

Meeting of the ERS Board of Trustees Audit Committee

December 8, 2020



Public Agenda Item #1

*Call Meeting of the ERS Board of Trustees
Audit Committee to Order*

December 8, 2020

Public Agenda Item #2

*Review and Approval of the minutes to the August 19,
2020 ERS Audit Committee Meeting - (Action)*

December 8, 2020

Questions?
Action Item

Public Agenda Item #3
Review of External Audit Reports

December 8, 2020

Tony Chavez, Director of Internal Audit

Texas State Auditor's Office Report on Incentive Compensation

SAO – Incentive Compensation Audit



Audit Information:

- Annual Audit
- Includes multiple agencies

ERS Information:

- ERS awarded almost \$4m to 74 employees in Plan Year 2019
- All awards payable over 3 years



An Audit Report on
**Incentive Compensation at the
Permanent School Fund, General Land
Office, Teacher Retirement System, and
Employees Retirement System**

August 2020
Report No. 20-040

SAO – Incentive Compensation Audit - Results



Chapter 4
Rating:
Low ⁶

ERS Calculated and paid Plan Year 2019 incentive compensation in accordance with its policies and procedures, but it should further strengthen controls over its calculation and review process

SAO Rating Legend:

| Summary of Issue Ratings | |
|--------------------------|--|
| Issue Rating | Description of Rating |
| Low | The audit identified strengths that support the audited entity's ability to administer the program(s)/function(s) audited, <u>or</u> the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited. |
| Medium | Issues identified present risks or effects that if not addressed could <u>moderately affect</u> the audited entity's ability to effectively administer the program(s)/function(s) audited. Action is needed to address the noted concern(s) and reduce risks to a more desirable level. |
| High | Issues identified present risks or effects that if not addressed could <u>substantially affect</u> the audited entity's ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern(s) and reduce risks to the audited entity. |
| Priority | Issues identified present risks or effects that if not addressed could <u>critically affect</u> the audited entity's ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern(s) and reduce risks to the audited entity. |

Questions?

Public Agenda Item #4
Review of Internal Audit Reports

December 8, 2020

Tony Chavez, Director of Internal Audit

COVID-19 IT Review

Tony Chavez, Director of Internal Audit

Tressie Landry, Audit Manager

Reema Parappilly, Partner, Weaver

David Friedenber, Manager, Weaver

COVID – 19 IT Review



- Consulting Engagement with Weaver as co-sourced firm



Reema Parappilly, CISA
Partner, IT Advisory
Services

Reema has more than 15 years of experience providing IT advisory services to companies, including supporting ERS' Internal Audit department on IT related projects since 2014



David Friedenber, CISA, CRISC,
CISSP, QSA
Manager, IT Advisory Services

David has more than 12 years of experience providing information technology, IT risk advisory and internal audit services to companies and government entities and agencies

COVID-19 IT Review

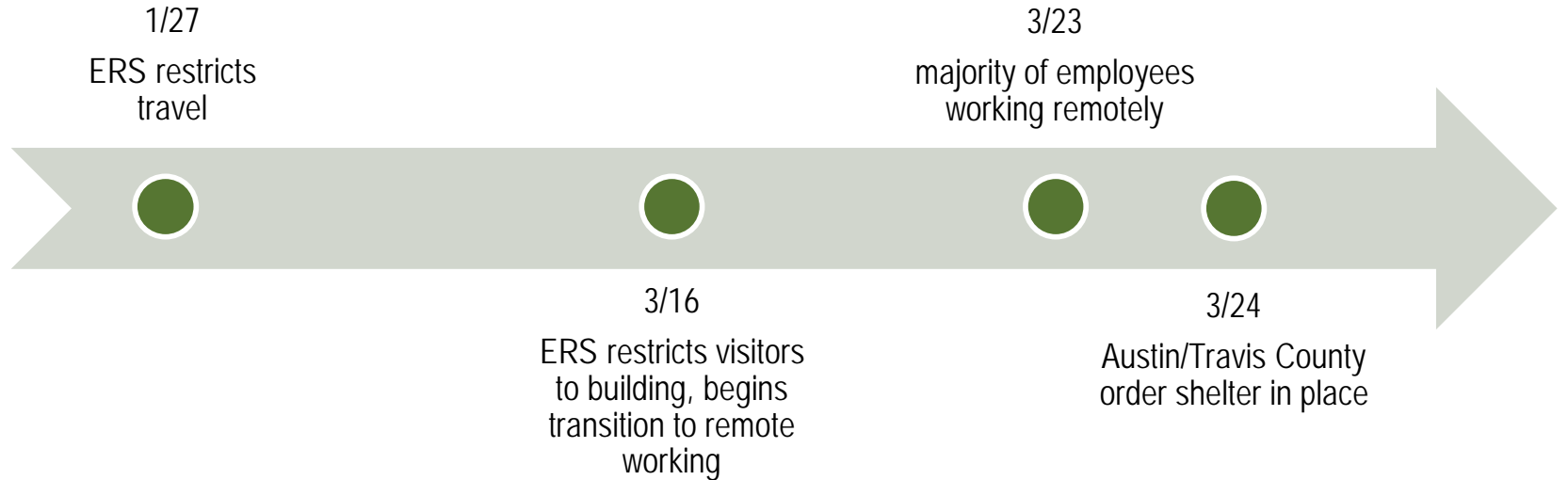


Objectives:

- **Scalability and Availability** – determine whether existing hardware and software capacity effectively supported increased demand for a remote workforce
- **Security** – determine whether appropriate internal controls over the security of the systems and software exist in support of a remote workforce
- **Governance** – determine whether existing governance requirements and controls effectively support a remote workforce related to the security, availability and scalability of ERS IT resources

COVID-19 IT Review

ERS COVID Response Timeline



COVID-19 IT Review

Results



Scope

Scalability and
Availability

Security

Governance

17 Points of Analysis

4 Observations

6 Improvement Opportunities

4 Commendations

Results

Process Owner Questionnaire - 32 Directors and Managers responded

- Collaboration Tools:
 - Primary tools changed from 41% SharePoint and 19% use Jabber to 31% Jabber and 28% SharePoint
 - 88% responded that at least half of their work is reliant on the availability of collaboration tools
 - 50% of teams experienced an outage that caused a moderate impact to work (primarily conferencing software)
- Work Monitoring:
 - 72% stated that monitoring tools were helpful or required
 - 78% monitor productivity based on task completion
- Connectivity:
 - 25% state the majority of the department is on VPN
 - 72% state the majority of the department is on VDI

COVID-19 IT Review

Observations



- 1) Update policies and procedures to reflect larger remote workforce
- 2) Implement stronger requirements for certain employees to allow Information Systems to perform required maintenance
- 3) Review encryption requirements for certain processes
- 4) Implement a formal rotation for recovery testing

COVID-19 IT Review

Commendations



Information Systems staff:

- Proactively repurposed existing hardware and contract resources to facilitate the transition
- Identified needs and acquired additional hardware and licenses in a timely manner
- Provided proactive end user support through FAQs and Wiki pages (Process Owner Questionnaire)
- Provided quick responses and resolution to support issues (Process Owner Questionnaire)

Questions?

Audit of Survivor Benefits

Tony Chavez, Director, Internal Audit Division

Tressie Landry, Manager, Internal Audit

Jonathan Puckett, Project Lead, Internal Audit

Survivor Benefits Audit

Strategic Alignment



Audit Objective: To determine if survivor benefits are processed accurately, timely and in accordance with statutory requirements

Strategic Objective: Support our members retirement security

Program Objective: Survivor Benefits works closely with families, state agencies, Social Security Administration, and other sources to process death benefits quickly and accurately.

Survivor Benefits Audit

Background – Survivor Benefits Available



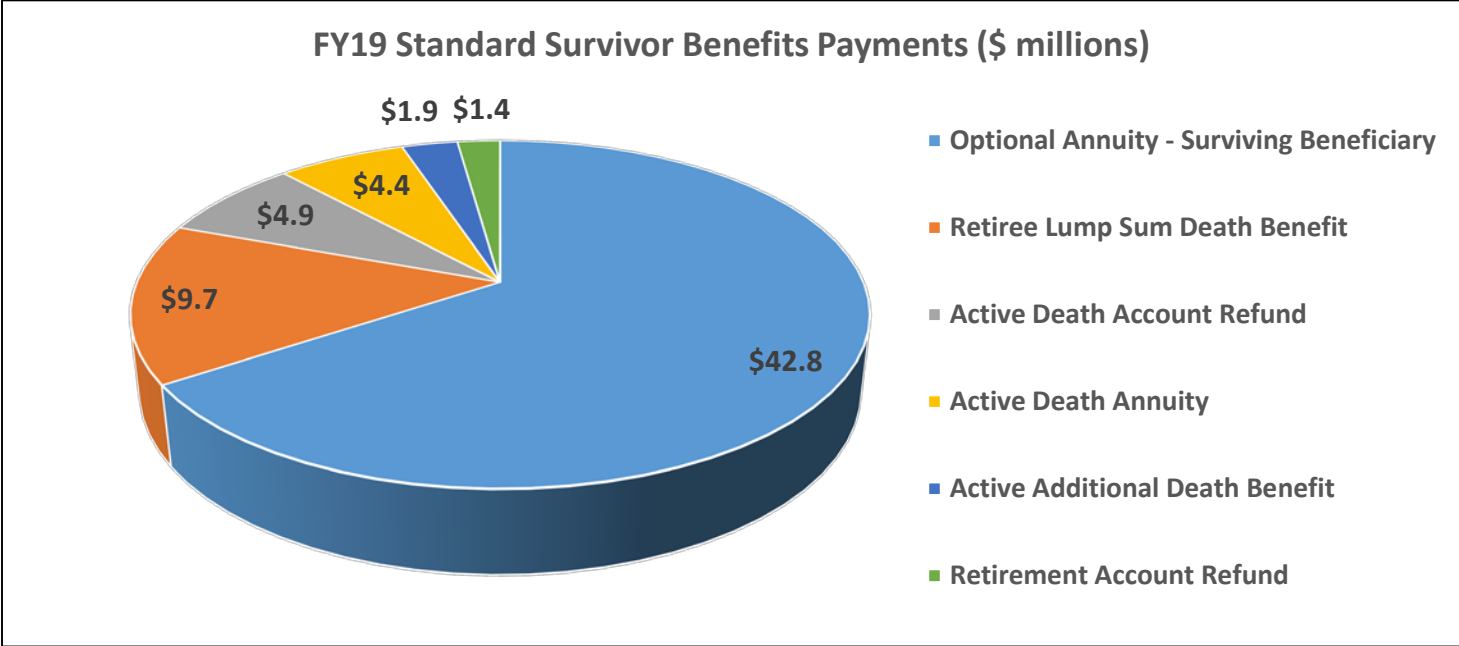
| Standard Survivor Benefits | | | | Public Safety (Ch. 615) Survivor Benefits |
|--------------------------------|---------------------------------|--------------------|--------------------------|--|
| Retiree Benefits | Active Member Benefits | Insurance Benefits | Other Benefits | All Benefits |
| Optional annuity | Active additional death benefit | Basic term life | Funeral assignment | \$500,000 lump sum payment |
| Retiree lump sum death benefit | Active death account refund | COBRA | Texa\$aver SM | Funeral expenses |
| Retirement account refund | Active death annuity | Dental | | Health insurance |
| | | Health | | Surviving child payments |
| | | Optional term life | | Surviving spouse annuity |
| | | Vision | | |

Survivor Benefits Audit

Background



Standard Survivor Benefits



Survivor Benefits Audit

Background



Public Safety (Chapter 615) Survivor Benefits

- Survivor(s) eligible if public safety officer died from injury in line-of-duty
- ERS is administrator of public safety survivor benefits program
 - Review and approve applications
 - Support from Office of General Counsel and Medical Board

Funding for public safety survivor benefits is provided
by the State of Texas, not ERS

Survivor Benefits Audit

Background



COVID-19 Impact

- Adjustments for processing of survivor benefits
 - Remote processing by ERS staff
 - Online notaries
 - Exceptions allowing copies when certified copies were previously required
- Significant increase in public safety (Chapter 615) survivor benefit claims

Survivor Benefits Audit

Results



| OVERALL ASSESSMENT | | SATISFACTORY |
|---|--|--------------|
| SCOPE AREA | RESULTS | RATING |
| Standard Survivor Benefits | Observation 1: Procedures for processing retiree lump sum death benefits do not align with timeliness requirements. (Moderate) | SATISFACTORY |
| Public Safety (Chapter 615) Survivor Benefits | Controls are in place to provide reasonable assurance that objectives are met. | SATISFACTORY |

Survivor Benefits Audit

Key Controls



- Benefits letters to survivors are reviewed to verify all available benefits communicated
- All manual calculations are reviewed for accuracy
- Notarization is required on claim forms as a deterrent of fraud
- For public safety (Chapter 615) survivor benefits, reviews are performed by:
 - Medical board review (if applicable)
 - Office of General Counsel
 - Director of Customer Benefits

Survivor Benefits Audit



Observation 1 – Timeliness of lump sum death benefit

| Retiree Lump Sum Death Benefits Highlights | |
|--|--|
| Retiree Death Benefit: | <ul style="list-style-type: none">• \$5,000 one-time payment |
| Recipient: | <ul style="list-style-type: none">• Designated beneficiary or retiree's estate |
| Required Documentation: | <ul style="list-style-type: none">• Death certificate• Claim form• Estate documentation (if applicable) |
| Fiscal Year 2019 Benefit Activity | <ul style="list-style-type: none">• \$9.7 million - Total payments• 2,480 - beneficiaries paid• 85% - Percent of total survivor benefits claims received this benefit |

A review of retiree lump sum death benefit payments determined:

- Payments processed accurately
- Instances where timeliness requirements were not met.

Survivor Benefits Audit



Observation 1 – Timeliness of lump sum death benefit

The board by rule shall adopt procedures to provide for the payment of this benefit not later than the seventh day after the date the board receives the required proof of death.

Source: Texas Government Code 814.501

Upon receipt of a properly completed claim form, death certificate and other information that may be required to establish beneficiary status or heirship for the uncontested payment of a retiree lump-sum death benefit, the System will provide for the payment of the lump-sum death benefit by notifying the Comptroller of Public Accounts not later than the seventh day after receipt.

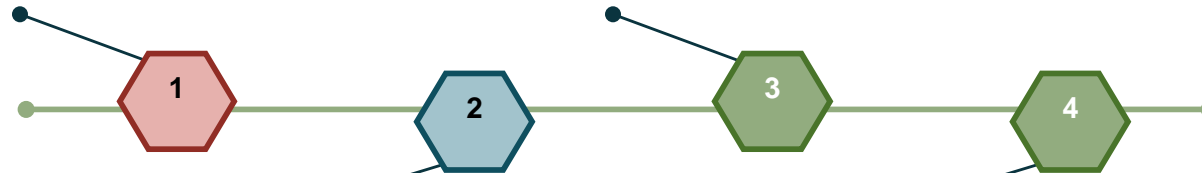
Source: Texas Administrative Code Title 34 Part 4 Rule 73.27

Survivor Benefits Audit

Observation 1 – Timeliness of lump sum death benefit

RETIREE LUMP-SUM DEATH BENEFIT PROCESSING TIMELINE

Receipt of benefit claim documentation by ERS
(Regulatory start date for determining timeliness)



Notify Comptroller to remit payment

Analyst reviews claim documentation

- Approves if complete
- If incomplete, beneficiary contacted to obtain additional information

(Current start date for determining timeliness)

Beneficiary receives payment

Survivor Benefits Audit



Observation 1 – Timeliness of lump sum death benefit

Recommendation / Management Action Plan

- Align procedures with regulatory requirements on timeliness
 - Update target to provide for payment 7 days from receipt of completed documentation
- Evaluate volume of claims and its impact on meeting this timeliness requirement
 - FY16 – FY19: 2,400 and 2,600 retiree lump sum benefits processed annually
 - All survivor benefits processed in FY19 was 3,800

Questions?

Texa\$aver Audit

Tony Chavez, Director of Internal Audit

Tressie Landry, Audit Manager

Karen Norman, Project Lead

Texa\$aver Program

Background



TEXA\$AVERSM 401(k) / 457 Program

Established in 1985

- 218k accounts
- \$2.8 billion in assets invested
- Available to State Agencies employees

Established in 1974

- 26k accounts
- \$1 billion in assets invested
- Available to State Agencies and Higher Education

The program is funded entirely by participants and receives no state funds

Audit Objective: To determine if contract management over the Texa\$aver program ensures member benefits are properly delivered



| Scope Area | Sub-Objectives |
|--------------------|--|
| Investment Options | <ul style="list-style-type: none">• Are high-quality and diversified investments offered to participants? |
| Service Delivery | <ul style="list-style-type: none">• Are participant deferrals processed accurately and timely?• Are participant distributions processed accurately? |
| Program Management | <ul style="list-style-type: none">• Is the monthly participant fee calculated accurately?• Is the monthly participant fee appropriate? |

Texa\$aver Audit

Results



| OVERALL ASSESSMENT | | SATISFACTORY |
|--------------------|--|--------------------------|
| SCOPE AREA | RESULTS | RATING |
| Investment Options | The Product Review Committee is actively providing fiduciary responsibilities over the Texa\$aver portfolio's quality and diversification. | EXCELLENT |
| Service Delivery | Observation #2 Enhancements to key controls would improve assessment of Service Delivery to participants. (Moderate) | SATISFACTORY |
| Program Management | Observation #1 Controls over the development of Texa\$aver participant fees have not been established. (Significant) | NEEDS IMPROVEMENT |

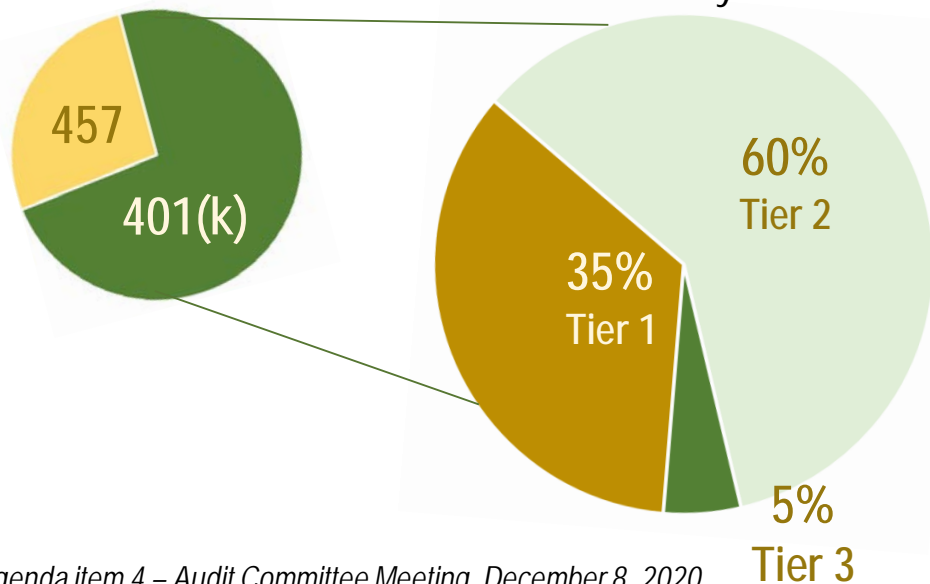
Texa\$aver Program

Investment Options



The portfolio is designed around a participant's level of engagement, preference and diversification

AUM by Tier



- Tier 1
Target Dates
- Tier 2
Core Funds
- Tier 3
Self Directed

The Product Review Committee provides oversight of the Texa\$aver investments quality and diversification

- ✓ Continuous Monitoring
- ✓ Sub-Committees
- ✓ Subject Matter Experts
 - Investment Staff
 - Investment Advisory Committee
- ✓ High-Quality
- ✓ 12-point criteria
- ✓ Diversification
- ✓ Semi Annual Meetings
- ✓ Benchmarks

Program Management



Observation 1 – No Reserve Fund Balance established

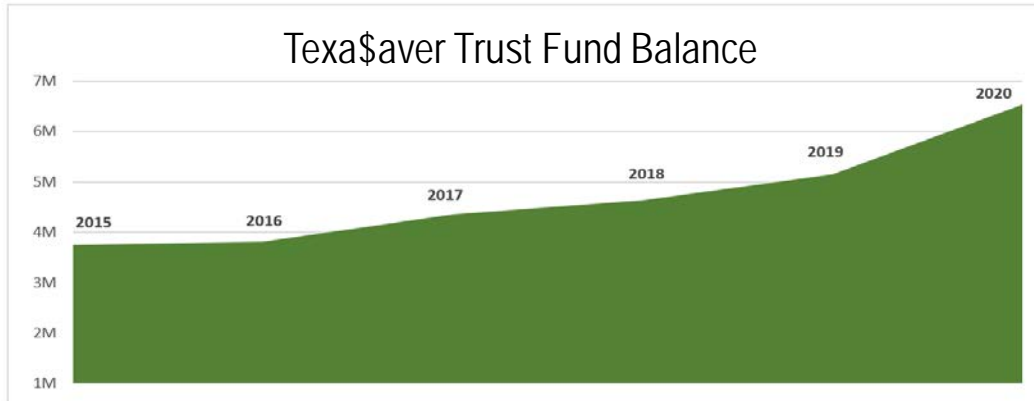
Texa\$aver is self-funded through Participant Fees

Participant Fee – Set by ERS, is charged to participants based on their average account balance for the month

Admin Fee – Fixed rate of \$1.54 assessed per account per month by the TPA

$$(\$Participant\ Fee - \$1.54) = ERS\ receives$$

$$(ERS\ receives - Internal\ Costs) = Surplus\ added\ to\ Texa\$aver\ Trust\ Fund$$



Current Treasury Balance is \$6.5M
But without an established reserve level

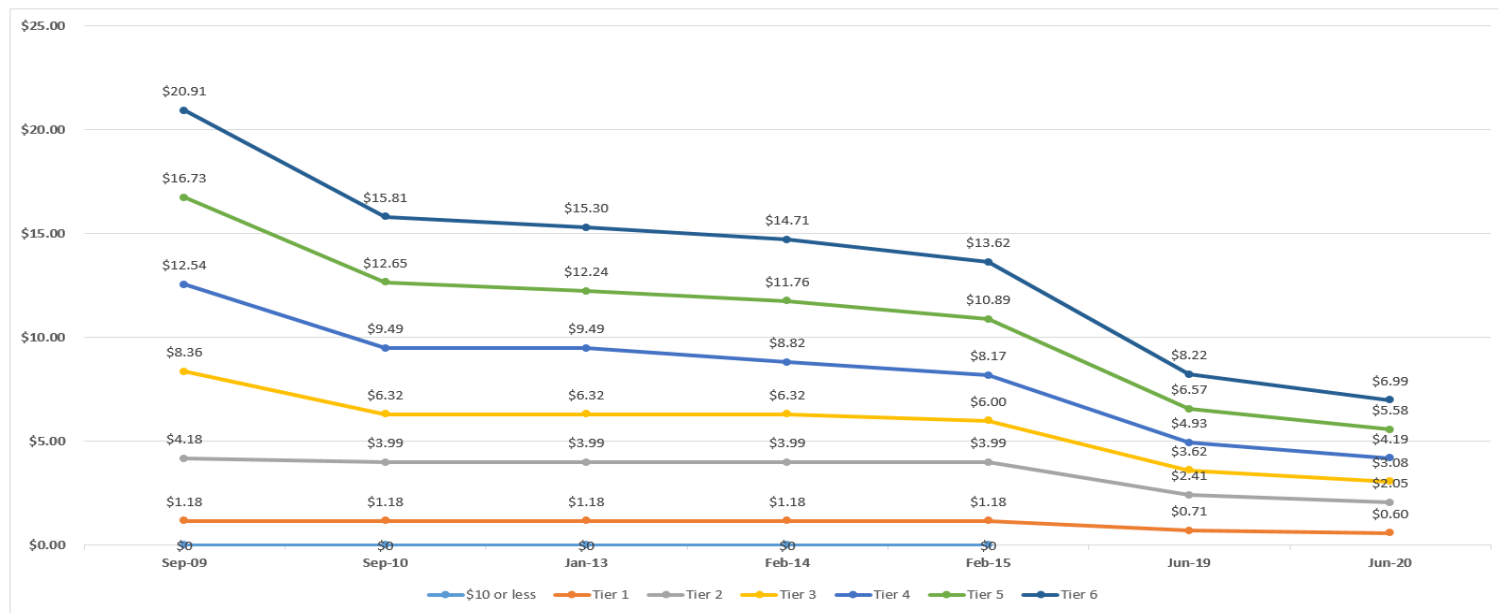
- Purpose of Balance
- Surplus or Deficit

Program Management

Observation 1 - Participant fees have reduced



Participant Fees have decreased consistently over 10+ years



Program Management

Observation 1 – Formalize Inclusion of Revenue/Expenses

Participant Fee methodology should include establishing a reserve fund balance and inclusion of all revenue streams and expenses



Inflows

Excess Participant Fees
PGs assessment
Interest Income
Refunds/Credits

Expenses

Internal Costs

Trust Fund Balance

\$6.5M

Given the inflow of revenue and current trust fund balance, how much money will ERS need from participant fees to cover program costs?

Program Management

Observation 1 – *Determining Reduced Fees & Tier Structure*



| Tier | Balance | Participant Fee | Admin Fee | ERS Receives | Average Participant Count (%) | Average Participant Count | ERS Receives per Tier |
|--------|---------------|-----------------|-----------|--------------|-------------------------------|---------------------------|-----------------------|
| Tier 1 | \$.01 - \$1k | \$0.60 | \$1.54 | (\$0.94) | 48% | 117,485 | (\$110,436) |
| Tier 2 | \$1k - \$16k | \$2.05 | \$1.54 | \$0.51 | 39% | 92,458 | \$47,154 |
| Tier 3 | \$16k- \$32k | \$3.08 | \$1.54 | \$1.54 | 4% | 10,378 | \$15,982 |
| Tier 4 | \$32k - \$48k | \$4.19 | \$1.54 | \$2.65 | 2% | 5,452 | \$14,448 |
| Tier 5 | \$48k - \$64k | \$5.58 | \$1.54 | \$4.04 | 1% | 3,403 | \$13,748 |
| Tier 6 | \$64k+ | \$6.99 | \$1.54 | \$5.45 | 6% | 13,317 | \$72,578 |
| | | | | | | 242,493 | \$53,473 |

Tier 1 has been established to incentivize lower balance participants by offering reduced fees to 48% of members

The Tier structure should be evaluated to determine if the \$16k threshold are still appropriately generating funds necessary to cover costs

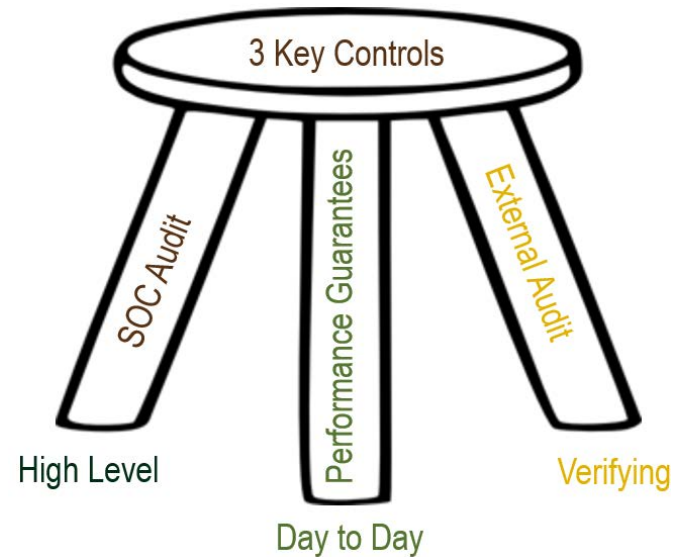
Service Delivery

Observation 2 - Key Controls evaluate TPA's performance



Controls have been established at various levels of the process; working together to provide assurance over participants accounts

High Level review of the TPA as a company
Day-to-Day review of Texa\$aver program
Verifying information used throughout the year is accurate



Service Delivery

Key Controls evaluate TPA's performance



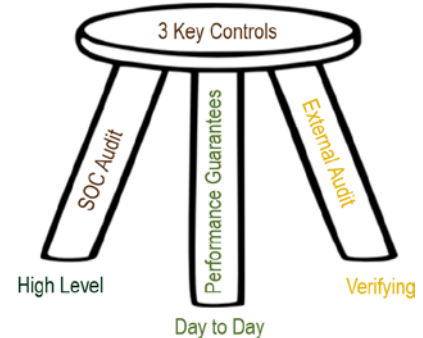
Improvements can be made to each control providing enhancements to the evaluation process

Formalize the SOC Review

- Applicability
- Evaluate
- Identify

Establish calculation Methodology

- Results match the PG objective
- Definitions, Systems and Calculation
- Confirms understanding



Timeliness of the External Audit

- Timely results
- Modify focus as needed

Questions?

Public Agenda Item #5

Review of Internal Audit Administrative Items

December 8, 2020

Tony Chavez, Director of Internal Audit

Tressie Landry, Audit Manager

Annual Audit Performance and Quality Review

Annual Audit Performance and Quality Review – *Reports*



- 1) **Internal Audit Annual Report** - Required reporting of internal audit plans, annual reports, and any weaknesses or concerns resulting from audit activity
- 2) **Internal Audit Annual Performance and Quality Review** – Results of annual performance and quality program assessment

Annual Audit Performance and Quality Review – *Summary*



Internal Audit provides independent and objective assurance on the effectiveness of controls and operations to meet ERS' strategic directions.

Strategic Goals:

1. Enhance Professional Practices
2. Enhance Performance Management and Accountability
3. Grow People Management

| OVERALL ASSESSMENT | | SATISFACTORY |
|--------------------|--|--------------|
| SCOPE AREA | OBSERVATIONS | RATING |
| Practice | Continuing to formalize and implement procedures related to Consulting engagements. Consulting engagements account for less than 10% of total division hours | SATISFACTORY |
| Performance | Improve budgeting of hours related to non- internal audit projects (Procurements, IT software implementations, external audit transition) Continue to improve on the timeliness and balance of director feedback on internal audit engagements. | SATISFACTORY |
| People | Peer group conference not held this year impacting core business CPE for some staff | SATISFACTORY |

Annual Audit Performance and Quality Review – *FY20 Audit Plan*



| Report # | Title | Date | Status |
|----------|------------------------|-------------|------------------------------|
| 2019-06 | IT Governance | Mar. 2020 | Report Issued |
| 2019-07 | Private Equity | August 2020 | Report Issued |
| 2019-08 | Profit Sharing | Dec. 2019 | Report Issued |
| 2020-01 | Incentive Compensation | May 2020 | Report Issued |
| 2020-03 | Texa\$aver | Dec. 2020 | Report Issued |
| 2020-04 | Survivor Benefits | Dec. 2020 | Report Issued |
| 2020-02 | Internal Public Equity | March 2021 | End-of-Fieldwork / Reporting |
| | Financial Opinion | Dec. 2019 | Report Issued |
| | Insurance Forecasting | May 2020 | Report Issued |

Annual Audit Performance and Quality Review – *COVID Impact*



- Audit Management Software allowed for continued performance/documentation of audit work
- Initial transition within Internal Audit gradual
- Transitioned to video conference meetings for all milestone meetings, audit interviews and internal team meetings
- Incorporation of screen-sharing tools
- Additional meetings to include division director prior to end-of-fieldwork meetings

Annual Audit Performance and Quality Review – *Enhance Professional Practices*



Process to ensure following requirements and standards.

| SCOPE AREA | OBSERVATIONS | RATING |
|------------|---|--------------|
| Practice | Continuing to formalize and implement procedures related to Consulting engagements. Consulting engagements account for less than 10% of total division hours | SATISFACTORY |

- Consulting engagements communication and documentation
- Continue to formalize the process
 - Continue to improve on data validation and analysis
 - IT System risk assessments
- Improved documentation to determine team competencies

Annual Audit Performance and Quality Review – *Enhance Performance Management*



Provide quality results efficiently.

| SCOPE AREA | OBSERVATIONS | RATING |
|-------------|--|---------------------|
| Performance | Improve budgeting of hours related to non- internal audit projects (Procurements, IT software implementations, external audit transition) Continue to improve on the timeliness and balance of director feedback on internal audit engagements. | SATISFACTORY |

- Increased business acumen contributing to improve critical thinking and value-add
- Continue to improve collaboration with process owners on best practices/peers/criteria
- Continue to improve on data validation and analysis
- Continue to improve data request methods

Annual Audit Performance and Quality Review – *Grow People*

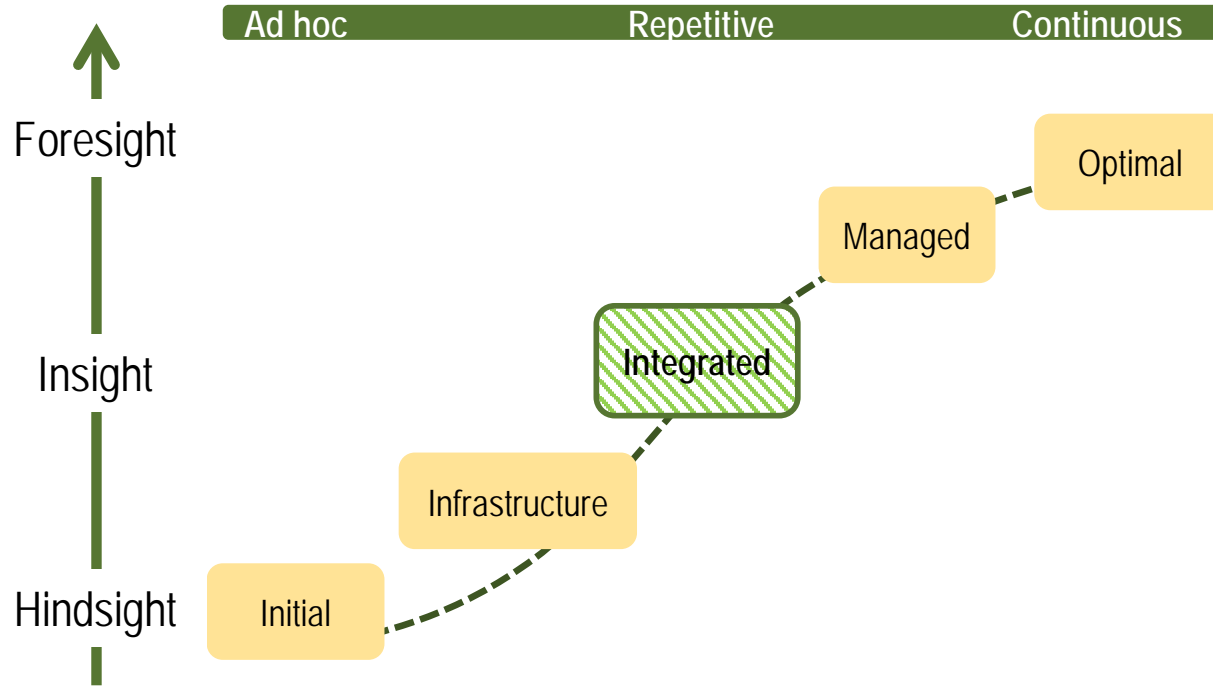


Audit staff professional development.

| SCOPE AREA | OBSERVATIONS | RATING |
|------------|---|---------------------|
| People | Peer group conference not held this year impacting core business CPE for some staff | SATISFACTORY |

- Training
 - Public Pension Financial Forum
 - Focused on Information Technology and data analysis
- Team Assessments
 - Ethical, Know the Standards
 - Continue emphasis on results and solutions
 - Increased business acumen being applied

Annual Audit Performance and Quality Review – *Wrap-Up*



Questions?

Public Agenda Item #6

Adjournment of the ERS Board of Trustees Audit Committee Meeting

December 8, 2020