

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)

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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



Brian K. Guthrie
Executive Director

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1000 Red River Street
Austin, Texas 78701-2698

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

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

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**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**

Teacher Retire Teacher Retirement System of Texas Internal Audit Annual Report for Fiscal Year 2015

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 1st 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

Teacher Retirement System of Texas
Internal Audit Annual Report for Fiscal Year 2015

III. Internal Audit Plan for Fiscal Year 2015

Status of Fiscal Year 2015 Planned Assurance, Consulting, and Advisory Services as of August 2015

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

Status of Fiscal Year 2015 Planned Assurance, Consulting, and Advisory Services as of August 2015

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

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

Teacher Retirement System of Texas

Internal Audit Annual Report for Fiscal Year 2015

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)

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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.

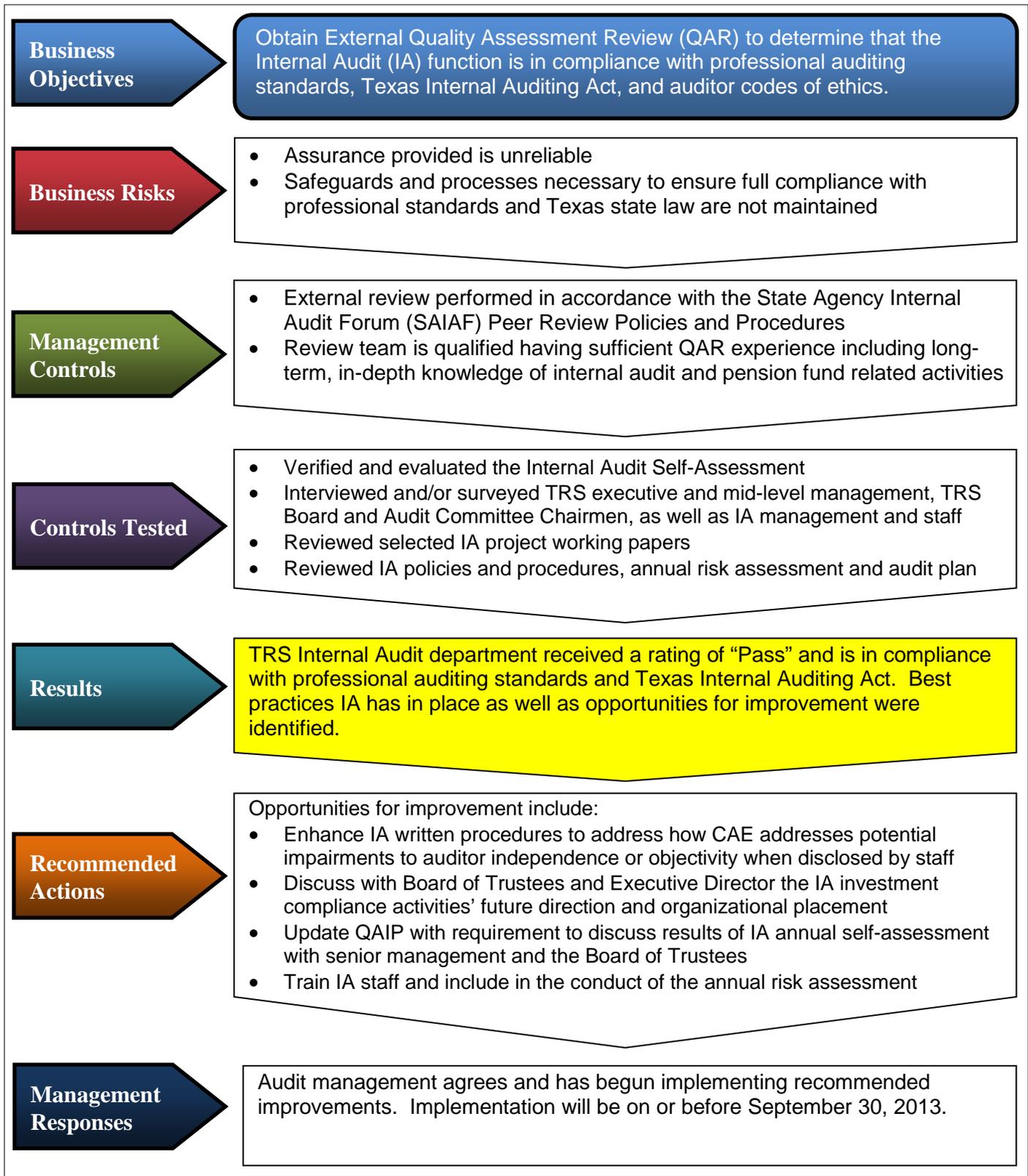
Internal Audit also performed various advisory (nonaudit services) as described in section III.

V. External Quality Assurance Review (Peer Review)

INTERNAL AUDIT EXTERNAL QUALITY ASSURANCE REVIEW

JUNE 2013

TRS Internal Audit Department



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.

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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

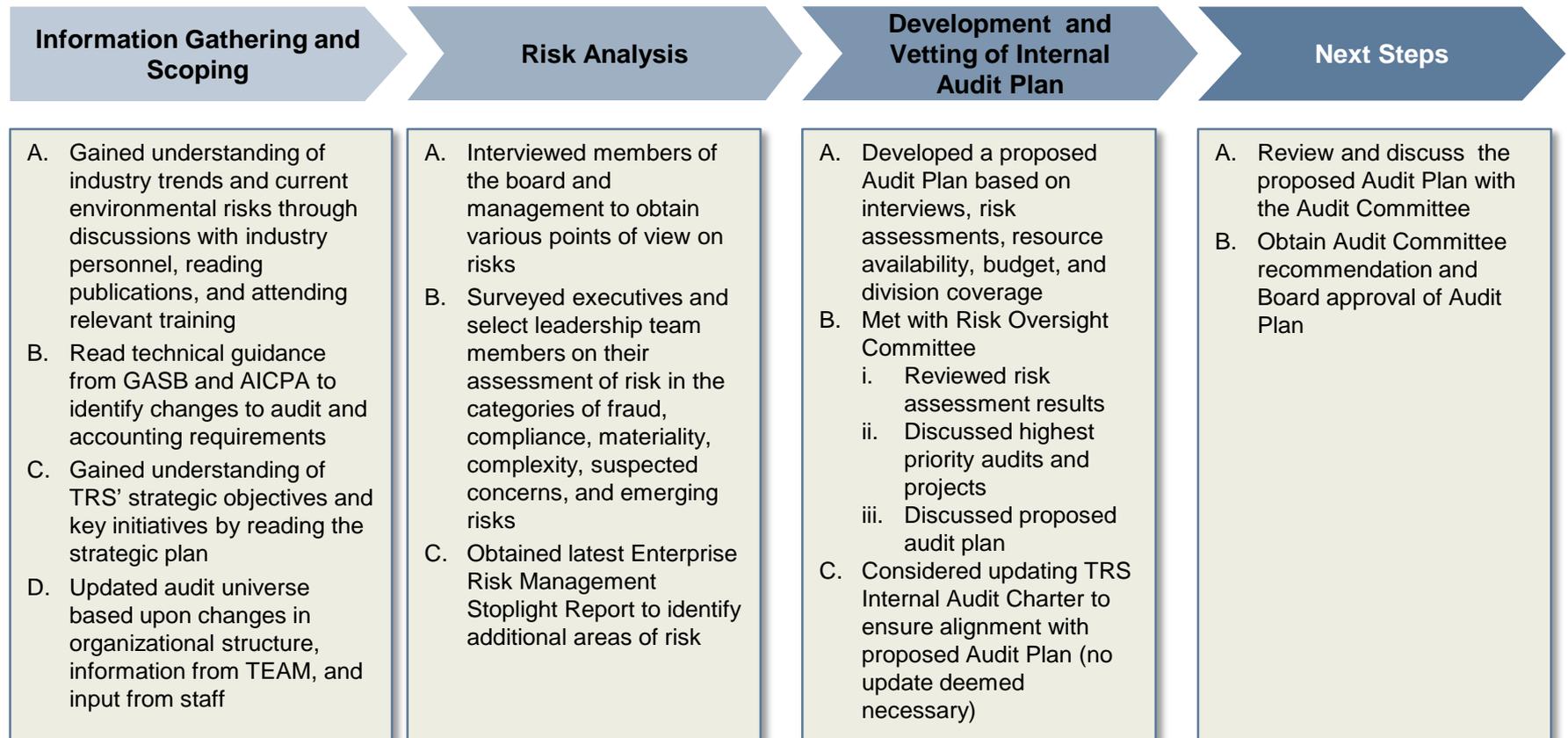
Our Audit Plan is designed to provide coverage of key risks, given the existing staff and approved budget. See the **Appendices** for information regarding the internal audit budget, performance measures, and audit universe.

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"> • Executive Steering Committee • TEAM Budget Committee • Organizational Change Management Advisory Groups • Business Procedures and Training Project • Select Detailed Level Requirements sessions • Decommissioning Project • Security Architecture meetings • Monthly meetings with TEAM program manager and HP executives

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

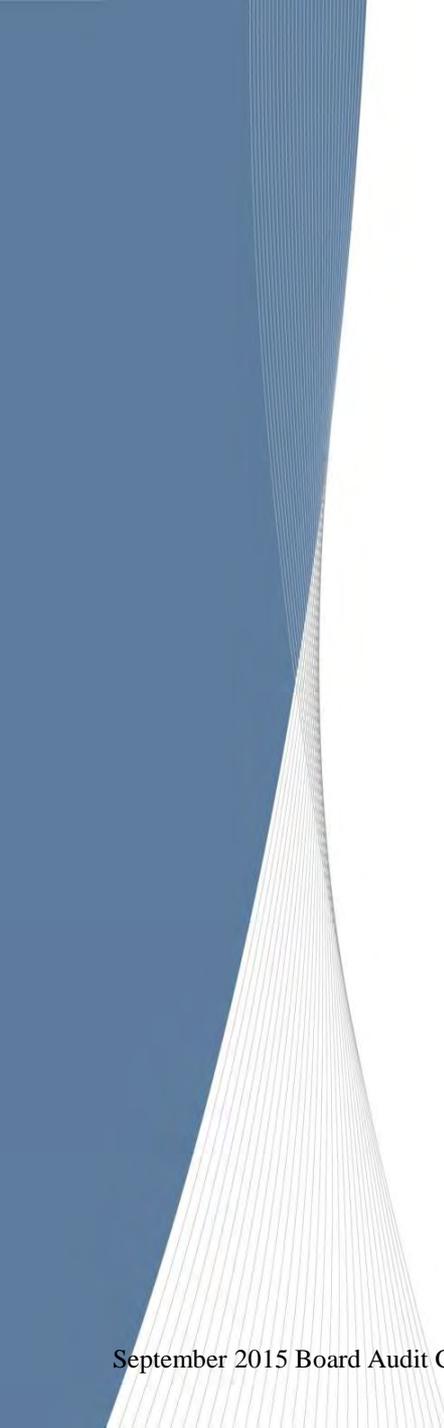
Title	Type	Preliminary Scope
Overall Internal Control Opinion on Investment Activities (focus on external public markets, strategic partners, and asset allocation)	Audit	Assess key operating, compliance, and reporting controls within the Investment Management Division and its service providers relating 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.



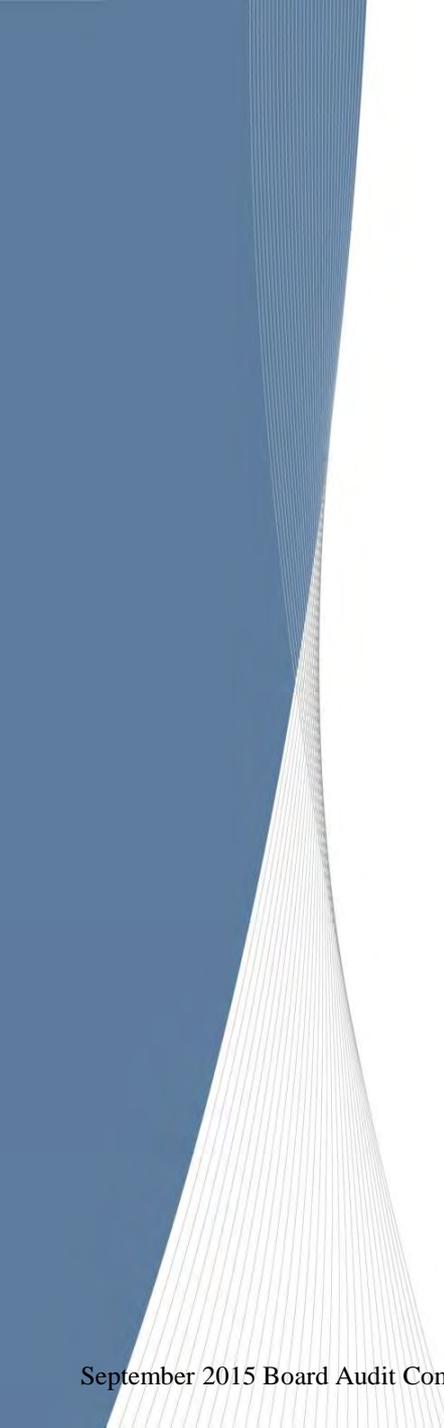
Appendix A

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

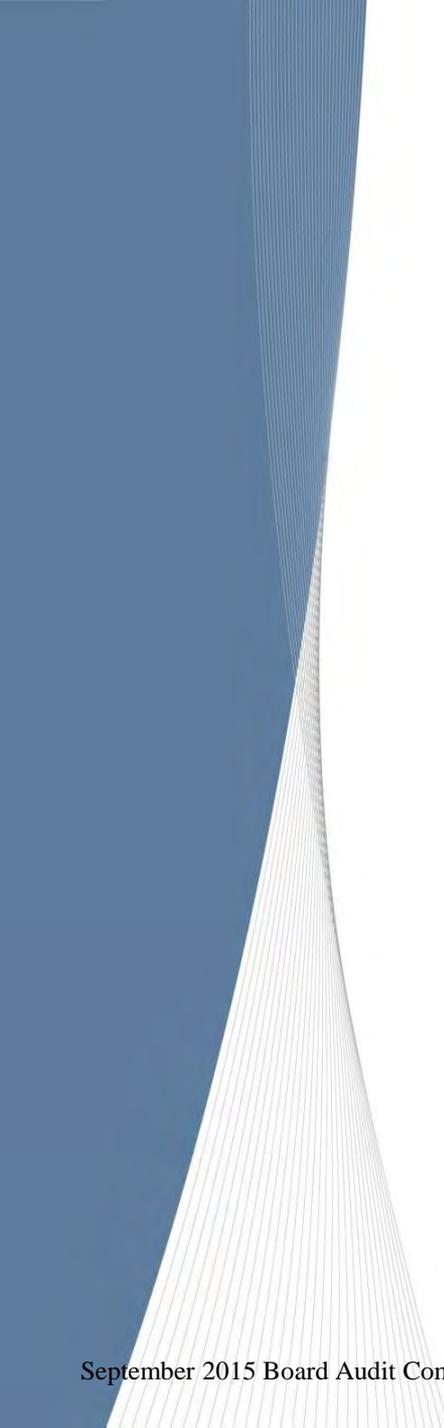
Performance Measures

- 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			
Governance, strategy, and risk management		Talent Continuity		Accounting & Reporting		Governance - IMD	
	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)	IMD Processes	
	Enterprise Risk Management		Internal policy setting and monitoring		Travel (FY14)		Internal Public Markets (FY14)
	Information technology governance (FY10)	Communications and External Relations			Federal withholdings/tax compliance		External Public Markets (FY13)
Open Government			Social media		Inventory		Private Equity (FY15)
	Open meetings compliance		Information and communication	Budget			Real Assets (FY15)
	Open records request compliance	403(b)			Budget process and reporting (FY10)		Trade Management (FY14)
Ethics and Fraud Prevention			403(b) certification process	Purchasing and Contracts			Emerging Manager Program (FY13)
	Employee ethics policies (FY15)	Records Management			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)
Regulatory, Compliance, & Litigation					Contract worker onboarding, monitoring and compliance (FY14)		Strategic Asset Allocation/Stable Value (FY14)
	Compliance: Pension Trust (FY15)	Accounting & Reporting			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)	Facilities and Facilities Planning			Risk Management (FY15)
	Litigation risk management		Other reporting (non-financial / CAFR)		Facility planning and maintenance		Performance Analytics and Operations (FY14)
Business Continuity			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)			Government Relations and Legislation			Investment Accounting (FY15)
				Pension Funding			(FY #) - indicates last year audited

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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 (84th 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

Objective 3: Use TRUST in future audits	
Strategy	Tactics
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
Objective 4: Provide input during development and implementation of the Financial System Replacement (FSR) software application	
Strategy	Tactics
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
Objective 2: Improve Internal Audit communication	
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
Objective 3: Provide information on effective Audit Committee practices	
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

Objective 4: Improve governance on fraud awareness, prevention, and detection activities	
Strategy	Tactics
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
GOAL 3: ENHANCE INTERNAL AUDIT STAFF’S COMPETENCE AND EXPERTISE IN SUPPORT OF TRS RISK MANAGEMENT, CONTROL, AND GOVERNANCE PROCESSES	
Objective 1: Cultivate in-house Subject Matter Experts	
Strategy	Tactics
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
Objective 2: Ensure continued competence and expertise of Internal Audit	
Strategy	Tactics
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

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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

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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.