



A Report on

The Audit of Teacher Retirement System's Fiscal Year 2017 Financial Statements

November 27, 2017

Members of the Legislative Audit Committee:

In our audit report dated November 20, 2017, we concluded that the Teacher Retirement System's (the System) basic financial statements for fiscal year 2017 were materially correct and presented in accordance with accounting principles generally accepted in the United States of America. The System published our audit report as part of its basic financial statements, which it intends to post on its Web site at https://www.trs.texas.gov/Pages/about_publications.aspx.

We also issued a report on internal control over financial reporting and on compliance and other matters as required by auditing standards (that report, including responses from management, is presented in the attachment to this letter). In that report, auditors determined that the System should strengthen controls to help ensure the completeness and accuracy of the active employee census data that employers submit.

Our procedures were not intended to provide an opinion on internal control over financial reporting or to provide an opinion on compliance with laws and regulations. Accordingly, we do not express an opinion on the effectiveness of the System's internal control over financial reporting or on compliance with laws and regulations.

Testing of Plan Member Census Data

Auditors conducted census data testing for fiscal year 2017 (see text box for the key data elements tested) as part of this audit. The completeness and accuracy of employees' census data is important because the System uses that data to calculate the System's liabilities for pensions and other post employment benefits.

Auditors implemented a risk-based approach for selecting employers (including school districts, charter schools, and higher education institutions) for fiscal year 2017 census data testing as required by American Institute of Certified Public Accountants (AICPA) guidance. That resulted in auditors selecting 91 employers for which census data was tested. (A list of the employers selected for testing is presented in the attachment to this letter.) Testing included reviewing documentation to verify that the census data that the employers submitted to the System was accurate.

Active Employee Census Data

Active employee census data is key demographic data that affects the actuarial estimate of the pension liability amount that the System presents in its financial statements.

Key data elements include:

- Name.
- Date of birth.
- Service credits.
- Pensionable earnings.
- Gender.
- Employment Status.

Source: Chapter 13 in *State and Local Governments - Audit and Accounting Guide*, American Institute of Certified Public Accountants.

SAO Report No. 18-005

Based on the testing performed, auditors determined that the underlying census data was materially complete and accurate to support the System's plan's financial statement amounts. That was reflected as part of our unmodified audit opinion on the System's financial statements for fiscal year 2017. For fiscal year 2016, auditors tested the System's census data using the same methodology described above and concluded that the data was materially complete and accurate. The System posted information on census data testing performed on its Web site at <http://trs.texas.gov>.

Additionally, auditors will be issuing an opinion later this fiscal year on the System's fiscal year 2017 pension liability allocation schedules. Those schedules provide employers with the information they need to record their share of the pension liability in their financial statements, in accordance with AICPA requirements. Auditors previously issued an opinion on the System's pension liability allocation schedules for fiscal year 2016. The System published our audit opinion, along with the pension liability allocation schedules, on its Web site at https://www.trs.texas.gov/Pages/re_gasb_67_68.aspx.

Other Issues

Auditors communicated certain issues that were not material or significant to the audit objectives separately in writing to the System's management.

As required by auditing standards, we will also communicate to the System's Board of Trustees certain matters related to the conduct of a financial statement audit.

We appreciate the System's cooperation during this audit. If you have any questions, please contact Michael Owen Clayton, CPA, CISA, CFE, CIDA Audit Manager, or me at (512) 936-9500.

Sincerely,

Lisa R. Collier, CPA, CFE, CIDA
First Assistant State Auditor

Attachment

cc: The Honorable Greg Abbott, Governor
Members of the Teacher Retirement System Board of Trustees
Mr. R. David Kelly, Chairman
Ms. Dolores Ramirez, Vice Chair
Ms. T. Karen Charleston
Mr. Joe Colonna
Mr. David Corpus
Mr. John Elliott
Dr. Greg Gibson
Mr. Christopher Moss
Mr. Brian Guthrie, Executive Director, Teacher Retirement System



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Attachment

Section 1

List of Employers Selected for Census Data Testing

Table 1 lists the 91 employers for which auditors tested the accuracy of census data to determine whether that data was materially complete and accurate to support the Teacher Retirement System's plan's financial statement amounts.¹

Table 1

List of Employers Selected for Census Data Testing for Fiscal Year 2017
<ul style="list-style-type: none">▪ Alvarado Independent School District▪ Anahuac Independent School District▪ Argyle Independent School District▪ Bandera Independent School District▪ Bay City Independent School District▪ Bishop Consolidated Independent School District▪ Bonham Independent School District▪ Brady Independent School District▪ Brownfield Independent School District▪ Brownsboro Independent School District▪ Brownsville Independent School District▪ Bushland Independent School District▪ Central Texas College▪ Cisco Independent School District▪ City View Independent School District▪ Coastal Bend College▪ Coldspring-Oakhurst Consolidated Independent School District▪ Commerce Independent School District▪ Conroe Independent School District▪ Crowley Independent School District▪ Cuero Independent School District▪ Dallas Independent School District▪ Dayton Independent School District▪ Deer Park Independent School District▪ East Chambers Independent School District▪ Edcouch-Elsa Independent School District▪ Edinburg Consolidated Independent School District▪ Ferris Independent School District

¹ Auditors followed the American Institute of Certified Public Accountants' sampling guide methodology and selected a representative population of employees from each employer selected for testing.

**List of Employers Selected for Census Data Testing
for Fiscal Year 2017**

- Fort Worth Independent School District
- Gladewater County Line Independent School District
- Glen Rose Independent School District
- Goose Creek Consolidated Independent School District
- Granbury Independent School District
- Greenville Independent School District
- Groveton Independent School District
- Hillsboro Independent School District
- Houston Independent School District
- Humble Independent School District
- Jacksboro Independent School District
- Jim Hogg County Independent School District
- Joshua Independent School District
- Junction Independent School District
- Kermit Independent School District
- Klein Independent School District
- La Joya Independent School District
- La Porte Independent School District
- Life School
- Livingston Independent School District
- Llano Independent School District
- Mission Consolidated Independent School District
- Montgomery Independent School District
- Muleshoe Independent School District
- Navasota Independent School District
- Northwest Independent School District
- Pharr-San Juan-Alamo Independent School District
- Pine Tree Independent School District
- Plano Independent School District
- Princeton Independent School District
- Promise Community School
- Red Oak Independent School District
- Region 1 Education Service Center
- Region 10 Education Service Center
- Region 16 Education Service Center
- Rio Hondo Independent School District
- Royal Independent School District
- Royse City Independent School District
- San Angelo Independent School District
- San Elizario Independent School District
- Santa Fe Independent School District
- Snyder Independent School District
- Southwest High School
- Southwest Texas Junior College
- Stafford Municipal School District
- Taylor Independent School District

**List of Employers Selected for Census Data Testing
for Fiscal Year 2017**

- Temple College
- Terrell Independent School District
- Texas A&M Transportation Institute
- Texas A&M University System
- Texas City Independent School District
- The University of Texas at Austin
- The University of Texas Health Science Center at San Antonio
- The University of Texas Health Science Center at Tyler
- The University of Texas M.D. Anderson Cancer Center
- The University of Texas Southwestern Medical Center
- Tomball Independent School District
- Trinity Basin Preparatory
- United Independent School District
- West Orange Cove Consolidated Independent School District
- White Settlement Independent School District
- Whitehouse Independent School District
- Winters Independent School District

Report on Internal Control Over Financial Reporting and on Compliance and Other Matters as Required by Auditing Standards



Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

Independent Auditor's Report

Teacher Retirement System Board of Trustees

Mr. R. David Kelly, Chairman
Ms. Dolores Ramirez, Vice Chair
Ms. T. Karen Charleston
Mr. Joe Colonna
Mr. David Corpus
Mr. John Elliott
Dr. Greg Gibson
Mr. Christopher Moss

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the major enterprise fund and the aggregate remaining funds information, consisting of the fiduciary funds and the non-major enterprise fund, of the Teacher Retirement System (System), a component unit of the State of Texas as of and for the year ended August 31, 2017, and the related notes to the financial statements, which collectively comprise the System's basic financial statements and have issued our report thereon dated November 20, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the System's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we do not express an opinion on the effectiveness of the System's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control described in the accompanying schedule of findings and responses that we consider to be a significant deficiency.

Summary of Findings and Responses
Finding Number
2017-1

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Auditors communicated certain issues that were not material or significant to the audit objectives separately in writing to the System's management.

System's Response to Findings

The System's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. The System's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control over financial reporting or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control over financial reporting and compliance. Accordingly, this communication is not suitable for any other purpose.

Lisa R. Collier, CPA, CFE, CIDA
First Assistant State Auditor

November 20, 2017

Schedule of Findings and Responses

Section 1

The System Should Strengthen Controls to Help Ensure the Completeness and Accuracy of the Active Employee Census Data That Employers Submit

Reference No. 2017-1

Type of finding: Significant Deficiency

The Teacher Retirement System (System) should strengthen controls over active employee census data to help ensure that data is complete and accurate (see text box for additional information). More than 1,300 school districts, colleges, and universities submit active employee census data regarding the active members who participate in the System's pension plan. The completeness and accuracy of the active employees' census data is important because the System uses that data to calculate member pension benefits and the pension liability amount that the System presents in its financial statements. Auditors previously reported this finding during the audits of the System's fiscal year 2014, 2015, and 2016 financial statements.¹

Active Employee Census Data

Active employee census data is key demographic data that affects the actuarial estimate of the pension liability amount that the System presents in its financial statements.

Key data elements include:

- Name.
- Gender.
- Date of birth.
- Pensionable earnings.
- Service credits.

Source: Chapter 13 in *State and Local Governments - Audit and Accounting Guide*, American Institute of Certified Public Accountants.

Since the initial finding in 2014, the System has begun performing audits on a limited basis of the employer census data information submitted. However, because those audits cover a limited number of plan participants, that audit coverage has not been adequate to serve as the System's controls. Therefore, controls over active employee census data are not sufficient to properly identify data that is incomplete or inaccurate. The absence of effective controls represents a significant deficiency in internal control over financial reporting, as noted in guidance issued by the American Institute of Certified Public Accountants.²

¹ See *A Report on the Audit of the Teacher Retirement System's Fiscal Year 2014 Financial Statements* (State Auditor's Office Report No. 15-010, November 2014); *A Report on the Audit of the Teacher Retirement System's Fiscal Year 2015 Financial Statements* (State Auditor's Office Report No. 16-009, December 2015); and *A Report on the Audit of the Teacher Retirement System's Fiscal Year 2016 Financial Statements* (State Auditor's Office Report No. 17-015, November 2016).

² See Chapter 13 in *State and Local Governments - Audit and Accounting Guide*, American Institute of Certified Public Accountants.

Auditors tested census data at 91 school districts, colleges, and universities. The majority of that data was accurate, and auditors identified no systematic issues.

Recommendation

The System should develop and implement a process to strengthen controls over active employee census data.

Management's Response

TRS agrees there is a need to strengthen the controls related to the accuracy and completeness of census data submitted by reporting entities (REs).

TRS is undertaking a modernization effort of its pension administration system that will, among other things, help strengthen controls over active employee census data to ensure its accuracy and completeness through additional data elements and stronger validations. Phase 1 of the new pension administration system went live on October 2, 2017. Phase 1 includes active membership and employer reporting. TRS strengthened the controls and validations around the data reported to TRS by TRS- Covered Employers. Effective with the September 2017 Employer Reports, TRS is requiring entities to report all employees, including those not eligible for membership. The new requirements have only one exception - student employees, who will not be reported until fiscal year 2019.

During fiscal year 2016, the TRS Benefit Reporting staff conducted 109 training sessions specifically related to the new RE Portal and the full payroll data requirements. In fiscal year 2017, staff conducted 12 training sessions that included the new reporting requirements, in addition to the normal RE training. TRS Benefit Reporting staff will begin spring training for entities in January 2018 through May 2018. This training will touch on TRS Laws & Rules and the new RE Portal. In addition to the training sessions, the Payroll Reporting Procedures have been updated and placed on the Reporting Entity page of the TRS website. The Reporting Entity section on the website also contains information related to the new requirements for employer reporting.

TRS Internal Audit staff will continue testing certain elements of the employer census data reporting process in fiscal year 2018. TRS is testing the following elements of the data: name; gender; dates of birth; dates of hire or years of service; eligible compensation; and termination or retirement dates. TRS internal auditors are also testing eligibility and compensation for accuracy, completeness and compliance with TRS Laws & Rules. Employer self-audit

tools are available on the TRS website. These tools provide specific how-to instructions and guidelines for conducting a self-audit of the data and contributions of various reports submitted to TRS.

All processes described above are ongoing and will continue for the foreseeable future. The TRS Chief Benefit Officer oversees the Benefit Services Division which is ultimately responsible for validating and verifying the data received from the REs.