

Internal Audit Annual Report

Fiscal Year 2017

October 2017



Teacher Retirement System of Texas
1000 Red River Street, Austin, Texas 78701-2698

TEACHER RETIREMENT SYSTEM OF TEXAS

BOARD AUDIT COMMITTEE (As of October 16, 2017)

Christopher Moss, Chair
T. Karen Charleston
David Corpus
Greg Gibson, Ed.D.

BOARD MEMBERS (As of October 16, 2017)

R. David Kelly, Chair
Dolores Ramirez, Vice Chair
T. Karen Charleston
Greg Gibson, Ed.D.
John Elliott
Joe Colonna
David Corpus
Christopher Moss

EXECUTIVE DIRECTOR

Brian Guthrie

INTERNAL AUDIT DEPARTMENT

Amy L. Barrett, CIA, CISA, CPA, Chief Audit Executive
Jan Engler, CIA, CISA, CFE, Director of Benefit Services
Lih-Jen Lan, CIA, CPA, CISA, CISSP, CCSA, Information Technology (IT)
Audit Manager
Hugh Ohn, CFA, CPA, CIA, FRM, Director of Investment Audit Services
Toma Miller, CIA, CGAP, Senior Auditor
Nick Ballard, CFA, CIA, Senior Auditor
Simin Pang, CIA, CISA, Senior IT Auditor
Anandhi Mani, CPA, CIA, Senior Benefits Auditor
Art Mata, CEBS, CPM, Senior Internal Audit Benefit Consultant
Carol Casey, CPM, Internal Audit Benefit Consultant
Rodrigo Dominguez, Investment Auditor



Brian K. Guthrie
Executive Director

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Austin, Texas 78701

Amy L. Barrett,
CIA, CISA, CPA
Chief Audit Executive

October 16, 2017

Honorable Greg Abbott, Governor
Members of the Legislative Budget Board
Members of the Sunset Advisory Commission
Ms. Lisa R. Collier, CPA, First Assistant State Auditor
Mr. R. David Kelly, Chair, TRS Board of Trustees
Mr. Christopher Moss, Chair, TRS Board Audit Committee
Members of the Board of Trustees, Teacher Retirement System of Texas
Mr. Brian Guthrie, Executive Director, TRS

Attached is the annual report of the Internal Audit department of the Teacher Retirement System of Texas (TRS). This report provides information on the audit plan, assurance, consulting, and advisory projects completed, and other Internal Audit activities. It also meets the annual reporting requirement of the Texas Internal Auditing Act (Texas Government Code, Chapter 2102.009 and Texas Government Code, Sections 2102.015 and 2102.0091). This report includes the following State Auditor's Office reporting guidelines:

- I. Compliance With Texas Government Code, Section 2102.015: Posting the Internal Audit Plan, Internal Audit Annual Report, and Other Audit Information on Internet Website
- II. Internal Audit Plan for Fiscal Year 2017
- III. Consulting Services and Nonaudit Services Completed
- IV. External Quality Assurance Review (Peer Review)
- V. Internal Audit Plan for Fiscal Year 2018
- VI. External Audit Services Procured in Fiscal Year 2017
- VII. Reporting Suspected Fraud and Abuse

The work performed by TRS Internal Audit contributes toward accountability, integrity, and good management practices within TRS operations. Fiscal year 2017 projects contributed to the improvement of risk management, control, and governance processes. Internal Audit (or those engaged by Internal Audit) issued 12 assurance and 7 agreed-upon procedures reports, followed-up and reported quarterly on the status of all outstanding audit recommendations, and performed advisory services in various areas including TEAM (TRS Enterprise Application Modernization) Program initiatives.

For further information about the contents of this report or to request copies of Internal Audit reports, please contact Amy Barrett at (512) 542-6559.

Sincerely,

Amy L. Barrett, CIA, CISA, CPA
Chief Audit Executive

TEACHER RETIREMENT SYSTEM OF TEXAS
INTERNAL AUDIT ANNUAL REPORT

FISCAL YEAR 2017

October 2017

Teacher Retirement System of Texas
Internal Audit Annual Report for Fiscal Year 2017

**I. Compliance With Texas Government Code, Section
2102.015:
Posting the Internal Audit Plan, Internal Audit Annual
Report, and Other Audit Information on Internet Website**

Teacher Retirement System of Texas

Internal Audit Annual Report for Fiscal Year 2017

I. Compliance with Texas Government Code, Section 2102.015: Posting the Internal Audit Plan, Internal Audit Annual Report, and Other Audit information on Internet Web site

Texas Government Code, Section 2102.015 requires state agencies and institutions of higher education, as defined in the statute, to post agency internal audit plans and internal audit annual reports on the agency's internet website within 30 days of approval. The statute also requires entities to update the posting on the Internet to include a.) a detailed summary of the weaknesses, deficiencies, wrongdoings, or other concerns raised by the audit plan or annual report and b.) a summary of the actions taken to address concerns, if any, that are raised by the audit plan or annual report.

TRS Internal Audit follows the following procedures to ensure compliance with the requirements of Texas Government Code, Section 2102.015:

- The **TRS Annual Internal Audit Plan** is approved each fiscal year by the TRS Board of Trustees as recommended by the TRS Audit Committee. The annual audit plan, as approved by the TRS Board of Trustees, is provided by Internal Audit staff to the TRS Website coordinators and posted to the TRS Website within 30 days of approval.
- The **TRS Internal Audit Annual Report** is prepared annually by Internal Audit staff in accordance with the Texas State Auditor's Office guidelines by the required deadline. This report, once approved by the Chief Audit Executive, is submitted to the Governor's Office, the Legislative Budget Board, the Sunset Advisory Commission, the State Auditor's Office and the TRS Board of Trustees by November 1 of each fiscal year. The annual report is provided by Internal Audit staff to the TRS Website coordinators to post to the TRS Website.
- **Summaries of the weaknesses, concerns, and actions** taken to address concerns in the audit plan or annual report are provided by Internal Audit in the quarterly TRS Audit Committee materials. The audit committee materials provide audit reports completed during each quarter, quarterly status reports on management action on outstanding audit recommendations, and the status of the current fiscal year audit plan. The individual audit reports provide the results, recommendations, and management actions taken to address the audit recommendations. The TRS Audit Committee materials are posted to the TRS Website, after dissemination to TRS Board of Trustees, through an administrative process of board and committee materials prior to the scheduled Board meeting.

Teacher Retirement System of Texas
Internal Audit Annual Report for Fiscal Year 2017

II. Internal Audit Plan for Fiscal Year 2017

**Fiscal Year 2017 Audit Plan Status
As of August 2017**

Title and Project #	Type	Status
Executive and Finance		
Records Management Audit Follow-Up (17-410)	Audit	Complete
403(b) Provider Compliance (17-601)	Audit	Complete
Federal Labor Standards Act (FLSA) Compliance (17-605)	Consulting	Complete
Coordination for State Auditor’s Office (SAO) Comprehensive Annual Financial Report (CAFR) Audit for Fiscal Year 2016	Advisory	Complete
Teacher Retirement Investment Company of Texas (TRICOT) Financial Audit Coordination (Grant Thornton)	Advisory	Complete
Testing of Executive Performance Incentive Pay Calculations (17-606)	Agreed-Upon Procedures	Complete
The University Of Texas at Austin Student Project (17-608)	Consulting	Complete
Enterprise Risk Management (ERM) Fraud Risk Assessment	Advisory	Complete
Committee and Workgroup Meetings Participation	Advisory	Ongoing
Special Requests and Emerging Issues – Healthcare Legislative Changes (17-203)	Consulting	Ongoing
TEAM Program		
TEAM Independent Program Assessment (IPA) Vendor Support	Advisory	Ongoing
TEAM Committees, Projects and Controls Assessment Participation	Advisory	Ongoing
Pension Benefits		
Annuity Payment Testing for SAO CAFR Audit of FY 2016 (17-100)	Audit	Complete
Annual Benefits Testing (17-101)	Agreed-Upon Procedures	Complete
Reporting Entity Audits (6 to 10 ISDs) (17-401s)	Audit	Completed 2 in FY17
Employer Audit Follow-up (17-402)	Audit	Complete
Employer Audit of Pension and TRS-Care Surcharges (17-403)	Audit	Complete
Higher Education Pilot and Audit Program Development (17-404)	Advisory	Complete
TRS Reporting Entity Website Audit Information and Communication	Advisory	Ongoing

Fiscal Year 2017 Audit Plan Status As of August 2017

Health Care		
Health Insurance Portability and Accountability Act (HIPAA) Gap Assessment and Validation (17-501)	Audit	Complete
Trust Expense Allocation Audit (17-503)	Audit	Complete
TRS-ActiveCare Open Enrollment Readiness Assessment Follow-Up (17-201)	Audit	Complete
TRS-ActiveCare Eligibility Pilot and Audit Program Development	Advisory	Deferred due to higher management priorities
Health Care Vendor Selection Observation	Advisory	Complete
Health Care Vendor Update Meetings	Advisory	Ongoing
Information Technology		
Contractor Onboarding and Off-boarding (17-502)	Audit	Complete
Disaster Recovery, Network Penetration Tests; Security Risk Assessment Review	Advisory	Complete
Investment Management		
Private Equity Fees (17-304)	Audit	Complete
Soft Dollars and Commission Sharing Arrangements (17-305)	Audit	Complete
Quarterly Investment and Ethics Policies Compliance Testing (17-302)	Agreed-Upon Procedures	Complete
Annual Testing of Investment Incentive Pay Plan (17-303)	Agreed-Upon Procedures	Complete
Investment Fiduciary Audit Coordination	Advisory	Complete
Investment Committees Attendance	Advisory	Ongoing
Internal Audit Department		
Annual Internal Audit Report (17-603)	Audit	Complete
Data Analysis Processes	Advisory	Deferred due to healthcare legislative changes project
Quarterly Audit Recommendations Follow-up	Audit	Ongoing
ERS Audit Quality Assurance Review	Audit	Complete
Internal Quality Assurance Review (17-602)	Advisory	Complete
Fiscal Year 2018 Audit Plan	Advisory	Complete
Internal Audit Strategic Plan Update	Advisory	Complete
Audit Committee Meetings Preparation	Advisory	Ongoing

**III. Consulting Services
and Nonaudit Services Completed**

Teacher Retirement System of Texas

Internal Audit Annual Report for Fiscal Year 2017

III. Consulting Services and Nonaudit Service Completed

During fiscal year 2017, Internal Audit conducted (or hired consultants to conduct) the following consulting (nonaudit services) projects resulting in formal recommendations to management.

1. Federal Labor Standards Act (FLSA) Compliance

(Project #17-605, PowerPoint presentation to Deputy Executive Director and Human Resources, June 01, 2017)

Objective: To assess TRS' compliance with the FLSA relating to employee exempt and non-exempt classification and may perform additional related data analysis.

Performed data analysis to assess compliance with FLSA related to employee exempt and non-exempt classification, as a result recommendations were made to continue to perform periodic re-evaluation of employee's FLSA status, obtain and document supervisor/manager's input when performing job duty test; and to document the FLSA status decision making process

2. The University of Texas at Austin Student Project

(Project #17-608, PowerPoint presentation to Human Resources, dated November 21, 2016)

Objective: To research and present to Human Resources best practices for manager training.

This was achieved by conducting interviews of TRS staff, surveying of pension fund peers for best practices and researching methods of manager training. As a result recommendations were made that manager training should be in-house or local third-party, last less than two hours per day on a variety of topics including effective communication, as well as, establishing a one-to-one mentor program.

Internal Audit also performed various advisory (nonaudit services) as listed in section II.

IV. External Quality Assurance Review (Peer Review)

**REPORT ON THE
EXTERNAL QUALITY ASSURANCE REVIEW
OF THE TEACHER RETIREMENT SYSTEM
INTERNAL AUDIT DEPARTMENT**

April 2016



PERFORMED BY

Benito Ybarra, CIA, CISA, CFE
Chief Audit and Compliance Officer
Texas Department of Transportation

Greg Royal, CPA, CIA, CRMA, CGAP
Chief Audit Executive
Texas Department of Insurance

Byron Williams, CPA
Chief Audit Executive
Oregon State Treasury

PERFORMED IN ACCORDANCE WITH THE
STATE AGENCY INTERNAL AUDIT FORUM
PEER REVIEW POLICIES AND PROCEDURES

OVERALL OPINION


Based on the information received and evaluated during this external quality assurance review, it is our opinion that the Teacher Retirement System (TRS) Internal Audit Department receives a rating of “pass” and is in compliance with the Institute of Internal Auditors (IIA) *International Professional Practices Framework* and Code of Ethics, the United States Government Accountability Office (GAO) *Government Auditing Standards*, and the Texas Internal Audit Act (*Texas Government Code*, Chapter 2102). 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 found that the Internal Audit Department is independent, objective, and able to render objective conclusions on the audit work performed. The staff members are qualified, proficient, and knowledgeable in the areas they audit. Individual audit projects are planned using risk assessment techniques; audit conclusions are supported in the working papers; and findings and recommendations are communicated appropriately.

The Internal Audit Department is well-managed. In addition, the Department has effective relationships with the Board of Trustees and is well-respected and supported by Executive Council management. Surveys and interviews conducted during the quality assurance review indicate that management considers Internal Audit a useful part of the agency and demonstrated a knowledge of the audit team’s mission.

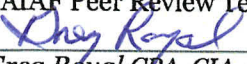
ACKNOWLEDGEMENTS

We appreciate the courtesy and cooperation extended to us by the Chief Audit Executive, Internal Audit staff, the Chairman of the Board of Trustees, the Audit Committee Chair, the Executive Director, and the executive managers who participated in the interview process. We would also like to thank each person who completed surveys for the quality assurance review. The feedback from the surveys and the interviews provided valuable information regarding the operations of the Internal Audit Department and its perceived value to the organization.



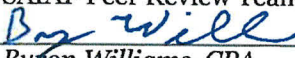
Benito Ybarra, CIA, CISA, CFE
Chief Audit and Compliance Officer
Texas Department of Transportation
SAIAF Peer Review Team Leader

04/15/16
Date



Greg Royal CPA, CIA, CRMA, CGAP
Chief Audit Executive
Texas Department of Insurance
SAIAF Peer Review Team Member

4/13/16
Date



Byron Williams, CPA
Chief Audit Executive
Oregon State Treasury
SAIAF Peer Review Team Member

4/11/16
Date

V. Internal Audit Plan for Fiscal Year 2018



Teacher Retirement System of Texas
Internal Audit Department

Fiscal Year 2018 Audit Plan

September 22, 2017

Amy Barrett, CIA, CISA, CPA
Chief Audit Executive

Christopher S. Moss
Chair, Audit Committee, Board of Trustees

Brian Guthrie
Executive Director

R. David Kelly
Chair, Board of Trustees





Executive Summary

Professional and Statutory Requirements

This document provides the *Fiscal Year 2018 Audit Plan* (Audit Plan) as required by professional auditing standards, the *Texas Internal Auditing Act* (Act), and *Texas Government Code 2102.008* for the Teacher Retirement System of Texas (TRS). The Act requires state agencies to conduct a program of internal auditing that includes an annual audit plan that is prepared using risk assessment techniques and identifies individual audit projects to be conducted during the year. The Audit Plan is required to be evaluated and updated annually for recommendation of approval by the TRS Audit Committee of the Board of Trustees (Audit Committee) to the TRS Board of Trustees (Board). Internal Audit is independent of management and provides objective assurance and consulting services designed to add value and improve TRS' operations.

Audit Plan Development and Scope

Our Audit Plan is designed to provide coverage of key risks, given the existing staff and approved budget. See the **Appendices** for information regarding the internal audit budget, performance measures, and audit plan mapped to the TRS Risk Assessment.

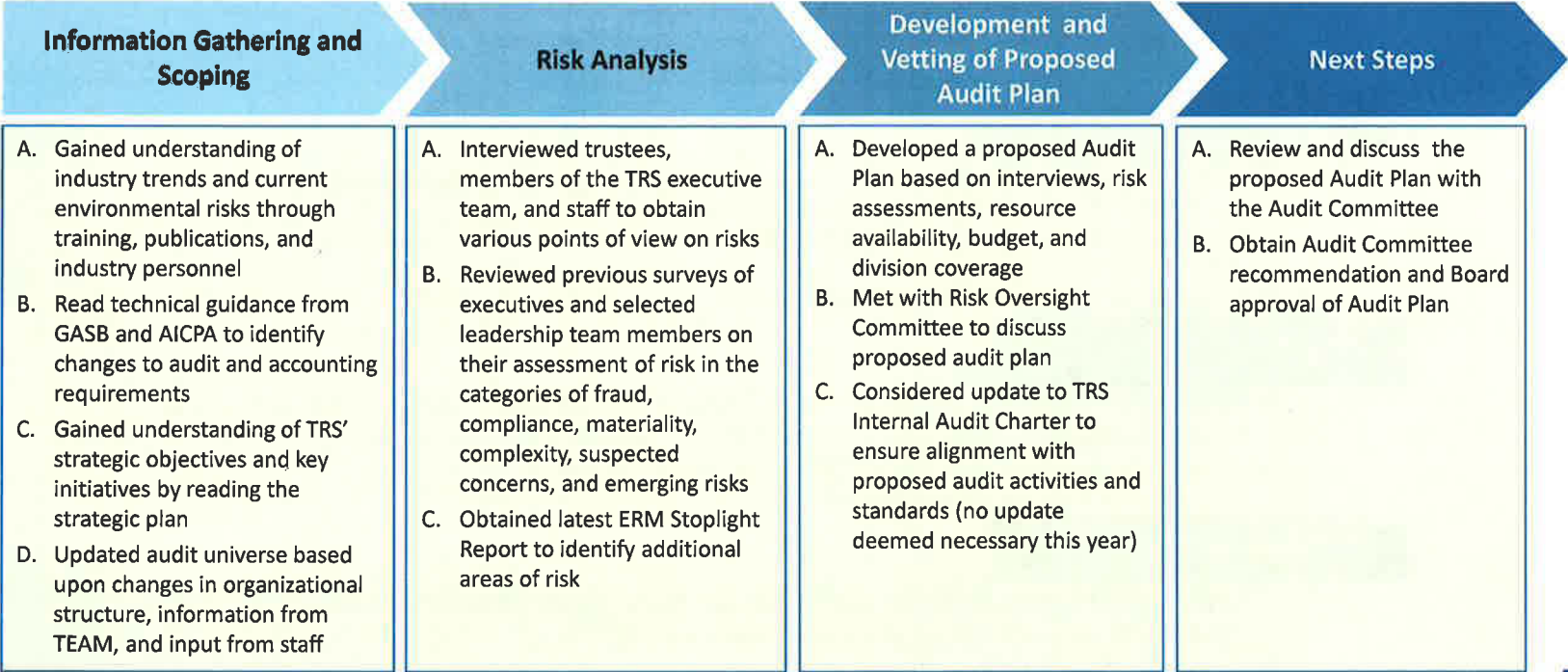
Changes Subsequent to Approval

Interim changes to the Audit Plan will occur from time to time due to changes in business risks, timing of TRS' initiatives, and staff availability. We will report Audit Plan changes to executive management and present changes to the Audit Committee at the next quarterly Audit Committee meeting. Amendments to the approved Audit Plan deemed to be significant (based on discussions with the executive director and audit committee chair) will be submitted to the Audit Committee for recommendation to the Board for approval. We will also notify the State Auditor's Office of material changes to the Audit Plan.



Risk Assessment & Audit Planning Approach

Interviews of TRS trustees, executives and staff, risk assessment surveys from prior years, and the current TRS Risk Assessment developed by the Enterprise Risk Management (ERM) team were used to identify areas of risk and potential internal audit projects. This information was combined into an overall audit plan designed to address critical risks to achieving TRS objectives while being sensitive to operational requirements. The Audit Plan also includes hours for ad hoc projects and special requests. The following approach was taken in creating the Audit Plan:





Types of Projects to Cover Risk Areas

An important part of the Audit Plan is that the identified processes, systems, and initiatives should receive differing types and levels of review based on their importance, perceived risk, and most efficient approach. Our suggested levels of review activities are as follows:

Audit

- Audit Focus: Assess evidence available in order to provide assurance on an audit objective
- Deliverable: Audit report for public distribution unless protected by statute
- Estimated level of effort per project: 400 - 500 hours

Agreed-Upon Procedures

- Agreed-Upon Procedures Focus: Determine specific steps to test with management's agreement and report on results; used for data analytics and quarterly testing of specific data and transactions
- Deliverable: Agreed-upon procedures report for public distribution (use is limited to those with understanding of procedures performed)
- Estimated level of effort per project: 100 - 300 hours

Formal Consulting

- Consulting Focus: Respond to requests for formal study or assessment with recommendations; no assurance provided
- Deliverable: Consulting report or memo for limited distribution; significant material weaknesses identified would be reported to executive management and the Audit Committee as required by professional auditing standards
- Estimated level of effort per project: 100 - 200 hours

Informal Consulting (Advisory)

- Advisory Focus: Participate in activities in a non-voting capacity, e.g., provide training and input on policies and procedures
- Deliverable: Verbal discussion or a brief memo to management
- Estimated level of effort per year: 10 – 100 hours



Audit Plan: Pension Benefits and Employer Audits

The tables on this page and the following pages provide the name of each project, type of project, and preliminary scope of work to be performed. Scope of work will be finalized as part of each project’s formal planning phase.

Title	Type	Preliminary Scope
Annual Benefits Testing	Agreed-Upon Procedures	Recalculate a sample of benefit payments annually and determine whether documentation on file supports the calculation; scope in other tests related to benefits as agreed-upon with management
Employer Audits	Audit	Determine whether information reported to TRS is complete and accurate, especially in the areas of eligibility, compensation, contributions, surcharges (pension and healthcare)
Employer Data Analysis Testing	Agreed-Upon Procedures	Gather and use full payroll data to risk assess reporting entities for audit and to identify noncompliance with TRS Laws and Rules
TRS Reporting Entity Website Audit Information Update and Communication Activities	Advisory	Update audit-related information and tools on the TRS employer (reporting entity) website. Information may include self-audits, audit programs, audit results, technical guidance, and frequently asked questions about reporting entity audits



Audit Plan: Health Care

Title	Type	Preliminary Scope
TRS-ActiveCare Billing, Reporting, and Exceptions Process Audit	Audit	Assess whether the billing process used by subcontractor results in bills that are complete and accurate; determine whether reporting entities are reconciling bills and reporting errors to subcontractor; assess the effectiveness of the exceptions process; assess the completeness and accuracy of reports provided to TRS by subcontractor and contractor including eligibility reports
TRS-Care and TRS-ActiveCare Vendor Procurement and Oversight Audit	Audit	Using recent healthcare procurements, validate that the processes were followed in accordance with the state procurement manual and TRS policies and procedures
Health Care Administrative Expenses audit	Audit	Validate completeness and accuracy of administrative expenses charged to TRS-Care and TRS-ActiveCare
TRS-Care Legislative Change Management Review	Consulting	Review legislative changes effective January 1 requiring programming changes by IT for accuracy
Health Care Vendor Update Meetings Attendance	Advisory	Attend quarterly meetings with health care vendors to understand results, issues, and TRS management's monitoring controls
Health Care Vendor Selection Observation	Advisory	Observe selection process of large vendor and service providers, when applicable



Audit Plan: Investment Management

Title	Type	Preliminary Scope
Private Equity Management Fees and Carried Interest Desk Audits	Audit	Assess the accuracy of management fees and carried interest using information contained in Limited Partnership portals as a starting point and other information as needed
Performance Calculations Audit	Audit	Assess whether pension trust and incentive pay plan investment returns are accurate, consistent, and based on accepted industry performance standards
Quarterly Investment and Ethics Policies Compliance Testing	Agreed-Upon Procedures	Assess compliance with TRS ethics policies and the Investment Policy Statement (IPS) requirements; assess select operating procedures
Annual Testing of Investment Incentive Pay Plan	Agreed-Upon Procedures	Prior to payment, recalculate the investment incentive compensation award amounts to determine if they are calculated in accordance with plan provisions; reconcile performance to the service provider
Investment Committees Attendance	Advisory	Stay current on Investment Management Division initiatives by attending the Internal Investment Committee, Derivatives Operations, monthly staff, and other meetings such as the Annual Town Hall meeting and meeting with risk, compliance, and operations staff



Audit Plan: Finance and Staff Services

Title	Type	Preliminary Scope
General Accounting Change in Management Audit	Audit	Determine whether key management controls are in place and functioning as intended. Key management controls could include account reconciliations, access controls, departmental policies and procedures, TRS-wide policies and procedures, segregation of duties, etc.
Capital Improvement Planning Process Review	Consulting	Review TRS' process for requesting and planning capital improvements and make recommendations for increased formalization
Comprehensive Annual Financial Report (CAFR) testing of annuity payments	Audit	Conduct pension benefits testing on behalf of the State Auditor's Office (SAO) to be used in completion of the CAFR audit
CAFR Audit Coordination (SAO, auditors)	Advisory	Coordinate activities of the SAO to ensure deadlines are met; coordinate quarterly update meetings with executive management and the SAO; maintain SAO document request SharePoint site; walkthrough CAFR development process and identify opportunities for efficiencies
CAPPS Implementation	Advisory	Participate in meetings associated with CAPPS and provide input into controls identification projects.
Teacher Retirement Investment Company of Texas (TRICOT) Financial Audit Coordination (Grant Thornton, auditors)	Advisory	Coordinate a financial audit of TRICOT, a wholly-owned subsidiary of TRS in London



Audit Plan: Executive

Title	Type	Preliminary Scope
Board Reporting Process and Materials Review	Consulting	Walk through the process for developing board materials; interview staff about challenges with timely board reporting and provide suggestions for improving timeliness
Executive Incentive Pay Testing	Agreed-Upon Procedures	Independently recalculate executive incentive pay in order to test the accuracy of the calculation by management
Special Requests and Emerging Issues	Advisory or Consulting	Set aside time to address special requests and emerging issues during the year as requested by management
Meetings Participation	Advisory	Participate (non-voting) in various TRS-wide meetings such as Executive Council, Leadership Team, and Risk Oversight Committee



Audit Plan: TEAM and Technology

Title	Type	Preliminary Scope
TEAM Independent Program Assessment (IPA) Vendor Support	Advisory	Coordinate and facilitate activities of the IPA vendor and ensure direct access to executive management and the board
TEAM Committees, Projects, and Controls Assessment Participation	Advisory	<p>Participate in TEAM Executive Steering Committee (ESC) and other committees and requirements-gathering sessions in a non-voting capacity, and provide advisory services related to TEAM project activities as outlined in the TEAM charter of internal audit activities. Provide input into controls identification projects. In FY 17, Internal Audit participated in the following TEAM committees and projects:</p> <ul style="list-style-type: none"> - Executive Program Oversight Committee (including TEAM budget) - Organizational Change Management Advisory Groups - Business Procedures and Training Project - Monthly meetings with TEAM program manager and DXC executives
Disaster Recovery, Network Penetration Tests; Security Risk Assessment Review	Advisory	Observe, obtain, read, and follow-up on any issues identified during the network disaster recovery, penetration tests, and the security risk assessment conducted by the TRS Information Security Officer



Audit Plan: Internal Audit Activities

Title	Project Description
Internal Quality Assurance Review	Assess Internal Audit's audit and administrative practices in order to make recommendations for continuous improvement. This project includes Internal Audit performance measure tracking and reporting
Annual Internal Audit Report	Prepare annual report of audit activities in accordance with SAO instructions
Quarterly Audit Recommendations Follow-Up	Follow-up and report on the status of outstanding audit recommendations
Data Analysis Process Buildout	Continue to build out data analysis skills of audit staff; incorporate into audit projects and annual audit plan development; and pilot analysis projects in various business units
Staff training initiative	Develop and launch auditor training in key areas including report writing, workpaper documentation, and audit risk assessment
Employer audit process re-engineering	Revise approach to auditing reporting entities including audit procedures, templates, documentation, internal communications, and reports
Fiscal Year 2019 Audit Plan	Prepare annual audit plan based on a documented risk assessment in accordance with professional auditing standards and the Texas Internal Auditing Act
Audit Committee Meetings Preparation	Prepare communications and attend Audit Committee and Board Meetings



Audit Plan: High Risk Areas (High, Elevated, or Caution) and Areas of Interest to the SAO (Procurement and IT Security) excluded from the Audit Plan

Area	Reason for Exclusion
Information Security & Confidentiality	TRS is in process of implementing recommendations made from two IT security-related audits in the prior year
Cybersecurity	TRS is in process of implementing recommendations made from two IT security-related audits in the prior year. TRS uses Department of Information Resources (DIR) services for network penetration testing
Records & Information Management	TRS is in process of revising its records management system and procedures
TEAM Program	TRS is in process of replacing its benefits systems (an effort known as the TEAM Program) and is using an independent program assessment vendor to assess the sufficiency of risk mitigation activities

Appendix A

Internal Audit Operating Budget



Appendix A Internal Audit Operating Budget

Line Item	Budget FY 2018	Budget FY 2017
000 – Salaries	\$1,094,123	\$1,086,970
000 – Benefits	280,233	279,344
200 – Professional Fees for Internal Audit Services	450,000	450,000
200 – Professional Fees for External Audit Services (CAFR, TRICOT, and Fiduciary Review)	442,500	500,000
505 – Travel-In-State	14,600	13,500
510 – Travel-Out-of-State	26,000	23,000
600 - Offsite Retreat	500	0
705 – Dues, Fees, and Staff Development	27,500	25,000
710 – Subscriptions and Reference Materials	2,000	2,000
Total Operating Budget	\$2,337,456	\$2,379,814
Full Time Equivalent (FTE) Positions (excluding interns)	13.0	12.0

Resources are sufficient to complete the annual audit plan.

Appendix B

Internal Audit Performance Measures



Appendix B

Internal Audit Goals and Performance Measures

For the internal audit function, the FY 2018 goals and performance measures are as follows:

Goal 1: Facilitate Audit Committee Governance

Objective 1: Provide assurance and advice to the Audit Committee and executive management on risk mitigation activities related to the pension and healthcare trusts

Performance Measures

- a. 80% or more of audit and agreed-upon procedures projects are completed in the fiscal year (80% allows for flexibility due to changes in TRS business practices and special requests)
- b. 70% or more of total available department hours (excluding uncontrollable leave) are spent for internal audit staff on direct assurance, consulting, and advisory services
- c. 100% of internal audit processes are in accordance with internal auditing standards as reported in the annual quality assurance and improvement report
- d. 80% (4.0/5.0) or higher score received for audit project client surveys in overall satisfaction
- e. 76% (3.8/5.0) or higher score on staff 360 evaluations in accountability, critical thinking, and initiative
- f. 90% (4.5/5.0) or higher score received for CAE 360 evaluation in "Leads the Agency" (aka Firm Leadership) and "Leads the Team" (aka Managerial Leadership)



Appendix B

Internal Audit Goals and Performance Measures

Goal 1: Facilitate Audit Committee Governance, continued

Objective 2: Improve Internal Audit communication

Performance Measures

- a. 80% (4.0/5.0) or higher score received for audit project client surveys regarding communication of the audit purpose, results, and reports
- b. 80% (4.0/5.0) or higher score on staff 360 evaluations in the area of verbal and written communication and collaborative audit perspective

Objective 3: Provide information on effective Audit Committee practices

Performance Measures

- a. 100% of relevant current "Tone at the Top" articles uploaded to Diligent
- b. One speaker on the benefits of an effective audit function presents at the February board meeting



Appendix B

Internal Audit Goals and Performance Measures

Goal 2: Support TRS Initiatives

Objective 1: Support the success of the TEAM Program and Financial Software Implementations

Performance Measures

- a. 86% (4.3/5.0) or higher score for CAE 360 evaluation in contribution goals
- b. 80% (4.0/5.0) or higher score received for audit project client surveys in TEAM-related projects, when applicable

Objective 2: Integrate TRS Core Values into Internal Audit activities

Performance Measures

- a. 80% (4.0/5.0) or higher score on staff 360 evaluations in the area of organizational awareness
- b. 83% (5.0/6.0) or higher score for departmental organizational health on the annual Workplace Dynamics Survey



Appendix B

Internal Audit Goals and Performance Measures

Goal 3: Enhance Internal Audit Staff Competence and Expertise

Objective 1: Cultivate in-house Subject Matter Experts (SME's)

Performance Measures

- a. 80% (4.0/5.0) or higher score received for audit project client surveys regarding the usefulness of audit recommendations in improving business processes and controls
- b. 80% (4.0/5.0) or higher score on staff 360 evaluations in the area of audit acumen
- c. 92% (4.6/5.0) or higher score for CAE 360 evaluation in "Leads the Self" (aka Technical Leadership)

Objective 2: Ensure continued competence and expertise of Internal Audit

Performance Measures

- a. 100% of audit staff complete annual training plans and obtain a minimum of 40 hours of continuing education credits
- b. 100% of audit staff maintain professional certifications or actively pursue certifications and related eligibility requirements
- c. 100% of audit staff participate in professional organizations
- d. 100% of audit staff acknowledge an understanding of their career path
- e. 92% or more of audit staff remain in internal audit or TRS (excluding retirements and transfers)



Appendix C

Audit Plan Mapped to TRS Risk Assessment



Appendix C

Audit Universe Mapped to TRS Risk Assessment

#	TRS Risk Level	TRS Risk Category	TRS Goal	TRS-Assessed Overall Risk	Planned Approach	Project Type
1	High	TRS-Care Funding	Facilitate long-term soundness of TRS-Care in order to provide sustainable retiree health care benefits.	Inadequate funding and/or unanticipated external forces would affect solvency of the program over the current biennium and future years, requiring significant premium increases or benefit reductions.	Employer audits of TRS-Care surcharges; Healthcare administrative expenses	Audit
2	Elevated	TRS-ActiveCare Affordability	Facilitate financial soundness of TRS-ActiveCare in order to provide affordable health care benefits.	Inadequate funding by the state and participating entities and/or unanticipated external forces could affect affordability.	TRS-ActiveCare billing audit; Healthcare administrative expenses	Audit
3	Elevated	Records & Information Management	Manage the organization, retention and disposition of TRS information and records with adherence to laws, rules, policies and best practices.	An ineffective records and information management program results in wasted resources; and does not protect, preserve, retain, dispose, or make records accessible in an accountable or transparent manner.	None - TRS project in process	n/a
4	Elevated	Employer Reporting	Accurately capture and utilize employer reported data to project and calculate future benefits of TRS members and to properly allocate the total pension liability across districts.	Incorrect reporting could lead to calculated benefits being inaccurate; Improperly allocating actuarial liability across districts.	Employer audits and data analysis; updates to external communications about audits	Audit; Advisory
5	Caution	TEAM Program	Implement cost effective, efficient, and sustainable processes and systems that enable TRS to serve its members, employers, and annuitants.	System design, implementation and functionality of the new processes and systems do not meet the growing demands of TRS in service of its members. Program/ project implementation schedule and cost exceeds original estimates.	TEAM oversight vendor coordination; participation in oversight committees; employer full payroll data analysis	Advisory
6	Caution	Pension Funding	Sustain a financially sound pension trust fund.	A lack of sound funding for the plan could lead to insufficient assets to pay for long-term benefits and financial obligations.	Employer audits	Audit
7	Caution	Legacy Information Systems	Provide information systems to meet TRS' business and customer service needs.	Inability to provide adequate and consistent information in a timely fashion via the preferred delivery mechanism.	TRS-Care legacy change management review	Consulting
8	Caution	Information Security & Confidentiality	Maintain the integrity, availability, and protection in the storage, use, and transfer of TRS information resources (in any form or medium).	Unauthorized or unintentional release/access of TRS confidential information could result in state or federal law violations, sanctions against TRS or its employees, and harm the best interests of TRS.	Quarterly follow up on prior year HIPAA and access controls audits	Advisory
9	Caution	Health Care Plans Administration	Administer retiree and active member health care programs that are valued by enrollees.	Inadequate administration of the health care programs could possibly affect the quality of health care services provided to those who depend on the delivery of TRS health care benefits which would in turn increase health care costs.	TRS-ActiveCare billing; vendor procurement and oversight; Healthcare administrative expenses	Audit



Appendix C

Audit Universe Mapped to TRS Risk Assessment

#	TRS Risk Level	TRS Risk Category	TRS Goal	TRS-Assessed Overall Risk	Planned Approach	Project Type
10	Caution	Cyber Security	To prevent malicious attacks and unauthorized access of TRS information resources.	Ineffective cyber threat controls could lead to breaches or sabotage of TRS systems.	Quarterly follow up on prior year HIPAA audit; DIR and other consultant Pen tests	Advisory
11	Guarded	Talent Continuity	Attract, retain and develop a highly competent staff.	The delivery of member services and pension fund management could be negatively impacted by turnover, the inability to retain qualified staff, lack of a sufficient knowledge transfer program, and an inconsistent performance management process.	Executive and investment incentive pay testing	AUP
12	Guarded	Regulatory, Compliance, & Litigation	Adhere to and analyze current laws, rules, and policies (e.g., maintain tax qualification status); Render competent advice on legal risk management and awareness, manage litigation risks, and negotiate contracts to address risks.	Non-compliance with laws and rules could lead to penalties, fines, liability and litigation; impaired ability to conduct business; burdensome oversight; third-party investigations/audits; adverse legislation; increased scrutiny; or loss of tax qualification status.	Employer audits; quarterly investment policy testing; annual benefits testing	Audit, Agreed-Upon Procedures (AUP)
13	Guarded	Procurement & Contracts	Maintain effective procurement and contract management systems. Inappropriate procurement practices could result in purchases of sub-standard products and services, unfavorable pricing or contract terms, and violation of laws. Ineffective contract management could result in contractors not fulfilling their contractual obligations.	Inappropriate procurement practices could result in purchases of sub-standard products and services, unfavorable pricing or contract terms, and violation of laws. Ineffective contract management could result in contractors not fulfilling their contractual obligations.	Vendor procurement and oversight audit	Audit
14	Guarded	Pension Benefit Administration	Accurate delivery of benefits to TRS members, retirees and beneficiaries, including systems monitoring and controls related to accurate calculations and benefit payments to others.	Ineffective delivery of benefits could lead to inaccurate information, inaccurate benefits/ payments, dissatisfied members, retirees, or beneficiaries, and loss of credibility, adverse public perception, increased scrutiny, and oversight.	CAFR benefits payment testing; annual benefits testing	SAO Audit, AUP
15	Guarded	Open Government	Ensure compliance with laws and rules related to open records and meetings.	Non-compliance could lead to penalties and fines or voiding of board actions.	None	n/a
16	Guarded	Investment Accounting	Ensure all TRS Investments are properly and completely accounted for; Ensure investments are valued correctly; Ensure investment fees are accurately reported and disclosed; Ensure cash flows into and out of the Fund are complete and properly controlled; Accurately calculate performance incentive pay (PIP)	TRS investments are not properly accounted for, valued correctly or properly reported, and investment-related cash is not properly controlled.	Incentive pay testing; SAO CAFR audit; private equity management fee/carried interest audit; performance calculation audit; quarterly investment compliance testing	AUP, SAO audit, audit
17	Guarded	Global Initiatives	Ensure employee safety by complying with laws and regulations and providing awareness of challenges when traveling abroad.	Not being aware of safety, compliance, and other challenges when traveling abroad could jeopardize the safety of our employees.	TRICOT Financial Audit	Audit



Appendix C

Audit Universe Mapped to TRS Risk Assessment

#	TRS Risk Level	TRS Risk Category	TRS Goal	TRS-Assessed Overall Risk	Planned Approach	Project Type
18	Guarded	Facilities Management & Planning	Provide a physical work environment that is safe and enhances productivity.	Inadequate facilities management or ineffective space utilization could result in less than desirable conditions for TRS members, visitors, and staff and could jeopardize our ability to continue providing an exemplary level of service to our members.	Capital improvement planning process project	Consulting
19	Guarded	Ethics & Fraud Prevention	Maintain a culture that upholds ethical behavior and values that contribute and promote the fiduciary duties of prudence and loyalty, and reduces fraud risks.	A lack of ethics could undermine the duties of prudence and loyalty and create fraud risks resulting in loss of assets, credibility, and business opportunities, adverse publicity, violations of law, and increased scrutiny and oversight.	Ethics policies compliance testing as part of investment policies compliance quarterly testing; participation in triage team	AUP
20	Guarded	Customer Service	Deliver superior service to members and internal/external customers.	Inadequate customer service could result in dissatisfied members or customers and could lead to increased scrutiny and oversight.	None (management is implementing consulting recommendations)	n/a
21	Guarded	Credit	Maintain effective management of counterparty and securities lending risks.	Unmanaged counterparty and securities lending exposures could result in losses to the investment portfolio.	Attendance at monthly securities lending calls; quarterly investment compliance testing	Advisory, AUP
22	Guarded	Communications & External Relations	Maintain effective communication and positive relations with members, retirees, employers, TRS employees, news media, and the public.	Poor communication could lead to confusion resulting in increased calls to TRS, poor or inappropriate decision-making regarding TRS benefits, and incorrect information provided to external parties.	Update employer audits webpage; make presentations on employer audit initiatives and common findings	Advisory
23	Guarded	Business Continuity	Recover and resume operations in the event of a major business interruption.	Members do not receive statutorily required services timely.	Observation of disaster recovery and business continuity exercises/tests	Advisory
24	Guarded	Budget	Ensure TRS has appropriate budget to provide and sustain resources necessary to successfully carry out TRS' mission, goals, and objectives to serve our members.	Lack of a sufficient operating budget could jeopardize our ability to effectively serve our members.	Attend TEAM budget meetings	Advisory
25	Guarded	Accounting & Reporting	Maintain and monitor the integrity, accuracy, and completeness of financial information and timeliness of reporting.	Materially inaccurate financial information and reports would result in Board of Trustees and Texas Legislature decisions being made on flawed data and adverse or qualified audit opinions.	General Accounting Change in Management Audit; SAO CAFR Audit; CAPPs implementation participation	Audit, SAO Audit; Advisory



Appendix C

Audit Universe Mapped to TRS Risk Assessment

#	TRS Risk Level	TRS Risk Category	TRS Goal	TRS-Assessed Overall Risk	Planned Approach	Project Type
26	Guarded	403(b)	Maintain a list of certified companies and a list of registered products and investment options which meet requirements of law and TRS rule. Adopt fee caps to help ensure fees paid by members are competitive.	Public education employees purchase products and investment options from companies that are not on either list.	None (audited in prior year)	n/a
27	Low	Market	Maintain market risk exposures consistent with investment objectives.	Too little or too much exposure to market risk could each lead to undesirable investment outcomes.	Quarterly investment compliance testing and reporting	Advisory
28	Low	Liquidity	Maintain levels of liquidity appropriate for the support of fund disbursements, anticipated investment funding needs and trust level leverage.	Inadequate liquidity could lead to cash shortfalls.	Quarterly investment compliance testing and reporting; updating meetings with risk officer	Advisory
29	Low	Performance Reporting	Maintain the integrity of investment information - reporting and disclosure, accuracy, completeness and valuation; Develop and disseminate customized investment reporting for both management and governance to enhance making better strategic and tactical investment decisions.	Performance reports contain material inaccuracies.	Performance calculation audit	Audit
30	Low	Private Market Operations	Maintain integrity of the transaction settlement and position information for optimal investment management decisions.	Inefficient or ineffective transaction settlement or position management process could result in losses to the fund.	Private market fee/carried interest audits	Audit
31	Low	Public Market Operations	Maintain the integrity of the transaction settlement and position information for optimal investment management decisions.	Inefficient or ineffective transaction settlement or position management process could result in losses to the fund.	Quarterly investment compliance testing and reporting; TRS Compliance monitors IMA compliance; IIC attendance	AUP, Advisory
32	Low	Government Relations	Maintain effective communications and positive relations with the Legislature, associations, and other public parties.	Poor communications could lead to adverse relations, unfavorable legislation, and restricted funding.	None	n/a
33	Other	Governance and Administration	n/a	n/a	Board materials project; executive incentive pay testing; General Accounting change in management audit; participation in various committees	Consulting, Audit, AUP, Advisory

2017 - 2021 TRS Internal Audit Strategic Plan



*Trusted Assurance,
Valued Advice*

Mission, Vision, and Stakeholders

- ▶ Our mission: to enhance and protect organizational value by providing risk-based and objective assurance, advice, and insight
- ▶ Our vision: to provide trusted assurance and valued advice through our services to primary stakeholders:
 - ▶ Assurance that TRS' risk management, governance, and control processes support achievement of TRS mission and business objectives
 - ▶ Advice and consultation for improving processes through business partnerships and collaboration
- ▶ Our primary stakeholders:
 - ▶ TRS Board of Trustees and the Audit Committee of the Board of Trustees
 - ▶ Executive Director and Executive Management

Strategic Goals

- ▶ Our strategic goals were developed to align with the TRS Strategic Plan and Core Values and ensure that we support the changing needs of TRS' stakeholders in fulfilling fiduciary duties and achieving business goals:
 - ▶ Internal Audit Goal 1: Facilitate Audit Committee governance
 - ▶ TRS Goal 1: Sustain a financially sound pension trust fund
 - ▶ TRS Goal 2: Continue to improve benefit delivery
 - ▶ TRS Goal 3: Facilitate access to competitive, reliable healthcare benefits for our members
 - ▶ Internal Audit Goal 2: Support TRS initiatives
 - ▶ TRS Goal 2: Continue to improve benefit delivery
 - ▶ TRS Core Values
 - ▶ Internal Audit Goal 3: Enhance Internal Audit staff competence and expertise
 - ▶ TRS Goal 4: Attract, retain, and develop highly competent staff

Goal 1: Facilitate Audit Committee Governance

Objective 1: Provide assurance and advice to the Audit Committee and executive management on risk mitigation activities related to the pension and healthcare trusts

Strategy 1	Conduct assurance activities relating to the completeness and accuracy of Reporting Entity information submitted to TRS
Strategy 2	Provide assurance on investment risk mitigation activities
Strategy 3	Provide assurance on health care risk mitigation activities
Strategy 4	Coordinate with Enterprise Risk Management (ERM) on risk assessment activities
Strategy 5	Collaborate with Compliance Team and Risk Group on risk and compliance monitoring of investment-related activities

- ▶ Quantitative measurements:
 - ▶ Audit project surveys (TRS and Reporting Entities)
 - ▶ TASBO presentation surveys
 - ▶ Chief Audit Executive (CAE) and staff 360 evaluations
 - ▶ Audit plan completion rate
 - ▶ Staff utilization rates

Goal 1: Facilitate Audit Committee Governance

Objective 2: Improve Internal Audit communication

Strategy 1	Refine report format of Internal Audit reports and Audit Committee materials
Strategy 2	Improve delivery of information
Strategy 3	Identify and promote resources within Internal Audit that could be beneficial to TRS

- ▶ Quantitative measurements:
 - ▶ CAE and staff 360 evaluations

Goal 1: Facilitate Audit Committee Governance

Objective 3: Provide information on effective Audit Committee practices

Strategy 1	Obtain and provide information to the Audit Committee on best practices of audit committees
Strategy 2	Consider using Audit Committee self-evaluation tool
Strategy 3	Share governance resources through Diligent

- ▶ Quantitative measurements:
 - ▶ CAE and staff 360 evaluations

Goal 2: Support TRS Initiatives

Objective 1: Support the success of the TEAM Program and Financial Software Implementations

Strategy 1	Facilitate independent oversight for board and external oversight agencies
Strategy 2	Provide input and assistance during development and implementation of TRUST (new Benefits system) and new financial system
Strategy 3	Use TRUST and financial system in future audits

- ▶ Quantitative measurements:
 - ▶ CAE and staff 360 evaluations

Goal 2: Support TRS Initiatives

Objective 2: Integrate TRS Core Values into Internal Audit activities

Strategy 1	Explore opportunities and methods to tie audit findings into TRS Core Values of Customer Satisfaction, Accountability, Ethics, and Excellence
Strategy 2	Integrate TRS Core Values of Collaboration/ Teamwork, Respect, and Employee Fulfillment into IA documents
Strategy 3	Establish staff recognition programs

- ▶ Quantitative measurements:
 - ▶ CAE and staff 360 evaluations
 - ▶ TRS Workplace Survey

Goal 3: Enhance Internal Audit Staff Competence and Expertise

Objective 1: Cultivate in-house Subject Matter Experts

Strategy 1	Deepen knowledge of TRS laws (federal and state), rules, and internal policies
Strategy 2	Broaden foundational skills in data analytics
Strategy 3	Define and broaden auditing skills

- ▶ Quantitative measurements:
 - ▶ TRS project surveys
 - ▶ CAE and staff 360 evaluations

Goal 3: Enhance Internal Audit Staff Competence and Expertise

Objective 2: Ensure continued competence and expertise of Internal Audit

Strategy 1

Develop workforce continuity plans

- ▶ Quantitative measurements:
 - ▶ CAE and staff 360 evaluations
 - ▶ TRS Workplace Survey
 - ▶ HR turnover rates

Teacher Retirement System of Texas
Internal Audit Annual Report for Fiscal Year 2017

VI. External Audit Services Procured in Fiscal Year 2017

Teacher Retirement System of Texas
Internal Audit Annual Report for Fiscal Year 2017

VI. External Audit Services Procured in Fiscal Year 2017

External Audit Services Procured and Outsourced by Internal Audit	Provided by	Report Date
Contractor Onboarding and Off-Boarding	Myers and Stauffer LC	5/2/2017

External Audit Services Procured by TRS	Provided by	Report Date
Review of Health Plan Administration	Truven Health Analytics	In Progress
Comprehensive Annual Financial Report (CAFR) – Fiscal Year 2016	State Auditor’s Office	11/17/2016
Comprehensive Annual Financial Report (CAFR) – Fiscal Year 2017	State Auditor’s Office	In Progress
TRS Investment Company (TRICOT) Financial Audit Fiscal Year 2016	Grant Thornton	12/6/2016
TRS Investment Company (TRICOT) Financial Audit Fiscal Year 2017	Grant Thornton	In Progress

VII. Reporting Suspected Fraud and Abuse

Teacher Retirement System of Texas

Internal Audit Annual Report for Fiscal Year 2017

VII. Reporting Suspected Fraud and Abuse

TRS has taken the following actions to implement the fraud detection and reporting requirements of Section 7.09 of the General Appropriations Act and Section 321.022 of the Texas Government Code:

- Updated in July 2017, *TRS Fraud, Waste, and Abuse Policy* establishes a fraud, waste, and abuse prevention awareness program that includes employee training and guidelines for reporting suspected fraud, waste, and abuse. Key elements of the policy include definitions, covered acts, reporting procedures of detected or suspected fraud, waste, or abuse, detection and investigation, awareness training, and corrective action.
- The TRS Internet site includes the contact number of the State Auditor's Office Hotline and a link for reporting instructions.
- Links are available on the TRS Intranet for both the State Auditor's Office Hotline and the TRS Internal Fraud and Ethics Hotline.
- Administration of the TRS Internal Fraud and Ethics Hotline is vested with the Chief Compliance Officer & Compliance Counsel since fiscal year 2016.
- In compliance with the reporting requirement of fraud, waste, and abuse, TRS reports all instances of suspected fraud, waste, and abuse to SAO.