A Report on

The Audit of the Teacher Retirement System's Fiscal Year 2016 Financial Statements

November 30, 2016

Members of the Legislative Audit Committee:

In our audit report dated November 17, 2016, we concluded that the Teacher Retirement System's (the System's) basic financial statements for fiscal year 2016 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 has posted 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 identified 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 2016 (see text box for the key data elements tested) as part of this audit. The completeness and accuracy of that data is important because the System's actuary uses that data to calculate the System's pension liability.

Auditors implemented a risk-based approach for selecting employers (including school districts, charter schools, and higher education institutions) for fiscal year 2016 census data testing as required by American Institute of Certified Public Accountants (AICPA) guidance. That resulted in auditors selecting 89 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.

> **Census Data Tested**
>
> Census data is key demographic data that affects the actuarial estimate of the pension liability amount that the System presents in the notes to its financial statements.
>
> Auditors identified and tested the following key data elements for the System's census data:
>
> - Name.
> - Date of birth.
> - Years of service.
> - Eligible compensation.
> - Gender.
> - Employment Status.

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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 2016. The System posts 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 2016 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 2015. 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 this financial statement audit.

We appreciate the System's cooperation during this audit. If you have any questions, please contact Michael O. Clayton, 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 Colonnetta
            Mr. David Corpus
            Mr. John Elliott
            Dr. Greg Gibson
            Mr. Christopher Moss
            Ms. Anita Smith Palmer
        Mr. Brian Guthrie, Executive Director, Teacher Retirement System

Attachment

List of Employers Selected for Census Data Testing

Table 1 lists the 89 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 2016
▪ Alice Independent School District
▪ Anna Independent School District
▪ Beeville Independent School District
▪ Breckenridge Independent School District
▪ Brooks County Independent School District
▪ Calhoun County Independent School District
▪ Carrizo Springs Consolidated Independent School District
▪ Carrollton Farmers Branch Independent School District
▪ Center Independent School District
▪ China Spring Independent School District
▪ Cleburne Independent School District
▪ Clyde Independent School District
▪ Collin County Community College
▪ Connally Consolidated Independent School District
▪ Cotulla Independent School District
▪ Crane Independent School District
▪ Dallas Independent School District
▪ DeSoto Independent School District
▪ Denison Independent School District
▪ Duncanville Independent School District
▪ El Paso Independent School District
▪ Flour Bluff Independent School District
▪ Forney Independent School District
▪ Fort Worth Independent School District

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[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 2016

- Fredericksburg Independent School District
- Frisco Independent School District
- Great Hearts Academy - San Antonio
- Gregory-Portland Independent School District
- Hamshire Fannett Independent School District
- Hereford Independent School District
- High Point Academy
- Houston Independent School District
- Itasca Independent School District
- Jacksonville Independent School District
- Katy Independent School District
- Kingsville Independent School District
- KIPP Austin College Prep
- KIPP Inc. Charter School
- La Vega Independent School District
- Liberty-Eylau Independent School District
- Little Elm Independent School District
- Lone Star College System
- Lovejoy Independent School District
- Magnolia Independent School District
- Mansfield Independent School District
- Mesquite Independent School District
- Midway Independent School District
- Mount Pleasant Independent School District
- Nederland Independent School District
- New Caney Independent School District
- North Central Texas College
- Palestine Independent School District
- Pampa Independent School District
- Pasadena Independent School District
- Ponder Independent School District
- Por Vida Academy
- Port Arthur Independent School District
- Prosper Independent School District
- Ralls Independent School District
- Region 4 Education Service Center
- Rockdale Independent School District
- Roosevelt Independent School District

List of Employers Selected for Census Data Testing for Fiscal Year 2016

- Socorro Independent School District
- Southwest Preparatory School
- Sweetwater Independent School District
- Taft Independent School District
- Texas A&M AgriLife Research and Extension Center
- The Rhodes School
- The University of Texas M.D. Anderson Cancer Center
- The University of Texas at Austin
- The University of Texas Southwestern Medical Center
- Trinity Valley Junior College
- The University of Texas at Tyler
- The University of Texas Health Science Center at Houston
- Van Independent School District
- Vernon Consolidated Independent School District
- Victoria Independent School District
- Waller Independent School District
- Weatherford Independent School District
- West Oso Independent School District
- Whitney Independent School District
- Willis Independent School District
- Wills Point Independent School District
- Wimberley Independent School District
- Windham School District
- Wylie Independent School District
- Ysleta Independent School District
- Zapata County Independent School District
- Zavalla Independent School District

State Auditor's Office

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 Colonnetta
    Mr. David Corpus
    Mr. John Elliott
    Dr. Greg Gibson
    Mr. Christopher Moss
    Ms. Anita Smith Palmer

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) as of and for the year ended August 31, 2016, 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 17, 2016.

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 were not 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
2016-1

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System's financial statements are free of 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 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 17, 2016

Schedule of Findings and Responses

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

Reference No. 2016-1
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 and 2015 financial statements.[1] Since the initial finding in 2014, TRS has begun performing audits on a limited basis of the employer census data information submitted.

> **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.
> - Salary.
> - Years of service.
>
> Source: Chapter 13 in *State and Local Governments - Audit and Accounting Guide*, American Institute of Certified Public Accountants, March 1, 2016.

The System's 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 deficiency in internal control over financial reporting, as noted in the new guidance issued by the American Institute of Certified Public Accountants.[2]

Auditors tested census data at 89 school districts, colleges, and universities. The majority of that data was accurate, and auditors identified no systematic issues. However, strengthening controls at the System would:

- Help to ensure that data is complete and accurate.

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[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) and *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).

[2] See Chapter 13 in *State and Local Governments – Audit and Accounting Guide*, American Institute of Certified Public Accountants, March 1, 2016.

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- Help to ensure that school districts, colleges, and universities are fully and accurately reporting that data.

- Improve the quality of the data that the System provides to its actuary to calculate the pension liability amount presented in the System's financial statements.

Examples of ways in which the System could strengthen controls over active employee census data include:

- Continuing to perform periodic site visits at employers to verify active employee census data.

- Providing employers with training or guidance on capturing active employee census data.

- Requiring school districts to periodically test the active employee census data and to certify the completeness and accuracy of that data when they submit that data to the System.

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.

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. The new pension administration system was originally scheduled to go live by 9/30/2016. The date for Phase 1 implementation has been adjusted and is now scheduled to go live by 09/30/2017.

In addition to the modernization effort TRS has multiple avenues in place to ensure more accurate and complete data in our current system and for migration to the new system. As part of the modernization effort the Data Management Project Team is assessing and identifying missing employee census data. Missing or incomplete data is being corrected by using Lexis Nexis software and our actuaries' software to identify accurate information on

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members based on tax identification numbers. The TRS staff is then correcting or adding the missing information to the employee data file. TRS Staff also conducted more than one hundred training sessions throughout the state for reporting entities on the new TRS Reporting System and the additional required data. TRS has added an online training module for the new reporting system on the TRS Website, in addition to other information updates related to the modernization efforts. TRS staff continues to provide training on the current system to reporting entities on a regular basis for current reporting officials and new reporting officials.

TRS internal audit will be increasing the number of employer audits in FY 2017 from 7 to 10. In addition TRS Internal Audit will be concentrating heavily on Employment After Retirement surcharges and piloting 2 higher education audits. Once an audit is complete TRS internal staff work with the reporting entities to provide additional training on TRS requirements for reporting entities. This will also assist in receiving more complete and accurate data from the reporting entities.

The TRS Chief Benefit Officer overseas the Benefit Services Division which is ultimately responsible for validating and verifying the data received from the reporting entities.

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