November 20, 2014

Members of the Legislative Audit Committee:

In our audit report dated November 17, 2014, we concluded that the Teacher Retirement System’s (System) basic financial statements for fiscal year 2014 were materially correct and presented in accordance with accounting principles generally accepted in the United States of America. The System published our audit report as part of its basic financial statements, which it intends to post on its Web site at http://www.trs.state.tx.us/info.jsp?submenu=publications&page_id=/global/publications_info.

We also issued a report on internal control over financial reporting 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). In that report, auditors recommended that the System strengthen its controls for verification of active member census data.

Our procedures were not intended to provide an opinion on internal control over financial reporting 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 or on compliance with laws and regulations.

Auditors communicated certain issues that were not material or significant to the audit objectives in writing to the System’s management.

As required by auditing standards, we will also communicate to the System’s board of trustees certain matters related to the conduct of a financial statement audit.

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

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 Colonnetta
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 financial statements of the major enterprise funds and the aggregate remaining funds information, consisting of the fiduciary funds and the non-major enterprise fund of the Teacher Retirement System (System), a component unit of the State of Texas, as of and for the year ended August 31, 2014, and the related notes to the financial statements, which collectively comprise the System’s basic financial statements and have issued our report thereon dated November 17, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the System’s internal control over financial reporting (internal control) to determine the 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 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 financial statements 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.

SAO Report No. 15-305
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.

<table>
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<tr>
<th>Summary of Findings and Responses</th>
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<tr>
<td>Finding Number</td>
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<td>2014-1</td>
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**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the System’s financial statements 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 financial statement 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 certain issues that were not material or significant to the audit objectives in writing to the System’s management.

**System’s Response to Findings**

The 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 financial statements 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 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 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 and compliance. Accordingly, this communication is not suitable for any other purpose.

John Keel, CPA  
State Auditor  
November 17, 2014
Schedule of Findings and Responses

Section 1
The System Should Strengthen Controls to Help Ensure the Completeness and Accuracy of the Active Employee Census Data That Employers Submit

Reference No. 2014-1

Type of finding: Significant Deficiency

The Teacher Retirement System (System) should strengthen controls over active employee census data to help ensure that data is complete and accurate (see text box for additional information). More than 1,300 school districts, colleges, and universities submit active employee census data regarding the active members who participate in the System’s pension plan. The completeness and accuracy of that data is important because the System uses that data to calculate member pension benefits and the pension liability amount that the System presents in its financial statements.

The System’s controls over active employee census data are not sufficient to properly identify data that is incomplete or inaccurate. The absence of effective management processes and controls represents a deficiency in internal control over financial reporting, as noted in the guidance that the American Institute of Certified Public Accountants (AICPA) issued in a February 2014 white paper.¹

Auditors tested census data at 99 school districts, colleges, and universities. The majority of that data was accurate, and auditors identified no systematic issues. However, strengthening controls at the System would:

- Help to ensure that data is complete and accurate.
- Help to ensure that school districts, colleges, and universities are fully and accurately reporting that data.
- Improve the quality of the data that the System provides to its actuary to calculate the pension liability amount presented in the System’s financial statements.

¹ The AICPA’s white paper is entitled Single-Employer and Cost-Sharing Multiple-Employer Plans: Issues Associated with Testing Census Data in an Audit of Financial Statements.
Examples of ways in which the System could strengthen controls over active employee census data include:

- Performing periodic site visits at employers to verify active employee census data
- Providing employers with training or guidance on capturing active employee census data.
- Requiring school districts to periodically test the active employee census data and to certify the completeness and accuracy of that data when they submit that data to the System.

**Recommendation**

The System should develop and implement a process to strengthen controls over active employee census data.

**Management’s Response**

TRS agrees with the recommendation. TRS is undertaking a modernization effort of its pension administration system that will, among other things, help to strengthen controls over active employee census data to help ensure that data is complete and accurate. The effort includes a new and improved web interface for employee data and payroll reporting and will replace the current employee data submission system. Once the new system goes live, TRS will receive more information, and information about more employees, than is currently received each month. These additional data elements will help TRS to ensure that it has complete and accurate information census data information per the new GASB 67 and 68 reporting and allocation guidelines. The new pension administration system is expected to go live in Fiscal Year 2016.

In the meantime, TRS is undertaking audit-related initiatives to improve the completeness and accuracy of information reported to it by its reporting entities. Specifically,

- An internal benefits consultant transferred to Internal Audit from Benefit Accounting to work with auditors to develop reporting entity audit programs, gather information, serve as a resource about TRS rules, and develop external communication about audit-related initiatives.
- The Audit Plan for 2015 approved by the TRS Audit Committee of the Board of Trustees provides for 3 - 4 audits of reporting entities. Audits may increase over time, depending on available resources and issues identified.

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Schedule of Findings and Responses
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
SAO Report No. 15-005
November 2014
Page 2
- In October of 2014, TRS launched a webpage on its internet site providing information on audit activities of reporting entities, audit programs, and self-audit tools for assessing accuracy of reporting to TRS.

- In September, October, and November of 2014, Internal Audit made four presentations at association meetings and one regional education service center about audit initiatives, areas of concern to TRS, and resources available.