An Audit Report on

Incentive Compensation at Selected Agencies

May 2015  
Report No. 15-032
Overall Conclusion

Through their incentive compensation plans for plan year 2014, the Teacher Retirement System (TRS), the Permanent School Fund (PSF) of the Texas Education Agency, and the General Land Office (GLO) awarded and paid incentive compensation awards in accordance with their policies and procedures.

While the Employees Retirement System (ERS) awarded plan year 2014 incentive compensation in accordance with its policies and procedures, it did not always pay incentive compensation accurately. Specifically, ERS did not accurately make necessary corrections to certain payment amounts to adjust for errors it had made in prior years. In addition, ERS should implement recommendations that its internal auditor made in November 2014 to strengthen plan performance goals, improve plan information that ERS provides to its board of trustees and key stakeholders, and formalize its plan review procedures.

In addition, GLO should strengthen its incentive compensation plan by formally approving its plan prior to the start of the plan performance period. The former land commissioner and the former chief clerk approved the GLO incentive compensation plan after the end of the plan performance period.

Auditors communicated other less significant issues separately in writing to management of TRS, the PSF, GLO, and ERS.

Summary of Management’s Response

Management of ERS and GLO agreed with the recommendations that this report addressed to them. This report did not address recommendations to TRS and the PSF.

Summary of Information Technology Review

Auditors assessed the reliability of the incentive compensation award data used in this audit by tracing the data to supporting documentation and reviewing access to
the data. Auditors verified the completeness of the incentive compensation award data by comparing information in the incentive compensation award calculation spreadsheets the audited agencies used to payroll information in the Uniform Statewide Payroll/Personnel System. Auditors determined that the incentive compensation award data was sufficiently reliable for the purposes of this audit.

For the PSF, auditors also determined that the investment performance data that the PSF obtained through Bank of New York Mellon was sufficiently reliable for the purposes of this audit.

For TRS, GLO, and ERS, auditors did not perform additional data reliability work related to investment performance data. For ERS, auditors relied on internal audit work. For GLO and TRS, auditors obtained investment performance data directly from third-party custodians.

Summary of Objective, Scope, and Methodology

The objective of this audit was to determine whether TRS, the PSF, GLO, and ERS calculate and pay incentive compensation in accordance with their policies and procedures.

The scope of this audit covered incentive compensation plan years ending September 30, 2014, at TRS; August 31, 2014, at the PSF and ERS; and June 30, 2014, at GLO.

The audit methodology included collecting information and documentation from the audited agencies; reviewing incentive compensation plans, policies, and procedures, and other guidance related to incentive compensation; and analyzing and evaluating data and the results of tests. Auditors selected non-statistical samples of incentive compensation awards primarily through random selection. Auditors used professional judgment to select additional samples of incentive compensation payments at TRS, ERS, and the PSF. Auditors tested the entire population of incentive compensation awards at GLO.

Auditors verified that recipients tested were eligible to receive incentive compensation payments, that data inputs used in calculations were correct, that calculated payment amounts were correct based on the terms of the incentive compensation plans, and that payment amounts distributed to recipients matched amounts calculated for each recipient. Auditors conducted additional procedures to determine whether auditors could rely on the work that ERS internal audit conducted. As noted above, auditors also tested access controls at each of the audited agencies and the reliability of investment performance data for the PSF.
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Detailed Results

Chapter 1
TRS Awarded and Paid Incentive Compensation in Accordance With Its Policies and Procedures

The Teacher Retirement System (TRS) awarded and paid incentive compensation for its plan year ended September 30, 2014, in accordance with its policies and procedures. In addition, the TRS board of trustees formally approved the TRS incentive compensation plan before the beginning of the plan performance start date.

TRS awarded a total of $7,620,310 in incentive compensation to 126 employees.\(^1\) TRS awarded the most incentive compensation to its chief investment officer, who was awarded $369,946 payable over a two-year period. That $369,946 represented 5 percent of the $7,620,310 in total incentive compensation that TRS awarded.

The TRS incentive compensation plan is based on a combination of investment performance and qualitative performance. The investment performance component compares investment performance with benchmarks (50 percent) and the performance of other large public funds (30 percent). The qualitative performance component (20 percent) assesses performance in a variety of areas such as interpersonal relationship skills, accountability, and effective teamwork.

The TRS incentive compensation plan measures investment performance of the total fund and of an employee’s individual assigned asset classes on both a one-year and three-year basis. If the investment performance exceeds the benchmarks or the performance of other large public funds, that triggers the awarding of incentive compensation. For example, the total fund investment performance:

- Exceeded the target benchmark by 0.915 percent (91.5 basis points) for the three-year period from October 1, 2011, to September 30, 2014.
- Exceeded the target benchmark by 0.540 percent (54.0 basis points) for the one-year period from October 1, 2013, to September 30, 2014.

\(^1\) As of February 11, 2015, TRS had paid employees $3,810,155 of the $7,620,310 it awarded; the remaining $3,810,155 was due to be paid in 2016.
Table 1 shows the positions eligible to earn incentive compensation in the TRS plan and the incentive compensation awards for each position for the 2014 plan year.

Table 1

<table>
<thead>
<tr>
<th>Eligible Position</th>
<th>Incentive Compensation Award (rounded to the nearest dollar) (^{a})</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chief investment officer</td>
<td>$369,946</td>
</tr>
<tr>
<td>Deputy chief investment officer</td>
<td>$225,819</td>
</tr>
<tr>
<td>Senior managing director</td>
<td>$158,426 to $258,218</td>
</tr>
<tr>
<td>Managing director</td>
<td>$115,543 to $181,802</td>
</tr>
<tr>
<td>Senior director</td>
<td>$110,557 to $164,543</td>
</tr>
<tr>
<td>Director</td>
<td>$64,147 to $149,472</td>
</tr>
<tr>
<td>Senior investment manager</td>
<td>$46,490 to $130,682</td>
</tr>
<tr>
<td>Investment manager</td>
<td>$13,458 to $86,931</td>
</tr>
<tr>
<td>Senior associate</td>
<td>$25,332 to $54,797</td>
</tr>
<tr>
<td>Associate</td>
<td>$4,319 to $31,239</td>
</tr>
<tr>
<td>Senior analyst</td>
<td>$2,371 to $17,200</td>
</tr>
<tr>
<td>Analyst</td>
<td>$1,005 to $11,257</td>
</tr>
<tr>
<td>Administrative assistant</td>
<td>$260 to $1,826</td>
</tr>
</tbody>
</table>

\(^{a}\) A single amount is presented when only one individual was in the position for plan year 2014; a range of amounts is presented when multiple individuals were in the position for plan year 2014. Some amounts are based on partial year awards.

Source: TRS.
Chapter 2

The PSF Awarded and Paid Incentive Compensation in Accordance With Its Policies and Procedures

The Permanent School Fund (PSF) of the Texas Education Agency awarded and paid incentive compensation for its plan year ended August 31, 2014, in accordance with its policies and procedures. In addition, the commissioner of education formally approved the PSF incentive compensation plan before the beginning of the plan performance start date.

The PSF awarded a total of $1,109,501 in incentive compensation to 42 employees. The PSF awarded the most incentive compensation to the deputy chief investment officer and director of fixed income, who was awarded $102,213 payable over a three-year period. That $102,213 represented 9 percent of the $1,109,501 in total incentive compensation that the PSF awarded.

The PSF calculates incentive compensation based on an employee’s achievement of goals related to total fund performance and the performance of the employee’s individual assigned asset classes. The PSF does not include a qualitative component in its calculation. If the three-year investment performance exceeds the benchmarks, that triggers the awarding of incentive compensation. (The PSF measures employees who have participated in the plan for two or fewer years against one-year or two-year investment performance.) For example, the total fund investment performance:

- Exceeded the target benchmark by 0.297 percent (29.7 basis points) for the three-year period from September 1, 2011, to August 31, 2014.
- Exceeded the target benchmark by 0.155 percent (15.5 basis points) for the two-year period from September 1, 2012, to August 31, 2014.
- Exceeded the target benchmark by 0.574 percent (57.4 basis points) for the one-year period from September 1, 2013, to August 31, 2014.

As of January 19, 2015, the PSF had paid employees $554,751 of the $1,109,501 it awarded; two remaining payments of $277,375 each were to be paid in the next two years.
Table 2 shows the positions eligible to earn incentive compensation in the PSF plan and the incentive compensation awards for each position for the 2014 plan year.

<table>
<thead>
<tr>
<th>Eligible Position</th>
<th>Incentive Compensation Award (rounded to the nearest dollar)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chief investment officer</td>
<td>$79,861</td>
</tr>
<tr>
<td>Deputy chief investment officer and director of fixed income</td>
<td>$102,213</td>
</tr>
<tr>
<td>Director of private markets</td>
<td>$52,180</td>
</tr>
<tr>
<td>Director of equities</td>
<td>$73,271</td>
</tr>
<tr>
<td>Deputy executive administrator</td>
<td>$50,281</td>
</tr>
<tr>
<td>Director of global risk control strategies</td>
<td>$80,300</td>
</tr>
<tr>
<td>Risk manager</td>
<td>Vacant position</td>
</tr>
<tr>
<td>Portfolio manager I-IV</td>
<td>$14,402 to $67,005</td>
</tr>
<tr>
<td>Risk analyst</td>
<td>Vacant position</td>
</tr>
<tr>
<td>Investment analyst I-IV</td>
<td>$5,060 to $26,350</td>
</tr>
<tr>
<td>Director of investment operations</td>
<td>$25,546</td>
</tr>
<tr>
<td>Director of operational due diligence</td>
<td>Vacant position</td>
</tr>
<tr>
<td>Director of finance</td>
<td>$21,089</td>
</tr>
<tr>
<td>Financial analyst I-IV</td>
<td>$2,530 to $15,339</td>
</tr>
<tr>
<td>Accountant I-V</td>
<td>$13,994</td>
</tr>
<tr>
<td>Attorney I-V</td>
<td>$5,688</td>
</tr>
<tr>
<td>Director of investment technology</td>
<td>Vacant position</td>
</tr>
<tr>
<td>Systems analyst I-V</td>
<td>$1,677 to $4,243</td>
</tr>
<tr>
<td>Program specialist I-V</td>
<td>$1,778</td>
</tr>
<tr>
<td>Staff services officer I-V</td>
<td>Vacant position</td>
</tr>
<tr>
<td>Executive assistant I-III</td>
<td>Vacant position</td>
</tr>
<tr>
<td>Director III</td>
<td>$7,217 b</td>
</tr>
</tbody>
</table>

a. A single amount is presented when only one individual was in the position for plan year 2014; a range of amounts is presented when multiple individuals were in the position for plan year 2014. Some amounts are based on partial year awards.

b. Although director III is not specifically listed in the PSF incentive compensation plan as an eligible position, the individual in that position (an employee of the Texas Education Agency) was assigned to the PSF cost center in May 2014, and that individual’s functions were equivalent to the vacant director of investment technology position. According to the PSF incentive compensation plan, positions assigned to the cost center for the PSF are considered eligible positions, and the commissioner of education has discretion to modify the definition of an eligible position.

Source: The PSF.
Chapter 3
GLO Awarded and Paid Incentive Compensation in Accordance With Its Policies and Procedures

The General Land Office (GLO) awarded and paid incentive compensation for its plan year ended June 30, 2014, in accordance with its policies and procedures. However, the former land commissioner and the former chief clerk did not formally approve the GLO incentive compensation plan until July 2014, which was after the plan performance end date. Obtaining formal approval of the incentive compensation plan prior to the beginning of the performance period could help ensure that the plan aligns with the intent of the land commissioner and the chief clerk.

In addition, GLO could not provide documentation of management’s review of the incentive award calculation spreadsheet. According to GLO, management verbally asserted that it had reviewed the calculation spreadsheet. Documenting that review could help ensure that the incentive award calculations are accurate and calculated in accordance with incentive compensation plan requirements.

GLO awarded a total of $290,105 in incentive compensation to 4 employees. GLO awarded the most incentive compensation to its deputy commissioner of funds management, who was awarded $209,718 payable over a two-year period. That $209,718 represented 72 percent of the $290,105 in total incentive compensation that GLO awarded.

The GLO incentive compensation plan compares investment performance of the total fund with a target benchmark on a one-year, three-year, and five-year basis. GLO calculates incentive compensation based on an employee’s achievement of goals in investment performance (60 percent) and a qualitative component (40 percent) that is tied to employee job performance for the period. Because investment performance exceeded the benchmark, that triggered the awarding of incentive compensation. Specifically, the total fund investment performance:

- Exceeded the target benchmark by 6.37 percent (637 basis points) for the five-year period from July 1, 2009, to June 30, 2014.
- Exceeded the target benchmark by 7.94 percent (794 basis points) for the three-year period from July 1, 2011, to June 30, 2014.
- Exceeded the target benchmark by 7.62 percent (762 basis points) for the one-year period from July 1, 2013, to June 30, 2014.

As of February 11, 2015, the GLO had paid employees $145,052 of the $290,105 it awarded; the remainder was due to be paid in late 2015.
Table 3 shows the positions eligible to earn incentive compensation in the GLO plan and the incentive compensation awards for each position for the 2014 plan year.

<table>
<thead>
<tr>
<th>Eligible Position</th>
<th>Incentive Compensation Award (rounded to the nearest dollar)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deputy commissioner of funds management</td>
<td>$209,718</td>
</tr>
<tr>
<td>Real assets portfolio manager</td>
<td>$52,003</td>
</tr>
<tr>
<td>Senior financial analyst</td>
<td>$17,340</td>
</tr>
<tr>
<td>Program specialist</td>
<td>$11,043</td>
</tr>
</tbody>
</table>

\[a\] Amounts do not sum to $290,105 due to rounding.

Source: GLO.

**Recommendations**

GLO should:

- Ensure that the land commissioner and chief clerk formally approve the incentive compensation plan prior to the beginning of the plan year.

- Document management’s review of the incentive award calculation spreadsheet.

**Management’s Response**

*Management agrees with the recommendation that the GLO should ensure the Land Commissioner and Chief Clerk formally approve the incentive compensation plan prior to the beginning of the plan year. The GLO will also retain formal documentation that the incentive award calculation spreadsheet was reviewed by management. The Director of Public Lands and Commercial Transactions, Office of General Counsel, will be responsible for the implementation related to the plan approval by June 30, 2015, and the Director of Budget and Planning will be responsible for documenting the spreadsheet review.*
ERS Awarded Incentive Compensation in Accordance With Its Policies and Procedures, But It Should Strengthen Controls to Help Ensure That Related Payments Are Accurate

The Employees Retirement System (ERS) awarded incentive compensation for its plan year ended August 31, 2014, in accordance with its policies and procedures. In addition, the ERS board of trustees formally approved the ERS incentive compensation plan before the beginning of the plan performance start date. However, ERS did not always correctly calculate the amount of incentive compensation that it actually paid to employees in fiscal year 2015. ERS awarded $2,224,814 in incentive compensation for its 2014 plan year, and it made payments of $2,203,256 in fiscal year 2015.

Although ERS makes incentive compensation awards each year, it pays those awards in installments over time. Specifically, ERS pays most employees 50 percent of an incentive compensation award for the current plan year, 25 percent of that award in the next year, and 25 percent of that award in the following year. As a result, its actual payments to employees consist of partial awards from three years. ERS did not correctly calculate payment amounts for certain employees for fiscal year 2015 because it did not accurately make certain payment adjustments necessary to correct award calculation errors that the State Auditor’s Office identified for plan year 2013. As a result, ERS made $8,813 in overpayments to 4 individuals and $3,222 in underpayments to 3 individuals. ERS asserted that it would adjust future payments to those individuals to correct those errors.

ERS revised its calculation review process for the 2014 plan year and hired an external reviewer to verify the accuracy of the incentive compensation award calculations; the ERS internal auditor also performed an internal audit of incentive compensation. In conducting the audit at ERS, State Auditor’s Office auditors relied on the ERS internal audit report entitled Incentive Compensation Audit released on November 12, 2014. The ERS internal audit report identified the following issues:

- The qualitative performance goals for participants in the ERS incentive compensation plan are not clearly defined to ensure alignment with the intent of the plan. The approved fiscal year 2014 and fiscal year 2015 plans did not provide direction on (1) how the weights of the qualitative performance goals should be determined or (2) how to assess the extent of qualitative performance goal achievement.

- Reports that ERS provides on the incentive compensation plan to the members of its board of trustees and key stakeholders are limited and do

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4 For certain operations employees, ERS paid 50 percent of the employees’ awards in fiscal year 2015 and will pay the remaining 50 percent in fiscal year 2016.
not allow for an overall assessment of the plan. Although ERS provided all required information to key stakeholders, it did not provide additional reports to allow for an overall assessment of the plan.

- ERS did not formalize its incentive compensation plan award review procedures to ensure that its review process was complete and consistent. Specifically, it did not clearly define the level of review procedures to be performed by internal staff. In addition, ERS investments and human resources management did not review and approve agreed-upon procedures that a third party would follow to review the accuracy of ERS’s calculations of incentive compensation award amounts. That review and approval would help to ensure that the agreed-upon procedures are appropriate.

ERS awarded a total of $2,224,814 in incentive compensation to 54 employees.\(^5\) ERS awarded the most incentive compensation to its executive director, who was awarded $217,757, half of which was paid for fiscal year 2014. However, due to a planned retirement, the executive director will forfeit the remaining half. ERS’s policy requires that, to receive an incentive compensation payment, an individual must be an ERS employee on the date on which the payment is made. The $217,757 award represented 10 percent of the $2,224,814 in total incentive compensation that ERS awarded.

The ERS incentive compensation plan is based on a combination of investment performance and qualitative performance. The investment performance component compares investment performance to benchmarks. The qualitative (discretionary, non-performance based) performance component assesses a variety of achievements, such as involvement in and recognition from industry conferences and organizations and enhancement of the ERS external advisor program. The weights of the investment performance and qualitative performance components vary depending on an employee’s role, and the ERS executive director approves those weights at the beginning of the plan year. The qualitative portion of the ERS incentive compensation payment ranges from 0 percent to 90 percent of the incentive compensation payment for each eligible employee.

ERS calculates the investment performance component of incentive compensation based on an employee’s achievement of goals related to total fund performance and the performance of the employee’s individual assigned asset classes. If the one-year, three-year, or five-year investment performance exceeds the benchmarks, that triggers the awarding of incentive compensation. For example, the total fund investment performance:

- Exceeded the target benchmark by 0.022 percent (2.2 basis points) for the five-year period from September 1, 2009, to August 31, 2014.

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\(^5\) As of February 11, 2015, the ERS had paid employees $1,112,407 of the $2,224,814 it awarded; $574,601 was due to be paid in fiscal year 2016 and $537,806 was due to be paid in fiscal year 2017.
• Exceeded the target benchmark by 0.029 percent (2.9 basis points) for the three-year period from September 1, 2011, to August 31, 2014.

• Was less than the target benchmark by 0.352 percent (35.2 basis points) for the one-year period from September 1, 2013, to August 31, 2014.

Auditors did not identify any calculation errors in the incentive compensation awards for the plan year ended August 31, 2014.

Table 4 shows the positions eligible to earn incentive compensation in the ERS plan and the incentive compensation awards for each position for the 2014 plan year.

Table 4

<table>
<thead>
<tr>
<th>Eligible Positions</th>
<th>Incentive Compensation Award (rounded to the nearest dollar) a</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive director</td>
<td>$217,757</td>
</tr>
<tr>
<td>Chief investment officer</td>
<td>$11,481</td>
</tr>
<tr>
<td>Deputy chief investment officer</td>
<td>$32,292</td>
</tr>
<tr>
<td>Chief of staff</td>
<td>Duties were transferred b</td>
</tr>
<tr>
<td>Director of investment services</td>
<td>$40,299</td>
</tr>
<tr>
<td>General counsel and chief compliance officer</td>
<td>$101,429</td>
</tr>
<tr>
<td>Investments and securities, attorney</td>
<td>$72,426 to $78,288</td>
</tr>
<tr>
<td>Investments and securities, paralegal</td>
<td>Ineligible for plan year 2014</td>
</tr>
<tr>
<td>Investment administrative support</td>
<td>Opted out of plan year 2014</td>
</tr>
<tr>
<td>Financial analyst I-IV</td>
<td>$3,117 to $14,635</td>
</tr>
<tr>
<td>Director of strategic research</td>
<td>Vacant position</td>
</tr>
<tr>
<td>Asset class portfolio managers/directors</td>
<td>$10,011 to $96,682</td>
</tr>
<tr>
<td>Chief trader I-II</td>
<td>$40,089 to $59,672</td>
</tr>
<tr>
<td>Trader I-II</td>
<td>$24,970</td>
</tr>
<tr>
<td>Portfolio manager I-IV</td>
<td>$4,045 to $87,264</td>
</tr>
<tr>
<td>Investment analyst I-IV</td>
<td>$6,535 to $46,184</td>
</tr>
</tbody>
</table>

a A single amount is presented when only one individual was in the position for plan year 2014; a range of amounts is presented when multiple individuals were in the position for plan year 2014. Some amounts are based on partial year awards.

b During the plan year, the chief of staff’s job title changed to deputy chief investment officer and the duties of that position were transitioned into the deputy chief investment officer and the director of investment services.

Source: ERS.
Recommendations

ERS should:

- Strengthen its review of incentive compensation plan payment calculations and related documents to help ensure that payment amounts align with policies and procedures and are accurate.

- Implement its internal auditor’s recommendations for the incentive compensation plan.

Management’s Response

ERS management agrees with both recommendations. ERS will continue to enhance its review processes, including enhancing agreed upon procedures with its 3rd-party reviewer, to help ensure that payment amounts align with policies and procedures and are accurate. ERS management is working to implement the recommendations of its internal auditor for the 2016 incentive compensation plan year as noted in its management action plan in the referenced ERS Internal Audit report.
Appendix

**Objective, Scope, and Methodology**

**Objective**

The objective of this audit was to determine whether the Teacher Retirement System (TRS), the Permanent School Fund (PSF) of the Texas Education Agency, the General Land Office (GLO), and the Employees Retirement System (ERS) calculate and pay incentive compensation in accordance with their policies and procedures.

**Scope**

The scope of this audit covered incentive compensation plan years ending September 30, 2014, at TRS; August 31, 2014, at the PSF and ERS; and June 30, 2014, at GLO.

**Methodology**

The audit methodology included collecting information and documentation from the audited agencies; reviewing incentive compensation plans, policies, and procedures, and other guidance related to incentive compensation; and analyzing and evaluating data and the results of tests.

Auditors verified that recipients tested were eligible to receive incentive compensation payments, that data inputs used in the calculations were correct, that payment amounts were calculated correctly based on the terms of the incentive compensation plan, and that payment amounts distributed to recipients matched amounts calculated for each recipient.

Auditors reviewed calculations, personnel files, payroll data, and externally reported fund performance results to determine whether the audited agencies calculated and paid incentive compensation in accordance with policies and procedures. Auditors also tested access controls over the spreadsheets the audited agencies used to calculate incentive compensation and the reliability of investment performance data for the PSF.

Auditors conducted additional procedures to determine whether auditors could rely on the work that the ERS internal audit conducted. ERS internal audit released an audit of incentive compensation for plan year 2014 in November 2014.

**Data Reliability and Completeness**

Auditors assessed the reliability of the incentive compensation award data used in this audit by tracing the data to supporting documentation and
reviewing access to the data. Auditors verified the completeness of the incentive compensation award data by comparing information in the incentive compensation award calculation spreadsheets the audited agencies used to payroll information in the Uniform Statewide Payroll/Personnel System. Auditors determined that the incentive compensation award data was sufficiently reliable for the purposes of this audit.

For the PSF, auditors also determined that the investment performance data obtained through Bank of New York Mellon was sufficiently reliable for the purposes of this audit. Auditors verified the completeness of the investment performance data by observing the PSF retrieve the monthly investment performance data, recalculating the annualized returns, and verifying that the data included all portfolios listed in the incentive compensation plan.

For TRS, GLO, and ERS, auditors did not perform additional data reliability work related to investment performance data. For ERS, auditors relied on internal audit work. For GLO and TRS, auditors obtained investment performance data directly from third-party custodians.

**Sampling Methodology**

Auditors selected non-statistical samples of incentive compensation awards primarily through random selection. In those cases, results may be extrapolated to the population, but the accuracy of the extrapolation cannot be measured. In addition, auditors used professional judgment to select a sample of items for testing at TRS, ERS, and the PSF. Those sample items generally were not representative of the population and, therefore, it would not be appropriate to extrapolate those results to the population. Auditors tested the entire population of incentive compensation awards at GLO.

**Information collected and reviewed included the following:**

- Incentive compensation plans at TRS, the PSF, GLO, and ERS.
- Incentive compensation payment calculation spreadsheets for incentive compensation plan years ending September 30, 2014, at TRS; August 31, 2014, at the PSF and ERS; and June 30, 2014, at GLO.
- Incentive compensation recipients’ personnel files.
- Payroll data related to incentive compensation recipients.
- Investment performance reports from custodian banks.
- Agency internal audit documents.
Procedures and tests conducted included the following:

- Interviewed management and key personnel at TRS, the PSF, GLO, and ERS.

- Tested and recalculated incentive compensation awards for recipients of incentive compensation for incentive compensation plan years ending September 30, 2014, at TRS; August 31, 2014, at the PSF and ERS; and June 30, 2014, at GLO.

- Verified that incentive compensation award payments matched award calculations.

- Reviewed and tested compliance with the audited agencies’ policies and procedures.

- Reviewed the ERS internal auditor’s education, professional certification, and continuing education to comply with *Government Auditing Standards*, Sections 6.40 and 6.41.

- Examined, on a test basis, internal auditors’ work to determine whether it could be used as audit evidence.

Criteria used included the following:

- *Teacher Retirement System of Texas Performance Incentive Pay Plan*.

- *Texas Permanent School Fund Performance Incentive Pay Plan*.

- *Texas General Land Office Performance Incentive Pay Plan*.

- *Employees Retirement System of Texas Incentive Compensation Plan*.

- TRS and ERS board of trustees meeting minutes.

- Section 44, Article III, Texas Constitution and related statutes.


- Texas attorney general opinions related to incentive compensation.


Project Information

Audit fieldwork was conducted from January 2015 through March 2015. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a
reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The following members of the State Auditor’s staff performed the audit:

- Sonya Tao, CFE (Project Manager)
- Ann E. Karnes, CPA (Assistant Project Manager)
- Mariah Johnson
- Adam Ryan, MACT
- Yue Zhang, MPA
- Michelle Ann Duncan Feller, CPA, CIA (Quality Control Reviewer)
- Angelica M. Ramirez, CPA (Audit Manager)
Copies of this report have been distributed to the following:

**Legislative Audit Committee**
The Honorable Dan Patrick, Lieutenant Governor, Joint Chair
The Honorable Joe Straus III, Speaker of the House, Joint Chair
The Honorable Jane Nelson, Senate Finance Committee
The Honorable Robert Nichols, Member, Texas Senate
The Honorable John Otto, House Appropriations Committee
The Honorable Dennis Bonnen, House Ways and Means Committee

**Office of the Governor**
The Honorable Greg Abbott, Governor

**Employees Retirement System**
Members of the Employees Retirement System Board of Trustees
  - Mr. Brian D. Ragland, Chair
  - Mr. Frederick E. Rowe, Jr., Vice Chair
  - Mr. Doug Danzeiser
  - Ms. Cydney Donnell
  - Ms. Yolanda Griego
  - Mr. I. Craig Hester
  - Ms. Ann S. Bishop, Executive Director
  - Mr. Porter Wilson, Executive Director Designate

**General Land Office**
The Honorable George P. Bush, Land Commissioner and Chairman of the
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Members of the School Land Board
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  - Mr. Thomas Orr, Jr.

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  - Mr. Thomas Ratliff, Vice Chair
  - Mr. Ruben Cortez, Jr., Secretary
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  - Ms. Patricia Hardy
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  - Mr. Ken Mercer
  - Ms. Sue Melton-Malone
  - Ms. Geraldine Miller
  - Ms. Marisa B. Perez
  - Mr. Marty Rowley
  - Mr. Michael L. Williams, Commissioner of Education
  - Mr. Holland Timmins, CFA, Executive Administrator and Chief
    Investment Officer, Permanent School Fund
Teacher Retirement System
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