



ERS

EMPLOYEES  RETIREMENT
SYSTEM OF TEXAS

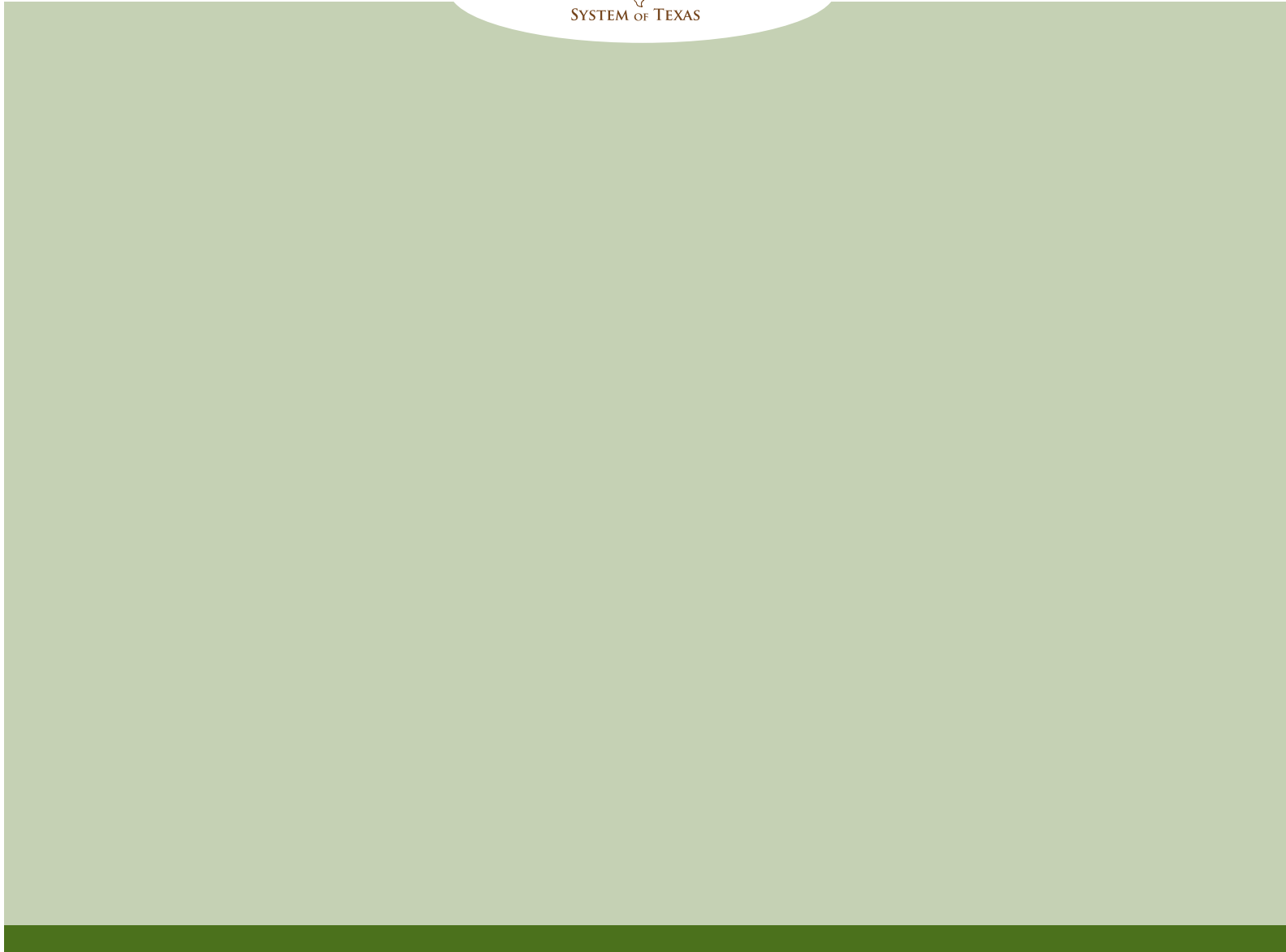


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**AUDIT COMMITTEE MEETING
EMPLOYEES RETIREMENT SYSTEM OF TEXAS**

**August 19, 2014
ERS Board Room
ERS Building – 200 E. 18th Street
Austin, Texas 78701**

TRUSTEES PRESENT

Brian Ragland, Chair
Frederick E. Rowe, Jr., Vice-Chair
Cydney Donnell, Member
I. Craig Hester, Member
Cheryl MacBride, Member

TRUSTEES ABSENT

Yolanda Griego, Member

ERS STAFF PRESENT

Ann S. Bishop, Executive Director
Larry Zeplin, Chief Operating Officer
Tony Chavez, Internal Auditor
Jordan Hajovsky, Operations Support Director
Paula A. Jones, General Counsel and Chief Compliance Officer
Robert P. Kukla, Director of Benefit Contracts
Wendy McAdams, Operations Support Director
Mel Mireles, Chief Information Officer
Shack Nail, Deputy Director of Governmental Affairs
Ralph Salinas, Human Resources Director
Marc B. Sundbeck, Manager of Enterprise Risk Management
Catherine Terrell, Director of Governmental Affairs
Tom Tull, Chief Investment Officer
Debbie Warren, Director of Customer Benefits
Mike Wheeler, Chief Financial Officer
Nora Alvarado, Benefit Contracts
Lori Blewett, Benefits Communication
Carlos Chujoy, Investments
Kyla Cloutier, Benefit Contracts
Kelley Davenport, Executive Office
Christi Davis, Customer Benefits
Brian Dowdy, Finance
Blaise Duran, Benefit Contracts
Leah Erard, Governmental Affairs
Beth Gilbert, Internal Audit
Bernie Hajovsky, Office Management Support
Robin Hardaway, Customer Benefits
Andrew Hodson, Investments
Jennifer Jones, Governmental Affairs
Sharmila Kassam, Investments
Debbie Leatham, Finance
Mark Lopez, Benefit Contracts
Betty Martin, Investments

Patricia Maugham, Executive Office
Gilbert Mokry, Internal Audit
Machelle Pharr, Finance
Lauren Russell, Benefit Contracts
Leighton Shantz, Investments
Chineque Sterns, Human Resources
John Streun, Investments
MaryJane Wardlow, Governmental Affairs
Erin Williams, Finance

ALSO PRESENT

Michael Clayton, State Auditor's Office
John Keel, State Auditor's Office
Angelica Ramirez, State Auditor's Office

Mr. Brian Ragland, Chairman of the Board of Trustees (BOT) of the Employees Retirement System of Texas (ERS), called the meeting to order and read the following statement:

"A public notice of the Board of Trustees meeting containing all items on the proposed agenda was filed with the Office of the Secretary of State at 10:02 a.m. on Thursday, August 7, 2014 as required by Chapter 551, Texas Government Code, referred to as "The Open Meetings Law."

The Board of Trustees convened as a committee of the whole at 8:00 a.m. to consider Audit Committee agenda items.

I. PRESENTATION, DISCUSSION AND CONSIDERATION OF AUDIT COMMITTEE AGENDA ITEMS:

a. External Audit Reports – Mr. Tony Chavez, ERS Director of Internal Audit introduced Mr. John Keel, the State Auditor as well as Angelica Ramirez and Michael Clayton with the State Auditor's Office (SAO) to present the results of the Incentive Compensation Audit that was performed for the plan year ending August 31, 2014. Mr. Clayton informed the board that he was the project manager on the Incentive Compensation Audit at selected state agencies. An audit was done on four separate state agencies as part of this project, which included the Employees Retirement System of Texas, the Teacher Retirement System of Texas, the Permanent School Fund and the General Land Office.

Mr. Clayton reported that the SAO determined that ERS did not always award incentive compensation appropriately with the plan policies and procedures. Ten (10) of the thirty-nine (39) payments that were tested were not calculated or paid in accordance with policies and procedures of the plan. He continued by stating there were certain incentive compensation metrics that were used in plan calculation and that ERS did not always maintain the documentation to support the calculation of the incentive compensation for some personnel. It was stated that ERS should strengthen its incentive compensation plan by formally approving the plan prior to the start of the plan performance period. Mr. Clayton also stated that ERS did use accurate amounts of qualitative metrics for the calculations. There were instances identified where ERS did not retain documentation, so the SAO had to go back and try to recreate as opposed to having the documentation to review to make sure that it was in line with what was used to calculate the amount.

The recommendations are to update its record retention schedule to require ERS to retain source documentation for all quantitative metrics it uses to calculate incentive compensation payments. It is also recommended that the ERS Board of Trustees formally approves the incentive compensation plan prior to the beginning of a plan year.

There were no questions or further discussion, and no action was required on this item.

b. Internal Audit Reports – Mr. Chavez announced the next agenda item for discussion is the Internal Audit Reports and introduced Mr. Gilbert Mokry and Mrs. Beth Gilbert as part of the Internal Audit staff to help present this agenda item. Mr. Mokry proceeded to discuss the first report on Travel Administration and Policy audit which according to principals of stewardship is necessity of travel and the cost effectiveness of those travel expenses. The objectives were to determine if travel incurred was necessary to meet ERS business needs and determine if the travel expenses were the lowest possible, considering relevant circumstances.

Mr. Mokry reported the scope of the audit was from travel expenses from September 2010 to May 2014 and the finding was that Benefits Communications division should continue to strengthen the controls over necessity and planning of its travel. Mr. Chavez then stated that Benefits Communications is moving toward implementing their controls.

The next audit committee report is the *Quarterly Investment Compliance Procedures* and Mr. Mokry briefly walked the board through a few items. In a response to a question asked by Mr. Hester, Mr. Mokry stated that SEDOL stands for *Stock Exchange Daily Official List*, and Ms. Betty Martin of the Investments division responded that voting of the proxies is handled by the analysts and the portfolio managers.

The third audit report is the *Status of Audit Recommendations* and Mr. Chavez stated that it is a follow up on the previous audits. Internal Audit has completed semi-annual procedures to monitor and report on the status of management action plans (MAPs) to address open audit recommendations as of June 30, 2014. Implementation status was based on individual MAP owner's self-assessment and Internal Audit's review of supporting documentation to corroborate the division's self-assessment. Audit work was not performed to verify the effectiveness of management actions implemented to determine if controls were working as intended. Future audit engagements in these areas will confirm the effectiveness controls implemented.

There were no questions or further discussion, and no action was required on this item.

c. Internal Audit Administrative Items – Mr. Chavez provided a high level overview on the Internal Audit Administrative items. Mr. Chavez discussed the annual audit plan roadmap as well as the proposed annual audit plan for Fiscal Year 2015. Staff developed a comprehensive annual internal audit plan report that included the process followed in developing the annual plan including project descriptions, the audit universe, and internal audit budgeting and staffing plan. The proposed FY2015 Audit Plan included audit engagements of key operational and regulatory processes that were assessed lower risk ratings, but periodic review of the business function and auditable unit is deemed necessary and appropriate.

There being no further questions or discussion the Board then took the following action:

MOTION made by Ms. Cydney Donnell, seconded by Ms. Cheryl MacBride and carried unanimously by the members of the Board of Trustees of the Employees Retirement System of Texas approve and adopt the proposed Fiscal Year 2015 ERS Internal Audit Plan as listed in this agenda item.

Mr. Chavez provided the Board on a high-level overview on the Internal Audit Fiscal Year 2015 Performance Measures and affirmed internal audit's independence.

There were no questions or further discussion, and no action was required on these items.

II. ADJOURNMENT OF THE AUDIT COMMITTEE – FOLLOWING ADJOURNMENT OF THE AUDIT COMMITTEE, THE BOARD OF TRUSTEES WILL TAKE UP THE REMAINING AGENDA ITEMS