



## Audit Committee Meeting

December 4, 2015



Presented for Review and Approval

February 23, 2016

**TABLE OF CONTENTS**

- XII. Review and Approval of the Minutes to the August 18, 2015 ERS Audit Committee.....2
- XIII. Presentation and Discussion of the Audit Committee Agenda Items:
  - a. Internal Audit Reports.....2
  - b. Internal Audit Administrative Items.....3
- XIV. Adjournment of the ERS Board of Trustees Audit Committee.....3

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

**December 4, 2015  
ERS Board Room  
ERS Building – 200 E. 18<sup>th</sup> Street  
Austin, Texas 78701**

**TRUSTEES PRESENT**

I. Craig Hester, Chair  
Doug Danzeiser, Vice-Chair  
Cydney Donnell, Member  
Brian Ragland, Member

**TRUSTEES NOT PRESENT**

Ilesa Daniels, Member\*  
Frederick E. Rowe, Jr., Member

**ERS STAFF PRESENT**

Porter Wilson, Executive Director  
Catherine Terrell, Deputy Executive Director  
Shack Nail, Special Projects and Policy Advisor  
Paula A. Jones, General Counsel and Chief Compliance Officer  
Tony Chavez, Internal Auditor  
Robin Hardaway, Director of Customer Benefits  
Robert Kukla, Director of Benefit Contracts  
Ralph Salinas, Director of Human Resources  
Tom Tull, Chief Investment Officer  
Charles Turner, Chief Information Officer  
Kelley Davenport, Executive Office  
Christi Davis, Customer Benefits  
Beth Gilbert, Internal Audit  
Gabiella Stokes, Legal Services  
Mary Jane Wardlow, Governmental Affairs

**ALSO PRESENT**

Bill Dally, Retiree  
David Doctor, Active Health Management  
Krystal Duran, Sunset  
Jennifer Modrea, Minnesota Life  
Daniella Nasar, Sunset

Mr. Craig Hester, Chairman of the Board of Trustees 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 1:33 p.m. on Monday, November 23, 2015 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 8:30 a.m. to consider Audit Committee agenda items.

*\*Footnote: Absence excused by vote of the Board upon convening the audit Committee of the Board of Trustees.*

**XII. REVIEW AND APPROVAL OF THE MINUTES TO THE AUGUST 18, 2015 ERS AUDIT COMMITTEE MEETING**

Audit Committee Chair, Cydney Donnell opened the floor for a motion on the approval of the minutes from the Audit Committee Meeting held on August 18, 2015.

**MOTION** made by Mr. Brian Ragland, seconded by Mr. Doug Danzeiser, and carried unanimously by the present members of the Audit Committee of the Employees Retirement System of Texas to approve the minutes held on August 18, 2015.

**XIII. PRESENTATION AND DISCUSSION OF THE AUDIT COMMITTEE AGENDA ITEMS:**

**a. Internal Audit Reports** – Mr. Tony Chavez, Director of Internal Audit presented the first agenda item, a follow-up to the Service Credit Purchases Audit report issued at the August 2015 Audit Committee meeting. Based on results of a prior internal audit over service credit purchases, the Audit Committee requested further analysis to determine impact of reported findings, specifically the impact of improper salary information used to calculate service credit purchase amounts. Jonathan Puckett, Internal Auditor will go over the work that was performed and over their analysis. Then Robin Hardaway, Director of Customer Benefits will discuss the results of their analysis.

Mr. Puckett, Internal Auditor, informed the board that his review determined procedures performed by Customer Benefits and Information Systems divisions were reasonable and appropriate to detect any errors in the calculation of service credits purchases from 2010 to 2014.

Ms. Hardaway, Director of Customer Benefits, informed the board that Customer Benefits worked with Information Systems and did a thorough analysis to determine the population of the service purchases that were potentially affected. As a result of analysis, Customer Benefits will work with each of the affected members to refund any overpayments that were made. Ms. Hardaway reported that ERS plans to refund approximately 11% of the total dollars back to members.

Mr. Danzeiser asked for an explanation of how the scope of affected members was determined. Ms. Hardaway replied that during the time frame of the service purchases, ERS did a complete analysis of purchased service, and determined if there were differences in calculations. Customer Benefits was able to determine if these calculations were correct.

Mr. Chavez introduced the next item for discussion, the Incentive Compensation Audit. The audit objective was to determine if recommended incentive compensation awards were in accordance with the ERS incentive compensation plan (ICP). The plan year 2015 incentive compensation awards are recommended to ERS' executive office by the Investments Division for approval. Sixty-five participants were recommended to receive an award amount of \$5.18 million (compared to \$2.1 million in 2014). The two main reasons for the increase were 1) Total Trust Performance and 2) Approved changes in the 2015 ICP that increased the maximum incentive awards range for certain positions.

Mr. Chavez reported the overall rating of "*Needs Improvement*" was due to plan award review procedures not ensuring a complete and consistent review process. Seven individuals did not receive a formal performance evaluation but were recommended for awards. One individual who was not preapproved to participate in the Plan was recommended for an award. One individual did not meet the overall minimum performance evaluation rating. One quantitative performance goal was not calculated in accordance with approved methodology.

The next item presented was the General Procurement Audit. The audit objective was to determine if controls are in place to procure goods and services at the best value to ERS and in accordance with regulatory requirements. The scope included procurements for goods and services paid between fiscal year 2013 and 2015 (excluding payments related to Group Benefits Program and investments in securities). Mr. Chavez reported the guidance to obtaining best value is the competitive bidding process, utilizing the state's purchasing power, or preferred vendor. The ERS procurement methodology is generally based on dollar value of goods or services procured.

Mr. Chavez reported the overall assessment was “Satisfactory” with two observations related to best value and recommended practices. For Best Value, control activities did not ensure existing contracts for goods and services were periodically reevaluated for best value once a contract had been awarded. Internal Audit identified several contracts over \$25,000 with original contract dates of five years or older. Recommended practices note rebidding contracts every four years.

In a response to Mr. Hester’s questioning whether every contract in excess of \$25,000 needs to be rebid every four years, Mr. Chavez responded that a rebid is a recommended best practice. Ms. Donnell stated the provision is a guideline. Mr. Wilson reminded the board that the scope of this audit did not include the GBP.

Ms. Gabriella Stokes, Director of Procurement, gave the board an update on the GBP procurement process noting that additional information would be discussed later in the agenda.

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

**b. Internal Audit Administrative Items** – Tony Chavez, Director of Internal Audit, stated the Audit Committee is responsible for reviewing the effectiveness of the internal audit function including conformance with audit standards. The fiscal year 2015 performance measures were reviewed and discussed at the August 2014 Audit Committee meeting.

Mr. Chavez reported there are three areas that Internal Audit focuses on. The first is *Enhance Professional Practice* which ensures both internal audit and governmental audit standards are followed. The next is *Enhance Performance Management*. A successful internal audit function must be both effective and efficient to meet stakeholder needs and focus on high value areas that are aligned with the organization’s strategic goals and objectives. The final area is *Grow People Management*. Auditors must have professional knowledge, skills and experience to diligently and competently perform audits.

Mr. Chavez presented the fiscal year 2015 performance measures which included: percent of internal audit plan completed, customer service levels, audit customer utilization rate, number of days in the reporting phase, percent of audit staff meeting CPE requirements, percent of audit engagement milestones met, percent of time spent on added-value services, and percent of recommendations accepted by management. Ms. Donnell asked if there are industry standard performance measures for internal audit. Mr. Chavez noted there is guidance provided by the Institute of Internal Auditors and other organizations but no uniform or standard performance measures.

Mr. Danzeiser asked why parts of the audit plan might not be completed. Mr. Chavez stated that the audit plan is for the entire fiscal year and there’s always going to be at least one engagement that Internal Audit will continue to work on through the end of August.

Mr. Chavez discussed the fiscal year 2015 annual internal audit report which was provided to the board in October 2015. The report guidelines are established by the State Auditor’s Office and provide a summary of Internal Audit activities for the prior fiscal year. This report is provided to the Governor’s Office, the Legislative Budget Board, and the State Auditor’s Office.

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

#### **XIV. ADJOURNMENT OF THE ERS BOARD OF TRUSTEES AUDIT COMMITTEE**

Following adjournment of the Audit Committee, the Board of Trustees will take up the remaining agenda items.