

Internal Audit Annual Report



October 2019

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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 the Internet Web site

House Bill 16 (83rd Legislature, Regular Session), signed by Governor Perry on June 14, 2013, amended the Internal Auditing Act to require state agencies and institutions of higher education, as defined in the bill, to post agency internal audit plans, internal audit annual reports, and any weaknesses or concerns resulting from the audit plan or annual report on the agencies' internet web site within 30 days after the audit plan and annual report are approved by the agencies' governing board or chief executive.

The Internal Audit Division meets the requirements by posting the approved documents at the following link: <https://ers.texas.gov/About-ERS/Reports-and-Studies/Reports-on-Overall-ERS-Operations-and-Financial-Management>

II. Internal Audit Plan for Fiscal Year 2019

Report Number	Title	Date	Status
2018-05	HealthSelect Contract Administration	08-2019	Report Issued
2018-07	Real Assets - Infrastructure	11-2018	Report Issued
2018-09	Investment Management Fees	11-2018	Report Issued
2019-01	Incentive Compensation	08-2019	Report Issued
2019-02	Temporary Workers Contract Management	05-2019	Report Issued
2019-03	Client Reconciliation	05-2019	Report Issued
2019-05	Data Loss Prevention	08-2019	Report Issued
	Financial Opinion Audit	03-2019	Report Issued
2019-06	IT Governance		Fieldwork Phase
2019-07	Private Equity		Fieldwork Phase
2019-08	Profit Sharing		Fieldwork Phase

Deviations from the approved Fiscal Year 2019 Audit Plan

One engagement from FY19 audit plan was not started.

Report Number	Title	Status
2019-04	HealthSelect Financial Management	Not Started (<i>Not carried to FY20 Audit Plan</i>)

Monitoring agency contracts

Monitoring of agency contracts is performed through regular audits of programs and the procurement and contract monitoring processes. In Fiscal Year 2019, the HealthSelect Contract Administration Audit (2018-05) was completed and focused on contract monitoring procedures.

III. Consulting Services and Nonaudit Services Completed

The Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing* define consulting services as advisory in nature and at the specific request of an engagement client. The nature and scope of consulting engagements are subject to agreement with the engagement client.

Consulting Engagements

Report Number	Title	Date	Status
2019-03	Client Reconciliation	05-2019	Report Issued
2019-06	IT Governance		Fieldwork Phase

Service Organization Control (SOC) reports

In Fiscal Year 2019, Internal Audit reviewed Service Organization Control (SOC) reports for compliance with Statement on Standards for Attestation Engagements No. 18 – *Concepts common to all Attestation Engagements*. Internal Audit did not perform review procedures to determine if the service organization control objectives, and the related control activities, are relevant to ERS nor did we perform procedures to identify any gaps in the service organizations control structure that may affect ERS' business objectives.

Deliverable	Title	Date
Memorandum	Securian Group Life	04-2019
Memorandum	Minnesota Life Insurance	05-2019
Memorandum	Community First	05-2019
Memorandum	Scott & White	05-2019
Memorandum	Superior Vision	05-2019
Memorandum	Empower	06-2019
Memorandum	Blue Cross Blue Shield	06-2019

Allegations of Fraud, Waste, and Abuse

In Fiscal Year 2019, Internal Audit continued to assist in compiling, tracking, and coordinating, with the Chief Compliance and Ethics Officer, internal and external allegations of wrongdoing. Trends identified are reported to the Board of Trustees annually by the Chief Compliance Officer.

Informal Consulting

Internal Audit provided input and guidance as a subject matter expert related to risk and control self-assessments. Internal Audit did not develop or implement any specific control activities nor assume any management responsibility. No formal deliverable was prepared.

IV. External Quality Assurance Review (Peer Review)

Internal Audit Division

November 11, 2019



**Sonya Etheridge, CPA
Director of Internal Audit at the
Texas Facilities Commission**

**Andrea Focht-Williams, CPA
Senior Internal Auditor at the Texas
Municipal Retirement System**

**Performed in Accordance with the State
Agency Internal Audit Forum Peer Review
Policies and Procedures**

11/11/2019

Anthony Chavez
Director of Internal Audit
Employee Retirement System of Texas

Dear Mr. Chavez,

We have completed a peer review of the Employee Retirement System of Texas Internal Audit Department for the period 9/1/2016-8/31/2019. In conducting our review, we followed the standards and guidelines contained in the Peer Review Manual published by the State Agency Internal Audit Forum (SAIAF).

The Institute of Internal Auditors (IIA) *International Standards for the Professional Practices of Internal Auditing and Code of Ethics*, U.S. Government Accountability Office (GAO) *Government Auditing Standards*, and the Texas Internal Auditing Act (Texas Government Code, Chapter 2102) require that internal audit functions obtain external quality assurance reviews (peer reviews) to assess compliance with standards and the Act and to appraise the quality of their operations.

We reviewed the internal quality control system of your audit organization and conducted tests in order to determine if your internal quality control system operated to provide reasonable assurance of conformance with the IIA *Standards*, the GAO *Standards*, and the Texas Internal Auditing Act. Due to variances in individual performance and judgment, conformance does not imply adherence to standards in every case but does imply adherence in most situations.

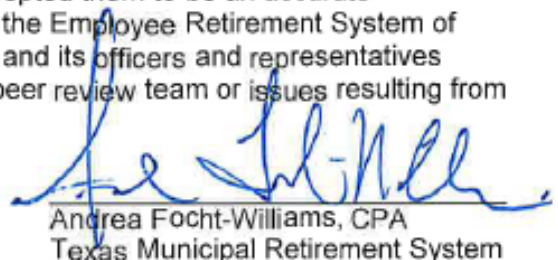
Based on the information received and evaluated during this external quality assurance review, it is our opinion that the Employee Retirement System of Texas Internal Audit Department receives a rating of:

"Pass/Generally Conforms" and is in compliance with the IIA Standards, the GAO Standards, and the Texas Internal Auditing Act. This opinion, which is the highest of the three possible ratings, means that policies, procedures, and practices are in place to implement the standards and requirements necessary for ensuring the independence, objectivity, and proficiency of the internal audit function.

We have provided suggestions in a separate communication to further strengthen the internal quality control system.

The Employee Retirement System of Texas Internal Audit Department has reviewed the results of the work performed by the peer review team and accepted them to be an accurate representation of their operations. To the extent lawful, the Employee Retirement System of Texas Internal Audit Department agrees to hold SAIAF and its officers and representatives harmless of any liability arising from the actions of the peer review team or issues resulting from the peer review.


Sonya Etheridge, CPA
Texas Facilities Commission


Andrea Focht-Williams, CPA
Texas Municipal Retirement System

CC:
Attachment A: Conformance Rating Definitions
Attachment B: Best Practices

V. Internal Audit Plan for Fiscal Year 2020

Introduction

The Texas Internal Auditing Act (Texas Government Code 2102) requires that a risk-based annual audit plan (Internal Audit Plan or Plan) be developed and approved by the Board of Trustees. The Plan is designed to provide coverage of key risks, given the existing staff and approved budget. Key risks were determined based on a systemic approach incorporating management input, Internal Audit analysis, and ERS' strategic objectives.

Continuous evaluation of the Internal Audit Plan, based on risks identified, timing of ERS' initiatives, and staff availability may result in modifications to the Plan during the year. Significant modifications to the Plan will be coordinated with the Executive Director and submitted to the Audit Committee Chair for review and approval.

Audit Plan Approach

The annual internal audit plan is developed based on ERS' audit universe, stakeholder input, and an assessment of risk and exposures affecting ERS. Throughout the year, Internal Audit advances its understanding of ERS strategic objectives and initiatives through attendance at strategic planning meetings and division presentations/training. Auditors also gain an understanding of industry trends and current environmental risks through discussions with industry personnel, review of trade publications, and attending relevant external training. On a periodic basis the audit universe and associated risk measurement tools are updated to reflect current strategies and the direction of the agency.

ERS' audit universe is divided into three separate and distinct groupings to better assess and measure risks associated with core business objectives. The first group, Member Services (Retirement, Group Benefits, and Operations), relates to ERS' core business objectives of providing retirement and benefit programs to state employees, retirees, and their dependents. The second group, Information Technology, relates to providing information technology for supporting ERS' core business objectives. The third group, Investments, relates to the ERS goal of earning investment returns on a long-term basis to support ERS' member services.

For each auditable unit (program process or investment strategy), Internal Audit utilized risk criteria tailored for each audit universe, auditor professional judgement, and feedback from stakeholders to measure the inherent risk by impact and likelihood that it would affect ERS goals or objectives. This allowed Internal Audit to identify those areas that were high risk and impact to ERS' strategic directions to

be carried forward to the fiscal year 2020 audit plan. In addition, key operational functions that were assessed lower risk ratings were also carried forward to the fiscal year 2020 audit plan because periodic review was deemed necessary and appropriate.

Internal Audit Plan

The Board of Trustees approved the Internal Audit Plan for fiscal year 2020 on August 21, 2019. The Internal Audit Plan consists of six risk-based, value-adding activities for the fiscal year in addition to the three audit engagements carried over from Fiscal Year 2019. The audit activities consist of two types of activities and coverage:

Audits

- Nature and scope of engagement determined by Internal Audit
- Highest level of assurance
- Deliverable: Report for public distribution

Consulting (Advisory)

- Nature and scope of engagement subject to agreement with audit customer
- No assurance provided
- Deliverable: Report or memo with limited distribution

The Internal Audit Division will provide the results of audit activities to the Audit Committee and Board of Trustees at the request of the Audit Committee Chair.

Approved Audit Plan for Fiscal Year 2020

Title	Type	Budgeted Hours
Private Equity	Audit	700
Profit Sharing	Audit	500
Incentive Compensation Plan	Audit	400
IT Governance	Consulting	200
Public Equity – Internal	Audit	1,200
Survivor Benefits	Audit	700
Deferred Compensation	Audit	800
PeopleSoft Pension IT Controls	Audit	900
Insurance Forecasting	Audit	100

Contingency List

A contingency list of four activities is also included in the internal audit plan. These risks were ranked as “high” but were not included in the FY20 Internal Audit Plan. This provides for additional coverage if the above activities are completed prior to the conclusion of the fiscal year.

Title	Type
Investment Diversification Limits	Audit
Retirement Account Withdrawals	Audit
Business Continuity	Audit

VI. External Audit Services Procured in Fiscal Year 2019

Audit Engagement	Vendor
The Audit of ERS' Fiscal Year 2019 Financial Statements	Texas State Auditor's Office
Schedule of Employer Allocation and the Collective Pension Amounts including: 1) Independent Auditor's Report and 2) Report on Internal Control Over Financial Reporting and on Compliance and Other Matters	Texas State Auditor's Office

VII. Reporting Suspected Fraud and Abuse

ERS has a responsibility to state employees, retirees, and the public to maintain the highest ethical standards when conducting business. Individuals are encouraged to report in good faith any suspected fraud, waste, abuse, or ethics policy violation in connection with programs administered by ERS.

ERS complies with the requirements of Article IX, *Section 7.09, Fraud Reporting, General Appropriations Act* (86th Legislature) by:

- Enforcing the ERS Fraud policy to minimize the impact of potential or actual fraudulent acts at ERS by deterring such activity or detecting it as early as possible
- Alerting all ERS employees that there are reporting mechanisms that are easy, safe and secure using:
 - ERS Public website
 - ERS Internal Connect Website (Intranet)
 - Direct contact with Internal Audit
 - State Auditor's Office Hotline
- Alerting the public that there are reporting mechanisms that are easy, safe, and secure using:
 - ERS Public website at <https://ers.texas.gov/About-ERS/Policies/Fraud-Policy>
 - Direct contact with the Director, Internal Audit Division or Chief Compliance and Ethics Officer
 - State Auditor's Office Fraud Hotline telephone number is listed on the ERS Public Website at <https://ers.texas.gov/Contact-ERS/Additional-Resources/Report-Fraud>

ERS complies with the requirements of Texas Government Code, Section 321.022 *Coordination of Investigations* by submitting *Reasonable Cause to Believe* report(s) to the State Auditor's Office if applicable. The Director of Internal Audit coordinates the *SAO Hotline Complaints* with the Texas State Auditor's Office designated contact.