



John Keel, CPA  
State Auditor

# The Audit of the Teacher Retirement System's Fiscal Year 2014 Employer Pension Liability Allocation Schedules

A Report on

June 15, 2015

Members of the Legislative Audit Committee:

In our audit report dated May 29, 2015, we concluded that the Schedule of Employer Allocations and the Schedule of Pension Amounts by Employer as of August 31, 2014, for the Teacher Retirement System (System) are presented fairly, in all material respects in accordance with accounting principles generally accepted in the United States of America. The System has posted the schedules and our audit report on its Web site at <http://www.trs.state.tx.us/>

We also issued a report on internal control over financial reporting of the schedules and on compliance and other matters as required by auditing standards (that report, including responses from management, is presented in the attachment to this letter). Our procedures did not identify any material weaknesses in internal control over financial reporting of the schedules or any noncompliance with laws or regulations that materially affected the schedules. Our procedures did identify one significant deficiency in control related to the preparation of the schedules that we included as part of the report on controls and compliance. However, the major internal controls that we tested for the purpose of forming our opinions on the schedules were operating effectively.

Our procedures were not intended to provide an opinion on internal control over financial reporting of the schedules or to provide an opinion on compliance with laws and regulations. Accordingly, we do not express an opinion on the effectiveness of the System's internal control over financial reporting of the schedules or on compliance with laws and regulations.

As required by auditing standards, we will also communicate to the System's Board of Trustees certain matters related to the conduct of this audit.

### Pension Liability Reporting Requirements

Governmental Accounting Standards Board Statement No. 68, *Accounting and Financial Reporting for Pensions* (GASB 68), which becomes effective for fiscal years beginning after June 15, 2014, requires governments to begin recording on the face of their financial statements a liability for pension plans administered through trusts, rather than disclosing those amounts in the notes to their financial statements. Specifically, a government will incur a "net pension liability" if the total obligation to members exceeds the value of the net assets the government has set aside to pay those benefits.

Employers in the plan will need to recognize their portion of the reported pension liability in the financial statements they produce.

The System prepared the Schedule of Employer Allocations and the Schedule of Pension Amounts by Employer to help participating employers comply with new requirements of GASB 68. Employers may use the pension liability schedules prepared by the System to aid them in determining their portion of the reported pension liability.

We appreciate the System's cooperation during this audit. If you have any questions, please contact Angelica Ramirez, Audit Manager, or me at (512) 936-9500.

Sincerely,

John Keel, CPA  
State Auditor

Attachment

cc: Members of the Teacher Retirement System Board of Trustees  
Mr. R. David Kelly, Chairman  
Ms. Nanette Sissney, Vice Chair  
Mr. Todd Barth  
Ms. T. Karen Charleston  
Mr. Joe Colonna  
Mr. David Corpus  
Mr. Christopher Moss  
Ms. Anita Smith Palmer  
Ms. Dolores Ramirez  
Mr. Brian Guthrie, Executive Director, Teacher Retirement System



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# Attachment



## Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Pension Schedules Performed in Accordance with Government Auditing Standards

### Independent Auditor's Report

Teacher Retirement System Board of Trustees:

Mr. R. David Kelly, Chairman  
Ms. Nanette Sissney, Vice Chair  
Mr. Todd Barth  
Ms. T. Karen Charleston  
Mr. Joe Colonna  
Mr. David Corpus  
Mr. Christopher Moss  
Ms. Anita Smith Palmer  
Ms. Dolores Ramirez

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 schedule of employer allocations of the Teacher Retirement System (System) Pension Plan, as of and for the year ended August 31, 2014, and the related notes. We have also audited the total for all entities of the columns titled net pension liability, total deferred outflows of resources, total deferred inflows of resources, and total pension expense (specified column totals) included in the accompanying schedule of pension amounts by employer of the System Pension Plan as of and for the year ended August 31, 2014, and the related notes. We issued our report thereon dated May 29, 2015.

### **Internal Control Over Financial Reporting**

In planning and performing our audit of the schedules, we considered the System's internal control over financial reporting of the schedules (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the schedules, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we do not express an opinion on the effectiveness of the System's internal control.

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 schedules will not be prevented, or detected and corrected on a timely basis. 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.

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Our consideration of internal control was for the limited purpose described in the first paragraph of this section 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. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control described in the accompanying schedule of findings and responses that we consider to be a significant deficiency.

Summary of Findings and Responses
Finding Number
2014-1

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the System's schedules are free of 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 determination of schedule amounts. 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*.

Auditors communicated an issue that was not material or significant to the audit objectives in writing to the System's management.

### **System's Response to Findings**

System's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. The System's response was not subjected to the auditing procedures applied in the audit of the schedules and, accordingly, we express no opinion on it.

### **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control over financial reporting of the schedules and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control over financial reporting of the schedules 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 over financial reporting of the schedules and compliance. Accordingly, this communication is not suitable for any other purpose.

John Keel, CPA  
State Auditor

May 29, 2015

## Schedule of Findings and Responses

### Section 1

### **The System Should Strengthen Controls Over Employer Pension Liability Allocation Schedules to Ensure That the List of Reporting Entities Is Complete**

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Reference No. 2014-1

#### **Type of finding: Significant Deficiency**

The Teacher Retirement System (System) did not have a process to verify the completeness of the list of reporting entities (employers) for its employer pension liability allocation schedules for fiscal year 2014. As a result, the System inappropriately excluded six charter schools from its fiscal year 2014 Schedule of Employer Allocations and Schedule of Pension Amounts by Employer (schedules). Those six charter schools had from 91 students to 1,022 students enrolled as of October 2013. Based on the reported enrollment numbers, auditors estimated that those six charter schools should have paid an estimated \$288,652 in employer contributions, which the System did not receive.

While the omission of those six charter schools was not material to the schedules as a whole, the System should implement a process to verify that the information the System provides in the schedules is complete. Performing periodic reconciliations between the list of reporting entities in the schedules to independent, third-party lists from the Texas Education Agency, the Higher Education Coordinating Board, and/or the Office of the Comptroller of Public Accounts would help the System ensure that all reporting entities are included on the schedules.

American Institute of Certified Public Accountants guidance entitled *Special Considerations--Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement: Auditing Interpretations of AU-C Section 805* states that retirement system management is responsible for the design, implementation, and maintenance of internal controls relevant to the preparation and presentation of the schedules.

The omission of reporting entities from the schedules could result in reporting entities not having the information necessary to produce their financial statements in accordance with governmental accounting and reporting requirements issued by the Governmental Accounting Standards Board.

## Recommendations

The System should:

- Establish a process to periodically verify that it has included all reporting entities in the employer pension liability allocation schedules.
- Verify that all reporting entities properly pay both employee and employer contributions based on requirements.

## Management's Response

*TRS agrees there is a need to strengthen controls related to Reporting Entities. The Benefit Accounting Department has an interim procedure in place to track new Reporting Entities with the effective start date. The current TRS Legacy system does not allow for adding reporting entities with a future date. The new Pension Line of Business system is being programed to add new Reporting entities with a future start/close date. TRS will add a step to our Reporting Entity Setup/Inactivation process, to verify that TRS' list of Reporting Entities is complete by verifying our list against the Texas Education Agency, Higher Education Coordinating Board, or the Comptroller of Public Accounts.*

*Implementation date of the annual verification of reporting entities will be implemented July 2015. The interim procedure was implemented in May 2015. The Pension Line of Business which will allow TRS to enter future start dates for Reporting Entities will be September 2016.*