objectives.

### **D. Quarterly Investment Testing (Agreed-Upon Procedures)**

Mr. Ballard informed the committee that no errors were identified during the quarterly investment testing.

### **E. Semi-Annual Testing of Benefit Payments (Agreed-Upon Procedures)**

Ms. Barrett reported that no errors were identified during the semi-annual testing of benefit payments.

### **F. Records Management Audit and Management's Action Plan**

Ms. Jan Engler presented the results of the Records Management Audit. She stated the objective of the project was to determine whether TRS records management practices align with current state statutes and guidelines, internal policies, and industry best practices.

She indicated that the audit identified one significant and three other reportable findings. The significant finding was related to electronic and hardcopy records not always being retained or purged timely and users being largely unsure of their role and responsibilities for creating, maintaining or disposing of records, including email.

The other reportable findings were:

- the Records Management Officer needs increased executive support, enterprise-wide visibility and coordination with related functions
- a long-term comprehensive plan that includes succession planning is needed to ensure improved and consistent compliance with records management policy and state laws
- TRS' records management policy needs to be revised to align with operating procedures

Ms. Engler stated that it was recommended that management use a formal assessment process to develop a strategic agency solution for records management that aligns with state laws,

guidelines and internal policies, creates more centralized processes, provides ongoing assessments and staff training at all levels, and includes succession planning to address TRS' records management needs now and in the future. She stated that management has agreed with this recommendation.

Mr. Jimmie Savage presented an overview of several electronic records management projects that TRS plans to implement in the near future. These included a records awareness and training project, the issuance of an email management policy, departmental assessments related to records management and retention, and the establishment of better record repositories using SharePoint and FileNet applications that are user controlled.

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

### **A. Follow-up Audit on Significant Benefit Audit Findings**

Ms. Toma Miller presented the results of the Follow-Up Audit on Significant Benefit Audit Findings. She stated that the follow-up audit covered recommendations related to significant audit findings during two previous benefit audits, the Refunds of Inactive and Dormant Accounts Audit and the Fraud Risk Identification and Prevention Audit.

She indicated that no issues were identified during the follow-up testing related to the Refunds of Inactive and Dormant Accounts. All previous recommendations were fully implemented and remained current. In regards to the follow-up testing for the Fraud Risk Identification and Prevention Audit, it was found that, while all recommendations had been initially implemented, not all had remained current. Individuals were identified as having excess system access that could provide an opportunity for internal fraud.

Ms. Miller stated that management had immediately addressed the findings related to excess system access and put new processes in place to avoid controls from breaking down in the future.

Ms. Barbie Pearson provided an overview of the processes that have been established within Benefit Services to ensure that internal controls around system access are closely managed going forward.

### **B. Report on the Status of Prior Audit and Consulting Recommendations**

Ms. Barrett provided a brief update on the status of prior audit and consulting recommendations. She stated that a lot of progress is being made on the recommendations from the Purchasing and Contract Management Audit, including the development of a new contract management policy that will replace the old contract administration manual. However, more time will be needed to complete a few of the recommendations in this area. She expects to be able to provide revised implementation dates at the committee meeting in November.

Ms. Barrett also informed the committee that the follow-up reports will now also include the status of recommendations made to school districts as a result of the reporting entity audits being conducted by Internal Audit.

## **6. RECEIVE REPORT ON QUALITY ASSURANCE IMPROVEMENT PROGRAM (QAIP) SELF-ASSESSMENT**

Ms. Barrett presented the results of the Internal Audit quality assurance self-assessment. She stated that the annual review is required under professional auditing standards and provides the department an opportunity to evaluate their compliance with auditing standards and internal policies and procedures. She indicated that the self-assessment resulted in two recommendations that the department will be implementing.

The first recommendation was to establish a process to ensure that the required memo assessing any threats to the independence and objectivity of the Internal Audit Department is updated annually. The second recommendation was to ensure that audit steps for wrap-up and project close-out within the electronic working papers software are completed timely.

## **7. CONSIDER RECOMMENDATIONS TO THE BOARD OF TRUSTEES REGARDING THE PROPOSED AUDIT PLAN FOR FISCAL YEAR 2016**

Ms. Barrett presented the proposed Audit Plan for Fiscal Year 2016. She stated that the Audit Plan was designed based on the results of a comprehensive risk assessment. As part of that assessment, the Chief Audit Executive spoke with every member of the TRS Board and executive management and issued five different surveys internally in order to get everyone's opinion regarding the biggest risks to the agency.

She stated that additional information was gathered from the Enterprise Risk Management (ERM) Stoplight Report that evaluates risk across TRS, as well as from meetings that Internal Audit staff attend throughout the year. Once the results of the risk assessment were compiled, the information was presented to the internal Risk Oversight Committee for its input.

Ms. Barrett reminded the committee of the four types of projects that Internal Audit performs, including assurance audits, agreed-upon procedures testing, consulting projects, and advisory projects. She stated that the results of assurance audits and agreed-upon procedures testing will always be presented to the committee; however, consulting and advisory projects, whether formal or informal, will not be reported to the committee, unless significant issues are identified during the course of the project.

Ms. Barrett highlighted a few key projects and discussed Internal Audit's continued advisory role in the TEAM project and related committees with specific emphasis on internal controls. Other key projects include reporting entity audits, which are being expanded to include testing related to TRS-ActiveCare information, data analytics especially in the benefits area, a SharePoint governance IT audit, agreed-up procedures testing related to the TRS budget with a focus on transfers between major expense categories, and an audit related to incentive compensation within IMD.

## **8. DISCUSS OR CONSIDER INTERNAL AUDIT ADMINISTRATIVE REPORTS AND MATTERS RELATED TO GOVERNANCE, RISK MANAGEMENT, INTERNAL CONTROL, COMPLIANCE VIOLATIONS, FRAUD, REGULATORY REVIEWS OR INVESTIGATIONS, NEW AND OUTSTANDING COMPLAINTS, FRAUD RISK**

**AREAS, AUDITS FOR THE ANNUAL INTERNAL AUDIT PLAN, OR AUDITORS' ABILITY TO PERFORM DUTIES**

Ms. Barrett stated that Internal Audit met all of its performance measures for the year, with the exception of one measure. Rather than engage a service provider to conduct a health care audit, the department hired EY (Ernst & Young) to help build out a data analytics program that can use data from across TRS, including health care, to help drive the audit work being performed.

In regards to staff accomplishments, Ms. Barrett noted that Hugh Ohn and Nick Ballard made a presentation at the State Auditor's Office Annual Conference regarding the work being performed to issue an overall control opinion. Nick Ballard also obtained his Certified Public Accountant (CPA) license during the quarter.

Lastly, Ms. Barrett informed the committee that Cari Casey will join Internal Audit, effective October 1. She stated that Cari is transferring from Benefit Services where she has served as the team leader of the Data Management Team for many years. She will serve as a benefits consultant to Internal Audit staff and assist with various benefits testing and employer audits.

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

The meeting adjourned at 10:05 a.m.

Approved by the Audit Committee of the Board of Trustees of the Teacher Retirement System of Texas on the 20th day of November 2015.

Attested by:

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

**TAB 2**



**John Keel, CPA**  
**State Auditor**

An Audit Report on

**Benefits Proportionality at the  
Office of the Comptroller of  
Public Accounts, the Teacher  
Retirement System, and the  
Employees Retirement System**

September 2015  
Report No. 16-003



John Keel, CPA  
State Auditor

An Audit Report on

# Benefits Proportionality at the Office of the Comptroller of Public Accounts, the Teacher Retirement System, and the Employees Retirement System

SAO Report No. 16-003  
September 2015

## Overall Conclusion

Inconsistencies in the benefits proportionality requirements in the General Appropriations Act make it unclear whether state entities should pay benefits (1) proportionately to their appropriated method of finance or (2) from the same source of funds used to pay the respective salaries.

In addition, under either of those interpretations of the benefits proportionality requirements, sufficient controls are still necessary at the state level to ensure that state entities pay benefits proportionately. However, it is important to note the following:

- State entities can request an unlimited amount of General Revenue funds to pay benefits.<sup>1</sup>
- There is inadequate data available at the state level to monitor whether state entities adhere to benefits proportionality requirements.

The Office of the Comptroller of Public Accounts (Comptroller's Office) developed accounting policy statement 011 (APS 011) and a related reporting form to administer benefits proportionality requirements. APS 011 and the related reporting form are designed to ensure that benefits are paid proportionately to a state entity's appropriated method of finance.

Under either interpretation of the benefits proportionality requirements, the Comptroller's Office should make certain improvements to

### Excerpts from Proportionality Requirements for the 2014-2015 Biennium

- a) Unless otherwise provided, in order to maximize balances in the General Revenue Fund, payment for benefits paid from appropriated funds, including "local funds" and "education and general funds" as defined in §51.009 (a) and (c), Education Code, shall be proportional to the source of funds except for public and community junior colleges.
- b) Unless otherwise specifically authorized by this Act, the funds appropriated by this Act out of the General Revenue Fund may not be expended for employee benefit costs, or other indirect costs, associated with the payment of salaries or wages, if the salaries or wages are paid from a source other than the General Revenue Fund except for public community or junior colleges...Payments for employee benefit costs for salaries and wages paid from sources, including payments received pursuant to interagency agreements or as contract receipts, other than the General Revenue Fund shall be made in proportion to the source of funds from which the respective salary or wage is paid or, if the Comptroller determines that achieving proportionality at the time the payment is made would be impractical or inefficient, then the General Revenue Fund shall be reimbursed for any such payment made out of the General Revenue Fund.  
Source: Sections 6.08(a) and 6.08(b), page IX-27, General Appropriations Act (83rd Legislature).

### Method of Finance

"Method of finance" refers to the sources and amounts authorized to finance certain expenditures or appropriations made in the General Appropriations Act. For example, sources could include General Revenue, General Revenue dedicated, federal funds, and other funds.

Sources: *Budget 101, A Guide to the Budget Process in Texas*, Texas Senate Research Center, January 2015 and Office of the Comptroller of Public Accounts accounting policy statement 011.

<sup>1</sup> There are certain exceptions. One example of an exception is the amount of appropriations for higher education group insurance (HEGI), which is based on a sum-certain appropriation. The Legislature specifies the maximum HEGI for each higher education institution in line-item appropriations; higher education institutions must pay any additional benefit costs out of other appropriated or local funds.

APS 011 and the related reporting form. For example, APS 011 and the related reporting form do not capture information on non-appropriated funds.

The Teacher Retirement System (TRS) and the Employees Retirement System (ERS) are not required to monitor benefit contributions they receive to ensure that state entities pay benefits from the appropriate funding source. However, they have certain processes to verify that pension and insurance funds receive the statutorily required contributions.

Auditors communicated other, less significant issues to the Comptroller's Office separately in writing.

#### Appropriations for Benefits

For fiscal year 2015, appropriations for the benefits of employees at state agencies and higher education institutions totaled \$4.12 billion.

Source: The General Appropriations Act (83rd Legislature).

#### Benefits

The benefits to which this report refers include the following:

- The state employer match for Social Security.
- Group health insurance.
- Retirement.
- Optional retirement program.
- Benefit replacement pay.

## Summary of Management's Response

The Comptroller's Office agreed with the recommendations addressed to it in this report, and the full response from Comptroller's Office management is presented in Appendix 2 on page 15. ERS agreed with the recommendation addressed to it in this report, and the full response from ERS management is presented in Chapter 5 on page 10. This report did not address any recommendations to TRS.

## Summary of Objective, Scope, and Methodology

The objective of this audit was to determine whether TRS, ERS, and the Comptroller's Office have developed and implemented controls, policies, and procedures for performing in a timely manner reconciliations and transfers of funds that are necessary to ensure that payments of benefit costs are proportional to a state agency's or a higher education institution's funding from appropriated funds and federal receipts.

The scope of this audit covered the work that TRS, ERS, and the Comptroller's Office performed during the 2014-2015 biennium.

The audit methodology included conducting interviews with management and staff at TRS, ERS, and the Comptroller's Office; reviewing applicable laws, regulations, and accounting policy statements; reviewing the results of applicable TRS internal audits; reviewing previous State Auditor's Office reports regarding benefits proportionality; and performing selected tests and other procedures. This audit did not include work on information technology.

Auditors relied on previous State Auditor's Office audit work to determine that data in the following systems was sufficiently reliable for the purposes of this audit: the TRS General Accounting System, the TRS Reporting and Query System, the Comptroller's Office's Uniform Statewide Accounting System, and the Comptroller's Office's Texas Network for Electronic Transfers. Auditors also assessed the reliability of data in a spreadsheet that the Comptroller's Office used to track state entities that are required to submit an APS 011 report for fiscal year 2014 and determined that the list of entities on the spreadsheet was sufficiently reliable for the purposes of this audit. In addition, auditors assessed the reliability of data in a spreadsheet that ERS used to calculate reallocation amounts for each higher education institution for fiscal year 2013 and determined that the data was sufficiently reliable for the purposes of this audit; however, one miscalculation was identified (see Chapter 5 for additional details).

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## ***Detailed Results***

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# Detailed Results

Chapter 1

## The Legislature Should Clarify Benefits Proportionality Requirements

Inconsistencies in the benefits proportionality requirements in Sections 6.08(a) and 6.08(b), page IX-27, the General Appropriations Act (83rd Legislature) make it unclear whether state entities should pay benefits (1) proportionately to their appropriated method of finance or (2) from the same source of funds used to pay the respective salaries.

- One section of the requirements states that, “in order to maximize the balances in the general revenue fund, payments for benefits paid from appropriated funds ... shall be proportional to the source of funds.” Some state entities have interpreted that to mean that they should pay benefits proportionately to their appropriated method of finance.
- Another section of the requirements states that benefit payments “shall be made in proportion to the source of funds from which the respective salary or wage was paid.”

The differing interpretations of the benefits proportionality requirements have a significant effect on how much General Revenue will be used to pay for benefits. Table 1 shows the specific differences in the proportionality calculations for a hypothetical state entity that (1) receives 85 percent of its funding from General Revenue and 15 percent from local funds and (2) pays 5 percent of its salaries from its General Revenue funds and pays 95 percent of its salaries from local funds.

Table 1

Effect of the Differing Interpretations of the Proportionality Requirements <sup>a</sup>	
Benefits Paid Proportionately to the Appropriated Method of Finance	Benefits Paid from the Same Source of Funds Used to Pay the Respective Salaries
General Revenue Fund pays for 85% of benefits	General Revenue Fund pays for 5% of benefits
Local funds pay for 15% of benefits	Local funds pay for 95% of benefits
<sup>a</sup> For an entity that: <ul style="list-style-type: none"> <li>▪ Receives 85 percent of its funding from General Revenue and 15 percent from local funds.</li> <li>▪ Pays 5 percent of its salaries from its General Revenue funds and pays 95 percent of its salaries from local funds.</li> </ul>	

The Legislative Budget Board's *Benefits for State Employees and Public and Higher Education Employees* (October 2014) specified that "Proportionality requires state General Revenue Funds benefits contributions be paid only on salaries also paid from state General Revenue Funds." In addition, a December 2008 Senate Finance Higher Education Subcommittee interim report specified that "the state's obligation to pay for benefits is limited to those employees whose salaries are paid with state general revenue." However, the Office of the Comptroller of Public Accounts' (Comptroller's Office) has made a different interpretation of the benefits proportionality requirements. Specifically, the Comptroller's Office's accounting policy statement 011 (APS 011) and related reporting form are designed to ensure that benefits are paid proportionately to a state entity's appropriated method of finance. Therefore, the Legislature should consider clarifying the benefits proportionality requirements to help ensure that state entities consistently apply the proportionality requirements correctly.

It is important to note that the State could better control how much General Revenue is spent on benefits if state entities (1) received sum-certain appropriations to pay benefits and (2) were required to provide explanations for any requests for funds in excess of those sum-certain amounts.

### **Recommendations**

To help resolve the inconsistencies regarding benefits proportionality requirements, the Legislature should consider:

- Clarifying the benefits proportionality requirements.
- Appropriating all benefits through sum-certain appropriations to each state entity.

## ***The Comptroller's Office Should Strengthen Controls Over State Entities' Requests for Funds to Pay Benefits***

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State entities can request an unlimited amount of general revenue funds to pay benefits, and there is no sum-certain limitation on those requests. The majority of funds the Legislature appropriates to state entities to pay benefits are estimated amounts. With some exceptions, there is not a limit on the amount of General Revenue appropriations that state entities can request to pay employee benefits.<sup>2</sup>

State entities estimate and establish budgets for benefits in the Uniform Statewide Accounting System (USAS). The Comptroller's Office then approves those estimated benefit budgets. However, the Comptroller's Office's process to ensure that those estimated benefit budgets are reasonable is not a formal, documented process, and the Comptroller's Office has not performed that process consistently for all state entities.

To help ensure that state entities do not request more funds than necessary to pay benefits, the Comptroller's Office asserts the following:

- For appropriation year 2016 budget requests, the Comptroller's Office plans to analyze state entities' requests for funds to pay Social Security matching benefits and optional retirement program benefits by comparing those requests with the requests the state entities made in the prior year.
- For appropriation year 2016 budget requests, the Comptroller's Office plans to require state entities to provide detailed information and justifications when requesting additional funds to pay benefits in excess of the original budget request.

The processes the Comptroller's Office plans to implement do not limit the funds that state entities can request to pay benefits. To improve the integrity of the estimated appropriation process for the purposes of benefits proportionality, the Comptroller's Office should (1) establish a limit on each state entity's estimated budget for benefits and (2) require state entities to provide explanations and support for any amounts requested in excess of the estimated budgets for benefits.

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<sup>2</sup> An example of an exception is the amount of appropriations for higher education group insurance (HEGI), which is based on a sum-certain appropriation. The Legislature specifies the maximum HEGI for each higher education institution in line-item appropriations; higher education institutions must pay any additional benefit costs out of other appropriated or local funds.

## Recommendations

The Comptroller's Office should:

- Require state entities to provide explanations and support for any amounts requested in excess of a pre-established threshold on the estimated budgets for benefits.
- Strengthen its analyses and monitoring of all funds appropriated to pay benefits based on the limits established for state entities' estimated budgets for benefits.
- Develop and implement policies and procedures to ensure that it conducts and documents its analyses and monitoring of all funds appropriated to pay benefits consistently for all state entities.

## ***The Comptroller's Office Should Strengthen Monitoring of Benefit Payment Processes***

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Although each state entity is responsible for ensuring that it pays benefits proportionately, having associated controls at the state level to monitor compliance is important, regardless of how the benefits proportionality requirements are interpreted. However, for the following reasons, there is inadequate data available at the state level to monitor whether state entities adhere to benefits proportionality requirements:

**State agencies.** The majority of state employees' payroll and benefits are processed in payroll systems at the state agency level, and the detailed information necessary to track compliance with benefits proportionality requirements is not provided to the Comptroller's Office. Therefore, information is not currently available at the state level to monitor all state agencies' compliance with benefits proportionality requirements.

**Higher education institutions.** Higher education institutions process payroll and benefits through their own payroll systems and then submit summary payroll data to the Comptroller's Office's Human Resource Information System (HRIS). Typically, higher education institutions pay their salaries and benefits out of local funds (non-State Treasury funds) and subsequently request reimbursements from the General Revenue Fund (State Treasury funds) for eligible salaries, wages, and benefits (that is done through a series of transfers in USAS). Therefore, that process does not currently provide information at the state level to monitor higher education institutions' compliance with benefits proportionality requirements.

**Comptroller's Office.** In the fall of 2014, the Comptroller's Office performed an analysis of higher education payroll and benefit transfers in USAS for appropriation years 2010 through 2014 that identified a variety of issues. The Comptroller's Office asserted that it will continue conducting a similar analysis periodically for each higher education institution. The Comptroller's Office also plans to design a report that will compare information from (1) the payroll information that higher education institutions submit to HRIS with (2) USAS data. That would allow the Comptroller's Office to follow up on salary expenditure transfers that did not have corresponding benefit expenditure transfers.

In 2015, the Comptroller's Office incorporated into its existing post-payment audits a questionnaire to obtain additional information from higher education institutions regarding their procedures for complying with benefits proportionality requirements.

Implementing a standard monitoring program for evaluating state entities' payments of benefits would enhance accountability and enable the

Comptroller's Office to regularly report the results of that monitoring to decision makers.

**State Auditor's Office.** The State Auditor's Office has conducted audits regarding benefits proportionality. The audit methodology for those audits involved verifying the accuracy of the information that entities submitted on the benefits proportional reporting forms that the Comptroller's Office requires.

## **Recommendations**

The Comptroller's Office should:

- Establish appropriations controls that require any salary expenditure transfer to have a corresponding transfer of the related benefits expenditure. Those controls should include minimum and maximum limits on the related benefits to be transferred.
- Periodically analyze the reasonableness of salary, wage, and benefit expenditure transfers in the General Revenue Fund for all state entities.
- Develop and implement policies and procedures to ensure that it conducts analyses of salary, wage, and benefit expenditure transfers consistently for all state entities.
- Perform specific procedures regarding benefits proportionality when conducting post-payment audits on payroll or benefit-related expenditures.
- Periodically evaluate all state entities' payments of benefits using a standard monitoring program, and report the results of that monitoring every six months to the Senate Finance Committee, the House Appropriations Committee, and the Governor.

The Legislature should consider requiring the internal auditors at each state entity to regularly audit the processes and controls over benefits proportionality to help ensure that state entities adhere to benefits proportionality requirements.

## ***The Comptroller's Office Should Improve Its Accounting Policy Statement, the Associated Reports for Benefits Proportionality, and Its Related Reviews***

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### **APS 011**

The Comptroller's Office developed APS 011 to provide guidance and a reporting mechanism for state entities to demonstrate benefits proportionality as required by Section 6.08(d), page X-27, the General Appropriations Act (83rd Legislature). Entities with multiple appropriated funds must complete a *Benefits Proportionality by Fund Report* (also known as the APS 011 report) and submit it annually to the Comptroller's Office by November 19.

The APS 011 report calculates the percentage of total funding for each appropriated fund and then uses those percentages to determine the amount of benefit charges that should be paid by each appropriated fund. State entities are required to make adjustments in USAS if the funding source used to pay benefits does not match the calculated proportional benefits.

The APS 011 report must be signed by the chief financial officer or a designee certifying that the report is in compliance with the General Appropriations Act requirements and was completed in accordance with APS 011 guidelines.

Source: The Comptroller's Office.

As discussed in Chapter 1, the APS 011 and related reporting form that the Comptroller's Office developed to administer benefits proportionality requirements are designed to ensure that benefits are paid proportionately to a state entity's appropriated method of finance. Regardless of how the benefits proportionality requirements are interpreted, the Comptroller's Office should make certain improvements to APS 011 and the related reporting form. Specifically:

- The APS 011 report does not incorporate a state entity's non-appropriated funds. Including that information would help to ensure that state entities consider all funding sources in their proportionality calculations.
- The APS 011 report includes a local funds adjustment for higher education institutions that increases benefit costs paid by the General Revenue Fund. The adjustment reduces the proportion of benefits to be paid from General Revenue dedicated and other funds and increases the proportion to be paid from the General Revenue Fund. That process does not maximize the balances in the General Revenue Fund, as the proportionality requirements in the General Appropriations Act require.
- The Comptroller's Office should strengthen the affidavit currently on the APS 011 report by specifically including the benefits proportionality requirements the state entity followed and additional information regarding payroll and related transfers.

In addition, the Comptroller's Office has a guide for its staff's reviews of APS 011 reports, but it does not require staff to maintain documentation of those reviews. For 9 of the 12 appropriation year 2014 APS 011 reports tested, the Comptroller's Office had some evidence of its review in the form of documentation and email correspondence. However, the documentation it maintained was inconsistent, and auditors could not determine whether the Comptroller's Office verified all the relevant information on the APS 011 reports. According to the Comptroller's Office, it was in the process of reviewing the remaining three APS 011 reports.

## Recommendations

The Comptroller's Office should:

- Improve APS 011 by:
  - Incorporating all funding sources available to a state entity, including non-appropriated funds.
  - Removing the local funds adjustment for higher education institutions.
  - Including in the affidavit signed by the chief financial officer a description clarifying the benefits proportionality requirements the state entity followed.
  - Including in the affidavit signed by the chief financial officer an additional attestation regarding the accuracy of any payroll and related benefit transfers in the General Revenue Fund.
- Establish standard procedures for reviewing state entities' APS 011 reports to ensure that it reviews all significant information for accuracy and reasonableness, performs reviews consistently across state entities, and consistently documents its reviews.

## ***TRS and ERS Are Not Required to Monitor Compliance with Benefits Proportionality Requirements***

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The Teacher Retirement System (TRS) and Employees Retirement System (ERS) are not required to monitor benefit contributions they receive to ensure that state entities adhere to proportionality requirements. However, they have certain processes to verify that pension and insurance funds receive the statutorily required contributions.

**TRS's Process for Verifying Whether the State's Retirement Contributions Are Accurate.** The Legislature appropriates to TRS an estimated amount of General Revenue for higher education pensions. TRS receives 1/12 of that amount each month from the General Revenue Fund; it also receives monthly employer contributions from higher education institutions to pay for the benefits of employees who are paid from funds outside of the State Treasury. At the end of the year, TRS determines, in the aggregate, how much the state portion of retirement contributions should have been for the year. If the estimated amount was less than the amount actually required, TRS requests additional funds from General Revenue; if the estimated amount was more than the amount actually required, TRS repays the difference to the State.

Auditors verified the accuracy of the calculations described above for fiscal year 2014 and did not identify any issues. For fiscal year 2014, that process resulted in TRS requesting and receiving an additional \$24 million in General Revenue for pension contributions associated with higher education institutions. However, the accuracy of the calculation depends on higher education institutions' self-reported contribution information. The internal audit department at TRS has recently started conducting audits at school districts to verify the accuracy of self-reported information, but it has not yet included higher education institutions in those audits.

**ERS's Process for Reallocating State Group Insurance Contributions Among Higher Education Institutions.** ERS receives the majority of contributions for pension and insurance through state entities' payroll processes. The exception to that is the sum-certain group insurance appropriations for higher education institutions. Each month, 1/12 of the sum-certain amount for each higher education institution is transferred from the General Revenue Fund to the insurance fund that ERS manages. ERS does not receive data on the salaries associated with the pension or insurance contributions that it collects.

Rider 6(a), page III-39, the General Appropriations Act (82nd Legislature), authorizes ERS to reallocate state group insurance contributions from higher education institutions for which the sum-certain amounts were too high (compared with the actual contributions required) to higher education institutions for which the sum-certain amounts were too low. For the 2012-2013 biennium, however, auditors determined that ERS did not accurately reallocate \$4.77 million to 17 higher education institutions because of a

miscalculation. The miscalculation resulted in an error of approximately \$70,000 (with one higher education institution receiving approximately \$35,000 more than it should have received and the remaining 16 higher education institutions collectively receiving approximately \$35,000 less than they should have received).

### **Recommendation**

ERS should ensure that it accurately reallocates state group insurance contributions to higher education institutions at the end of each biennium.

### **Management's Response**

*ERS agrees and has implemented additional internal controls to address cause of error including additional verification procedures. ERS is coordinating with the Comptroller of Public Accounts to correct reported errors.*

*Implementation Date: Completed*

*Responsible Position: General Accounting Manager*

# Appendices

Appendix 1

## **Objective, Scope, and Methodology**

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### **Objective**

The objective of this audit was to determine whether the Teacher Retirement System (TRS), the Employees Retirement System (ERS), and the Office of the Comptroller of Public Accounts (Comptroller's Office) have developed and implemented controls, policies, and procedures for performing in a timely manner reconciliations and transfers of funds that are necessary to ensure that payments of benefit costs are proportional to a state agency's or a higher education institution's funding from appropriated funds and federal receipts.

### **Scope**

The scope of this audit covered the work that TRS, ERS, and the Comptroller's Office performed during the 2014-2015 biennium.

### **Methodology**

The audit methodology included conducting interviews with management and staff at TRS, ERS, and the Comptroller's Office; reviewing applicable laws, regulations, and accounting policy statements; reviewing the results of applicable TRS internal audits; reviewing previous State Auditor's Office reports regarding benefits proportionality; and performing selected tests and other procedures. This audit did not include work on information technology.

### **Data Reliability**

Auditors relied on previous State Auditor's Office audit work to determine that data in the following systems was sufficiently reliable for the purposes of this audit: the TRS General Accounting System, the TRS Reporting and Query System, the Comptroller's Office's Uniform Statewide Accounting System (USAS), and the Comptroller's Office's Texas Network for Electronic Transfers (TEXNET).

Auditors assessed the reliability of data in a spreadsheet that the Comptroller's Office used to track state entities that are required to submit an accounting policy statement 011 (APS 011) report for fiscal year 2014 by comparing the list of entities on that spreadsheet to the entities included in the General Appropriations Act for fiscal year 2014. Auditors determined that the list of entities on the spreadsheet was sufficiently reliable for the purposes of this audit.

Auditors assessed the reliability of data in a spreadsheet that ERS used to calculate reallocation amounts for each higher education institution for fiscal year 2013 by (1) tracing the amounts to the General Appropriations Act for fiscal year 2013 and the submitted APS 011 reports and (2) verifying the accuracy of the calculations in that spreadsheet. Auditors determined that the data was sufficiently reliable for the purposes of this audit; however, one miscalculation was identified (see Chapter 5 for additional details).

#### **Sampling Methodology**

To test a sample of the APS 011 reports for evidence of Comptroller's Office review, auditors used professional judgment to select a sample of 10 percent of those reports for testing. The sampled reports may not be representative of the population and, therefore, it would not be appropriate to extrapolate the test results to the population.

Information collected and reviewed included the following:

- The Comptroller's Office's APS 001, APS 005, and APS 011 and the associated reports.
- APS 011 reports that higher education institutions submitted for fiscal year 2013.
- Previous State Auditor's Office audit reports.
- Comptroller's Office, TRS, and ERS policies and procedures related to benefits processes.
- TRS's *Employer Review Program for Independent School Districts and Charter Schools* for October 2014 and a summary of the audit results.
- TRS's settle-up letter with the Comptroller's Office for fiscal year 2014 and associated supporting documentation.
- The Comptroller's Office's summary of higher education institutions' APS 011 reports for fiscal year 2013.
- ERS's spreadsheet for reallocation of group insurance for higher education institutions for fiscal year 2013 and associated supporting documentation.
- Selected USAS transactions.

Procedures and tests conducted included the following:

- Interviewed management and staff at the Comptroller's Office, TRS, and ERS.
- Reviewed the Comptroller's Office's APS 001, APS 005, and APS 011.

- Reviewed the results of TRS internal audits conducted on the accuracy of school district employer and employee pension contributions.
- Reviewed previous State Auditor’s Office reports regarding benefit proportionality.
- Reviewed applicable benefits proportional controls in place at the Comptroller’s Office.
- Tested a sample of the APS 011 reports that auditors selected using professional judgement for evidence of Comptroller’s Office review.
- Verified the accuracy of TRS’s General Revenue year-end settle-up for the pension contributions made to TRS.
- Verified the accuracy of ERS’s General Revenue reallocation of group insurance contributions among higher education institutions.

Criteria used included the following:

- Section 6.08, page IX-27, the General Appropriations Act (83rd Legislature).
- Rider 6(a), page III-39, the General Appropriations Act (82rd Legislature).
- The Comptroller’s Office’s APS 001, APS 005, and APS 011.
- The Comptroller’s Office’s APS 011 *Analysis Guide*.
- *Budget 101, A Guide to the Budget Process in Texas*, Texas Senate Research Center, January 2015.
- Legislative Budget Board’s *Benefits for State Employees and Public and Higher Education Employees* (October 2014).
- Senate Finance Higher Education Subcommittee interim report (December 2008).

## **Project Information**

Audit fieldwork was conducted from June 2015 through July 2015. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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

- Hillary Eckford, CIA (Project Manager)
- William Morris, CPA (Assistant Project Manager)
- John Barnhart
- Alejandra Moreno
- Michelle Rodriguez
- Shelby Rounsaville
- Sherry Sewell, CGAP
- Mary Ann Wise, CFE, CPA (Quality Control Reviewer)
- Angelica M. Ramirez, CPA (Audit Manager)

## Management's Response from the Comptroller's Office

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**Glenn Hegar**

Texas Comptroller of Public Accounts

September 1, 2015

John Keel, CPA  
State Auditor  
Texas State Auditor's Office  
1501 N. Congress Ave.  
Austin, Texas 78701

Dear Mr. Keel:

We are in receipt of the report, *An Audit Report on Benefits Proportionality at the Office of the Comptroller of Public Accounts*. We have reviewed the findings and recommendations and have enclosed our responses.

We appreciate your Office's evaluation of our processes and the related recommendations. We would like to thank your staff for their professionalism on this audit.

Please let me know if you have any questions or comments regarding our responses or planned actions.

Sincerely,



Mike Reissig  
Deputy Comptroller

Enclosure



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512-463-4444  
Toll Free: 1-800-531-5441 ext: 3-4444  
Fax: 512-463-4902

## Attachment

### OVERALL CONCLUSION

The Comptroller's office agrees with the recommendations in the audit report and will take steps to formalize and improve policies and procedures to ensure that payments of benefit costs comply with the requirements established in the General Appropriations Act (GAA).

We agree that there can be different interpretations of the proportionality requirements established in the GAA. We feel the interpretation currently followed by the Comptroller's office is responsive to the legislative direction contained in the rider. By requiring that state agencies and institutions of higher education pay for benefits in proportion to their methods of finance, the Comptroller's office ensures that the General Revenue Fund is not disproportionately used to fund employee benefits.

The table below shows the specific differences in the proportionality calculations for a hypothetical state agency that (1) receives 85 percent of its funding from General Revenue and 15 percent from local funds and (2) pays 95 percent of its salaries from its General Revenue funds and pays 5 percent from its local funds.

Table 1

Effect of the Differing Interpretations of the Proportionality Requirements <sup>a</sup>	
Benefits Paid Proportionately to the Appropriated Method of Finance	Benefits Paid from the Same Source of Funds Used to Pay the Respective Salary
General Revenue Fund pays for 85% of benefits	General Revenue Fund pays for 95% of benefits
Local Funds pay for 15% of benefits	Local Funds pay for 5% of benefits

<sup>a</sup> For an entity that:

- Receives 85 percent of its funding from General Revenue and 15 percent from local funds
- Pays 95 percent of its salaries from its General Revenue funds and pays 5 percent from local funds.

If the Legislature provides additional guidance on the requirements to pay benefits in proportion to the funds used to pay the associated salaries, the Comptroller's office will amend its policies and procedures accordingly.

### CHAPTER 1

These are Legislative recommendations and as such, we have no response.

## CHAPTER 2

We agree with the recommendations and will formalize and improve policies and procedures to ensure that analysis and monitoring of payments of employee benefits are effective, timely and consistent. Improvements to the process are underway and will be fully implemented by March 31, 2016, and will be the responsibility of the Fiscal Integrity Department Manager.

## CHAPTER 3

We agree with the recommendations and will formalize and improve policies and procedures to ensure that analysis and monitoring of payments of employee benefits are effective, timely and consistent. The Comptroller's office will continue to evaluate different ways to analyze available data. Improvements to the process are underway and will be fully implemented by March 31, 2016, and will be the responsibility of the Fiscal Integrity Department Manager.

## CHAPTER 4

The Comptroller's office will continue to evaluate necessary changes to the form used by state agencies and institutions of higher education to calculate the proportionality of their benefit payments, including the removal of the local funds adjustment for institutions of higher education. Additionally, the procedures for, and documentation of, the review process will be standardized and formalized. This process will be implemented by March 31, 2016, and will be the responsibility of the Fiscal Integrity Department Manager.

**Related State Auditor's Office Work**

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Related State Auditor's Office Work		
Number	Product Name	Release Date
15-002	An Investigative Report on the University of North Texas	September 2014
14-027	An Audit Report on Compliance with Benefits Proportional by Fund Requirements at Selected State Entities	March 2014
11-005	An Audit Report on Compliance with Benefits Proportional by Fund Requirements at Selected State Entities	September 2010
07-013	An Audit Report on Agencies' and Higher Education Institutions' Compliance with Benefits Proportional by Fund Requirements	February 2007

Copies of this report have been distributed to the following:

### **Legislative Audit Committee**

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

### **Office of the Governor**

The Honorable Greg Abbott, Governor

### **Office of the Comptroller of Public Accounts**

The Honorable Glenn Hegar, Comptroller of Public Accounts

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Mr. Doug Danzeiser, Vice Chair  
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Mr. Frederick E. Rowe, Jr.  
Mr. Porter Wilson, Executive Director

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Ms. Dolores Ramirez  
Mr. Brian Guthrie, Executive Director



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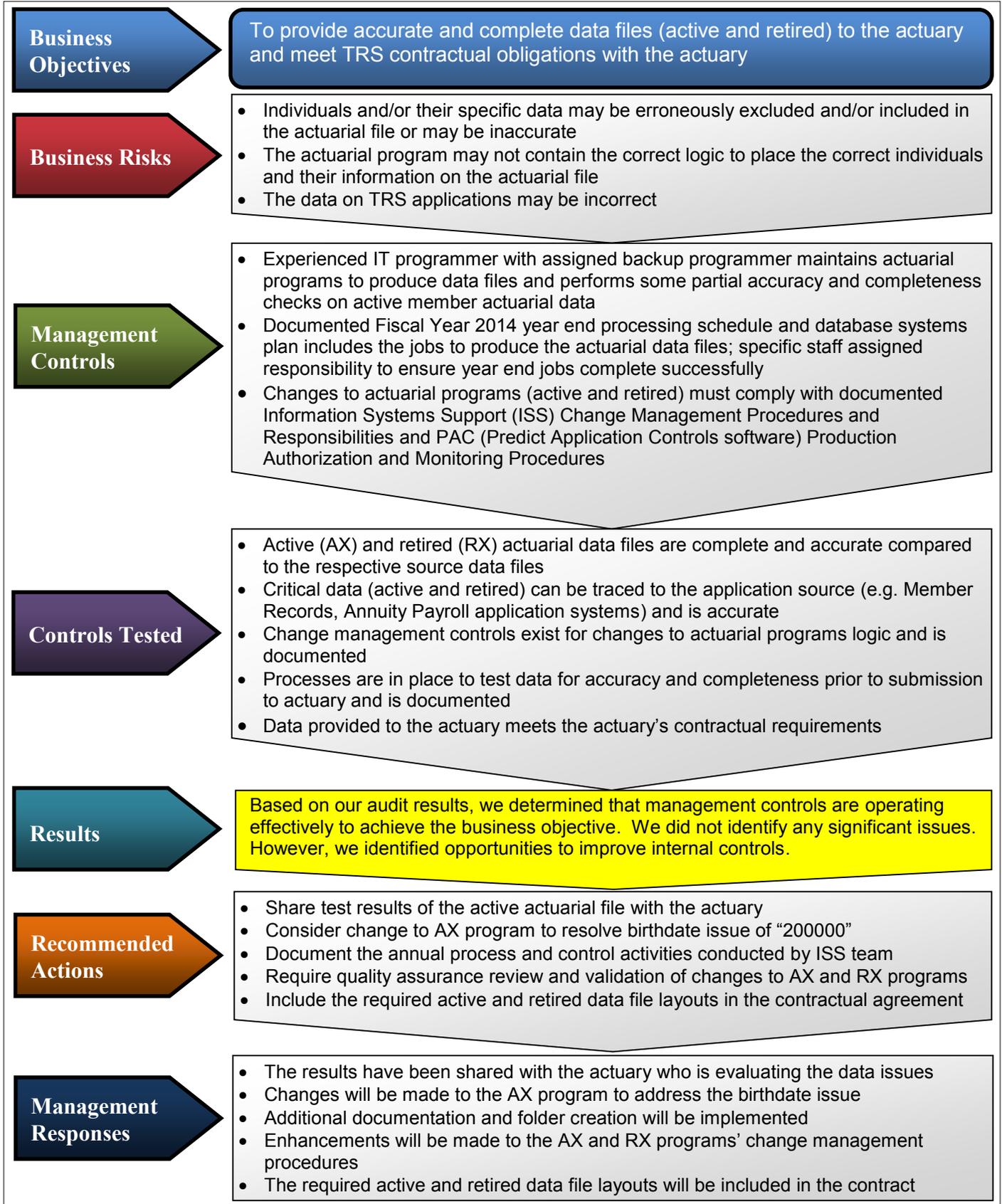
TAB 3

**TAB 3A**

# ACTUARIAL DATA CONTROLS PROJECT

November 13, 2015

TRS Internal Audit Department



Legend of Results:

Red  
Yellow

- Significant to TRS  
- Other Reportable Issue

Orange  
Green

- Significant to Business Objectives  
- Positive Finding or No Issue

November 13, 2015

Audit Committee, Board of Trustees  
Brian Guthrie, Executive Director

## EXECUTIVE SUMMARY

We have completed the audit of **Actuarial Data Controls** as included in the *Fiscal Year 2016 Audit Plan*. ***This is a carryover project from fiscal year 2015.*** The business objective related to the production of the actuarial data files is as follows:

- To provide accurate and complete data files (active and retired) to the actuary and meet TRS contractual obligations with the actuary

The audit objective was to assess whether internal controls are in place and working effectively to determine the accuracy and completeness of the fiscal year 2014 actuarial data files for the pension trust fund.

Based on our audit results, we determined that management controls are operating effectively to achieve the business objective. We did not identify any significant issues. However, we identified the following opportunities to improve controls:

- Document the annual process and control activities conducted by information systems programmers to produce and submit the actuarial data files to the actuary
- Enhance change management controls for changes to the active and retired actuarial programs which produce the actuarial files, and
- Include the required active and retired data file layouts in the contractual agreement with the actuary

Results of our procedures are presented in more detail in the **Results and Recommendations** section (page 4). The audit objective, scope, methodology and conclusion are described in **Appendix A** (pages 9-13).

## **BACKGROUND**

Gabriel, Roeder, Smith and Company (GRS) conducts the annual actuarial valuations for TRS and has provided these services for TRS for more than ten years. The current agreement with TRS is for the period September 1, 2013 through August 31, 2017 for GRS to provide actuarial valuation and pension consulting services for the TRS pension fund.

The primary purpose of the valuation report is to determine the adequacy of the current State contribution rate through measuring the resulting funding period, to describe the current financial condition and to analyze changes in the pension fund condition as of August 31 of each fiscal year. GRS calculates the defined benefit liability for one million plus TRS members and compares the results to the current assets contribution expectations to make sure the fund is actuarially sound. The valuation report also provides various summaries of the data.

In preparing the actuarial valuation, GRS relies upon member and asset data provided by TRS staff. GRS does not conduct any auditing procedures of this data but examines the data for reasonableness and for consistency with prior years' data. GRS also makes various assumptions including assumptions for active members' missing information such as birth dates and gender.

In order to produce the active and retired data for the actuary, one AX (active membership) Natural code program and two RX (retired membership) Natural code programs are run based on the fiscal year-end processing schedule and the success of the year-end closeout processing jobs. Documented fiscal year end processing schedule and database systems plan includes the jobs to produce the actuarial data files and specific staff are assigned responsibility to ensure year end jobs complete successfully. The AX and RX programs are modified as needed due to legislative, management, technical, or actuarial requirements. Changes to these programs are required to be initiated and implemented in compliance with documented Information Systems Support (ISS) Change Management Procedures and Responsibilities and Predict Application Control (PAC) Production Authorization and Monitoring Procedures. The data that these programs extract resides across multiple large files. The primary source data files for the AX program includes the member records file and TRS employees payment file. The primary source data files for the RX program includes benefits payee, annuity payment, and lump sum payment files. The fiscal year 2014 active (AX) actuarial data file included 1,063,373 records and the retired (RX) actuarial data file included 641,476 records.

An experienced Information Systems Support (ISS) programmer, along with an assigned backup programmer, maintains the actuarial programs to produce data files and performs some limited accuracy and completeness checks on active member actuarial data before the files are encrypted and sent through secure transmission to GRS and the State Auditor's Office. Upon sending the actuarial data files to GRS, the ISS programmer requests that GRS staff verify the file record counts and confirm counts back to him.

## BUSINESS OBJECTIVES, RISKS, AND CONTROLS

For the audit of the actuarial data controls, we obtained information about the following business objective, as well as the related risks and the controls management established to mitigate these risks:

<b>Business Objective</b>	To provide accurate and complete data files (active and retired) to the actuary and meet TRS contractual obligations with the actuary
<b>Business Risks</b>	<ul style="list-style-type: none"> <li>• Individuals and/or their specific data may be erroneously excluded and/or included in the actuarial file or may be inaccurate</li> <li>• The actuarial program may not contain the correct logic to place the correct individuals and their information on the actuarial files</li> <li>• The data on TRS applications may be incorrect</li> </ul>
<b>Management Controls</b>	<ul style="list-style-type: none"> <li>• Experienced IT programmer with assigned backup programmer maintains actuarial programs to produce data files and performs some partial accuracy and completeness checks on active member actuarial data</li> <li>• Documented Fiscal Year 2014 year end processing schedule and database systems plan includes the jobs to produce the actuarial data files; specific staff assigned responsibility to ensure year end jobs complete successfully</li> <li>• Changes to actuarial programs (AX and RX) must comply with documented ISS Change Management Procedures and Responsibilities and PAC Production Authorization and Monitoring Procedures</li> </ul>
<b>Controls Tested</b>	<ul style="list-style-type: none"> <li>• Active and retired actuarial data files are complete and accurate compared to the respective source data files</li> <li>• Critical data (active and retired) can be traced to the application source (e.g. Member Records, ANPA) and is accurate</li> <li>• Change management controls exist for changes to actuarial programs logic and is documented</li> <li>• Processes are in place to test data for accuracy and completeness prior to submission to actuary and is documented</li> <li>• Data provided to the actuary meets the actuary's contractual requirements</li> </ul>

# RESULTS AND RECOMMENDATIONS

## OVERALL RESULTS

Based on audit results, we determined that management controls are operating effectively to achieve the business objective. We did not identify any significant issues or errors. The positive test results as well as opportunities for management to improve internal controls are described below.

## POSITIVE RESULTS

### A. Fiscal Year 2014 AX (active membership) actuarial data files

A sample of 60 records from the fiscal year 2014 AX active member actuarial data file was randomly selected. For fourteen critical data fields listed below, the value from the AX file was compared to the value in the member ledgers application (LGRS).

- Fiscal year of best 5 salary 1
- Total annual salary of the first of best 5
- Fiscal year of best 5 salary 2
- Total annual salary of the second of best 5
- Fiscal year of best 5 salary 3
- Total annual salary of the third of best 5
- Fiscal year of best 5 salary 4
- Total annual salary of the fourth of best 5
- Fiscal year of best 5 salary 5
- Total annual salary of the fifth of best 5
- Birth date of member
- Year of entry
- Years of Service
- Accumulated Contributions

Results: No errors were found in the accuracy of the values for the fourteen critical data fields of the sample of 60 AX records compared to the values in the member ledgers application (LGRS).

### B. Fiscal Year 2014 RX (retired) actuarial data files

From a sample of 60 retirees, the values of the critical data fields in the RX actuarial data file were compared to the data values tested in the semi-annual benefit payment testing (project #14-101 and 15-101) or as applicable to the values in ANPA (annuity payroll) and/or DCLM (death claims) application systems. The following six critical data fields were tested:

- Years of Credited Service
- Average Salary (average of three highest annual salaries or 5 year average salary at time of retirement as applicable)
- Retirement Date - effective date of retirement of member/annuitant

- Death Date - death of member/annuitant
- Accumulated Contributions at retirement
- Benefit Payment Amount - monthly/Annual/Lump Sum of Annuity

Results: No errors were found in the accuracy of the values for the six critical data fields tested in the sample of 60 RX records on the actuarial data file.

## **SIGNIFICANT RESULTS<sup>1</sup>**

No significant issues and recommendations were identified.

## **OTHER REPORTABLE RESULTS**

### **1. Overall testing of AX actuarial data file population to source data files indicated some errors**

Review and testing of the fiscal year 2014 AX actuarial data file, by comparison of this file to fiscal year 2014 source data files (member records and TRS employees payment file) and analyzing the values between these files for the fourteen critical data fields, indicated some errors on the active actuarial file due to the way the AX program was converting certain data fields from the source files. Other results indicated one test record on the AX file, and duplicate records for TRS employees on the AX file due to the lack of interfaces on the legacy application systems and resulting records for TRS employees on member records. See **Appendix A**, pages 11-12, “Overall Testing of AX Actuarial Data File Population to Source Data Files” for detailed information.

### **Recommendations**

Due to the nature and the small number of the errors/data issues compared to the overall file population, these results do not appear to have a significant impact to the actuarial valuation. Several of these type of data results will be resolved when the new Pension Line of Business, TRUST, is implemented. However, there are some actions management should take in the interim:

- General Accounting management should discuss these results with the actuary for any possible impact to the actuarial valuations and to ensure that the actuary is aware of these data issues.
- Information Systems Support management should consider changes to the AX program so that the program does not convert birthdates of zero or blanks from member records to a year/month value of “200000” as a result of a “Year 2000” subroutine.

### **Management Responses**

- General Accounting management agrees with the recommendation and has shared the audit results with the actuary. The actuary is currently evaluating the identified data issues to

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<sup>1</sup> A significant result is defined as a control weakness that is likely to create a high risk of not meeting business objectives if not corrected.

determine any impact to the valuation. TRS will follow up with the actuary and discuss the results by January 31, 2016.

- B. Information Technology management agrees. A change request will be submitted and subsequent changes will be made to the AX program to address the birthdate issue as outlined in the recommendation. This change will be implemented by December 1, 2015.

**2. The annual process and control activities performed by the Information Systems Support (ISS) programmers for production and submission of the actuarial data files to the actuary are not completely documented**

Based on review of existing documentation and interviews with the ISS programmer, the annual process and control activities that the programmer performs, outside of the events documented on the fiscal year end processing schedule and the year-end database systems plan, to ensure the accuracy and completeness of the actuarial data files produced and sent to the actuary are not completely documented. Programmer verification of data accuracy on a sample basis on the active (AX) actuarial data files is not documented.

As a result, without documented procedures and outcomes of activities performed, ISS management and business users are not able to measure whether control activities are sufficient and occurring as expected for actuarial data files' process and activities.

**Recommendation**

Information Systems Support (ISS) management should take steps to enhance documentation of the significant process and control activities performed annually by the ISS programmer to produce and submit the actuarial data files to the actuary. Furthermore, a centralized network folder should be established for each year's actuarial data files' results and activities to allow the ISS team as well as appropriate business users to access this information as needed.

**Management Responses**

Information Technology management agrees. The additional documentation and folder creation as outlined in the recommendation will be completed and implemented by March 1, 2016.

**3. Changes to the AX (active) and RX (retired) actuarial data programs are not required to go through quality assurance review and validation**

We reviewed the last change made to the AX actuarial program in August 2014 prior to the production of the fiscal year 2014 actuarial data files. The EasyVista change documentation, PAC reports, and PAC emails were reviewed for compliance against the ISS Change Management Procedures and Responsibilities and EasyVista workflow, and the PAC Production Authorization and Monitoring procedures.

The change documentation demonstrated compliance with the ISS Change Management Procedures and PAC Procedures and Authorization with one exception. Business user acceptance was not obtained and documented in the EasyVista Change documentation.

Based on the overall test results and interviews with ISS management, changes to the AX and RX actuarial programs are not required to go through quality assurance review and validation.

As a result, errors in the programming logic could occur. The actuarial program may not contain the correct logic to place the correct individuals and their information on the actuarial file.

### **Recommendation**

Given criticality of AX and RX programs and resulting output actuarial data files used by the actuary and the State Auditor's Office, ISS management should implement change management procedures that involve the quality assurance team in the review and validation of changes to these critical programs. In addition, ISS management should emphasize to the ISS team that business user approval should be captured in the change request documentation as required by procedures.

### **Management Responses**

Information Technology (IT) management agrees about the critical nature of the AX and RX programs. However, historically, changes to these programs have been few and simple in nature. Given that and completely understanding the reasons behind the recommendation, IT management will implement the following enhancements to the AX and RX change management procedures; 1) simple changes will require a walk-thru of the program changes by the responsible IT programmer and several peer programmers ; 2) moderately complex changes will require a walk-thru of the program changes by the responsible IT programmer, several peer programmers and one or more Quality Assurance (QA) staff; 3) complex changes will require a walk-thru of the program changes by the responsible IT programmer, several peer programmers and one or more QA staff, along with subsequent testing by QA staff. ISS management will decide the level of complexity of the changes that relate to these procedures. These change management enhancements will be implemented immediately.

IT management agrees with following through with business user acceptance as outlined in the change management procedures.

#### **4. The current required data file layouts are not attached in the current contractual agreement with the actuary**

Gabriel, Roeder, Smith and Company (GRS) conducts the actuarial valuations for TRS. The current agreement between GRS and TRS is for the period September 1, 2013 through August 31, 2017. In section I.C. of the contract it states that "TRS and GRS agree to the following restrictions concerning extract data submitted by TRS to GRS for the actuarial valuation process:.....2. the extract data shall be submitted in formats for active members and retired members attached hereto as Data Layouts for Actuarial Valuations."

Upon review of the contract and further inquiry, we determined that the current data file layouts for the active member and retired member actuarial data files are not attached to the contract between GRS and TRS.

As a result, without the data file layouts and their definitions formally agreed upon between TRS and the actuary, it is possible that the data provided to the actuary may not meet the actuary's data requirements.

### **Recommendation**

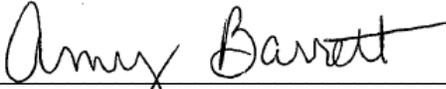
Executive management should include the required actuarial data file layouts with the actuarial contract the next time contract goes out for bid solicitation or when the required data file layouts are updated (whichever comes first).

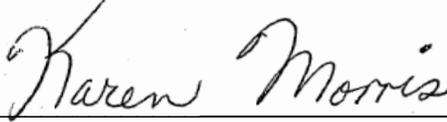
### **Management Responses**

Executive management agrees. The next time the contract goes out for bid solicitation or when the required data file layouts are updated, we will include the required actuarial data file layout as part of the actuarial contract. Estimated implementation date is September 30, 2016.

\* \* \* \* \*

We appreciate Information Technology, General Accounting, Benefit Services, and Executive management and staff for their cooperation, courtesy, and professionalism extended to us during this audit.

  
\_\_\_\_\_  
Amy Barrett, CIA, CPA, CISA  
Chief Audit Executive

  
\_\_\_\_\_  
Karen Morris, CIA, CRMA, CISA  
Director of Pension Audit Services

  
\_\_\_\_\_  
Dorvin Handrick, CISA, CDP  
IT Audit Manager

## APPENDIX A

### AUDIT OBJECTIVE, SCOPE, METHODOLOGY, AND CONCLUSION

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 assess whether internal controls are in place and working effectively to determine the accuracy and completeness of the fiscal year 2014 actuarial data files for the pension trust fund.

The business objective is to provide accurate and complete data files (active and retired) to the actuary and meet TRS contractual obligations with the actuary.

#### SCOPE

The scope of the audit included the fiscal year 2014 actuarial active and retired data files for the pension trust fund that were submitted to the actuary in September 2014.

The audit scope did not include the following:

- TRS-Care Trust Fund
- Government Accounting Standards Board (GASB) 68 data and related processes
- Fiscal year-end close out programs and processes that occur prior to the actuarial data files being produced
- Security controls surrounding the transmission of actuarial data files

#### METHODOLOGY

Our methodology included obtaining information on management's business objectives and risks, and focused on key processes and monitoring controls that management has established to address significant risks.

To meet the audit objective, we specifically performed the following procedures:

General:

- Obtained and reviewed copies of the AX6000, RX6000 and RX6010 Natural code programs and any associated documentation. Performed a desk review of these programs to gain an understanding of the key processes and to identify the key input files for creating the AX actuarial file.
- Interviewed the primary Information Systems Support programmer and other information technology personnel to gain an understanding of the activities he performs as well as the AX and RX programs, the source data files, and the actuarial data files.
- Requested and obtained extracts of the 2014 AX and RX actuarial data files and the associated file layouts, and obtained controls total for both files.
- Determined the completeness and accuracy of the AX and RX actuarial data files through control total checks and basic data integrity testing.
- Obtained data dictionaries for the primary source input files to the AX program.
- Identified key input fields in the primary source input files required for testing of completeness and accuracy of the primary source input files.
- In coordination with management, identified fourteen critical data files from the AX actuarial data file and six critical data fields from the RX data file to test accuracy.
- Mapped the fourteen critical key data fields from the source data files to the AX data file. Documented any intermediary processing/modification of the fields in the AX6000 program.
- Requested and obtained extracts of the AX and RX primary source data files and the associated file layouts. Obtained control totals for the primary source data files.
- For the AX file, determined the completeness and accuracy of the primary source data files through control total checks and basic data integrity testing.

Sample Testing of AX and RX Actuarial Data Files:

- Audit software, ACL, was used to select a random sample of 60 items from the AX file. The entire AX file population of 1,063,373 records was the sample population.
  - For each sampled member record, we traced the AX value for each critical data field tested to the value in member ledgers application, LGRS, to see if agreed. For any differences, we researched for explanations or determined if an error occurred. All results were positive.
- Sixty retirees were selected in the sample from the retiree test worksheets tested in Semi-annual Benefit Testing (project #14-101 and #15-101).
  - We compared the values of the selected critical data fields in the RX actuarial data files to the data values tested in semi-annual benefit payment testing or to the values in ANPA and/or DCLM. For any differences, we researched for explanations or determined if an error occurred. All results were positive.

Overall Testing of AX Actuarial Data File Population to Source Data Files:

Using audit software, ACL, fourteen critical data fields were matched to the corresponding data fields on the source data files, member records and TRS employee payment files. Review and testing of the fiscal year 2014 AX actuarial data file by comparison of this file to the source data files (member records and TRS employees payment file) and analyzing the values between these files for the fourteen critical data fields indicated the following:

	<b>Test Results</b>	<b>Explanation</b>	<b>Discussion outcome with management at fieldwork completion</b>
1.	<p>96 records were found on the FY 14 AX file where a TRS employee could potentially have two active records on the AX file - one from the TRS source file, TRS Employee Payments, with TRS Employee identifier coming from the “X Ref” number and one from TRS source file Member Records with identifier associated with the SSN. These records could appear as two different individuals to the actuary.</p> <p>30 of these 96 records have accumulated contributions and interest totaling \$500,698.13 and \$121,842.79, respectively. The remaining 66 records have zero balances in these fields.</p> <p>The “Entry Year” for these records appear to be the year it is “rehabbed” and not a true year of entry. The “Years of service” could be the years purchased or transferred and not total years of service.</p>	<p>Determined that the second record for TRS employees on the AX actuarial data file were created on TRS member records through a “rehab” process which is necessary when a TRS employee terminates TRS employment, buys back service, or transfers service from another TRS covered employer to TRS. Then the records have to be manually entered into TRSP (TRS Payroll System for TRS Employees). There is no interface between the TRSP and SSBB and Member records. TRS Payroll team, once they know a TRS Employee has purchased service, or transferred service, they can transfer the record into TRSP and zero out the account on member records but the records of the zero out account remains on member records for termination ledgers history purposes.</p>	<ul style="list-style-type: none"> <li>• Excel spreadsheets of the detailed records was provided to General Accounting to share with the actuary.</li> <li>• This issue will be resolved with the implementation of the new Pension Line of Business, TRUST. All TRS employees will be a member and there will not be a separate process outside of TRUST when the TRS employee terminates TRS employment, buys back service, or transfers service from another TRS covered employer to TRS.</li> </ul>

	<b>Test Results</b>	<b>Explanation</b>	<b>Discussion outcome with management at fieldwork completion</b>
2.	There are 16,951 records on the FY 14 AX file that have a member birthdate of "200000" due to way that AX Program is converting birthdates in a MMY format that a value of either "00 " or " " from the New Member Records file to a YYYYMM format on the AX file.	TRS AX program which produces the actuarial AX file is converting birthdates in a MMY format that a value of either "00 " or " " from the TRS source file "New Member Records" file to a YYYYMM format on the AX file.	<ul style="list-style-type: none"> <li>• This information was provided to General Accounting to share with the actuary.</li> <li>• ISS management stated this issue can be corrected through code change in the AX program so that a "Year 2000" subroutine is not used.</li> </ul>
3.	There are two different members that have records on the AX file with the same SSN.	Resulted from the way that TRS AX program is processing the SSNs for non-TRS employees and XR (cross-reference) numbers for TRS employees on the AX file.	This issue will go away with the new Pension Line of Business implementation. Every member will have a unique identifier and TRS employees will be treated within the new system as any other member with their own unique identifier.
4.	There is one Test Demo Record on the AX data file.	The test record exists on the TRS member records source file and the AX program is reading the member records source file to produce the AX data file.	After discussing with the ISS team, they researched and determined that this test record was no longer needed. They made the request in coordination with the respective business users to have this record deleted from the member records, and record was subsequently deleted.

#### Tests of Changes to the RX and AX Programs for Compliance with Procedures

- Determined if any changes to the AX Program and RX Program since January 2011. Requested from IT Technical support a detailed report that includes the before and after changes for the AX and RX library for the period January 1, 2011 to current date of this request.
- For the AX program, we determined one change to test - a change made August 28, 2014 to add the last reporting district.

- Tested the AX program change for compliance with ISS Change Management Procedures and Responsibilities, ISS Change Management Easy Vista Workflow, and the PAC Production Authorization and Monitoring procedures.
- Determined if the changes to the AX and RX program are required to go through quality assurance review and validation due to the criticality of the programs.

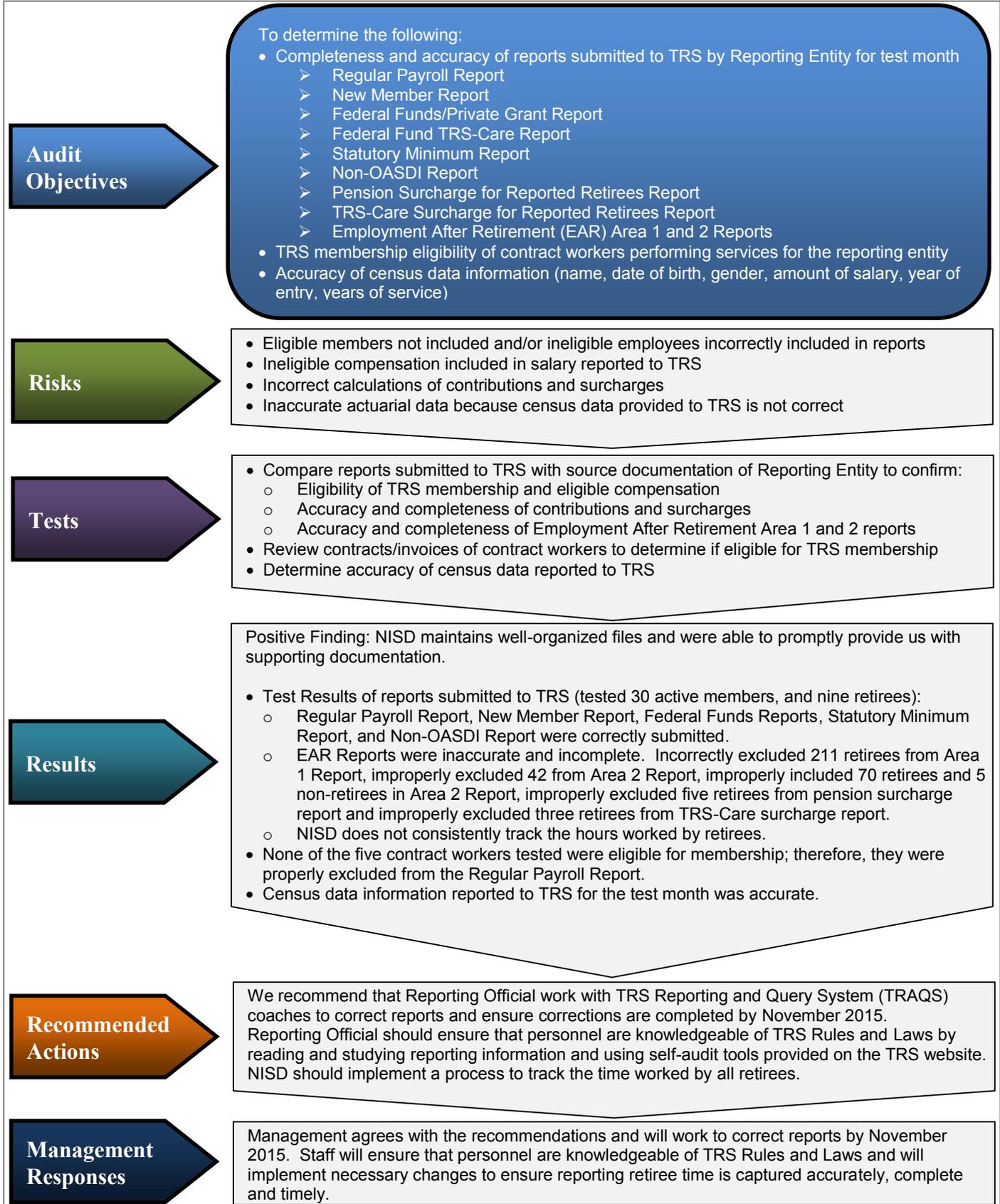
## **CONCLUSION**

Based on our audit work, we determined that management controls are operating effectively to achieve the business objective. We did not identify any significant issues or errors but identified the following opportunities to improve controls:

- document the annual process and control activities conducted by information systems programmers to produce and submit the actuarial data files to the actuary
- enhance change management controls for changes to the active and retired actuarial programs which produce the actuarial files, and
- include the required active and retired data file layouts in the contractual agreement with the actuary

**TAB 3B**

**AUDIT OF NORTHSIDE INDEPENDENT SCHOOL DISTRICT  
SAN ANTONIO  
October 29, 2015  
TRS Internal Audit Department**





October 29, 2015

Dr. Brian T. Woods  
Superintendent of Schools  
Northside Independent School District  
5900 Evers Road  
San Antonio, TX 78238

## AUDIT REPORT OF NORTHSIDE INDEPENDENT SCHOOL DISTRICT SAN ANTONIO

### EXECUTIVE SUMMARY

We have completed the audit of eligibility and contributions, as included in the *Fiscal Year 2015 Audit Plan*. Our audit objectives were to determine the following:

- Completeness and accuracy of the reports submitted to TRS by the Reporting Entity<sup>1</sup> for the test month
- Eligibility of contract workers performing services for the Reporting Entity for TRS membership
- Accuracy of census data information (name, date of birth, gender, amount of salary, year of entry, years of service)

Based on our audit results, we noted a positive finding that the Northside Independent School District San Antonio (NISD) maintains well-organized files and were able to provide us with supporting documentation.

We concluded the following:

- Employment After Retirement Reports were inaccurate and incomplete and NISD does not consistently track time worked for all retirees
- No contract workers performing services for the Reporting Entity were eligible for membership; therefore, they were properly excluded from the Regular Payroll Report
- Census data information reported to TRS was accurate

Refer to **Appendix B** for detailed results of testing.

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<sup>1</sup> A Reporting Entity is an employer, as defined in Texas Government Code, Title 8, Subtitle C, Chapter 821.001.

# BACKGROUND

## PROJECT BACKGROUND

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

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

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

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

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

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

## REPORTING ENTITY BACKGROUND<sup>2</sup>

Northside Independent School District, San Antonio, (NISD) is committed to the belief that children come first. The mission of the district is to encourage each student to strive for personal excellence and to ensure all students learn to function, contribute, and compete as responsible individuals in an ever-changing world.

NISD has an enrollment of 102,953 students and is the 4th largest district in Texas and the 27th largest district in the nation. More than 13,500 people are employed full-time by NISD, making it one of the largest employers in San Antonio. The District opens two to three schools each year to accommodate an enrollment that is growing by about 1,500 students per year. Altogether, NISD has 146 schools and support facilities that comprise 17.4 million square feet of space.

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<sup>2</sup> Information obtained from the ISD website and other internet sources.

Northside was established in 1949 when 12 rural school districts joined to form the 355-square-mile district that is today northwest San Antonio. The very first graduating class in 1951 had nine graduates. Today, more than 6,000 seniors cross the graduation stage each year. Almost 90 percent of NISD is in Bexar County. The rest is in Banderita and Medina counties.

For five straight years, NISD had a finalist for Texas Teacher of the Year and NISD was the first school district in the state to be honored by H-E-B Excellence in Education Awards. Since 1995, the Northside Education Foundation has awarded more than \$8 million in scholarships and teacher and program grants. Earlier this year, the Washington Post released their annual rankings of America's Most Challenging High Schools and nine Northside high schools made the 2015 list, including Communications Arts High School which was ranked in the top 100 nationally and top 30 in the state.

Northside's extensive energy management program has saved the District more than \$3.9 million in utility bills since 2010, and has collected more than \$3.3 million in CPS Energy rebates. NISD has made history by being recognized by the Environmental Protection Agency (EPA) as a member of the 2014 ENERGY STAR Certification Nation for certifying more than five buildings in 2014. In fact, NISD has ten schools that are EPA ENERGY STAR rated in 2014. NISD is the only school district in San Antonio to have ENERGY STAR Certified Schools.

## **RESULTS AND RECOMMENDATIONS**

### **OVERALL RESULTS**

#### **Positive Findings**

Based on our audit results, we noted a positive finding that the NISD maintains well-organized files and were able to provide us with supporting documentation.

#### **Other Findings**

We tested:

- Thirty of the population of 13,559 members reported to TRS in the Regular Payroll Report for the test month of February 2015
- Nine of the 71 retirees who performed services in February 2015
- 343 people reported in the Employment After Retirement Area 1 and 2 Reports
- Five employees paid in the test month who were not reported to TRS in the Regular Payroll Report

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

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

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

NISD improperly classified retirees in the Area 2 Report.

NISD does not consistently track the hours worked by retirees; thus, information to support the EAR reports is inaccurate and incomplete.

We tested five of the 10,333 payments made to vendors to determine if contract workers performing services were eligible for TRS membership and concluded that none of the five were eligible and were properly excluded from the Regular Payroll Report.

Census data information reported to TRS was accurate.

## RECOMMENDATION

The Reporting Official should work with the TRS Reporting and Query System (TRAQS) coaches to correct the reports and ensure that corrections are completed by November 2015.

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

NISD should implement a process to track the time worked by all retirees.

## MANAGEMENT RESPONSES

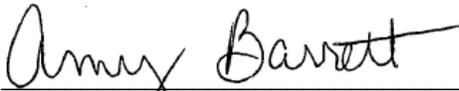
We concur with the recommendations made by Internal Audit. We will work with our TRAQS coach to adjust the reports. We plan to have the adjustments completed within the time frame recommended by TRS.

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

We will review our process to track time worked by retirees. We will make and implement necessary changes to ensure reporting retiree time is captured accurately, complete and timely.

\* \* \* \* \*

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



Amy Barrett, CIA, CPA, CISA  
Chief Audit Executive



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



Art Mata, CEBS, CPM  
Internal Audit Consultant

cc: Northside ISD Board of Trustees

## APPENDIX A

### AUDIT OBJECTIVE, SCOPE, METHODOLOGY, AND CONCLUSION

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

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

#### AUDIT OBJECTIVE

Our audit objectives were to determine the following:

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

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

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

#### SCOPE

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

- Thirty of the population of 13,559 members reported to TRS in the Regular Payroll Report for the test month of February 2015
- Nine of the 71 retirees who performed services in February 2015
- 343 people reported in the Employment After Retirement Area 1 and 2 Reports
- Five employees paid in the test month who were not reported to TRS in the Regular Payroll Report

With the exception of the superintendent's salary, we did not test whether salary amounts were authorized by the Board of Trustees.

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

## METHODOLOGY

We specifically performed the procedures below.

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

## CONCLUSION

Based on our audit results, we noted a positive finding that the Northside Independent School District (NISD) maintains well-organized files and were able to provide us with supporting documentation.

We concluded the following:

- Employment After Retirement Reports were inaccurate and incomplete
- No contract workers performing services for the Reporting Entity were eligible for membership; therefore, they were properly excluded from the Regular Payroll Report
- Census data information reported to TRS was accurate

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

## APPENDIX B

### NORTHSIDE ISD

### DETAIL OF ADJUSTMENTS TO REPORTS

**Population, sampling, and overview of test results:**

Test month: February 2015

**SECTION 1** Tested 30 of 13,559 total members reported to TRS in the test month for eligibility and accuracy of contributions.

Test results - no exceptions.

Tested five of the 2,565 employees not reported to TRS for the test month.

Test results - no exceptions.

Tested five of the approximately 10,333 payments made to vendors during the test month to determine TRS eligibility.

Test results - no exceptions.

**SECTION 2** Tested nine of the 71 retirees that worked in the test month in a position other than a substitute to determine if worked more than half-time and surcharges owed.

Test results - no exceptions; however, management disclosed that five other retirees of the 71 that worked in the test month worked more than half-time and were improperly excluded from the pension surcharge report and that three of these five retirees were improperly excluded from the TRS-Care surcharge report. Surcharges are due to TRS.

**SECTION 3** Tested 343 people reported on the Employment After Retirement Area 1 and 2 Reports.

Test results - 211 retirees were improperly excluded from the Area 1 report. In the Area 2 report, 42 retirees were improperly excluded and 75 were improperly included.

**SECTION 1**

MEMBER CONTRIBUTIONS TO PENSION FUND	REPORT TOTAL	UNDER STATED	OVER STATED	REVISED REPORT TOTAL	% ERROR
No exceptions	\$ 3,372,072.66	\$ -	\$ -	\$ 3,372,072.66	0%

MEMBER CONTRIBUTIONS TO TRS-CARE	REPORT TOTAL	UNDER STATED	OVER STATED	REVISED REPORT TOTAL	% ERROR
No exceptions	\$ 327,141.35	\$ -	\$ -	\$ 327,141.35	0%

REPORTING ENTITY CONTRIBUTIONS TO TRS-CARE	REPORT TOTAL	UNDER STATED	OVER STATED	REVISED REPORT TOTAL	% ERROR
No exceptions	\$ 276,811.25	\$ -	\$ -	\$ 276,811.25	0%

NEW MEMBER REPORT	REPORT TOTAL	UNDER STATED	OVER STATED	REVISED REPORT TOTAL	% ERROR
No exceptions	\$ 38,280.89	\$ -	\$ -	\$ 38,280.89	0%

FEDERAL FUNDS/PRIVATE GRANT REIMBURSEMENT TO STATE REPORT	REPORT TOTAL	UNDER STATED	OVER STATED	REVISED REPORT TOTAL	% ERROR
No exceptions	\$ 219,608.77	\$ -	\$ -	\$ 219,608.77	0%

FEDERAL FUNDS REIMBURSEMENT TO TRS-CARE	REPORT TOTAL	UNDER STATED	OVER STATED	REVISED REPORT TOTAL	% ERROR
No exceptions	\$ 32,521.69	\$ -	\$ -	\$ 32,521.69	0%

<b>STATUTORY MINIMUM REPORT</b>	<b>REPORT TOTAL</b>	<b>UNDER STATED</b>	<b>OVER STATED</b>	<b>REVISED REPORT TOTAL</b>	<b>% ERROR</b>
No exceptions	\$ 743,071.65	\$ -	\$ -	\$ 743,071.65	0%

<b>NON-OASDI REPORT</b>	<b>REPORT TOTAL</b>	<b>UNDER STATED</b>	<b>OVER STATED</b>	<b>REVISED REPORT TOTAL</b>	<b>% ERROR</b>
No exceptions	\$ 582,936.62	\$ -	\$ -	\$ 582,936.62	0%

**SECTION 2**

<b>PENSION SURCHARGE FOR RETIREES REPORT</b>	<b>TOTAL REPORTED</b>	<b>UNDER STATED</b>	<b>OVER STATED</b>	<b>REVISED REPORT TOTAL</b>	<b>% ERROR</b>
Improperly excluded and did not pay contributions on five members		\$ 1,006.29			
	\$ -	\$ 1,006.29	\$ -	\$ 1,006.29	100%

<b>TRS-CARE SURCHARGE FOR RETIREES REPORT</b>	<b>REPORT TOTAL</b>	<b>UNDER STATED</b>	<b>OVER STATED</b>	<b>REVISED REPORT TOTAL</b>	<b>% ERROR</b>
Improperly excluded and did not pay contributions on three members		\$ 2,821.00			
	\$ -	\$ 2,821.00	\$ -	\$ 2,821.00	100%

**SECTION 3**

<b>EMPLOYMENT AFTER RETIREMENT AREA 1 AND 2 REPORT</b>	<b>REPORT TOTAL</b>	<b>UNDER STATED</b>	<b>OVER STATED</b>	<b>REVISED REPORT TOTAL</b>	<b>% ERROR</b>
Improperly excluded 211 retirees from Area 1 Report					
Improperly included 70 retirees in Area 2 Report					
Improperly excluded 42 retirees from Area 2 Report					
Improperly classified retirees in Area 2 Report					
Improperly included 5 non-retirees in Area 2 Report	N/A	N/A	N/A	N/A	
<b>GRAND TOTALS</b>	\$ 5,592,444.88	\$ 3,827.29	\$ -	\$ 5,596,272.17	0.07%

**TAB 3C**

## QUARTERLY INVESTMENT TESTING

### INVESTMENT POLICY STATEMENT (IPS), SECURITIES LENDING POLICY (SLP), EMPLOYEE ETHICS POLICY, CODE OF ETHICS FOR CONTRACTORS, PERFORMANCE INCENTIVE PAY PLAN (PIP), AND WIRE TRANSFER PROCEDURES, CALENDAR QUARTER ENDED SEPTEMBER 30, 2015

<b>Business Objectives</b>	<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, PIP, wire transfers)</u> Policies and procedures are followed for other investment programs and activities</p>	<p>4. <u>Ethics Policies</u> Ethics filing and reporting requirements are met</p>
<b>Business Risks</b>	Board is not informed of key investment decisions and critical information	Approvals and fundings exceed delegated limits	Risks exceed Board established tolerances or established procedures are not followed	Ethics policy requirements are not performed or filed
<b>Management Assertions</b>	All required reports are made to the Board	Approvals and fundings are within limits and made for qualified managers	Programs are within risk limits and activities follow established policies and procedures	Ethics policies and requirements are being followed
<b>Agreed-Upon Procedures</b>	<ul style="list-style-type: none"> <li>Compare Board reports to IPS requirements</li> </ul>	<ul style="list-style-type: none"> <li>Vouch Internal Investment Committee (IIC) approved investments to supporting documentation</li> <li>Verify approval limits of new investments</li> </ul>	<ul style="list-style-type: none"> <li>Verify monitoring of the securities lending agent and the program performance</li> <li>Test accuracy of PIP calculations for the quarter ended June 30, 2015</li> <li>Test supporting documentation for wire transfers</li> </ul>	<ul style="list-style-type: none"> <li>Obtain evidence that financial disclosures were made to the Texas Ethics Commission</li> <li>Obtain evidence that financial service providers disclosed conflicts</li> </ul>
<b>Test Results</b>	<ul style="list-style-type: none"> <li>All reporting requirements tested are met</li> <li>Documentation provides support for reports tested</li> </ul>	<ul style="list-style-type: none"> <li>All supporting documentation exists</li> <li>All investments tested were in compliance with approval limits</li> </ul>	<ul style="list-style-type: none"> <li>All other requirements of the IPS, SLP, PIP, wire transfer procedures, etc. tested are met</li> </ul>	<ul style="list-style-type: none"> <li>All ethics filing and training requirements tested are met.</li> </ul>
<b>Management Responses</b>	None	None	None	None

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



November 10, 2015

Carolina de Onis, TRS General Counsel

We have completed the **Quarterly Investment Testing** of compliance with the requirements of the Investment Policy Statement (IPS), Securities Lending Policy (SLP), Employee Ethics Policy, Code of Ethics for Contractors, Performance Incentive Pay Plan, and procedures for wire transfers as included in the *Fiscal Year 2016 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 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**.

### **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.



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Amy Barrett, CIA, CPA, CISA  
Chief Audit Executive



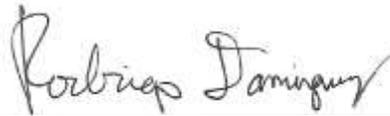
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Hugh Ohn, CFA, CPA, CIA, FRM  
Director of Investment Audit Services



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Nick Ballard, CFA, CPA  
Senior Investment Auditor



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Rodrigo Dominguez  
Internal Audit Intern

**APPENDIX A**  
**AGREED-UPON PROCEDURES AND RESULTS**

STEP #	OBJ. #	TEST PURPOSE	TEST DESCRIPTION	TEST RESULT	MANAGEMENT RESPONSE
1	1	IPS Article 1.7 - Verify that all requirements were reported to Board of Trustees. Quarterly reporting requirements include investment performance, asset class exposures, and external investments under consideration. Semiannual reports include outstanding derivatives, leverage, liquidity positions, and risk limits	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	2	IPS Article 2.6 – Verify that Investment Management Division (IMD) evaluated hedge fund classification	<ul style="list-style-type: none"> <li>• Select sample of approved investments in hedge funds and external managers</li> <li>• Obtain analysis indicating whether each investment is hedge fund or not. If analysis is unavailable, inconclusive, or erroneous, report that result</li> <li>• For any analysis requiring Board approval of classification, obtain Board minutes to test whether approval was obtained</li> </ul>	Each of approved investments in hedge funds and external managers tested had analysis indicating whether investment was a hedge fund or not. No Board approval was required.	No response required
3	2	<p>IPS Article 2.7a – Verify that the Internal Investment Committee (IIC) approved all private and relevant public markets fund investments</p> <p>IPS Article 2.7g – Verify funds added to previously approved investments for purposes of rebalancing or adjusting risk did not exceed 2% of associated portfolios</p>	<ul style="list-style-type: none"> <li>• For the private and public markets funds approved during the quarter, obtain existence of IIC approval</li> <li>• Inquire with Director of External Public Markets whether portfolios were adjusted for the purposes of rebalancing or adjusting risks</li> <li>• If funds added, test if such additional investments or allocations did not exceed 2% of Hedge Fund Portfolio, External Manager Portfolio, or Other Absolute Return Portfolio (as appropriate) per investment on a monthly basis</li> <li>• Obtain documentation from IMD staff supporting rebalancing analytics.</li> </ul>	<p>IIC approval existed for all funds approved during the quarter.</p> <p>Funds added to previously approved investments or purposes of rebalancing or adjusting risk did not exceed 2% of associated portfolios.</p>	No response required

STEP #	OBJ. #	TEST PURPOSE	TEST DESCRIPTION	TEST RESULT	MANAGEMENT RESPONSE
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"> <li>• Each is independent private investment management firm with less than \$2 billion in assets under management</li> <li>• Each has a performance track record as a firm of less than 5 years, or both</li> <li>• TRS commitment did not exceed 40% of fund size</li> </ul>	All emerging managers tested during this time period were in compliance with this provision	No response required
5	3	IPS Article 10.3d – Obtain evidence of IMD’s examination of requirements of its securities lending agent	Obtain monthly securities lending review reports for the quarter to test whether the securities lending agent is an organization rated A- or better by a Nationally Recognized Statistical Rating Organization (NRSRO)	The rating for the TRS securities lending agent was A- or better per Moody’s, Fitch, and Standard and Poor’s	No response required
6	2	IPS Article 10.9 – Verify leverage used meets requirements	<ul style="list-style-type: none"> <li>• Obtain leverage report provided to the TRS Board and compare reported leverage uses to leverage use allowed by the IPS</li> <li>• Inquire whether risk parameters were exceeded and if so, was the limit caused by leverage</li> </ul>	Leverage was used only as authorized and no risk parameters were exceeded.	No response required
7	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"> <li>• For each investment selected for testing, test whether IMD obtained responses to the questionnaire</li> <li>• Obtain transparency reports to test whether IMD compiled responses to the questionnaires and reported all results to Board at least semi-annually</li> </ul>	Each investment tested had a completed questionnaire and was included in the summary report to the Board	No response required
8	2	IPS Appendix B – Verify investments approved are within policy limits	<ul style="list-style-type: none"> <li>• 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"> <li>a) Initial allocation: 0.50%</li> <li>b) Additional or follow-on: 1%</li> <li>c) Total Manager Limits: 3%</li> <li>d) Total limit each manager organization: 6%</li> </ol> </li> <li>• Obtain documentation from IMD staff that supports the calculations of the authorized limits</li> <li>• Inquire if any “Special Investment Opportunities” were made for the quarter. If Special Investment Opportunities</li> </ul>	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
			were made, obtain evidence that the Executive Director was notified and that the Opportunity was communicated to the TRS Board. Also, obtain evidence that the amount of the opportunity was \$1 billion or less.		
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, and test that supporting documentation, including manager authorizations, exists for each	All wire transfers tested were properly authorized and correct amounts were wired.	No response required
10	3	Securities Lending Policy – Verify IMD review of securities lending program and performance of lender	Obtain evidence for the following securities lending policy requirements: a) TRS loaned only eligible securities (i.e. domestic and international equity and fixed income securities). Additionally the TRS prime broker is prohibited from lending securities. b) Collateral received from borrowers was in the form of cash or government securities. c) Cash collateral received was invested in a collective trust that is qualified for exemption from taxation; or, if approved by the CIO, (1) in any open-ended money market fund managed by a registered investment advisor or (2) any short-term money market investment collective trust fund of which the current TRS bank custodian or securities lending agent is the trustee (no more than 10% of cash collateral may be invested in #2).	a) TRS loaned only eligible securities. Additionally, prime broker contract prohibited the TRS prime broker from lending securities. b) All collateral received was cash or government securities. c) Cash collateral was only invested in a collective trust that was qualified for exemption from taxation.	No response required
11	4	Employee Ethics Policy – Verify that the Executive Director filed a personal financial statement with the Texas Ethics Commission	Obtain evidence that the TRS Executive Director filed a personal financial statement with the Texas Ethics Commission for the year ended December, 31, 2014. Ensure that that the filing was made prior to the April 30 <sup>th</sup> deadline.	The Executive Director’s 2014 personal financial statement was filed with the Texas Ethics Commission. The document was dated prior to the April 30 <sup>th</sup> deadline.	No response required

STEP #	OBJ. #	TEST PURPOSE	TEST DESCRIPTION	TEST RESULT	MANAGEMENT RESPONSE
12	4	Code of Ethics for Contractors – Verify that all TRS brokers, financial advisors, and financial service providers filed annual disclosure statements with the TRS General Counsel.	<p>Obtain evidence that all TRS brokers, financial advisors, and financial service providers complied with the Code of Ethics for Contractors by filing annual disclosure statements with the TRS General Counsel. Annual filing deadline is April 30<sup>th</sup>.</p> <p>Obtain listing of disclosure statements received from TRS brokers, financial advisors, and financial service providers for calendar year 2014. Compare this list to the listing of all service providers to ensure completeness.</p> <p>Select a sample of contractors and obtain copies of the disclosure statements for each contractor selected.</p>	Listing of disclosure statements was validated, and all disclosure statements were signed and dated prior to the April 30, 2015 due date. No selected contractors noted conflicts.	No response required
13	3	Performance Incentive Pay Plan – Verify that investment performance results used in quarterly Internal Public Markets (IPM) portfolio matches data from TRS financial applications and custodian bank and that the excess return calculations for individual portfolio managers and sector analysts are correct.	<p>Trace quarterly IPM individual component calculation spreadsheet to TRS financial performance application data and TRS custodian bank data.</p> <p>Test whether employee assignments were approved by Senior Director in TRS IPM prior to quarter start by obtaining approval email from Senior Director in TRS IPM to Investment Operations Performance Analyst. If any assignment changes are included in the approval, compare the approved changes to the assignments in the quarterly IPM individual component calculation spreadsheet.</p> <p>Test whether formulas in the quarterly IPM individual component calculation spreadsheet are correct by recalculating investment return totals by portfolio manager and sector manager, and comparing total investment returns to returns provided by the TRS Custodian Bank.</p>	There were no data, employee assignment, or formula errors included in the quarterly IPM individual component calculation spreadsheet. Thus, excess return calculations for individual portfolio managers and sector analysts for the IPM portfolio were correct for the quarter ended September 30, 2015.	No response required

**Note: Testing procedures for the Investment Policy Statement (IPS), Securities Lending Policy (SLP), Employee Ethics Policy, Code of Ethics for Contractors, and Wire Transfer are for the quarter ended September, 30, 2015. Testing procedures for the Performance Incentive Pay Plan are for the quarter ended June 30, 2015.**

**TAB 4**

**TAB 4A**

# **Internal Audit Annual Report**

## **Fiscal Year 2015**

**October 2015**



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

# **TEACHER RETIREMENT SYSTEM OF TEXAS**

## **BOARD AUDIT COMMITTEE (As of October 15, 2015)**

Christopher Moss, Chair  
T. Karen Charleston  
David Corpus  
Anita Smith Palmer  
Nanette Sissney

## **BOARD MEMBERS (As of October 15, 2015)**

R. David Kelly, Chair  
Nanette Sissney, Vice Chair  
Todd Barth  
T. Karen Charleston  
Joe Colonna  
David Corpus  
Christopher Moss  
Anita Smith Palmer  
Dolores Ramirez

## **EXECUTIVE DIRECTOR**

Brian Guthrie

## **INTERNAL AUDIT DEPARTMENT**

Amy L. Barrett, CIA, CISA, CPA, Chief Audit Executive  
Karen Morris, CIA, CISA, CRMA, Director of Pension Audit Services  
Jan Engler, CIA, CISA, CFE, Audit Manager  
Lih-Jen Lan, CIA, CPA, CISA, CISSP, CCSA, Information Technology (IT)  
Audit Manager  
Hugh Ohn, CFA, CPA, CIA, FRM, Director of Investment Audit Services  
Dinah G. Arce, CIA, CPA, CFE, CIDA, Senior Auditor  
Toma Miller, CIA, CGAP, Senior Auditor  
Dorvin Handrick, CISA, IT Audit Manager  
Nick Ballard, CFA, CPA, Senior Investment Auditor  
Art Mata, CEBS, CPM, Senior Internal Audit Benefit Consultant  
Carol Casey, CPM, Internal Audit Benefit Consultant  
Rodrigo Dominguez, Intern

October 15, 2015

Honorable Greg Abbott, Governor  
Members of the Legislative Budget Board  
Members of the Sunset Advisory Commission  
Mr. John Keel, CPA, State Auditor  
Mr. R. David Kelly, Chair, TRS Board of Trustees  
Mr. Christopher Moss, Chair, TRS Board Audit Committee  
Members of the Board of Trustees, Teacher Retirement System of Texas  
Mr. Brian Guthrie, Executive Director, TRS

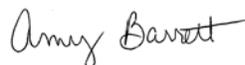
Attached is the annual report of the Internal Audit department of the Teacher Retirement System of Texas (TRS). This report provides information on the audit plan, assurance, consulting, and advisory projects completed, and other Internal Audit activities. It also meets the annual reporting requirement of the Texas Internal Auditing Act (Government Code, Chapter 2102.009 and Texas Government Code, Sections 2102.015 and 2102.0091). This report includes the following State Auditor's Office reporting guidelines.

- I. Compliance With Texas Government Code, Section 2102.015: Posting the Internal Audit Plan, Internal Audit annual report, and Other Audit Information on Internet Website
- II. Compliance with the Benefits Proportionality Audit Requirements for Higher Education Institutions
- III. Internal Audit Plan for Fiscal Year 2015
- IV. Consulting Services and Nonaudit Services Completed
- V. External Quality Assurance Review (Peer Review)
- VI. Internal Audit Plan for Fiscal Year 2016
- VII. External Audit Services Procured in Fiscal Year 2015
- VIII. Reporting Suspected Fraud and Abuse

The work performed by TRS Internal Audit contributes toward accountability, integrity, and good management practices within TRS operations. Fiscal year 2015 projects contributed to the improvement of risk management, control, and governance processes. Internal Audit (or those engaged by Internal Audit) issued 10 assurance and 6 agreed-upon procedures reports, followed-up and reported quarterly on the status of all outstanding audit recommendations, and performed advisory services in various areas including TEAM (TRS Enterprise Application Modernization) Program initiatives.

For further information about the contents of this report or to request copies of Internal Audit reports, please contact Amy Barrett at (512) 542-6559.

Sincerely,



Amy L. Barrett, CIA, CISA, CPA  
Chief Audit Executive

cc: Executive Council Members  
Internal Audit Staff Members

**TEACHER RETIREMENT SYSTEM OF TEXAS**

**INTERNAL AUDIT ANNUAL REPORT**

**FISCAL YEAR 2015**

**October 2015**

**I. Compliance With Texas Government Code, Section  
2102.015:  
Posting the Internal Audit Plan, Internal Audit Annual  
Report, and Other Audit Information on Internet Website**

## **Section 1: Texas Internal Auditing Act – Compliance with House Bill 16: Publication of Internal Audit Plan, Internal Audit Annual Report, and Other Audit Information on Internet Website**

House Bill 16 (83rd Legislature, Regular Session) amended the Texas Internal Auditing Act, by adding section 2102.015, which requires state agencies and institutions of higher education, as defined in the bill, to post agency internal audit plans and internal audit annual reports on the agency's internet website within 30 days of approval. House Bill 16 also requires entities to update the posting on the Internet to include a.) a detailed summary of the weaknesses, deficiencies, wrongdoings, or other concerns raised by the audit plan or annual report and b.) a summary of the actions taken to address concerns, if any, that are raised by the audit plan or annual report.

TRS Internal Audit follows the following procedures to ensure compliance with the requirements of House Bill 16:

- The **TRS Annual Internal Audit Plan** is approved each fiscal year by the TRS Board of Trustees as recommended by the TRS Audit Committee. The annual audit plan, as approved by the TRS Board of Trustees, is provided by Internal Audit staff to the TRS Website coordinators and posted to the TRS Website within 30 days of approval.
- The **TRS Internal Audit Annual Report** is prepared annually by Internal Audit staff in accordance with the Texas State Auditor's Office guidelines by the required deadline. This report, once approved by the Chief Audit Executive, is submitted to the Governor, the Legislative Budget Board, the Sunset Advisory Commission, the State Auditor's Office and the TRS' Board of Trustees by November 1<sup>st</sup> of each fiscal year. The annual report is provided by Internal Audit staff to the TRS Website coordinators to post to the TRS Website.
- **Summaries of the weaknesses, concerns, and actions** taken to address concerns in the audit plan or annual report are provided by Internal Audit in the quarterly TRS Audit Committee materials. The audit committee materials provide audit reports completed during each quarter, quarterly status reports on management action on outstanding audit recommendations, and the status of the current fiscal year audit plan. The individual audit reports provide the results, recommendations, and management actions taken to address the audit recommendations. The TRS Audit Committee materials are posted to the TRS Website, after dissemination to TRS Board of Trustees, through an administration process of board and committee materials prior to the scheduled board meeting.

**II. Compliance with the Benefits Proportionality Audit Requirements for Higher Education Institutions**

Not applicable to TRS

### **III. Internal Audit Plan for Fiscal Year 2015**

<b>Title and Project #</b>	<b>Type</b>	<b>Status</b>
<b>Executive</b>		
University of Texas Students' Projects (15-606A)	Consulting	<b>Complete</b>
Internal Ethics and Fraud Hotline Administration	Advisory	<b>Complete</b>
Meetings Participation	Advisory	<b>Complete</b>
Special Requests	Advisory	<b>Complete</b>
<b>Finance</b>		
Payables Audit (15-403)	Audit	<b>Complete</b>
Actuarial Data Controls (14-402)	Audit	<b>In Progress; to be reported in November 2015</b>
Reporting Entity Audits and Investigations (15-401)	Audit	<b>Complete</b>
Business Process Analysis of Activities Involving Multiple Departments (15-404)	Consulting	<b>Complete</b>
TRS Reporting Entity Website Audit Information	Advisory	<b>Complete</b>
State Auditor's Office (SAO) Financial (CAFR) Audit Coordination	Advisory	<b>Complete</b>
Meetings Participation	Advisory	<b>Complete</b>
Special Requests and Surprise Inspections	Advisory	<b>Complete</b>
<b>TEAM Program</b>		
TEAM Program Internal Controls Assessment (15-601)	Advisory	<b>Delayed Due to LOB Project Schedule Delay; planned for FY 16</b>
TEAM Independent Program Assessment (IPA) Vendor Support	Advisory	<b>Ongoing - FY 16</b>
TEAM Committees and TEAM Projects Participation	Advisory	<b>Ongoing - FY 16</b>
<b>Pension Benefits</b>		
Follow-Up Audit on Significant Findings of Prior Benefits Audits (15-102)	Audit	<b>Complete</b>
Benefits Testing for State Auditor's Office (SAO) Audit of Comprehensive Annual Financial Report (CAFR) (15-100)	Audit	<b>Complete</b>
Semi-Annual Benefits Testing (11-501)	Agreed-Upon Procedures	<b>Complete</b>
<b>Health Care</b>		
Health Care Audit Services Review	Advisory	<b>Complete</b>

<b>Title and Project #</b>	<b>Type</b>	<b>Status</b>
Health Care Vendor Selection Observation	Advisory	<b>In Progress</b>
Health Care Vendor Update Meetings	Advisory	<b>Complete</b>
<b>Information Technology</b>		
Records Management (titled Electronic Records in FY 2015 Audit Plan) (15-501)	Audit	<b>Complete</b>
Cloud Computing, Mobile Device Security, Co-Location/Disaster Recovery, IT Security	Consulting and Advisory	<b>Complete</b>
Network Penetration Test; Security Risk Assessment Review	Advisory	<b>Complete</b>
Technology Committees Meeting Participation	Advisory	<b>Complete</b>
<b>Investment Management</b>		
Overall Internal Control Opinion on Investment Activities (includes periodic status reports) (15-301)	Audit	<b>Complete</b>
Quarterly Investment Compliance and Ethics Policies Testing (15-302)	Agreed-Upon Procedures	<b>Complete</b>
Emerging Risks Reviews	Advisory	<b>Complete</b>
Incentive Compensation Plan Review	Advisory	<b>Complete</b>
Investment Committees Attendance	Advisory	<b>Complete</b>
<b>Internal Audit Department</b>		
Annual Internal Audit Report (15-603)	Audit	<b>Complete</b>
Quarterly Audit Recommendations Follow-up	Audit	<b>Complete</b>
Internal Quality Assurance Review	Advisory	<b>Complete</b>
Fiscal Year 2016 Audit Plan	Advisory	<b>Complete</b>
Internal Audit Vendor Request for Qualifications (RFQ) – Health Care Audits	Advisory	<b>In Progress</b>
Audit Committee Meetings Preparation	Advisory	<b>Complete</b>

**IV. Consulting Services  
and Nonaudit Services Completed**

#### **IV. Consulting Services and Nonaudit Service Completed**

During fiscal year 2015, Internal Audit conducted (or hired consultants to conduct) the following consulting (nonaudit services) projects resulting in formal recommendations to management.

**1. University of Texas Students' Consulting Project on Best Practices on Education Assistance Policy**

(Project #15-606a, PowerPoint presentation to TRS Human Resources staff, November 19, 2014)

Objective: To benchmark TRS' HR Employee Education Assistance Policy against best practices and make recommendations for enhancements.

Research on best practices provided HR management with ideas for improving visibility of program, incorporating staff education goals with performance measures, increasing reimbursement amounts, and monetary bonuses for achievement of Masters and PhD degrees.

**2. University of Texas Students' Consulting Project on Policy to Retain Top Performing Employees and Managers Best Practices on Education Assistance Policy**

(Project #15-606b, PowerPoint presentation to TRS Human Resources staff, May 1, 2015)

Objective: To benchmark TRS' HR Policy for retaining top performing employees and managers against best practices and make recommendations for enhancements.

Research on best practices provided HR management with ideas for improving hiring, reducing staff turnover, and refreshing employment information on the website.

**3. Business Process Analysis of Activities Involving Multiple Departments**

(Project #15-404, memo to TRS Chief Financial Officer, March 2, 2015)

Objective: Document and analyze business processes that overlap multiple departments; provide options to TRS management for realigning and streamlining process activities while considering segregation of duties requirements.

Results included realigning departments, increasing some staffing, increasing training, increasing external outreach efforts at service centers, and updating the TRS Employer website.

#### **4. Data Analytics Development Project**

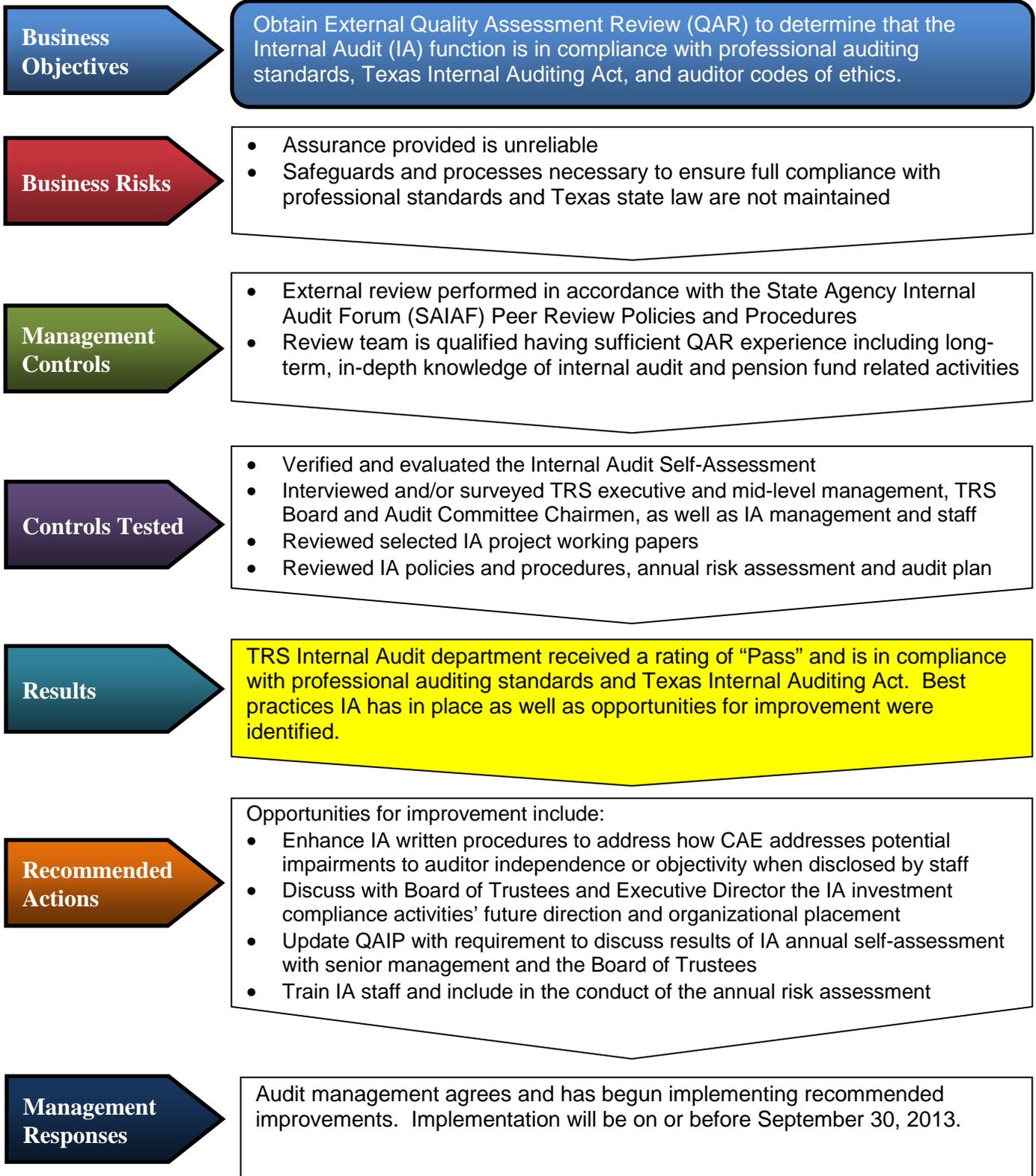
(Project #: 15-601, Report - none)

Objective: To assist TRS Internal Audit staff in the achievement of Goal 3 of the *TRS Internal Audit Strategic Plan FY 2015 - 2019*: “Enhance Internal Audit Staff's Competence and Expertise in Support of TRS Risk Management, Control, and Governance Processes” by cultivating in-house subject matter experts and broadening the foundational skills in data analytics.

Results: The project included a current state assessment of Internal Audit data analytics, capability assessment, and data analytics enablers by capability maturity model.

Internal Audit also performed various advisory (nonaudit services) as described in section III.

## **V. External Quality Assurance Review (Peer Review)**



Legend of Results:

**Red** - Significant to TRS  
**Yellow** - Other Reportable Issue

**Orange** - Significant to Business Objectives  
**Green** - Positive Finding or No Issue

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

*June 2013*



**Performed by**

Karin Hill, CIA, CGAP, CRMA  
Director of Internal Audit  
Texas Department of Assistive and Rehabilitative Services

Jennifer Hymel  
Director of Compliance and Assurance  
Texas County and District Retirement System

Nicki Russell, MPA, CIA, CPA  
Internal Auditor  
Missouri State Employees Retirement System

## OVERALL OPINION

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

We found that the Internal Audit Department is independent, objective, and able to render impartial and unbiased judgments on the audit work performed. The staff members are qualified, proficient, and knowledgeable in the areas they audit and the Department is supported in obtaining additional expertise as necessary. Individual audit projects are planned using risk-based internal auditing; audit conclusions are supported in the working papers; and findings and recommendations are communicated clearly and concisely.

The Internal Audit Department is well-managed internally. In addition, the Department has an effective relationship with the Board of Trustees and is well respected and supported by management. Surveys and interviews conducted during the quality assurance review indicate that management considers Internal Audit an integral part of the overall agency operations and finds that the audit process and report recommendations add value and help improve the agency's operations.

## **VI. Internal Audit Plan for Fiscal Year 2016**

# Fiscal Year 2016 Audit Plan

*September 25, 2015*



Amy Barrett, CIA, CISA, CPA  
Chief Audit Executive



Christopher S. Moss  
Chair, Audit Committee, Board of  
Trustees



Brian Guthrie  
Executive Director



R. David Kelly  
Chair, Board of Trustees



# Executive Summary

## Professional and Statutory Requirements

This document provides the *Fiscal Year 2016 Audit Plan* (Audit Plan) as required by professional auditing standards, the *Texas Internal Auditing Act* (Act), and the *Texas Government Code 2102.008* for the Teacher Retirement System of Texas (TRS). The Act requires state agencies to conduct a program of internal auditing that includes an annual audit plan that is prepared using risk assessment techniques and identifies individual audit projects to be conducted during the year. The Audit Plan is required to be evaluated and updated annually for recommendation of approval by the TRS Audit Committee of the Board of Trustees (Audit Committee) to the TRS Board of Trustees (Board). Internal Audit is independent of management and provides objective assurance and consulting services designed to add value and improve TRS' operations.

## Audit Plan Development and Scope

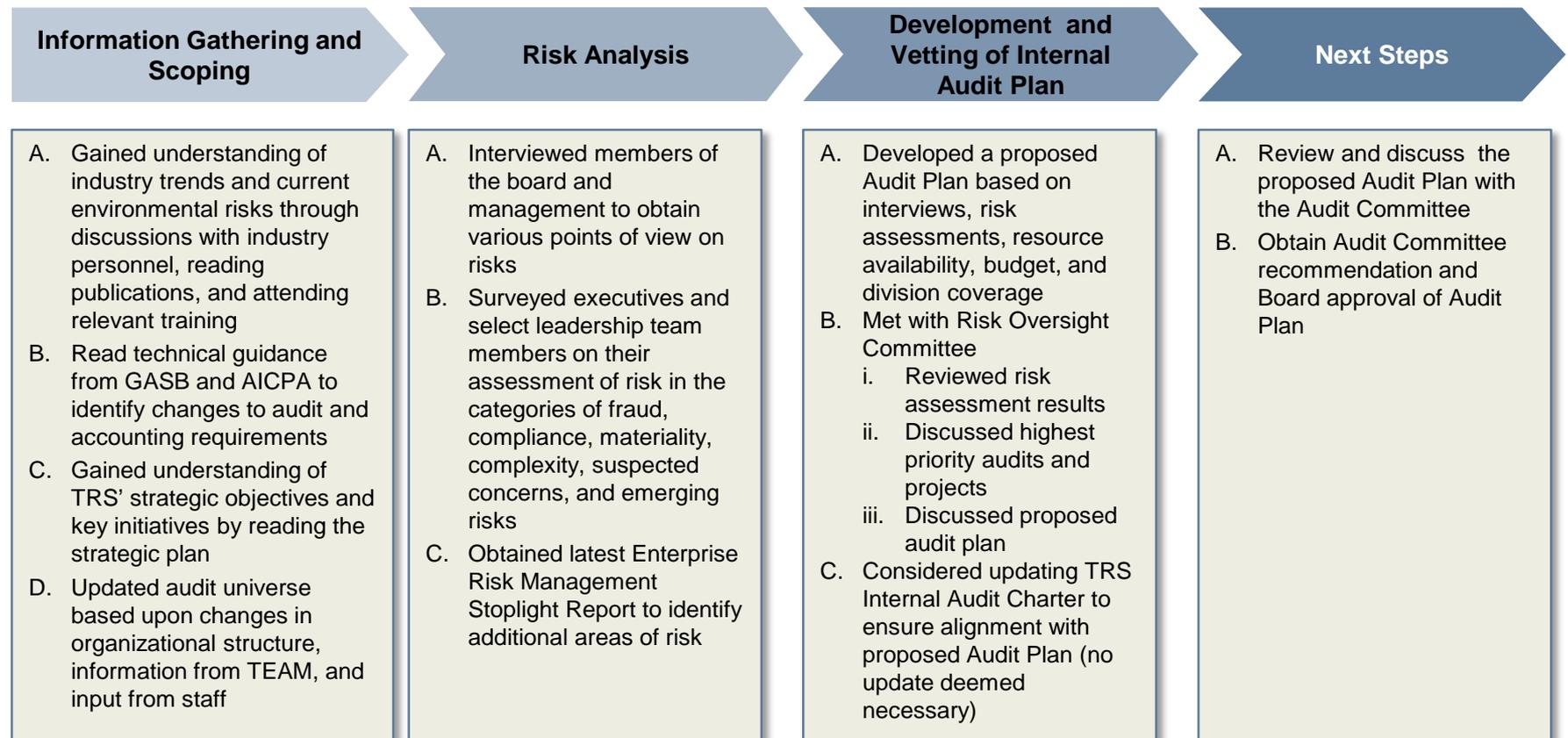
Our Audit Plan is designed to provide coverage of key risks, given the existing staff and approved budget. See the **Appendices** for information regarding the internal audit budget, performance measures, and audit universe.

## Changes Subsequent to Approval

Interim changes to the Audit Plan will occur from time to time due to changes in business risks, timing of TRS' initiatives, and staff availability. We will report Audit Plan changes to senior management and present changes to the Audit Committee at the following quarterly Audit Committee meeting. Amendments to the approved Audit Plan deemed to be significant (based on discussions with the executive director and audit committee chair) will be submitted to the Audit Committee for recommendation to the Board for approval. The State Auditor's Office also requires notification of material changes to the Audit Plan.

# Risk Assessment & Audit Planning Approach

*Interviews, risk assessment surveys, and the Stoplight Report developed by the Enterprise Risk Management (ERM) team were used to identify areas of risk and potential internal audit projects. This information was combined into an overall audit plan designed to address critical risks to achieving TRS objectives while balancing operational requirements. The Audit Plan also includes hours for ad hoc projects and special requests. The following approach was taken in creating the Audit Plan:*



# Types of Projects to Cover Risk Areas

***An important part of the Audit Plan is that the identified processes, systems, and initiatives should receive differing types and levels of review based on their importance, perceived risk, and most efficient approach. Our suggested levels of review activities are as follows:***

## Audit

- Audit Focus: Assess evidence available in order to conclude on an audit objective
- Deliverable: Audit report for public distribution unless protected by statute
- Estimated level of effort per project: 400 - 500 hours

## Agreed-Upon Procedures

- Agreed-Upon Procedures Focus: Determine specific steps to test with management's agreement and report on results; used for data analytics and quarterly testing of specific data and transactions
- Deliverable: Agreed-upon procedures report for public distribution (use is limited to those with understanding of procedures performed)
- Estimated level of effort per project: 100 - 300 hours

## Formal Consulting

- Consulting Focus: Respond to requests for formal study or assessment with recommendations; no assurance provided
- Deliverable: Consulting report or memo for limited distribution; significant material weaknesses identified would be reported to executive management and the Audit Committee as required by professional auditing standards
- Estimated level of effort per project: 100 - 200 hours

## Informal Consulting (Advisory)

- Advisory Focus: Participate in activities in a non-voting capacity, e.g., provide input on policies and procedures
- Deliverable: Verbal discussion or a brief memo to management
- Estimated level of effort per year: 10 – 100 hours

# Audit Plan: TEAM

*The tables on this page and the following pages provide the name of each project, type of project, and preliminary scope of work to be performed. Scope of work will be finalized as part of each project's formal planning phase.*

Title	Type	Preliminary Scope
TEAM Program Internal Controls Assessment	Advisory	Assist management in its evaluation of key internal controls incorporated into TRUST, the new benefits system, and business processes
TEAM Security and Access Controls Assessment	Advisory	Assist management in its evaluation of segregation of duties and security controls incorporated into TRUST
TEAM Independent Program Assessment (IPA) Vendor Support	Advisory	Coordinate and facilitate activities of the IPA vendor and ensure direct access to executive management and the board
TEAM Committees and TEAM Projects Participation	Advisory	<p>Participate in TEAM Executive Steering Committee (ESC) and other committees in a non-voting capacity, and provide advisory services related to TEAM projects' activities as outlined in the TEAM projects' charters pertaining to internal audit activities. In FY 2015, Internal Audit participated in the following TEAM committees and projects:</p> <ul style="list-style-type: none"> <li>• Executive Steering Committee</li> <li>• TEAM Budget Committee</li> <li>• Organizational Change Management Advisory Groups</li> <li>• Business Procedures and Training Project</li> <li>• Select Detailed Level Requirements sessions</li> <li>• Decommissioning Project</li> <li>• Security Architecture meetings</li> <li>• Monthly meetings with TEAM program manager and HP executives</li> </ul>

# Audit Plan: Pension Benefits

Title	Type	Preliminary Scope
Benefits Testing for State Auditor's Office (SAO) Audit of Comprehensive Annual Financial Report (CAFR)	Audit	Conduct pension benefits testing on behalf of the SAO to be used in completion of the CAFR audit
Semi-Annual Benefits Testing	Agreed-Upon Procedures	Recalculate a sample of benefit payments semi-annually and determine whether documentation on file supports the calculation; scope in other tests related to benefits as agreed-upon with management
Reporting Entity Audits (6 – 8) and investigations	Audit	Determine whether information reported to TRS is complete and accurate, especially in the areas of eligibility (pension and health care), compensation, contributions, surcharges (pension and health care), and health care premiums paid
TRS Reporting Entity Website Audit Information	Advisory	Update audit-related information and tools on the TRS employer (reporting entity) website. Information may include self-audits, audit programs, audit results, technical guidance, and frequently asked questions about reporting entity audits.
Benefits Data Analysis Pilot Project	Advisory	Develop data analysis capabilities of Internal Audit staff and analyze benefits data to identify potential errors or omissions

# Audit Plan: Finance and Executive

Title	Type	Preliminary Scope
Actuarial Data Controls	Audit (Carryover Project from FY 2015)	Assess whether internal controls are in place and working effectively to determine the accuracy and completeness of the fiscal year 2014 actuarial data files for the pension trust fund (final audit objective)
State Auditor's Office (SAO) Financial (CAFR) Audit Coordination	Advisory	Coordinate activities of the SAO to ensure deadlines are met; coordinate quarterly update meetings with executive management and the SAO; maintain SAO document request SharePoint site
Special Requests and Emerging Issues	Advisory	Address special requests and emerging issues during the year in coordination with management
Internal Ethics and Fraud Hotline Administration	Advisory	Follow-up on hotline calls (both internal and external) including complaints disclosed to TRS Internal Audit through other communication means
Meetings Participation	Advisory	Participate (non-voting) in various TRS-wide meetings such as Executive Council, Leadership Team, and Risk Oversight Committee

# Audit Plan: Health Care

Title	Type	Preliminary Scope
Health Care Risk Assessment Follow Up	Consulting	Update health care risk assessment; identify key processes and controls that mitigate risks; assess control design; make recommendations for inclusion into a short-term and long-term work plan to be utilized by Health Insurance Benefits staff. Provide feedback for updating security contract language with third party vendors for purposes of annual confirmation.
Health Care Vendor Update Meetings	Advisory	Attend quarterly meetings with health care vendors to understand results, issues, and TRS management's monitoring controls
Health Care Vendor Selection Observation	Advisory	Observe selection process of large vendor and service providers, when applicable

# Audit Plan: Information Technology

Title	Type	Preliminary Scope
SharePoint Governance Audit	Audit	Assess effectiveness of SharePoint governance, access controls, and protection of confidential and sensitive data
Wi-Fi Vulnerability Assessment	Agreed-Upon Procedures	Assess security/vulnerability of Wi-Fi connections
Data Protection Project	Advisory	Provide technical expertise to Enterprise Risk Management staff in a TRS-wide project for all departments to identify, document, classify, and control sensitive and confidential data
Disaster Recovery, Network Penetration Tests; Security Risk Assessment Review	Advisory	Obtain, review, and follow-up on any issues identified during the network disaster recovery, penetration tests, and the security risk assessment conducted by the TRS Information Security Officer

# Audit Plan: Investment Management

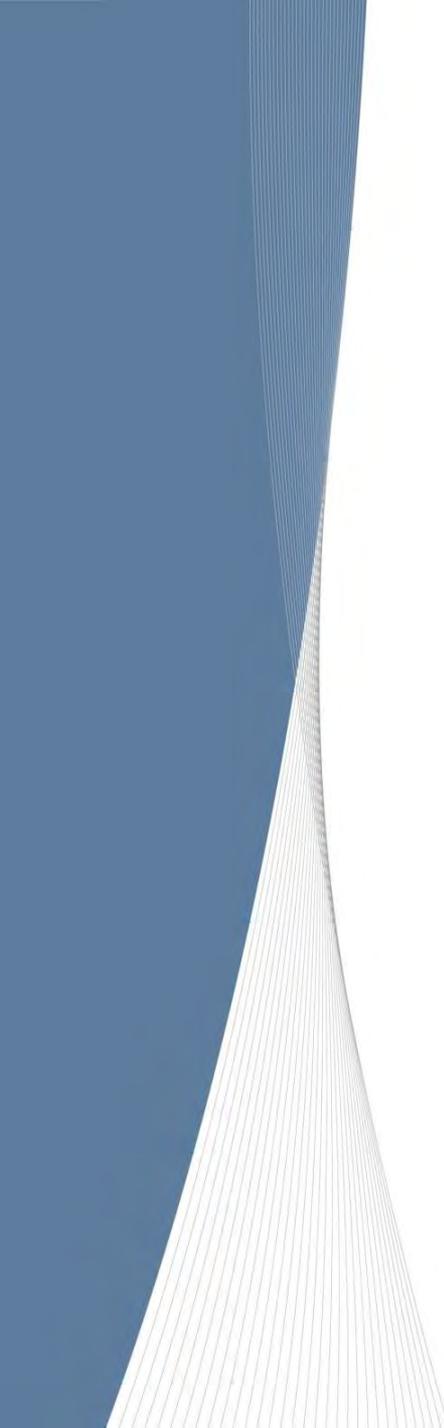
Title	Type	Preliminary Scope
Overall Internal Control Opinion on Investment Activities (focus on external public markets, strategic partners, and asset allocation)	Audit	Assess key operating, compliance, and reporting controls within the Investment Management Division and its service providers relating to external public markets, strategic partners, and asset allocation activities. Activities to be assessed relating to those areas include, but are not limited to, due diligence, valuation, fees, fund transfers, risk management, governance, management and board reports, information systems, compliance, accounting, investment operations, and investment accounting.
Quarterly Investment Compliance, Incentive Pay, Ethics Policies, and Budget Testing	Agreed-Upon Procedures	Assess compliance with TRS ethics policies and the Investment Policy Statement (IPS) requirements; incorporate other tests such as board report accuracy, wire transfer compliance with internal procedures, incentive pay results, and budget report and transfer accuracy
Annual Incentive Compensation Plan Testing	Agreed-Upon Procedures	Prior to payment, recalculate the incentive compensation award amounts to determine if they are calculated in accordance with plan provisions; reconcile performance to the service provider, and calculated in accordance with plan provisions
Investment Committees Attendance	Advisory	Stay current on Investment Management Division initiatives by attending the Internal Investment Committee, Derivatives Operations, Monthly Staff, and other meetings such as the Annual Town Hall meeting
Investments Data Analysis Pilot Project	Advisory	Develop data analysis capabilities of Internal Audit staff and analyze external public markets data to identify anomalies and unusual trends for follow up in conjunction with the overall internal controls opinion

# Audit Plan: Internal Audit Activities

Title	Project Description
Internal and External Quality Assurance Review	Prepare an internal assessment and engage an independent evaluation of that assessment and of Internal Audit's compliance with professional auditing standards as required every three years by the Texas Internal Auditing Act
Annual Internal Audit Report	Prepare annual report of audit activities in accordance with SAO instructions
Quarterly Audit Recommendations Follow-Up	Follow-up and report on the status of outstanding audit recommendations
Fiscal Year 2017 Audit Plan	Prepare annual audit plan based on a documented risk assessment in accordance with professional auditing standards and the Texas Internal Auditing Act
Audit Committee Meetings Preparation	Prepare communications and attend Audit Committee and Board meetings
Internal Audit Vendor Request for Qualifications (RFQ)	Post an RFQ and select qualified vendors for conducting and participating in investment , technology, health care audits and to support other audit activities such as data analysis, as needed
Data Analytics Capabilities Development	Utilize an outside vendor to develop internal auditors processes and expertise around data analytics

# Audit Plan: High Risk Areas (High, Elevated, or Caution) And Areas of Interest to the SAO Excluded from the Audit Plan

Area	Reason for Exclusion
Records Management	Audited in FY 2015. TRS is in process of implementing audit recommendations.
Purchasing and Contracts	Audited in FY 2014. TRS is in process of implementing audit recommendations.



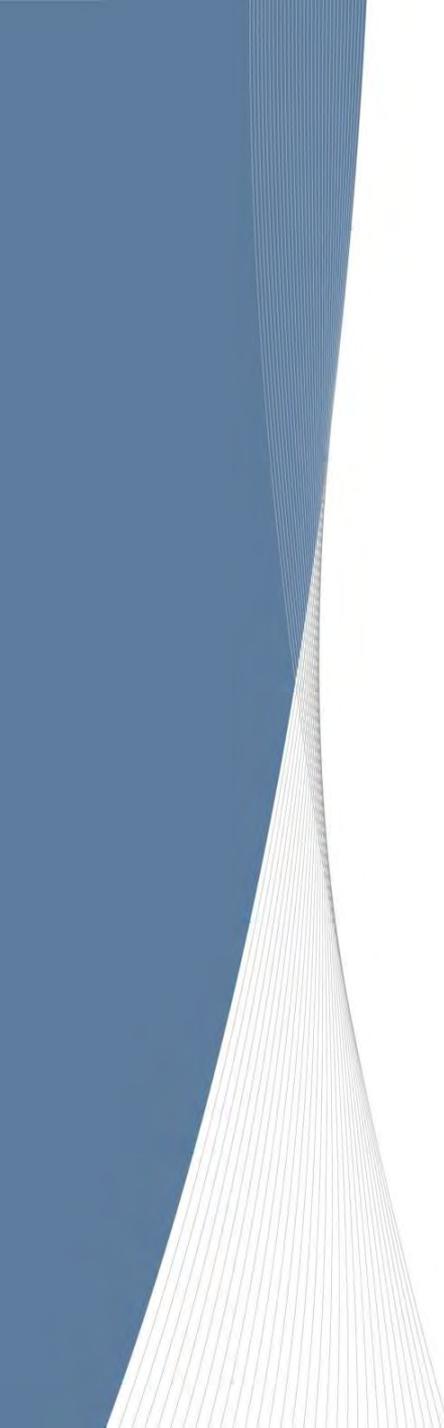
# **Appendix A**

## **Internal Audit Operating Budget**

# Internal Audit Operating Budget

Line Item	Budget FY 2016	Budget FY 2015
000 – Salaries	\$998,762	\$977,204
000 – Benefits	226,847	230,556
200 – Professional Fees	681,500	652,500
505 – Travel-In-State	14,500	14,500
510 – Travel-Out-of-State	18,000	18,000
705 – Dues, Fees, and Staff Development	22,500	22,500
710 – Subscriptions and Reference Materials	4,500	4,500
Total Operating Budget (excluding indirect costs such as computers, office space, and utilities)	\$1,966,609	\$1,919,760
Full Time Equivalent (FTE) Positions	10.0 – 11.0*	10.0

\*Excludes interns. Internal Audit anticipates one retirement and two new staff hired in FY 2016, with no overall impact to the budget.



**Appendix B**  
**Internal Audit**  
**Performance Measures**

# Internal Audit Goals and Performance Measures

***For the internal audit function, the FY 2016 goals and performance measures are as follows:***

## **Goal 1: Enhance Effectiveness of Internal Audit Organization**

### *Performance Measures*

- a. Spend a minimum of 75% of total available department hours (excludes uncontrollable leave) for professional staff on direct assurance, consulting, and advisory services
- b. Complete an independent external assessment and report the results of the Quality Assurance and Improvement Program

## **Goal 2: Develop and Implement Internal Audit Annual Audit Plan based on Formal Risk Assessment**

### *Performance Measures*

- a. Prepare an annual audit plan based on a documented risk assessment and obtain input from trustees and staff
- b. Execute 80% of audit and agreed-upon procedures projects (80% allows for flexibility due to changes in TRS business practices and special requests)
- c. Update a formal reporting entity risk assessment to identify reporting entities for audit

## **Goal 3: Enhance Internal Audit Staff Skills and Knowledge in Emerging Risks and Controls with Emphasis on Information Technology, Investment and Health Care**

### *Performance Measures*

- a. Enhance staff knowledge of services provided to the Investment Management Division by visiting one TRS asset manager or service provider
- b. Engage a service provider for developing data analytics capabilities

# Internal Audit Goals and Performance Measures, continued

## **Goal 4: Deliver Value-Added Consulting and Advisory Activities**

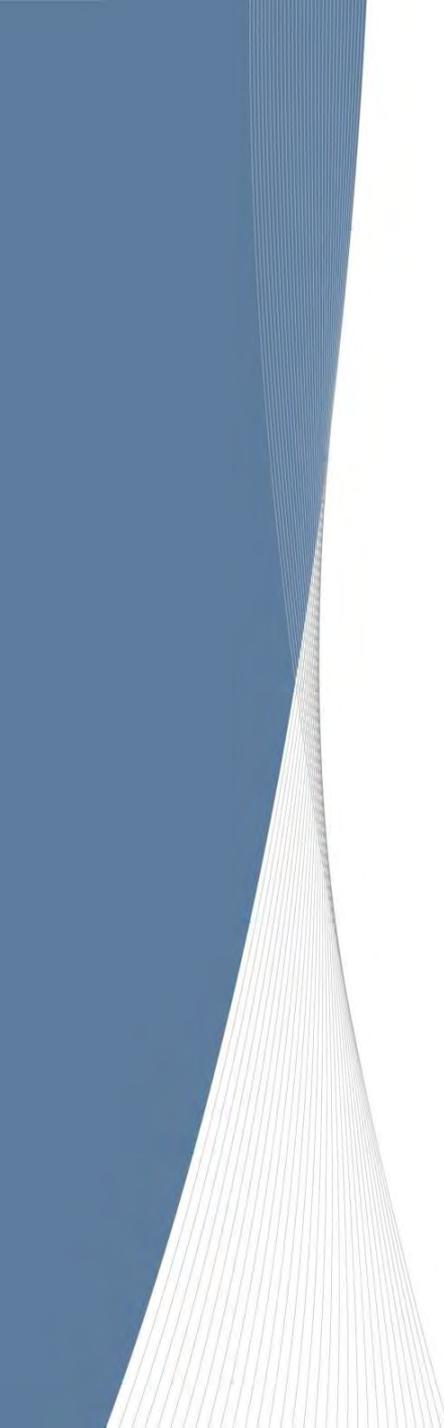
### *Performance Measures*

- a. 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
- b. Facilitate timely completion and success of State Auditor's Office (SAO) audits in fiscal year 2016 by effectively providing audit support, coordinating meetings, reserving facilities and gathering schedule and documentation requests

## **Goal 5: Enhance Participation in Professional and Peer Organizations**

### *Performance Measures*

- a. Participate in professional organizations (APPFA, IIA, ISACA, ACFE, SIAIF, CFA Institute) through monthly chapter meetings and participation in leadership roles in at least one professional organization
- b. Support staff in obtaining additional certifications such as the CFA, CPA, and CIA certifications and have all staff obtain a minimum of 40 continuing professional education hours



# **Appendix C**

## **Audit Universe**

Executive and Finance Divisions				IMD Processes			
<b>Governance, strategy, and risk management</b>		<b>Talent Continuity</b>		<b>Accounting &amp; Reporting</b>		<b>Governance - IMD</b>	
	Board governance (FY13)		Employee recruiting and hiring practices (FY10)		Accounts receivable		Investment Governance and Management (FY15)
	Strategic planning and performance measures (FY13)		Employee training compliance (FY11)		Accounts payable (FY15)	<b>IMD Processes</b>	
	Enterprise Risk Management		Internal policy setting and monitoring		Travel (FY14)		Internal Public Markets (FY14)
	Information technology governance (FY10)	<b>Communications and External Relations</b>			Federal withholdings/tax compliance		External Public Markets (FY13)
<b>Open Government</b>			Social media		Inventory		Private Equity (FY15)
	Open meetings compliance		Information and communication	<b>Budget</b>			Real Assets (FY15)
	Open records request compliance	<b>403(b)</b>			Budget process and reporting (FY10)		Trade Management (FY14)
<b>Ethics and Fraud Prevention</b>			403(b) certification process	<b>Purchasing and Contracts</b>			Emerging Manager Program (FY13)
	Employee ethics policies (FY15)	<b>Records Management</b>			Vendor file, encumbrance, purchasing (FY14)		Energy/Natural Resources (ENR) (FY14)
	Fraud risk detection and prevention controls (FY15)		Records management (FY15)		Contract administration and monitoring (FY14)		Strategic Partners (FY14)
<b>Regulatory, Compliance, &amp; Litigation</b>					Contract worker onboarding, monitoring and compliance (FY14)		Strategic Asset Allocation/Stable Value (FY14)
	Compliance: Pension Trust (FY15)	<b>Accounting &amp; Reporting</b>			HUB program compliance and reporting		Tactical Asset Allocation (FY13)
	Compliance: Health Care Trusts (FY13)		Financial/CAFR reporting including, new accounting pronouncements, reconciliations, general ledger, closing process (FY15)	<b>Facilities and Facilities Planning</b>			Risk Management (FY15)
	Litigation risk management		Other reporting (non-financial / CAFR)		Facility planning and maintenance		Performance Analytics and Operations (FY14)
<b>Business Continuity</b>			Employee leave, timekeeping, and payroll (FY12)		Mail room operations (FY10)		Information Systems (FY15)
	Business continuity plan (FY09)		Cashier (FY10)		Security (FY12)		Business Center, Reporting, HR, Incentive Pay (FY15)
	Risk management (health and safety, insurance) (FY12)			<b>Government Relations and Legislation</b>			Investment Accounting (FY15)
				<b>Pension Funding</b>			<b>(FY #) - indicates last year audited</b>



## **Budget Hours for Fiscal Year 2016 Audit Plan Projects**

As part of our annual audit plan development, we establish estimated budgets and timelines for completing assurance, consulting, advisory, and administrative projects. This information is used internally as project management tools and is not published in the annual audit plan. The chief audit executive (CAE) and audit managers review the status of scheduled projects on an ongoing basis throughout the fiscal year. The CAE must approve changes to scheduled audit projects.

The status of each audit plan project as well as projects added during the year is published quarterly in the TRS Board Audit Committee board books. The Audit Committee reviews these status reports in the quarterly Audit Committee meetings.

## **Projects Related to Expenditure Transfers, Capital Budget Controls, or any other limitation or restriction in the General Appropriations Act**

TRS plans to perform limited testing of budget reports and transfers as part of the Quarterly Investment Testing in fiscal year 2016.

## **Projects Related to Contract Management and Other Requirements of Senate Bill 20 (84<sup>th</sup> Legislature)**

TRS Internal Audit does not have any assurance projects planned related to contract management in fiscal year 2016 as TRS is in the process of implementing outstanding recommendations from a prior procurement and contracting audit.

# 2015 - 2019

TRS' Internal Audit Strategic Plan



*Looking Towards the Future*

*Trusted Assurance,  
Trusted Assurance,  
Valued Advice  
Valued Advice*

# TRS INTERNAL AUDIT STRATEGIC PLAN FY2015 – 2019

## Our Mission

The mission of the Internal Audit department is to provide independent, objective assurance and consulting services designed to add value and improve the organization's operations. Internal Audit helps the organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

## Our Vision

We strive to provide ***trusted assurance and valued advice*** through our services to the Board of Trustees, the Audit Committee, and executive management:

- Assurance that TRS' risk management, governance, and control processes support achievement of TRS mission and business objectives
- Advice and consultation for improving processes through business partnerships and collaboration

## Our Stakeholders

One of our priorities is to assess key stakeholder expectations, identify gaps, and implement a comprehensive strategy for improvement. Our primary stakeholders include:

- TRS Board of Trustees, and the Board Audit Committee
- Executive Director
- Executive Management

# TRS INTERNAL AUDIT STRATEGIC PLAN FY2015 – 2019

## STRATEGIC GOALS

Our four strategic goals were developed to ensure that Internal Audit supports the changing needs of TRS' stakeholders in achieving business goals and objectives. These goals represent a strategy for enhancing our contribution to the TEAM Program success, supporting effective Audit Committee governance processes, improving internal audit business expertise, and integrating TRS core values into internal audit processes.

- Goal 1 Assist with the Success of the TRS Enterprise Modernization Application (TEAM) Program
- Goal 2 Support Audit Committee Governance
- Goal 3 Enhance Internal Audit Staff's Competence and Expertise in Support of TRS Risk Management, Control, and Governance Processes
- Goal 4 Support Agency Culture Initiatives

The **table** on the following pages identifies the objectives and related strategies and tactics for each goal.

## TRS INTERNAL AUDIT STRATEGIC PLAN FY2015 – 2019

### GOAL 1: ASSIST WITH THE SUCCESS OF THE TRS ENTERPRISE APPLICATION MODERNIZATION (TEAM) PROGRAM

#### Objective 1: Facilitate independent oversight for Board and external oversight agencies

Strategy	Tactics
S1. Provide contract oversight and monitoring of Independent Program Assessment (IPA) vendor	T1: Obtain deliverables, schedule required meetings, and approve invoices for payment T2: Monitor hours incurred and contract performance
S2. Coordinate communication process between IPA vendor and key stakeholders	T1: Obtain and address feedback from stakeholders and IPA regarding communications process and access requests T2: Clarify audit's role relating to IPA in Internal Audit Charter update
S3. Coordinate with State Auditor's Office (SAO) for testing of Financial System Replacement (FSR) software application for financial and other future audits	T1: Participate in status update and key decision-making meetings on FSR T2: Communicate documentation requirements for SAO future audits T3: Review sufficiency of documentation in preparation for SAO future audits

#### Objective 2: Provide input and assistance during development and implementation of TRUST (new Benefits system)

Strategy	Tactics
S1. Define involvement in TEAM program related to TRUST system	T1: Participate in TEAM committees and other activities, as requested, and ensure Internal Audit (IA) role is stated clearly in TEAM documents such as project charters T2: Allocate resources in annual audit plan to provide coverage of significant committees and projects activities T3: Participate in review of documents by established TEAM deadlines
S2. Assist management in evaluating key <u>internal</u> controls incorporated in TRUST system and business processes	T1: Allocate/schedule IA resources in annual audit plan T2: Obtain list of key controls from management where assistance in validation is desired T3: Assist management in evaluating selected key controls, participate in controls testing, review test results and follow-up on test exceptions T4: Formally communicate observations from testing participation to project management
S3. Assist management in evaluating key <u>security</u> controls incorporated in TRUST system and business processes	T1: Allocate/schedule IA resources in annual audit plan T2: Obtain list of key security controls from management where assistance in validation is desired T3: Assist management in evaluating selected key security controls, participate in controls testing, review test results, and follow-up on test exceptions T4: Formally communicate observations from testing participation to project management

## TRS INTERNAL AUDIT STRATEGIC PLAN FY2015 – 2019

<b>Objective 3: Use TRUST in future audits</b>	
<b>Strategy</b>	<b>Tactics</b>
S1. Obtain training on using TRUST	T1: Coordinate with Business Process Managers (BPMs) to ensure Internal Audit (IA) training needs are identified and scheduled T2: Allocate/schedule IA resources in annual audit plan for TEAM training T3: Augment IA TEAM training with internal meetings as needed by IA Subject Matter Experts T4: Maintain IA repository for “training” documents as a permanent file for future use
S2. Utilize data analytics and continuous auditing	T1: Participate in TEAM program requirements gathering and detailed reviews to ensure that the TRUST system has the capability of providing data to perform data analysis T2: Based on knowledge obtained from training, identify potential new data analytic tests in the TRUST system T3: Incorporate data analytics and continuous auditing into projects associated with TRUST system
<b>Objective 4: Provide input during development and implementation of the Financial System Replacement (FSR) software application</b>	
<b>Strategy</b>	<b>Tactics</b>
S1. Define involvement in TEAM program related to the FSR software application	T1: Participate in TEAM committees and other activities, as requested, and ensure Internal Audit (IA) role is stated clearly in TEAM documents such as project charters T2: Allocate resources in annual audit plan to provide coverage of significant committees and projects activities T3: Participate in review of documents by established TEAM deadlines
S2. Assist management in evaluating key internal controls incorporated in the FSR software application and business processes	T1: Allocate/schedule IA resources in annual audit plan T2: Obtain list of key controls from management where assistance in validation is desired T3: Assist management in evaluating selected key controls, participate in controls testing, review test results and follow-up on test exceptions T4: Formally communicate observations from testing participation to project management
S3. Assist management in evaluating <u>security</u> controls incorporated in the FSR software application and business processes	T1: Allocate/schedule IA resources in annual audit plan T2: Obtain list of key security controls from management where assistance in validation is desired T3: Assist management in evaluating selected key security controls, participate in controls testing, review test results, and follow-up on test exceptions T4: Formally communicate observations from testing participation to project management

## TRS INTERNAL AUDIT STRATEGIC PLAN FY2015 – 2019

Objective 5: Use FSR software application in future audits	
Strategy	Tactics
S1. Obtain training on using new FSR software application	T1: Coordinate with Business Process Managers (BPMs) to ensure Internal Audit (IA) training needs are identified and scheduled T2: Allocate/schedule IA resources in annual audit plan for TEAM training T3: Augment IA TEAM training with internal meetings as needed by IA Subject Matter Experts T4: Maintain IA repository for “training” documents as a permanent file for future use
S2. Utilize data analytics and continuous auditing	T1: Participate in TEAM program requirements gathering and detailed reviews to ensure that the FSR application has the capability of providing data to perform data analysis T2: Based on knowledge obtained from training, identify potential new data analytic tests in the FSR application T3: Incorporate data analytics and continuous auditing into projects associated with the FSR application
GOAL 2: SUPPORT AUDIT COMMITTEE GOVERNANCE	
Objective 1: Provide assurance to the Audit Committee and executive management on risk mitigation activities related to the pension and healthcare trusts	
Strategy	Tactics
S1. Conduct assurance activities relating to the completeness and accuracy of Reporting Entity information submitted to TRS	T1: Conduct audits and investigations of Reporting Entities as requested or as scheduled on the annual audit plan based on an objective risk assessment T2: Conduct internal audits of controls maintained by TRS or its vendors over completeness and accuracy of Reporting Entity data T3: Communicate to Reporting Entities regarding issues found during audits via presentations, the TRS website, and direct communication T4: Coordinate with the SAO to facilitate their audit of the TRS financial statements and with other interested organizations conducting reporting entity audits T5: Monitor changes in auditing requirements of professional organizations and the SAO
S2. Provide assurance on investment risk mitigation activities	T1: Issue an overall opinion annually on the effectiveness of internal controls relating to investment activities for the past three years T2: Test investment compliance, cash transfers, and ethics controls quarterly T3: Continuously monitor changes to the investment environment by analyzing investment data, attending important meetings, reading relevant documents, utilizing consultants, networking, attending relevant training, and maintaining certifications

## TRS INTERNAL AUDIT STRATEGIC PLAN FY2015 – 2019

Strategy	Tactics
S3. Provide assurance on health care risk mitigation activities	T1: Stay current on legislative changes impacting TRS health plans and associated risks T2: Utilize TRS and vendor health care risks assessments to develop a reasonable and flexible approach for performing routine audits of the health care trusts T3: Procure health care expertise to execute risk-based audit plans, if needed T4: Obtain training for dedicated Internal Audit staff on health care risks and compliance requirements
S4. Coordinate with Enterprise Risk Management (ERM) on risk assessment activities	T1: Enhance collaboration with ERM through regular meetings and information sharing T2: Utilize risk assessments developed by management through the ERM program as the basis of the annual audit plan T3: Provide feedback after each audit to ERM about the completeness of management's risk assessments for future consideration T4: Participate in internal Risk Oversight Committee meetings
<b>Objective 2: Improve Internal Audit communication</b>	
Strategy	Tactics
S1. Refine report format of Internal Audit reports and Audit Committee materials	T1: Review current materials for possibilities for improvement T2: Survey Audit Committee members and management on report format and incorporate feedback T3: Review other entities' presentations for ideas
S2. Improve delivery of information	T1: Survey Audit Committee and management for improvement on delivery of information and incorporate feedback T2: Identify and participate in public speaking training/opportunities T3: Maintain Internal Audit intranet and internet sites
<b>Objective 3: Provide information on effective Audit Committee practices</b>	
Strategy	Tactics
S1. Obtain and provide information to the Audit Committee on best practices of audit committees	T1: Designate a portion of the spring meeting to Audit Committee education during legislative session years T2: Provide Audit Committee orientation to new trustees
S2. Consider using Audit Committee self-evaluation tool	T1: Present and explore concept of self-evaluation with the Audit Committee chair T2: Develop a self-evaluation tool for consideration by the Audit Committee chair
S3. Explore sharing governance resources through Diligent	T1: Meet with Diligent owner to discuss ideas and potential resources T2: Discuss idea of sharing information with the Audit Committee chair

## TRS INTERNAL AUDIT STRATEGIC PLAN FY2015 – 2019

<b>Objective 4: Improve governance on fraud awareness, prevention, and detection activities</b>	
<b>Strategy</b>	<b>Tactics</b>
S1. Develop fraud detection activities	T1: Document standard procedures for Internal Audit fraud investigations T2: Provide input into updates to the TRS Fraud Policy T3: Provide assistance in investigations as formally requested T4: Incorporate control tests in assurance projects to ensure controls are there to prevent or timely detect unusual “fraud” red flag activity
S2. Improve fraud awareness and prevention program	T1: Administer the TRS Fraud and Ethics Hot Line, including updating promotional materials
<b>GOAL 3: ENHANCE INTERNAL AUDIT STAFF’S COMPETENCE AND EXPERTISE IN SUPPORT OF TRS RISK MANAGEMENT, CONTROL, AND GOVERNANCE PROCESSES</b>	
<b>Objective 1: Cultivate in-house Subject Matter Experts</b>	
<b>Strategy</b>	<b>Tactics</b>
S1. Deepen knowledge of TRS laws (federal and state), rules, and internal policies	T1: Pilot new auditor rotation into operational functions T2: Participate in internal training in business units T3: Hold lunch-and-learn knowledge transfers sessions at audit meetings T4: Analyze other audit reports and share best practices identified in those reports T5: Leverage knowledge transfer from contractors
S2. Broaden foundational skills in data analytics	T1: Prepare and present training programs (e.g., Audit Command Language, Microsoft Access, Computer-Aided Audit Tools) to Internal Audit (IA) staff T2: Add a project scoping step in TeamMate to include data analytics on every project T3: Identify data analytics mentors for IA staff T4: Attend and apply external data analysis training in projects
<b>Objective 2: Ensure continued competence and expertise of Internal Audit</b>	
<b>Strategy</b>	<b>Tactics</b>
S1. Develop workforce continuity plans	T1: Work with Human Resources to develop a continuity plan for Internal Audit (IA) T2: Establish a cross training policy within IA T3: Participate in the TRS Leadership Development Program

## TRS INTERNAL AUDIT STRATEGIC PLAN FY2015 – 2019

### GOAL 4: SUPPORT AGENCY CULTURE INITIATIVES

#### Objective 1: Integrate TRS Core Values into Internal Audit activities

Strategy	Tactics
S1. Explore opportunities and methods to tie audit findings into TRS core values	T1: Recognize Internal Audit and client actions that demonstrate TRS core values T2: Identify in audit activities when positive findings directly demonstrate a TRS core value
S2. Integrate TRS Core Values into IA policies and procedures	T1: Incorporate TRS core values into the internal Ethics and Fraud Hot Line materials T2: Update job descriptions and performance evaluations to include TRS core values (Human Resources led initiative)

## **VII. External Audit Services Procured in Fiscal Year 2015**

## External Audit Services Procured in Fiscal Year 2015

External Audit Services Procured and Outsourced by Internal Audit	Provided by	Report Date
TRS Information Security Follow-Up Audit	Myers and Stauffer LC	09/02/2014

External Audit Services Procured and Co- sourced by Internal Audit	Provided by	Report Date
Audit of Information Technology Controls at Third-Party Investment Service Providers	Protiviti, Inc.	09/16/2015

External Audit Services Procured by TRS	Provided by	Report Date
Independent Audit Report on TRS-ActiveCare Service Providers	Sagebrush Solutions	09/25/2015
Comprehensive Annual Financial Report (CAFR) – Fiscal Year 2014	State Auditor’s Office	11/17/2014

## **VIII. Reporting Suspected Fraud and Abuse**

## **VIII. Reporting Suspected Fraud and Abuse**

TRS has taken the following actions to implement the fraud detection and reporting requirements of Section 7.09 of the General Appropriations Act and Section 321.022 of the Texas Government Code:

- Adopted in January 2006, *TRS Fraud, Waste, and Abuse Policy* established a fraud, waste, and abuse prevention awareness program that includes employee training and guidelines for reporting suspected fraud, waste, and abuse. Key elements of the policy include definitions, covered acts, reporting procedures of detected or suspected fraud, waste, or abuse, detection and investigation, awareness training, and corrective action.
- The TRS Internet site includes the contact number of the State Auditor's Office Hotline and a link for reporting instructions.
- Links are available on the TRS intranet for both the State Auditor's Office Hotline and the TRS Internal Fraud and Ethics Hotline.
- In compliance with the reporting requirement of fraud, waste, and abuse, TRS reports all instances of suspected fraud, waste, and abuse to SAO.

**TAB 4B**

## TRS Internal Audit Summary of Audit Recommendations Status – October 2015

Project	Recommendation	Status	Issue Type	Estimated Date	Revised / Actual Date
<b>14-401 Purchasing and Contract Administration</b>					
	TRS' Contract Administration Manual revision process should ensure: <ul style="list-style-type: none"> <li>➤ revisions are made by a coordinated workgroup across various TRS departments</li> <li>➤ the competitive selection process is well defined and new procedures are inclusive of various procurement processes</li> <li>➤ new procedures include a clear process for documenting the justification and approval for all exceptions</li> </ul>	Implemented	Other Reportable	9/2015	10/2015
	TRS' Contract Administration Manual should have a coaching component for all contract sponsors, their designees, and anyone involved in procurement at TRS. Coaching should be provided to the Board and include information regarding fiduciary responsibility and TRS fiduciary obligation.	In Progress	Other Reportable	12/2015	6/2016
	TRS' Contract Administration Manual should have a monitoring component to ensure compliance with the revised Contract Administration Manual and a method for follow-up and/or escalation of non-compliance.	In Progress	Other Reportable	9/2015	6/2016
	The Purchasing Department should update written procedures to match current and new processes.	In Progress	Other Reportable	10/2015	4/2016

### Significant to Business Objectives

	<ul style="list-style-type: none"> <li>• Past <i>original</i> estimated completion date</li> <li>• No management action plan <u>or</u> No progress on management action plan</li> </ul>
	<ul style="list-style-type: none"> <li>• Past <i>original</i> estimated completion date</li> <li>• Progress on management action plan</li> </ul>
	<ul style="list-style-type: none"> <li>• <i>Original</i> estimated completion date has not changed</li> <li>• Progress on management action plan</li> </ul>
	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"> <li>• Past <i>original</i> <u>or</u> first <i>revised</i> estimated completion date</li> <li>• No management action plan <u>or</u> No progress on management action plan</li> </ul>
	<ul style="list-style-type: none"> <li>• Past <i>original</i> <u>or</u> first <i>revised</i> estimated completion date</li> <li>• Progress on management action plan</li> </ul>
	<ul style="list-style-type: none"> <li>• Within <i>original</i> <u>or</u> first <i>revised</i> estimated completion date</li> <li>• Progress on management action plan</li> </ul>
	Satisfactory implementation of management action plan <u>or</u> Acceptance of risk by management

**TRS Internal Audit  
Summary of Audit Recommendations Status – October 2015**

Project	Recommendation	Status	Issue Type	Estimated Date	Revised / Actual Date
<b>14-401 Purchasing and Contract Administration (continued)</b>					
	Financial Services management should work with Legal Services to improve control over who is authorized to obligate TRS during purchasing or contracting activities.	Implemented	Other Reportable	2/2015	10/2015
	Improve central contract files to include all necessary documentation and train purchasing staff and contract sponsors on these requirements. Implement an escalation process to ensure required documentation is provided to the owner of the contract file.	In Progress	Other Reportable	12/2014	2/2016
	Update TRS record retention schedules to clearly define who the official record holders are for all contracts and related documentation.	In Progress	Other Reportable	2/2015	2/2016
<b>15-301 FY 2015 Overall IMD Internal Control Opinion</b>					
	Continue efforts to increase General Partners' transparency on fees and expenses	In Progress	Other Reportable	6/2015	12/2015
	Provide clear guidelines for acceptable accounting and valuation standards for Private Equity investments	In Progress	Other Reportable	9/2015	3/2016
	TRS request that service providers produce SOC 2 report	In Progress	Other Reportable	1/2016	
	Refine the IMD Contract Management checklist and log	Implemented	Other Reportable	10/2015	10/2015
<b>15-501 Records Management Audit</b>					
	Require Certification for Terminating Employee and Contract Workers	In Progress	Significant	12/2015	
	Perform routine enterprise-wide departmental records retention assessments	In Progress	Significant	10/2015	
	Provide well-defined guidelines for users of electronic records systems and increase records management awareness	In Progress	Significant	10/2015	
	Records Management Officer should enhance coordination among related TRS departments and key functions	In Progress	Other Reportable	10/2015	
	Formally assess the records management program's current and future resource needs, including succession planning	In Progress	Other Reportable	10/2015	

**TRS Internal Audit  
Summary of Audit Recommendations Status – October 2015**

<b>Project</b>	<b>Recommendation</b>	<b>Status</b>	<b>Issue Type</b>	<b>Estimated Date</b>	<b>Revised / Actual Date</b>
<b>15-501 Records Management Audit (continued)</b>					
	Formally document the decision that TRS' Records Management Officer position report to the Chief Administrative Officer	In Progress	Other Reportable	10/2015	
	TRS' records management policy contents should be updated to reflect current operating procedures	In Progress	Other Reportable	10/2015	
	Formally assess the records management program's future role and responsibilities within the agency	In Progress	Other Reportable	11/2015	
<b>15-602 Internal Audit Self-Assessment</b>					
	Ensure that the required documentation of threats to independence and objectivity be updated at least annually, or more often as situations change. This process can be achieved by including it as an item for discussion on the agenda for the Annual Internal Audit Retreat.	Implemented	Other Reportable	10/2015	10/2015
	Ensure proper close out of projects	Implemented	Other Reportable	10/2015	10/2015

**TRS Internal Audit  
Summary of Audit Recommendations Status – October 2015**

**Status of Reporting Entity Audit Recommendations:**

	<b>Audit Project #</b>	<b>Audit Report Date</b>	<b>Reporting Entity (RE)</b>	<b>Status</b>
1	15-401A	4/29/2015	Santa Maria ISD	In Progress
2	15-401B	5/21/2015	College Station ISD	In Progress
3	15-401C	5/21/2015	Presidio ISD	In Progress
4	15-401D	5/21/2015	El Paso ISD	In Progress

**Statuses:**

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

**TRS Internal Audit  
Summary of Audit Recommendations Status – October 2015**

**State Auditor’s Office (SAO) Audit Recommendations**

Project	Recommendation	Status	Issue Type	Estimated Date	Revised / Actual Date
<b>15-035 SAO Audit of Employer Pension Liability Allocation Schedules</b>					
	Establish verification process of reporting entities and verify payment of contributions - Step 1 – develop interim procedures for tracking	Implemented	Significant	5/2015	5/2015
	Establish verification process of reporting entities and verify payment of contributions – Step 2 – implement annual verification	Implemented	Significant	7/2015	7/2015
	Establish verification process of reporting entities and verify payment of contributions - Step 3 – implement new Pension Line of Business	In Progress	Significant	9/2016	
<b>15-305 SAO Audit of Fiscal Year 2014 Comprehensive Annual Financial Report</b>					
	Strengthen controls over census data	In Progress	Significant	8/2016	

**TAB 5**

**Teacher Retirement System of Texas**  
**November 2015 Audit Committee Agenda Items Mapped to TRS Stoplight Report**

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

## Status of Fiscal Year 2016 Planned Assurance, Consulting, and Advisory Services as of November 2015

Title and Project #	Type	Status
<b>Executive and Finance</b>		
Actuarial Data Controls (15-402)	Audit	<b>Complete</b>
State Auditor's Office (SAO) Financial (CAFR) Audit Coordination	Advisory	<b>In Progress</b>
Internal Ethics and Fraud Hotline Administration	Advisory	<b>Ongoing</b>
Meetings Participation	Advisory	<b>Ongoing</b>
Special Requests and Emerging Issues	Advisory	
<b>TEAM Program</b>		
TEAM Program Internal Controls Assessment	Advisory	
TEAM Security and Access Controls Assessment	Advisory	<b>In Progress</b>
TEAM Independent Program Assessment (IPA) Vendor Support	Advisory	<b>Ongoing</b>
TEAM Committees and TEAM Projects Participation	Advisory	<b>Ongoing</b>
<b>Pension Benefits</b>		
Benefits Testing for State Auditor's Office (SAO) Audit of Comprehensive Annual Financial Report (CAFR) (16-100)	Audit	<b>Complete</b>
Semi-Annual Benefits Testing (16-101)	Agreed-Upon Procedures	
Reporting Entity Audits (6-8) and Investigations (16-401)	Audit	<b>In Progress</b>
TRS Reporting Entity Website Audit Information	Advisory	<b>In Progress</b>
Benefits Data Analysis Pilot Project	Advisory	
<b>Health Care</b>		
Health Care Audit Risk Assessment Follow Up	Consulting	<b>In Progress</b>
Health Care Vendor Selection Observation	Advisory	<b>In Progress</b>
Health Care Vendor Update Meetings	Advisory	<b>Ongoing</b>
<b>Information Technology</b>		
SharePoint Governance and Security Audit (16-501)	Audit	<b>In Progress</b>
Wireless Network Security Assessment (16-502)	Agreed-Upon Procedures	<b>In Progress</b>
Data Protection Project	Advisory	<b>In Progress</b>

## Status of Fiscal Year 2016 Planned Assurance, Consulting, and Advisory Services as of November 2015

Title and Project #	Type	Status
<b>Information Technology</b>		
Disaster Recovery, Network Penetration Tests; Security Risk Assessment Review	Advisory	<b>Ongoing</b>
<b>Investment Management</b>		
Overall Internal Control Opinion on Investment Activities (16-301)	Audit	<b>In Progress</b>
Quarterly Investment Compliance, Incentive Pay, Ethics Policies and Budget Testing (16-302)	Agreed-Upon Procedures	<b>1<sup>st</sup> QTR complete</b>
Annual Incentive Compensation Plan Testing (16-303)	Agreed-Upon Procedures	<b>In Progress</b>
Investments Data Analysis Pilot Project	Advisory	
Investment Committees Attendance	Advisory	<b>Ongoing</b>
<b>Internal Audit Department</b>		
Annual Internal Audit Report (16-603)	Audit	<b>Complete</b>
Quarterly Audit Recommendations Follow-up	Audit	<b>Ongoing</b>
External Quality Assurance Review	Audit	
Internal Quality Assurance Review	Advisory	<b>In Progress</b>
Fiscal Year 2017 Audit Plan	Advisory	
Internal Audit Vendor Request for Qualifications (RFQ)	Advisory	<b>In Progress</b>
Audit Committee Meetings Preparation	Advisory	<b>Ongoing</b>

**Fiscal Year 2016 Internal Audit Advisory Services<sup>1</sup>  
September 2015 – November 2015**

<b>BENEFIT SERVICES</b>
<p><b>Participated in the TEAM Program</b></p> <ul style="list-style-type: none"> <li>• Executive Steering Committee</li> <li>• Budget Committee</li> <li>• Security Architecture Meetings</li> <li>• Organizational Change Management Advisory Group</li> <li>• Business Procedures and Training</li> <li>• Decommissioning Legacy Systems</li> <li>• CMT Prioritization Review Meetings</li> <li>• Detailed Level Requirements Reviews – Audit, Legal, and Member Account Maintenance Workflows</li> <li>• Monthly meetings with TEAM Program Manager and vendor personnel</li> <li>• Independent Program Assessment Vendor Coordination and Support</li> </ul>
<b>HEALTH BENEFITS</b>
<ul style="list-style-type: none"> <li>• Attended the Health Plan Administrator (HPA) and Pharmacy Benefit Manager (PBM) Vendor Quarterly Update Meetings</li> <li>• Participated (non-voting) in the HIB Claims Audit Vendor selection process</li> <li>• Coordinated Health Care Risk Assessment Follow-Up project</li> </ul>
<b>INVESTMENTS</b>
<ul style="list-style-type: none"> <li>• Attended Internal Investment Committee (IIC) meetings</li> <li>• Attended monthly securities lending monitoring calls with State Street Bank</li> <li>• Participated in the Proxy Voting Committee meeting</li> <li>• Attended London Office Working Group meetings</li> <li>• Participated in Performance Incentive Pay Procedures Working Group meetings</li> </ul>
<b>FINANCIAL SERVICES</b>
<ul style="list-style-type: none"> <li>• Assisted with census data confirmations for reporting entity auditors</li> <li>• Coordinated State Auditor’s Office Audit of FY 2015 Comprehensive Annual Financial Report</li> <li>• Participated in meetings discussing revisions to Contract Administration Policy</li> <li>• Provided input on approach to GASB 72 implementation (related to investment valuation)</li> </ul>
<b>EXECUTIVE</b>
<ul style="list-style-type: none"> <li>• Facilitated SAO’s Quarterly Update Meetings</li> <li>• Administered and facilitated Hot Line Calls</li> <li>• Participated in the Risk Oversight Committee</li> <li>• Participated in Safety Committee Quarterly Committee Meetings</li> </ul>
<b>INFORMATION TECHNOLOGY (IT)</b>
<ul style="list-style-type: none"> <li>• Participated in planning meetings for Co-Location Disaster Recovery (DR) Test, and observed the DR test</li> <li>• Participated in the Enterprise Security Team meetings</li> <li>• Participated in the Enterprise Risk Management (ERM) Data Protection Project</li> </ul>

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

**Internal Audit Goals and Performance Measures - Fiscal Year 2016  
1st Quarter Ending November 2015**

Target Performance	Activity	Status
<b>Goal 1: Enhance Effectiveness of Internal Audit Organization</b>		
1. Spend a minimum of 75% of total available department hours (excludes uncontrollable leave) for professional staff on direct assurance, consulting, and advisory services.	Achieved 81% for the 1 <sup>st</sup> quarter of fiscal year 2016.	On Task
2. Complete an independent external assessment and report the results of the Quality Assurance and Improvement Program.	The team for the external assessment has been determined and the review will be conducted in April 2016.	On Task
<b>Goal 2: Develop and Implement Internal Audit Annual Audit Plan based on Formal Risk Assessment</b>		
3. Prepare an annual audit plan based on a documented risk assessment and obtain input from trustees and staff.	Audit planning and risk assessment is scheduled for the 4 <sup>th</sup> quarter.	On Task
4. Execute 80% of audit and agreed-upon procedures projects (80% allows for flexibility due to changes in TRS business practices and special requests).	Planned assurance and agreed-upon procedures projects are on schedule and assigned to staff.	On Task
5. Update a formal reporting entity risk assessment to identify reporting entities for audit.	The update of the reporting entity risk assessment is in progress.	On Task
<b>Goal 3: Enhance Internal Audit Staff Skills and Knowledge in Emerging Risks and Controls with Emphasis on Information Technology, Investment, and Health Care</b>		
6. Enhance staff knowledge of services provided to the Investment Management Division by visiting one TRS asset manager or service provider.	Open – to be scheduled	On Task
7. Engage a service provider for developing data analytics capabilities.	Open – to be scheduled	On Task
<b>Goal 4: Deliver Value-Added Consulting and Advisory Activities</b>		
8. Facilitate coordination of TEAM Independent Program Assessment (IPA) vendor by coordinating meetings with Executive Director, Executive Steering Committee (ESC) and Core Management Team (CMT), quarterly presentations to the TRS Board of Trustees, and other contractual activities.	Coordination and support of IPA vendor is ongoing.	On Task

**Internal Audit Goals and Performance Measures - Fiscal Year 2016  
1st Quarter Ending November 2015**

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

**Legend: Target Status**

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

## Internal Audit Staff Quarterly Accomplishments

- Cari Casey joined the Internal Audit department in October. Prior to joining Internal Audit, she was team lead of the TRS Data Management team for many years.
- Nick Ballard attended the TeamMate User Forum 2015 in September.
- Lih-Jen Lan attended the ACL (Audit Command Language) Connections 2015 in October.
- Lih-Jen Lan and Jan Engler attended the MISTI SuperStrategies 2015 Conference in November.
- Hugh Ohn attended and participated in a panel at the Association of Public Pension Fund Auditors (APPFA) Conference in November.

## MEMORANDUM

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

**FROM:** Amy Barrett, Chief Audit Executive

**SUBJECT:** External Quality Assurance Review of TRS Internal Audit

**DATE:** October 26, 2015

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Per the *Texas Government Code*, Internal Audit is required to undergo an external quality assurance review (QAR) every three years to determine whether the department is operating in compliance with professional auditing standards. The QAR team will spend one week at TRS in April 2016 to conduct their independent review and will report the results of their review to Audit Committee in June 2016. The QAR team consists of three volunteers with broad experience in Texas state government and public pension plans.

**Benito (Benny) Ybarra, Chief Audit and Compliance Officer  
Texas Department of Transportation (TxDOT)**

Mr. Ybarra oversees TxDOT's Offices of Internal Audit and Compliance whose functions are aimed at improving controllership, risk management, accountability and governance. Prior to joining TxDOT in September 2011, he worked at Dell Inc. and Texas Guaranteed Student Loan Corporation. He is a Certified Internal Auditor (CIA), Certified Information Systems Auditor (CISA) and Certified Fraud Examiner (CFE). He serves on the American Center for Government Auditing's Advisory Board, the Institute of Internal Auditors' Professional Issues Committee, the American Association of State Highway and Transportation Officials (AASHTO) and State Agency Internal Audit Forum (SAIAF) Internal Audit and Peer Review committees, and he is an active member of several additional professional organizations.

**Byron Williams, Chief Audit Executive  
Oregon State Treasury**

Mr. Williams has been the Chief Audit Executive for the Oregon State Treasury since 2011. The Treasury is responsible for managing \$90 Billion in state investment funds, including the pension fund, as well as the state's banking and debt issuance operations. Prior to joining the Oregon State Treasury, he was a principal auditor with the Oregon Secretary of State Audits Division leading their investment valuation group. He holds a Bachelor of Science Degree in Business from Oregon State University. He is a CPA and Certified Investment and Derivatives Auditor (CIDA). He is also a member of the ILPA Fee Transparency Initiative working group.

**Greg Royal, Director of Internal Audit  
Texas Department of Insurance**

Mr. Royal assumed the position of Director of Internal Audit in March 2006 and has 27 years of Texas state government experience. Greg received a Bachelor of Science from Texas A&M University in December 1986. He has several professional certifications that include CPA, CIA, CIDA, CGAP (Certified Government Auditing Professional) and CRMA (Certification in Risk

Management Assurance). He has previously been active in the local IIA Chapter serving in various roles including president. He was also a two-year international committee member of the Board of Research and Education Advisors of the IIA. He previously was an officer for six years for the State Agency Internal Audit Forum (SAIAF) composed of internal audit directors from state agencies and institutions of higher education.