



**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

Board of Trustees
Employees Retirement System of Texas
Austin, Texas

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Employees Retirement System of Texas (ERS), a blended component unit of the State of Texas, as of and for the year ended August 31, 2023, and the related notes to the financial statements, which collectively comprise the ERS' basic financial statements and have issued our report thereon dated February 16, 2024.

Report on Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered ERS' internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of ERS' internal control. Accordingly, we do not express an opinion on the effectiveness of ERS' internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.

We consider the deficiencies described in the accompanying schedule of findings and responses as items 2023-001 and 2023-002 to be material weaknesses.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency described in the accompanying schedule of findings and responses as item 2023-003 to be a significant deficiency.

Report on Compliance and Other Matters

As part of obtaining reasonable assurance about whether ERS’ financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

ERS’ Response to Findings

Government Auditing Standards requires the auditor to perform limited procedures on the ERS’ response to the findings identified in our audit and described in the accompanying schedule of findings and responses. ERS’ response was not subjected to the other auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity’s internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity’s internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



CliftonLarsonAllen LLP

Boston, Massachusetts
February 16, 2024

**EMPLOYEES RETIREMENT SYSTEM OF TEXAS
SCHEDULE OF FINDINGS AND RESPONSES
AUGUST 31, 2023**

Finding 2023-001 - Investment Accounting

Type of Finding

Material weakness in internal control over financial reporting.

Condition

We identified a material investment allocation error totaling approximately \$197 million between the internal service fund and the fiduciary funds.

Criteria or Specific Requirement

Management is responsible for designing, implementing, and maintaining internal controls that support the fair presentation of financial statements in accordance with accounting principles generally accepted in the United States of America (GAAP).

Effect

The internal service fund's investments and net investment income were understated by approximately \$197 million, and the Employees Retirement Fund, Law Enforcement Custodial Officer Supplemental Fund, and Judicial Retirement System Plan II (all Fiduciary Funds) investments and net investment income were collectively overstated by \$197 million.

Cause

An incorrect investment directive was provided from ERS to the custodial bank which resulted in the investment allocation error. Internal controls were not in place to detect and correct the error at either the transaction or financial statement preparation levels.

Repeat Finding

No.

Recommendation

We recommend procedures be implemented that require two supervisory reviews of investment directives for internal investment portfolio transfers.

We recommend the Chief Investment Officer, or designee, review the draft financial statements and related information relevant to investments and investment returns in the ACFR for reasonableness.

We recommend that a process be developed to compare investment performance reporting with accounting records at the fund level.

**EMPLOYEES RETIREMENT SYSTEM OF TEXAS
SCHEDULE OF FINDINGS AND RESPONSES (CONTINUED)
AUGUST 31, 2023**

Views of Responsible Officials and Planned Corrective Action

ERS agrees that controls around investment directives can be strengthened. We will implement multiple supervisory reviews of investment directives. We have established a methodology to compare investment performance data to corresponding accounting records on a regular basis. We also plan to incorporate a step in the ACFR development for review of investment relevant information by the Chief Investment Officer for reasonableness.

Finding 2023-002 – Governmental Funds Financial Statements

Type of Finding

Material weakness in internal control over financial reporting.

Condition

ERS' governmental funds (general, social security administration, death benefits – peace officers, fireman, etc., compensation to victims of crime, and death benefits – retiree \$5,000 lump sum funds) represent individual major funds under accounting principles generally accepted in the United States of America (GAAP). As a result, each of these funds is considered a separate opinion unit with a separately calculated materiality threshold.

Certain routine journal entries related to the governmental funds were not recorded until identified during audit procedures, including recording annually prepared entries related to the social security administration fund and recording voided payments related to the death benefits – retiree \$5,000 lump sum fund.

Criteria or Specific Requirement

Management is responsible for designing, implementing, and maintaining internal controls that support the fair presentation of financial statements in accordance with accounting principles generally accepted in the United States of America (GAAP).

Effect

- The social security administration fund estimated uncollectible accounts receivable was understated by \$23,701.
- The social security administration fund revenues and fund balance were understated by \$3,135.
- The death benefits – retiree \$5,000 lump sum fund benefit payments were overstated by \$45,090 and fund balance was understated by the same amount.

Cause

Financial reporting controls were not followed to verify that all governmental funds activity was recorded during the year.

**EMPLOYEES RETIREMENT SYSTEM OF TEXAS
SCHEDULE OF FINDINGS AND RESPONSES (CONTINUED)
AUGUST 31, 2023**

Repeat Finding

No.

Recommendation

We recommend ERS implement a review process to ensure all year-end governmental funds journal entries are recorded.

Views of Responsible Officials and Planned Corrective Action

ERS agrees that follow-up was not performed to ensure that all year-end governmental funds journal entries were recorded. ERS will implement a review process to ensure all year-end governmental funds journals are recorded.

Finding 2023-003 – Defined Benefit Plan Contributions

Type of Finding

Significant deficiency in internal control over financial reporting.

Condition

ERS' contribution rate verification tools, used to validate the accuracy of contributions remitted by individual agencies, were not utilized during fiscal year 2023. This condition increases the risk that contributions are not being remitted by individual agencies correctly based on pensionable wages.

Criteria or Specific Requirement

Internal controls should be in place to verify contributions made are based on current rates and represent pensionable wages.

Effect

Employer contributions to the defined benefit plans may not be remitted appropriately by individual agencies.

Cause

Although a new contribution rate verification tool was created to reflect the change in rates or the new Group 4 membership tier, it has not been fully implemented for use.

Repeat Finding

No.

Recommendation

We recommend ERS fully implement use of the rate verification tool. We also recommend this tool formally be reviewed monthly by finance for reasonableness.

**EMPLOYEES RETIREMENT SYSTEM OF TEXAS
SCHEDULE OF FINDINGS AND RESPONSES (CONTINUED)
AUGUST 31, 2023**

Views of Responsible Officials and Planned Corrective Action

ERS agrees the tools used to verify the state contribution are not fully implemented. ERS has recruited several agencies to assist in fully implementing the tool, including on-going review for reasonableness.