



Audit Committee Meeting

August 25, 2021

ERS

EMPLOYEES  RETIREMENT
SYSTEM OF TEXAS

Presented for Review and Approval

December 7, 2021

Contents

1. Call Meeting of the ERS Board of Trustees Audit Committee to Order 2

2. Consideration of the Minutes to the March 10, 2021 ERS Audit Committee Meeting – (ACTION) .. 2

3. Review of Internal Audit Reports 2

5. Consideration of Internal Audit Administrative Items (Action) 4

6. Adjournment of the ERS Board of Trustees’ Audit Committee Meeting..... 4

**AUDIT COMMITTEE MEETING
EMPLOYEES RETIREMENT SYSTEM OF TEXAS
August 25, 2021**

TRUSTEES PRESENT

Brian Barth, Audit Committee Chair
Craig Hester, Board Chair
Catherine Melvin, Board Vice-Chair
Ilesa Daniels, Member
Dr. James Kee, Member

ERS DIRECTORS PRESENT

Porter Wilson, Executive Director
Cathy Terrell, Deputy Executive Director
Bernie Hajovsky, Director of Enterprise Planning
Cynthia Hamilton, Acting General Counsel
Tony Chavez, Director of Internal Audit
Tom Tull, Chief Investment Officer

ERS STAFF PRESENT

Jason Avants, Information Systems
Raquel Colón, Investments
Kelley Davenport, Executive Office
Lanesia Jones, Investments
Tressie Landry, Internal Audit
Jonathan Puckett, Internal Audit
Nile Stork, Information Systems
David Veal, Incoming Chief Investment Officer

VISITORS PRESENT

Neika Clark, Trustee-Elect

Meeting of the ERS Board of Trustees Audit Committee

1. Call Meeting of the ERS Board of Trustees Audit Committee to Order

Mr. Brian Barth, Chair of the Audit Committee of the Employees Retirement System of Texas (ERS), noting a quorum was present, called the meeting to order at 8:00 a.m. on Wednesday, August 25 2021 and read the following statement:

“A public notice of the ERS Board of Trustees Audit Committee meeting containing all items on the proposed agenda was filed with the Office of the Secretary of State at 11:42 a.m. on Monday, August 16, 2021, as required by Chapter 551 Texas Government Code, referred to as the Open Meetings Law.”

2. Consideration of the Minutes to the March 10, 2021 ERS Audit Committee Meeting – (ACTION)

Chair Brian Barth opened the floor for a motion on the approval of the minutes from the March 10, 2021 ERS Audit Committee meeting.

Move that the ERS Board of Trustees Audit Committee of the Employees Retirement System of Texas approve the minutes to its meeting held on March 10, 2021.

Motion by Craig Hester second by Jim Kee

Final Resolution: Motion Carries

Aye: Craig Hester, Brian Barth, Ilesa Daniels, Jim Kee, Catherine Melvin

3. Review of Internal Audit Reports

Qualified Domestic Relations Orders Audit

The audit objective was to determine if benefits are processed in accordance with legal orders following a divorce or legal separation.

Qualified Domestic Relations Orders (QDROs) start as domestic relations orders, which are court ordered separations of community assets, usually as a result of a divorce proceeding. Within ERS, the Customer Benefits Division and Office of General Counsel share responsibility for reviewing domestic relations orders to determine if they qualify under Texas statute for the state pension plan. Domestic relations orders are either qualified (accepted) or returned with further guidance on how to correct deficiencies that prevent qualification. When a member with a QDRO on file retires, ERS uses the calculation for division of benefits ordered by the court and creates a payment for each party – the member and their alternate payee (ex-spouse).

The overall results of the audit were satisfactory, finding that the controls in place were satisfactory to ensure accurate processing of domestic relations orders. However, there were two observations:

Observation 1: Establish timeliness targets for reviews (qualifications/denials) of domestic relations orders (DROs) (Moderate)

While there is no statutory requirement for processing domestic relations orders, the process would benefit from a timeliness target to ensure all files are processed within a reasonable amount of time.

- A significant increase in efficiency occurred when the authority to approve qualification of certain domestic relations orders was delegated to the Director of Customer Benefits, cutting the number of days to process in half between Fiscal Years 2018 and 2019.
- One challenge to the process is that domestic relations orders are sometimes submitted to ERS for a qualification review several years after the court order was created. For example, a member might have been granted a divorce 15 years prior to retiring and the member or alternate payee might wait until the member retires to submit the document to ERS for qualification. The statute does not change often so older domestic relations orders do not often require revision through the court system, but it is possible that the order is not written

in a manner that complies with the statute and would require the member and alternate payee to get a revision through the courts.

Observation 2: Refine procedures to enhance the accuracy of manual calculations. (Moderate)

Due to the complexity in the benefit calculation and the uniqueness of each court order, benefits for members with QDROs are calculated manually. While there are several reviews of calculations, improvements in accuracy could be made through increasing the automated calculations in worksheets used to calculate the separation of benefits. In addition, review calculations should be retained to identify the root cause when an error occurs.

Alternative Investments Funding Audit

The audit objective was to determine if contributions and distributions of funds for ERS' alternative investments are properly processed and reconciled.

Alternative investments are defined by our investment policy and include private real estate, private equity, private infrastructure, hedge funds, private credit and special situations. Participants in the process include investment partners (general partners), ERS custodian bank (currently BNY Mellon) and ERS.

When ERS commits to investing in an alternative investment, the total funding committed is not transferred to the general partner at one time, rather the general partners make several capital calls or draw downs of the total funds committed. These capital calls are approved by the ERS Asset Class Director and the Chief Investment Officer. Capital distributions (money returned to ERS) often occur during the investment period as well.

Key controls include multiple reconciliations between the general partner reporting, custodial bank reporting and ERS accounting systems.

Overall the results of the audit were satisfactory and no observations were noted.

Status of Audit Recommendations

Internal Audit periodically follows-up on prior audit recommendations. This report includes the status of management action plans for three reports that included four audit recommendations. Management action plans have one of the following statuses:

- Implemented
- Partially Implemented
- No action taken
- Management acceptance

The results in this report include:

Audit Engagement	Observation #	Status
Temporary Workers Contract Management (2019-02)	1	Implemented
Profit Share (2019-08)	1	Implemented
	2	Partially Implemented
Survivor Benefits (2020-04)	1	Management Acceptance

The observation related to Survivor Benefits related to the statutory requirement that a lump sum death benefit payment to member beneficiaries be processed within seven days. Management reviewed the necessary staffing increase needed to meet that requirement and determined the cost outweighed the benefit of complying with statute given a mitigating factor. A recent change in legislation allows beneficiaries to assign their payment directly to a funeral home. Based on the analysis performed by Internal Audit and the ability to assign benefits to funeral homes, the risk of non-compliance with the statutorily required seven day processing is mitigated to an acceptable level.

There were no further questions or discussion, and no action was required on this item.

4. Consideration of Internal Audit Administrative Items – (Action)

Internal Audit's Proposed Fiscal Year 222 Audit Plan

Tony Chavez, Director of Internal Audit, presented the proposed FY22 Audit Plan for consideration and approval. Including the following audits:

- Private Real Estate
- Public Equity – Externally Managed
- Dental Insurance
- Budgeting
- ERS Performance Measure Management
- Contact Center
- Pension Forecasting
- Security Monitoring & Event Analysis
- Cyber Security Framework
- Disaster Recovery
- Financial Statement Opinion

Move that the Board of Trustees Audit Committee of the Employees Retirement System of Texas approve and adopt the proposed Fiscal Year 2022 ERS' Internal Audit Plan as discussed in this agenda item.

Motion by Catherine Melvin, second by Craig Hester

Final Resolution: Motion Carries

Aye: Craig Hester, Brian Barth, Ilesa Daniels, Jim Kee, Catherine Melvin

5. Adjournment of the ERS Board of Trustees' Audit Committee Meeting

The Audit Committee meeting adjourned at 8:46 a.m. on Wednesday, August 25, 2021