



**ERS INTERNAL  
AUDIT DIVISION**

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

# Status of Audit Recommendations

FROM THE DIRECTOR, INTERNAL AUDIT

MARCH 11, 2020

Internal Audit (IA) has completed procedures to monitor and report on the status of management action plans (MAPs) to address open audit recommendations. Implementation status was based on management's self-assessment and IA's review of supporting documentation to corroborate the self-assessment. Supporting documentation included, but was not limited to, revised documented policies/procedures, worksheets, management status reports and reconciliations. Audit work was not performed to verify the effectiveness of management actions implemented to determine if controls were working as intended. Future audit engagements in these areas will confirm the effectiveness of the controls implemented.

Results are detailed in the subsequent pages.

Sincerely,

A handwritten signature in black ink, appearing to read "Anthony Chavez".

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

## Table of Contents

<b>MAP Implementation Status .....</b>	<b>2</b>
<b>Summary Status .....</b>	<b>2</b>
<b>Hedge Funds .....</b>	<b>3</b>
<b>Real Assets— Infrastructure.....</b>	<b>4</b>
<b>HealthSelect<sup>SM</sup> of Texas<sup>(R)</sup> Denial Process.....</b>	<b>6</b>
<b>Outstanding Recommendations.....</b>	<b>7</b>

# MAP IMPLEMENTATION STATUS

MAP implementation status is designated by the following levels:

- **Implemented** – Sufficient and appropriate evidence to support all reported management action items
- **Partially Implemented** – Management has implemented some management action items but not all to fully address reported risk
- **No Action Taken** – No management action taken and/or evidence provided to support management action
- **Management Acceptance** – Executive management has accepted the risk of not fully implementing reported management action plan.

*The chief audit executive must establish a follow-up process to monitor and ensure that management actions have been effectively implemented or that senior management has accepted the risk of not taking action.*

*Institute of Internal Auditors standard 2500.A1*

## SUMMARY STATUS OF AUDIT REPORT RECOMMENDATIONS AND SUMMARY

Audit Engagement	MAP Owner	MAPs Implemented	MAPs Partially Implemented
Hedge Funds	Director Hedge Funds	1	
Real Assets—Infrastructure	Director of Infrastructure	2	
HealthSelect of Texas Denial Process	Assistant Director of Group Benefits	1	

## HEDGE FUNDS — INVESTMENTS (REPORT #2016-03)

### Observation 2

Monitoring of performance versus peer group hedge funds not performed. (Moderate)

### Recommendations

To comply with the hedge fund policy, the hedge fund program should develop a process to monitor the performance of individual funds against peer groups. The process should include a supervisory review and required action to address poor performing funds.

### **Management Action Plan Status**

Status	Clarification
Partially Implemented February 2018	<p>An investment analyst was hired to oversee the peer reporting review process. Preliminary peer review reports have been developed to assist with monitoring portfolio performance. However, due to the highly manual intensive process and limited availability of data, a long-term solution continues to be evaluated.</p> <p><u>Left to accomplish:</u></p> <ul style="list-style-type: none"> <li>• Continue to improve the current reporting process including documenting the required action to address poorly performing funds if applicable</li> <li>• Continue researching potential software/vendors that would allow for a greater automated report process</li> </ul>
Implemented March 2020	<p>A quarterly Peer Group Performance report is produced and reviewed quarterly, with comparisons required by the Investment Guidelines.</p>

# REAL ASSETS—INFRASTRUCTURE (REPORT #2018-07)

## Observation 1

Key information unavailable to support performance incentive benchmarks. (Significant)

## Recommendations

Incentive compensation goals and benchmarks developed specifically for the ICP methodologies should be more fully analyzed and documented. To improve transparency and support the reasonableness of benchmarks established for incentive compensation awards Internal Audit recommends:

- Retain any documentation that supports industry market economic fund terms including:
  - ◊ Any industry reports from investment data service providers (Preqin, Burgiss, Institutional Limited Partners Association (ILPA)) used as a basis or reference in determining market economics.
  - ◊ Any market analysis performed internally or by consultants to determine market economics. Analysis could include, but not limited to, examination of actual management fees agreed to with general partners, management fees originally proposed by general partners or surveys originated by ERS Investments staff or consultants.
- Document any ERS economic factors that would cause the ICP benchmark to diverge from industry market economic fund terms. ERS economic factors that may effect management fees relative to general market economics include, but are not limited to, investment strategy, developed vs. emerging markets and commitment size. Explanation should also be communicated to stakeholders the effect of ERS economic factors on management fees relative to general market economics and whether a fee premium or discount is expected.
- Clearly communicate the basis for the target fee rate to be used in the incentive compensation goal calculation. Information should include applicability to current ICP plan year conditions, any consideration or disregard of actual infrastructure investment economics and any analysis of the impact of co-investments on overall incentive compensation goal performance.

## Management Action Plan Status

Status	Clarification
Implemented	<p>Staff has implemented the following actions:</p> <ul style="list-style-type: none"> <li>• Documentation to support ICP performance benchmarks and target ranges are being retained.</li> <li>• Additional details to justify non-standard benchmarks and calculation methodologies included in approved ICP goal memos.</li> <li>• Phase out of a cost saving based performance metric to a fund performance based one including a timeline for full transition.</li> </ul>

## REAL ASSETS—INFRASTRUCTURE (REPORT #2018-07)

### Observation 2

Select investments included in the ICP goal calculation do not align with ERS' Incentive Compensation Plan objectives. (Significant)

### Recommendations

Negotiated management fees is the sole factor in determining incentive compensation performance and award for the Infrastructure goal. While investment activities such as investment selection, portfolio management and oversight will impact overall investment returns, these activities will not impact calculated incentive compensation performance either positively or negatively through-out the life-cycle of an infrastructure fund . Based on the unique structure of the infrastructure incentive compensation calculation Internal Audit recommends:

- Evaluate if legacy investments made prior to the creation of the Infrastructure portfolio and whose management fees were negotiated prior to the develop of the Infrastructure incentive compensation goal should continue to be included in the ICP goal calculation. Evaluation should address the ICP goal directives that “*no incentive shall be applied retrospectively for past performance*” and “*directly tied to a participant's actual performance*” and be formally documented and submitted to executive management for approval.
- Evaluate if investments whose negative performance cannot be attributed to the normal investment life-cycle but rather fundamental performance issues should continue to be included in the ICP goal calculation. Evaluation should address the ICP goal directive that goals “*incentivize achievement of the highest level of performance*” and be formally documented and submitted to executive management for approval.

### Management Action Plan Status

Status	Clarification
Implemented	Per Plan Year 2020 ICP goal memo, legacy investments will be excluded in calculations for the cost savings ICP performance metric.

# HEALTHSELECT<sup>SM</sup> OF TEXAS<sup>(R)</sup> DENIAL PROCESS — GROUP BEBEFITS (REPORT #2017-09)

Observation 2

Key information that supports appeal decisions is not consistently documented. (Moderate)

Recommendation:

To provide transparency and accountability in the decisions that are made on HealthSelect appeals, the following information should be documented for each appeal case.

- Key information presented to the GRC during meetings that was considered in the appeal decision recommendation made to the Director of Group Benefits Division
- Basis for the appeal decision recommendations such as a plan provision

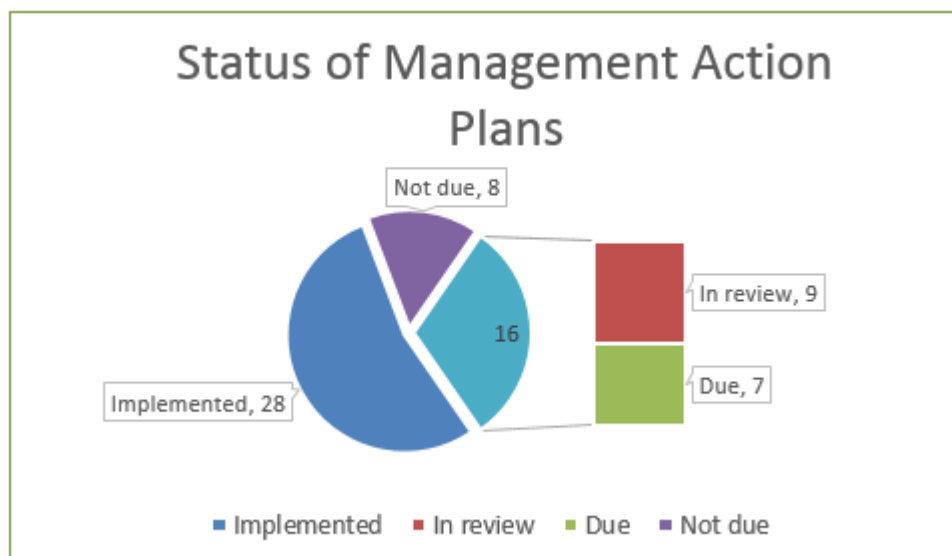
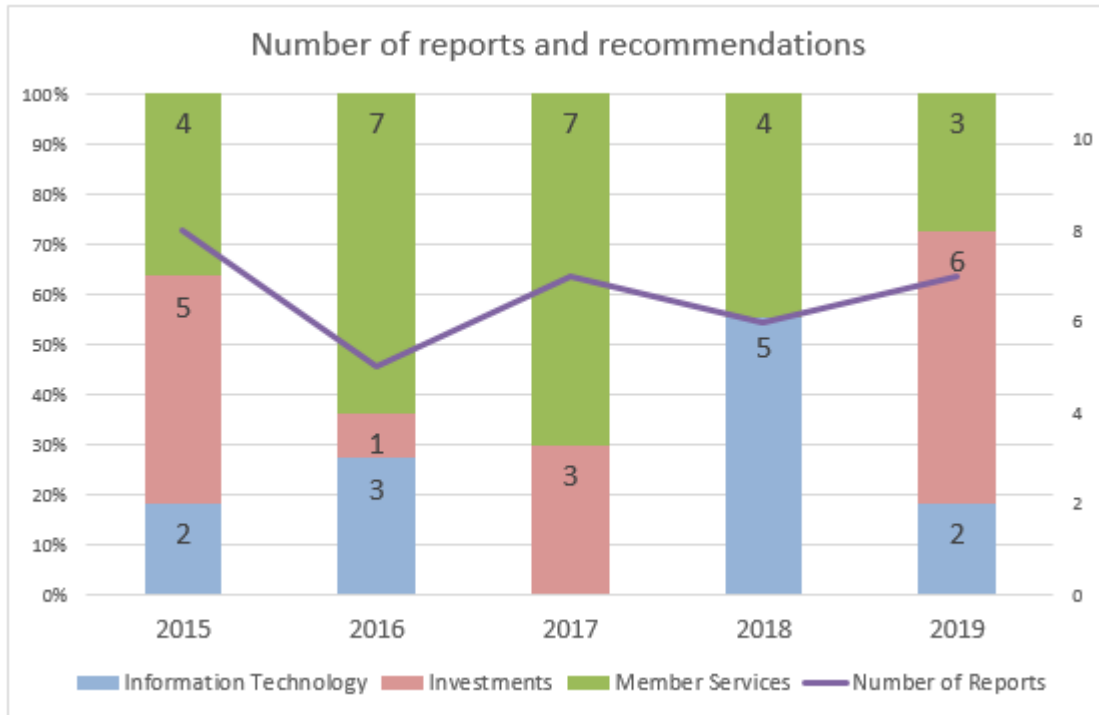
**Management Action Plan**

Status	Clarification
Partially Implemented July 2018	<p>Staff is in the process of developing a HIPAA-compliant summary document template to accompany appeal cases which can be leveraged for GRC-reviewed appeals. A policy statement providing objectives and elements of this new template has been drafted to provide guidance.</p> <p><b>Left to accomplish:</b></p> <p>The drafted HIPAA-compliant summary is expected to be finalized and implemented by October 1, 2018.</p>
Implemented	A HIPAA compliant worksheet summary has been finalized and implemented.

## STATUS OF ALL RECOMMENDATIONS

The information below is a summary of the status of recommendations resulting from Internal Audit reports for the past five fiscal years (audit report date within FY15–FY19). This new section reports the status of management action plans and is based on a full review of all recommendations made in the prior five fiscal years, excluding consulting engagements.

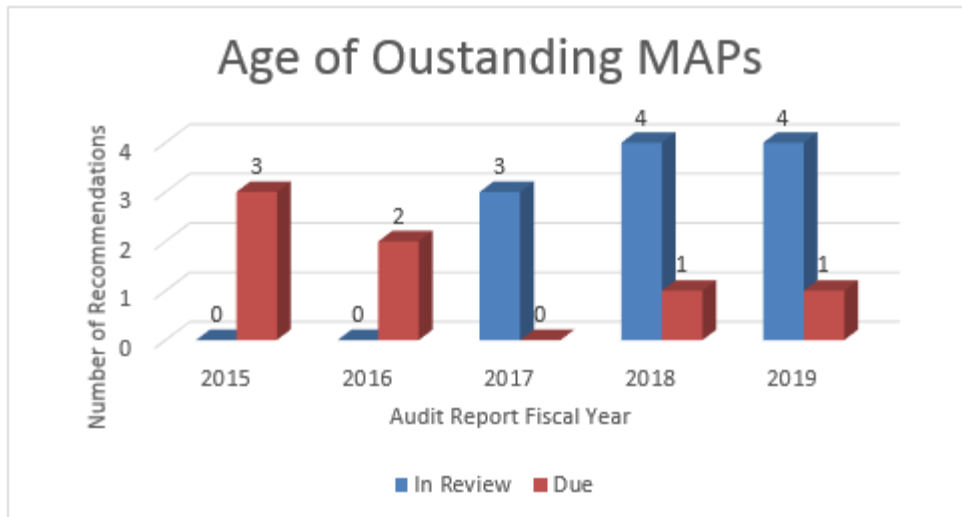
To understand the number of reports, recommendations and the status of all management action plans, the following charts and graphs are presented:



## STATUS OF ALL RECOMMENDATIONS

Based on the full review of all recommendations, some older recommendations were found to be without updated information on the status. The age of all outstanding management action plans is presented in the following chart by the year in which the recommendation made.

Internal Audit has changed the procedures for tracking and initiating follow-up reviews to ensure management action plans are reviewed timely.



***In Review***—the program area has been notified that Internal Audit intends to follow-up on the status of the management action plan and documentation has been submitted to Internal Audit for review. The review is currently ongoing.

***Due***—the management action plan is due for review, but the program area has not yet been contacted by Internal Audit.