

# ERS<sup>®</sup>

EMPLOYEES  RETIREMENT  
SYSTEM OF TEXAS

## Internal Audit Risk Assessment & Proposed FY24 Annual Audit Plan

August 23, 2023

### FROM THE AUDIT DIRECTOR

We are pleased to submit the Internal Audit Risk Assessment and Proposed Internal Audit Plan (Plan) for Fiscal Year 2024.

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

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

Sincerely,



Anthony Chavez, CIA, CGAP, CRMA  
Director, Internal Audit Division



### ERS INTERNAL AUDIT DIVISION

To provide independent and objective assurance on the effectiveness of controls and operations to meet ERS' strategic directions.

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## AUDIT PLAN OVERVIEW

The annual internal audit plan is developed based on ERS' audit universe (See *Appendix B*), stakeholder input and an assessment of risk and exposures affecting ERS. The objective of a risk-based audit plan is to identify and prioritize operational functions that present the greatest risk to meeting agency objectives and goals. In assessing risk ratings for each auditable unit, Internal Audit focuses on the inherent risk of each function. *Inherent risk is the susceptibility of not meeting agency objectives assuming there are no mitigating controls.* Consideration of mitigating controls in addressing key inherent risk was evaluated based on prior period audit engagements, discussions with senior management and industry knowledge. See *Appendix A* for a detailed description of the Audit Plan methodology.

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*The Chief Audit Executive must establish a risk-based audit plan to determine the priorities of the Internal Audit Activity, consistent with organization's goals. (IIA Standard 2010—Planning)*

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## KEY TAKEAWAYS AND REVISIONS

In addition to overall risk rating of individual audit units, the following factors had a significant influence on the inclusion of individual engagements in the final Proposed Audit Plan:

- Areas of limited or no prior year audit coverage
- Communication and discussions held during Board of Trustee meetings
- Current events identified to have direct impact to ERS operations
- ERS Internal Audit staffing levels

*Internal Audit is an independent, objective assurance and consulting activity that is guided by a philosophy of adding value and improving the operations of the Employees Retirement System (ERS).*

*Internal Audit assists ERS in accomplishing its objectives by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of the organization's risk management.*

## FY 24 PROPOSED ANNUAL INTERNAL AUDIT PLAN

CORE BUSINESS	ENGAGEMENT OBJECTIVE
INVESTMENTS	<p><b>Global Credit—Internal High Yield*</b> — <i>determine if investments in global credit securities are in accordance with ERS Investment Policy. (AUDIT)</i></p> <p><b>Operational Due Diligence*</b> — <i>determine if reviews of private market general partners ensure proper controls over administration of ERS alternative investments. (AUDIT)</i></p>
MEMBER SERVICES	<p><b>Group Benefits Rate Development and Analysis*</b>—<i>assess the effectiveness and efficiency of the rate setting process for group benefit premiums. (AUDIT)</i></p> <p><b>Retirement Account Withdrawals Audit*</b> – <i>determine if retirement account withdrawals are processed accurately. (AUDIT)</i></p>
INFORMATION SYSTEMS	<p><b>Change Management Audit</b>—<i>determine if procedures are in place to ensure change management to ERS information systems are properly incorporated. (AUDIT)</i></p> <p><b>Portable and Remote Computing Audit</b>—<i>determine if procedures are in place to ensure ERS data is properly safeguarding when accessed remotely. (AUDIT)</i></p>
ENTERPRISE	<p><b>Financial Opinion Audit</b>—<i>To opine on whether ERS' fiscal year 2022 annual financial statements are free from material misstatement and in conformity with generally accepted accounting principles. (AUDIT)</i></p> <p><b>Ethics Audit*</b>— <i>Determine if the Ethics program provides reasonable assurance of compliance with applicable laws, regulations and ERS policy. (AUDIT)</i></p>

\* Carried over from FY23 Audit Plan

Internal Audit performs multiple types of audit engagements that provide various levels of service and assurance. Each engagement type has unique performance and reporting requirements to comply with audit standards. Standard project engagement types include:

**AUDITS (75%)** - Nature and scope of the engagement determined by Internal Audit; Highest level of assurance; Deliverable: Report for public distribution

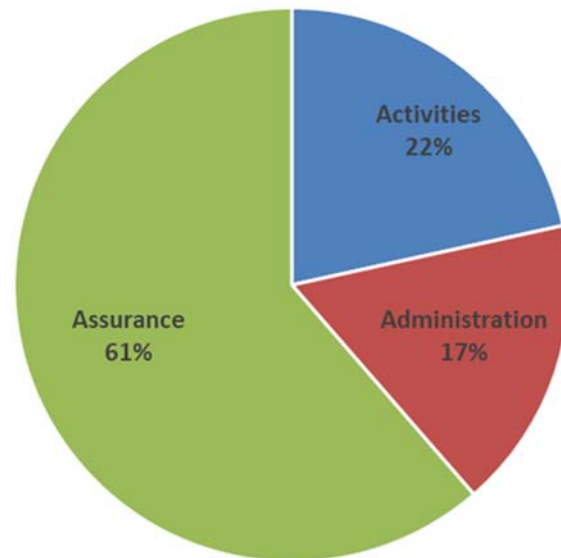
**CONSULTING (15%)** - Nature and scope of engagement subject to agreement with audit customer; No assurance provided; Deliverable: report or memo with limited distribution.

**AGREED UPON PROCEDURES (5%)** - Specific procedures agreed to between management and Internal Audit to perform and report on the results; Lowest level of assurance; Deliverable: Report or memo for public distribution

**INFORMAL CONSULTING (5%)** - Ad-hoc assistance; Subject matter expert input ; Deliverable: Verbal discussions or memo to management.

## OPERATING BUDGET

Internal Audit has five (5) full-time equivalent (FTE) positions with an operating budget of approximately \$1.1 million<sup>1</sup> which includes **\$260,000** for required financial opinion audit work. Based on FTEs and co-source audit resources, estimated available audit hours are **9,000**. Internal Audit is required by laws and professional audit standards to conduct certain activities on an annual and/or periodic basis (see IA Major Activities below). Those activities are also included in the estimated audit hours.



Resources (employees and operating budget) are adequate to complete the projects listed in the proposed FY24 Annual Audit Plan.

## FY24 INTERNAL AUDIT MAJOR ACTIVITIES

### **Risk Assessment & Annual Audit Plan**

Assess and update ERS Audit Universe and corresponding risk ratings. Develop the FY24 Annual Internal Audit Plan in coordination with the Board and Executive Office.

### **Internal Audit Quality Assurance Improvement Program Review**

Conduct an annual self-assessment of Internal Audit's compliance with professional auditing standards.

### **Annual Internal Audit Report**

Prepare annual report of audit activities in accordance with statutory requirements for submission to required agencies.

### **Status of Audit Recommendations**

Report on the implementation status of Management Action Plans (MAPs) to address prior audit observations and recommendations.

### **External Audit Liaison and Oversight**

Coordinate audits and other activities between external regulatory agencies and ERS.

### **Fraud, Waste & Abuse**

Coordinate tracking, disposition, and reporting instances via ERS' public website, ERS' Intranet and SAO Hotline Complaints.

<sup>1</sup>—Budgeted amount excludes Investment Compliance allocations

# APPENDIX A—AUDIT PLAN METHODOLOGY

- 1) **Evaluate Audit Universe** - The audit universe represents all the functions, programs and activities available to audit (audit units). The audit universe is reviewed and updated to reflect changes in strategic directives or organization structure during the prior year. (See Appendix B)
- 2) **Review Risk Criteria** - For each audit universe, unique risk factors are used to assess risk. Risk factors are intended to align with current goals and objectives of ERS' core functions. Risk factors are weighted based on strategic goals, external landscape and emerging risks for the upcoming fiscal year. (See Appendix C)
- 3) **Gather Stakeholder Input** - Held discussions with members of management to solicit input over planned activity, challenges that may impact meeting goals and objectives and potential areas of interest from governing bodies.
- 4) **Risk Rate Audit Units** - Utilizing risk criteria, measure the inherent risk of each audit unit in meeting ERS' strategic missions.
- 5) **Analyze Risk Scores** - Review risk results by core business function, business objective/process and auditable unit. Discuss results with executive and senior management for reasonableness.
- 6) **Prioritize Auditable Units** - Narrow the list of potential audits deemed high value for ERS. Include key operational functions that were assessed lower risk ratings, but periodic review is deemed necessary and appropriate. Discuss results with Executive Management.
- 7) **Board Communication** - Communicate with Board results of the annual audit plan procedures. Incorporate feedback received regarding Board priorities into proposed audit plan.

*Audit provides essential accountability and transparency over government programs. Given the current challenges facing governments and their programs, the oversight provided through audit activities is more critical than ever. Audits provide objective analysis and information needed to make decisions necessary to create a better future.*

*The Internal Audit Division's audit engagements are conducted in accordance with the United States Government Accountability Office's (GAO) Government Auditing Standards, the Institute of Internal Auditors' (IIA) International Professional Practices Framework, the Texas Internal Auditing Act (Texas Government Code, Chapter 2102) and Committee of Sponsoring Organizations of the Treadway Commission (COSO) 2013 Framework.*

# Member Services

□ Prior Audits (FY14-18)

▨ External Audits

■ Prior Audits (FY19-23)

■ FY24 Audits

## STRATEGIC MANAGEMENT

Governance		Program Management	
Strategic Planning	Ethics & Compliance	Pension Forecasting	Enterprise Planning
Public Information & Records Retention	Legislative Reporting	Insurance Forecasting	GBP Rate Development & Analysis
	Business Continuity		

## MEMBER PROGRAMS

Group Benefits			Retirement	
<b>Health Insurance</b>	Vision	Appeals Administration	Disability Retirements	Deferred Compensation (Texa\$aver)
HealthSelect	Life Insurance	Prescription Drug Program	Retirement Account Withdrawals	Survivor Benefits
HealthSelect Out of State	Disability Insurance	Wellness	Standard Retirements	Qualified Domestic Relations Orders
Medicare Advantage	Flexible Spending Accounts	Insurance Processing	Service Credits	
Dental Insurance			Service Purchases	
Contact Center				
Benefit Coordinators				

## OPERATIONS


Financial		Support Services		
Budgeting	Travel	Facility Management	Print Services	<b>Workforce Management</b>
Financial Reporting	Agency Accounting	Communications	Contracting	Hiring
Procurement	Member Program Accounting	Physical Security		Retention
Purchasing		Legal Services		Employee Training
				Temporary Workforce

# ERS Investments

 Prior Audits (FY14-18)

 External Audits

 Prior Audits (FY19-23)

 FY24 Audits

## GOVERNANCE

Policy		Management
Asset Allocation	Performance Measurement (Benchmarking)	Investment Compliance
Incentive Compensation	Investment Diversification Limits	Shareholder Governance
Investment Governance	Tactical Planning	

## INVESTMENTS

Return Seeking			Risk Reduction / Liquidity	
Private Equity	<b>Real Estate</b>	<b>Public Equity</b>	Cash	Rates
Private Infrastructure	Private RE	Internal	Securities Lending	Absolute Return (Hedge Funds)
<b>Credit</b>	Public RE	Externally Advised	Texas Employees Group Benefits Program (Insurance Portfolio)	
Internal High Yield	Special Situations	Emerging Managers		
Private Credit		Directional Growth		
		Best Ideas		

## OPERATIONS

Financial	Services
Management Fees	Custodian Services
Profit Sharing	Operational & Financial Due Diligence
Valuations	Alternative Investment Fund Processing
Investment Accounting	Trading
Investment Reporting	

# Information Technology

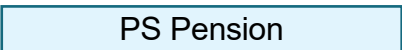
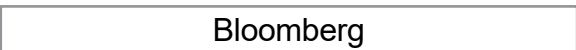




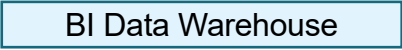




 Prior Audits (FY14-18)

 External Audits












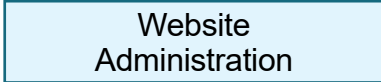
 Prior Audits (FY19-23)

 FY24 Audits






## BUSINESS APPLICATION

Member Services	Investments	Operations
 PS Pension	 Bloomberg	 PS Financials
 PS - Benefits	 FactSet	 PS Human Resources
 BI Data Warehouse	 n-Tier	 Concur
	 Eagle Investment Accounting System	 Clarity

## MANAGEMENT

Governance		Support Services	
 IT Governance	 Data Governance	 Service Desk	 Remote Connectivity
 Asset Management	 Cloud Management	 Database Administration	 Network Services
 IS Acquisition	 Project Prioritization	 Mobile Devices	 Website Administration

## CYBER SECURITY

 Detect	 Identify	 Protect	 Recover	 Respond
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# APPENDIX C—RISK CRITERIA

RISK	INVESTMENT RISK ATTRIBUTES	MEMBER SERVICES RISK ATTRIBUTES	INFORMATION SERVICES RISK ATTRIBUTES
<b>STRATEGIC (Directive)</b>	<ul style="list-style-type: none"> <li>Board/Management initiative</li> <li>Asset allocation targets and ranges</li> <li>Tactical planning and positioning (over/under weight)</li> <li>High tracking error volatility</li> <li>Legislative interest</li> <li>Public perception</li> <li>Investment literacy (complexity)</li> </ul>	<ul style="list-style-type: none"> <li>Criticality to achieving mission</li> <li>Board/Management initiative</li> <li>Reputation loss if goals not achieved</li> <li>Size of population served</li> <li>Criticality of service/program provided</li> <li>Legislative interest</li> <li>Public perception</li> </ul>	<ul style="list-style-type: none"> <li>Criticality data/system in achieving mission</li> <li>Level of system availability required to achieve mission</li> <li>System delivery direct to members</li> <li>Reputation loss if goals not achieved</li> <li>Size of population served</li> <li>Legislative interest</li> </ul>
<b>OPERATIONAL (Implementation)</b>	<ul style="list-style-type: none"> <li>Asset class maturity</li> <li>Complexity of investment strategy</li> <li>Market accessibility to meet tactical plans</li> <li>Investment risk management complexity</li> <li>Required expertise</li> <li>Staffing levels/Turnover</li> <li>Level of external management</li> <li>Opportunity for personal gain, misuse/misappropriation;</li> </ul>	<ul style="list-style-type: none"> <li>Service/Program complexity and maturity</li> <li>Transaction volume</li> <li>Required expertise</li> <li>Staffing levels/Turnover</li> <li>Level of external management in delivery services</li> <li>Opportunity for personal gain, misuse/misappropriation</li> </ul>	<ul style="list-style-type: none"> <li>System complexity and maturity</li> <li>Required confidentiality of data/transactions</li> <li>Transaction volume</li> <li>Level of data ownership</li> <li>Data origination (internal vs. external)</li> <li>Staffing levels/turnover</li> </ul>
<b>FINANCIAL (Dollars)</b>	<ul style="list-style-type: none"> <li>Percent of total fund balance</li> <li>Frequency of valuation (market price)</li> <li>Utilization of leverage as part of investment strategy</li> <li>Liquidity</li> <li>Risk for material financial misstatement</li> <li>Corresponding incentive compensation</li> </ul>	<ul style="list-style-type: none"> <li>Total program expenditures</li> <li>Level of cost oversight of expenditures (direct payment vs. pass-through)</li> <li>Market cost conditions and trends</li> <li>Cost transparency</li> <li>Risk for material financial misstatement</li> </ul>	<ul style="list-style-type: none"> <li>Total direct cost of information system</li> <li>Total cost for related program</li> <li>Risk for material financial misstatement</li> </ul>
<b>REGULATORY (Mandates)</b>	<ul style="list-style-type: none"> <li>Volume and complexity of regulatory requirements</li> <li>Level of negative public perception from non-compliance</li> <li>Potential loss of autonomy/stewardship from non-compliance</li> <li>Severity of fines from non-compliance</li> <li>Time since last audit</li> <li>Prior audit observations</li> <li>Potential for conflict of interest</li> </ul>		