



Audit Committee Meeting

May 17, 2016



Presented for Review and Approval

August 16, 2016

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

**May 17, 2016
ERS Board Room
ERS Building – 200 E. 18th Street
Austin, Texas 78701**

TRUSTEES PRESENT

I. Craig Hester, Chair
Doug Danzeiser, Vice-Chair
Ilesa Daniels, Member
Brian Ragland, Member

TRUSTEES NOT PRESENT

Cyndey Donnell, Member (*Excused by the Board*)
Frederick E. Rowe, Jr., Member

ERS STAFF PRESENT

Porter Wilson, Executive Director
Catherine Terrell, Deputy Executive Director
Paula A. Jones, Deputy Executive Director & General Counsel
Shack Nail, Special Projects and Policy Advisor
Tony Chavez, Internal Auditor
Robert Kukla, Director of Benefit Contracts
Machelle Pharr, Chief Financial Officer
Gabrielle Stokes, Director of Procurement & Contract Oversight
Tom Tull, Chief Investment Officer
Kelley Davenport, Executive Office
Beth Gilbert, Internal Audit
Robert Lee, Investments
Betty Martin, Investments
Karen Norman, Internal Audit
Jonathan Puckett, Internal Audit
Robert Sessa, Investments
Keith Yawn, Enterprise Planning Office

ALSO PRESENT

Keith Barnes, Blue Cross Blue Shield of Texas
David Dorman, Active Health Management
Joseph Halbert, Senator Schwertner's Office
Yves-Laurent Khary, Blue Cross Blue Shield of Texas
Bobby Wilkinson, Office of the Governor

Mr. Craig Hester, Chairman of the Board of Trustees of the Employees Retirement System of Texas (ERS), noting a quorum was present, 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 9:03 a.m. on Thursday, May 5, 2016 as required by Chapter 551, Texas Government Code, referred to as “The Open Meetings Law.”

The Board of Trustees then convened as a committee of the whole at 8:15 to consider Audit Committee agenda items.

I. REVIEW AND APPROVAL OF THE MINUTES TO THE FEBRUARY 23, 2016 ERS AUDIT COMMITTEE MEETING

Mr. Craig Hester, opened the floor for a motion on the approval of the minutes from the Audit Committee Meeting held February 23, 2016.

MOTION made by Mr. Brian Ragland, seconded by Mr. Doug Danzeiser and carried unanimously by the present members of the Audit Committee approved the minutes to the meeting held on February 23, 2016

II. PRESENTATION, DISCUSSION AND CONSIDERATION OF INTERNAL AUDIT REPORTS

Mr. Tony Chavez, Director of Internal Audit (IA), introduced Ms. Karen Norman, internal auditor. Mr. Chavez reported on the Group Benefits Program (GBP) procurements follow-up audit. Based on related internal and State Auditor audit recommendations, the objective was to assess the status of corrective actions and implementation of recommendations in the contract procurement and management process following the Texas contract management guide. Exhibits presented an overview of contract management framework made up of contract planning, procurement and monitoring/oversight areas. Mr. Chavez referenced the numerous GBP related contracts procured and monitored by the Benefits Contracts Division.

Ms. Norman reviewed inherent operational risk factors in the procurement process when evaluating and communicating best value, performance factors and lowest cost measurements. She emphasized the GBP program’s complexity containing multiple deliverables and price points. As a result of Senate Bill 20, regulatory changes in contract management best practices have been instituted to comply with the new Contract Management Guide. While compliance, planning and development scope areas were rated “satisfactory”, the overall rating for the procurement, selection and recommendation process was “needs improvement”. Management is in compliance with the State Auditor’s Office contract management requirements. However, the procurement evaluation process methodology needs to improve RFP evaluation scoring tools incorporating elements recommended in the Texas Contract Management Guide.

Mr. Hester asked about the timing of this audit and the creation of the new Office of Procurement and Contract Oversight (OPCO). IA worked with the both Benefit Contracts and OPCO during this audit. Board members asked questions concerning the evaluation matrix and best value. Mr. Chavez stated the audit was concerned with methodology. The board asked about the complexity and necessary elements of the scoring sheet. Ms. Norman stated no elements were missing from the scoring sheets. The board asked additional questions about the complexity of the scoring matrix and performance factors. Ms. Gabrielle Stokes, Director of OPCO, further clarified the scoring process methodology evolution during the audit and its future use for contract evaluation.

Mr. Chavez then introduced Mr. Jonathan Puckett, internal auditor, to review the quarterly procedures to test compliance with ERS' Investment Policy using agreed upon procedures (AUP) as a part of the FY16 Annual Audit Plan. Reporting impacts and risk to the organization concerning investment compliance – securities lending, Mr. Puckett reported that in February the Investments Division temporarily suspended its securities lending program. Recalling these borrowed securities contributed to atypical instances of noncompliance in diversification limit for Eurozone counterparties exceeding 10% and diversification limit for non-Eurozone counterparties exceeded 20%. Mr. Chavez stated that Investments kept Internal Audit informed so IA was aware when the compliance flags were raised.

Two other minor compliance issues were noted. They were both a result of corporate timing issues and were resolved within a few days. Mr. Hester noted on the personal trading side, there were no policy violations and congratulated the Investments staff.

There being no further discussion, the Audit Committee adjourned.

III. ADJOURNMENT OF THE ERS BOARD OF TRUSTEES AUDIT COMMITTEE AND RECESS OF THE BOARD OF TRUSTEES

Following a temporary recess, the Board of Trustees will reconvene with the Investment Advisory Committee to take up the following Joint Board of Trustees and Investment Advisory Committee agenda items.