

# 2. Meeting of the ERS Board of Trustees Audit Committee

December 13, 2017



## Public Agenda Item #1.1

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

December 13, 2017

## Public Agenda Item #2.1

*Approval of the minutes to the August 23, 2017  
ERS Audit Committee Meeting – (Action)*

December 13, 2017

Questions?  
(Action Item)

# Public Agenda Item #3.1

## *Review of External Audit Reports*

December 13, 2017

Tony Chavez, Director of Internal Audit

# Incentive Compensation Audit

Tony Chavez, Director of Internal Audit

Sarah Puerto, State Auditor's Office, Project Manager

Michael Clayton, State Auditor's Office, Audit Manager

# Incentive Compensation

*State Auditor's Office*



## **Objective:**

To determine whether ERS calculated and paid incentive compensation in accordance with policies and procedures

## **Scope Areas/Results:**

- Plan Year 2016 award calculations
- Fiscal Year 2016 payments (Plan Year 2016 (50%), 2015 (25%) and 2014 (25%))

Questions?

# Public Agenda Item #3.2

## *Review of Internal Audit Reports*

December 13, 2017

Tony Chavez, Director of Internal Audit

# Incentive Compensation Audit

Tony Chavez, Director of Internal Audit  
Beth Gilbert, Internal Auditor

# Incentive Compensation Audit



**Audit Objective:** To determine if recommended incentive compensation awards were in accordance with ERS' Incentive Compensation Plan

**Scope:** Plan Year 2017 incentive compensation awards recommended to ERS' executive office for approval.

**Scope Areas:** 1) Participation and Development  
2) Award Calculation

# Incentive Compensation Audit



Overall Assessment		Satisfactory
Scope Area	Result	Rating
Participation and Development	Based on audit scope areas reviewed internal controls are effective to ensure eligible participant performance goals are in accordance with the ICP.	Satisfactory
Award Calculation	Based on audit scope areas reviewed internal controls are effective to ensure accuracy of award calculations.	Satisfactory

# ICP Award Roles and Process



- Human Resources Division primary owner of the ICP
- Finance Division calculates ICP awards
- Independent third-party contracted to review for accuracy of recommended awards and compliance with ICP

# Plan Year 2017 Award Highlights



- **71**– Participants recommended to receive ICP
- **\$5.30 million** – Plan Year 2017 ICP Awards submitted for approval
- **\$7.03 million** – Maximum Plan Year 2017 awards possible
- **\$4.4 million** – Payment in fiscal year 2018 (50% - Year 1, 25% -Year 2, 25% -Year 3)

Questions?

# Investment Compliance

## July 1 – September 30, 2017

Tony Chavez, Director, Internal Audit Division

Beth Gilbert, Internal Auditor

Jonathan Puckett, Internal Auditor

# Securities Lending



Counterparties are below the 100% collateralization limit – 3 instances:

- 1 of 3 caused by differences between the way the borrowing broker calculates collateral and the industry norm
- 2 of 3 due to rights that were issued on securities that were lent out, which increased the effective loans outstanding.
  - The borrowers were unaware at the time and therefore did not count the rights in their calculation of collateral due

Questions?

## Public Agenda Item #3.3

*Executive Session – In accordance with Section 551.076, Texas Government Code, the Audit Committee of the Board of Trustees, a committee of the whole of the Board, will meet in executive session to deliberate: (1) the deployment, or specific occasions for implementation, of security personnel or devices; and (2) a security audit. Thereafter, the Board may consider appropriate action in open session.*

December 13, 2017

## Public Agenda Item #3.4

*Review of Internal Audit Administrative Items (Action)*

December 13, 2017

Tony Chavez, Director of Internal Audit

# Internal Audit Charter

Tony Chavez, Director, Internal Audit Division  
Beth Gilbert, Internal Auditor

# Internal Audit Charter



International Professional Practices Framework (IPPF), standard 1000, *Purpose, Authority and Responsibility* requires the Chief Audit Executive to periodically review the internal audit charter and present it to senior management and the Board for approval.

Reasons for revisions:

- Institute of Internal Auditors' Model Internal Audit Activity Charter template was revised March 2017 (noted in red)
- Investment Compliance function was established and reports to the Director, Internal Audit (noted in blue)

Questions?  
**(Action Item)**

## Public Agenda Item #3.5

*Review of Audit Administrative Items – Annual Performance*

December 13, 2017

Tony Chavez, Director of Internal Audit

# Annual Internal Audit Report

Tony Chavez, Director of Internal Audit  
Beth Gilbert, Internal Auditor

# FY2017 Annual Internal Audit Report



- Statutorily required by Texas Government Code with guidelines prescribed by the Texas State Auditor's Office
  
- Provides a summary of internal audit activities including:
  - FY2017 Internal Audit Plan Results
  - Consulting and Non-Audit Services Completed
  - FY2018 Internal Audit Plan
  - External Audit Services procured in FY2017
  - Reporting Suspected Fraud, Waste & Abuse

Questions?

# Quality Assurance Improvement Program

Tony Chavez, Director of Internal Audit  
Beth Gilbert, Internal Auditor

# Audit Standard



*A quality assurance and improvement program is designed to enable an evaluation of the internal audit activity's conformance with the Standards and an evaluation of whether internal auditors apply the Code of Ethics.*

*The program also assesses the efficiency and effectiveness of the internal audit activity and identifies opportunities for improvement.*

*The chief audit executive should encourage board oversight in the quality assurance and improvement program.*

- 1) External Assessments
- 2) Internal Assessments

# External Assessment



External Peer Review performed in October 2016

## **Objective:**

To determine whether the Internal Audit (IA) function is in compliance with professional auditing standards, Texas Internal Auditing Act, and internal auditor codes of ethics.

## **Results: Generally Conforms (highest rating)**

ERS Internal Audit's has controls in place to ensure audit work is performed in accordance with professional standards.

# External Quality Assurance Review Recommendation Status



## Management Action Plan Commitment

## Implementation Status

Formal independence assessments will be reported annually in August

Fully Implemented  
August 2017

Review of quality assurance activities will be reported annually in December

Fully Implemented  
December 2017

Exploration of additional opportunities for supervision, mentoring and specialized knowledge are ongoing. An extra FTE will facilitate teamwork

Fully Implemented  
February 2017

Working paper documentation is regularly evaluated to ensure efficient and effective process in place

Fully Implemented  
Continuous evaluation

Consideration of an additional IT audit resource and leveraging internal resources will be given over time and is currently supplemented with co-source projects

Current position good

# Internal Self Assessment



Internal assessments must include:

- *Ongoing monitoring of the performance of the internal audit activity*
- *Periodic self-assessments or assessments by other persons within the organization with sufficient knowledge of internal audit practices*

# Internal Self Assessment – Opportunities



- Identification of key risks
- Timeliness in meeting established milestones
- Effective communication of audit findings
- Documenting and organizing audit evidence to support audit results

# Internal Self Assessment – Action Plan



- Coordinating with process owners to develop an overall program objective if one does not exist
- Utilize preliminary milestone meetings with process owners to gather input on program risks and challenges
- Greater evaluation of audit sub-objectives to ensure alignment with program objective

Questions?

# Internal Audit Performance Measures

Tony Chavez, Director of Internal Audit  
Beth Gilbert, Internal Auditor

# Internal Audit Performance



- The Audit Committee is responsible for reviewing the effectiveness of the internal audit function including conformance with audit standards
- Performance measures help assess the effectiveness, efficiency and sustainability of the internal audit function
- FY2017 performance measures were reviewed and discussed with the Board at the December 2016 Audit Committee meeting

# Internal Audit Strategic Goals



Enhance Professional **Practices**

Enhance **Performance** Management and Accountability

Develop **People**

# Enhance Professional Practices



## **2012 – 2017 Accomplishments**

- Building of audit team (4 team members)
- Revised Audit Universe based on core business functions and specific risk criteria
- Implementation of automated audit management software (TeamMate)
- Revised audit report format and established audit ratings
- Quality Assurance Improvement Program

## **2018 Initiatives:**

- Continue improved leverage of co-source audit resources

# Enhance Performance Management



## **Providing Assurance and Insight**

- Aligns with the strategies, objectives and risks of the organization
- Provides risk-based assurance
- Promotes organization improvement

## **2018 Initiatives**

- Coordinating with process owners to develop an overall program objective if one does not exist
- Utilize preliminary milestone meetings with process owners to gather input on program risks and challenges
- Greater evaluation of audit sub-objectives to ensure alignment with program objective

# Develop People



**Skilled Team** - All staff certified as either Certified Internal Auditor, Certified Government Auditing Professional or both

## **2017 Highlights:**

- State Agency Internal Audit Forum(SAIAF) Internal Auditing Leadership Development Program
- Hosted University of Texas interns
- Committee Co-Chair for IIA Southern Regional Conference held in Austin

## **2018 Initiatives:**

- Training emphasis in ERS core business functions (Investments, IT, Healthcare)

# FY2018 Changes



- Number of Days From End of Fieldwork to Draft Report is Sent to Executive Director (25 business days)
- Percent within Audit Engagement Budgeted Hours (90%)
- Percent of Audit Staff attending 16 (40%) hours of annual training in core business to increase business acumen (100%)

Questions?

## Public Agenda Item #4.1

*Adjournment to the ERS Board of Trustees Audit Committee- Following adjournment to the ERS Audit Committee, Board of Trustees will take up the remaining agenda items.*

December 13, 2017