



A Report on

The Audit of the Employees Retirement System's Fiscal Year 2019 Financial Statements

January 13, 2020

Members of the Legislative Audit Committee:

In our audit report dated December 20, 2019, we concluded that the Employees Retirement System's (System) basic financial statements for fiscal year 2019 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 posted on its Web site at <https://ers.texas.gov/About-ERS/Reports-and-Studies/Reports-on-Overall-ERS-Operations-and-Financial-Management>.

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 identified a significant error wherein the System incorrectly recorded an entry for its fiduciary funds. However, the System corrected the error before issuing its fiscal year 2019 financial statements.

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.

Testing of Plan Member Census Data

Auditors conducted census data testing for fiscal year 2019 (see text box for the key data elements tested) as part of this audit. The completeness and accuracy of employees' census data is important because the System uses that data to calculate the System's liabilities for pensions and other postemployment benefits.

Auditors selected a representative sample of System members for fiscal year 2019 census data testing as required by American Institute of Certified Public Accountants (AICPA) guidance. That resulted in auditors selecting members from 23 participating state employers for which pension and other postemployment benefit census data was tested and 16 additional employers for which only other postemployment benefit census data was tested. (A list of the employers of those members selected for testing is presented in the attachment to this letter.) Testing

Employee Census Data

Employee census data is key demographic data that affects the actuarial estimate of the pension and the other postemployment benefit liability amounts that the System presents in its financial statements.

Key data elements include:

- Name.
- Date of birth.
- Service credits.
- Pensionable earnings.
- Gender.
- Employment status.
- Dependent information (name, gender, and date of birth).

Source: Chapters 13 and 14 in *State and Local Governments - Audit and Accounting Guide*, American Institute of Certified Public Accountants, March 1, 2019.

SAO Report No. 20-017

included reviewing documentation to verify that the census data that the employers submitted to the System was accurate.

In addition, to help determine the System's other postemployment benefit liability, auditors relied on fiscal year 2018 census data testing that the State Auditor's Office performed at the Teacher Retirement System for higher education institutions, community colleges, and junior colleges, whose employees are part of the System's other postemployment benefit plan.

Based on the testing performed, auditors determined that the underlying census data was materially complete and accurate to support the System's plan's financial statement amounts. That was reflected as part of our unmodified audit opinion on the System's financial statements for fiscal year 2019.

Additionally, auditors will be issuing an opinion later this fiscal year on the System's fiscal year 2019 pension and other postemployment benefit liability allocation schedules. Those schedules provide employers with the information they need to record their share of the associated liabilities for pension and other postemployment benefit liabilities in their financial statements, in accordance with AICPA requirements. Auditors previously issued an opinion on the System's pension and other postemployment benefit liability allocation schedules for fiscal year 2018. The System published our audit opinion, along with the pension and other postemployment liability allocation schedules, on its Web site at <https://ers.texas.gov/About-ERS/GASB-Requirements>.

Other Issues

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 Michael Clayton, Audit Manager, or me at (512) 936-9500.

Sincerely,

Lisa R. Collier, CPA, CFE, CIDA
First Assistant State Auditor

Attachment

cc: The Honorable Greg Abbott, Governor
Members of the Employees Retirement System's Board of Trustees
Ms. Ilesa Daniels, Chair
Mr. I. Craig Hester, Vice-Chair
Mr. Brian Barth

Members of the Legislative Audit Committee

January 13, 2020

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Dr. James Kee

Ms. Catherine Melvin

Mr. Porter Wilson, Executive Director, Employees Retirement System



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Attachment

Section 1

Report on Internal Control Over Financial Reporting and on Compliance and Other Matters as Required by Auditing Standards



Lisa R. Collier,
CPA, CFE, CIDA,
First Assistant State Auditor

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

Employees Retirement System's Board of Trustees

Ms. Ilesa Daniels, Chair
Mr. I. Craig Hester, Vice-Chair
Mr. Brian Barth
Dr. James Kee
Ms. Catherine Melvin

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 that include the proprietary fund and the aggregate remaining fund information, consisting of the fiduciary funds of the Employees Retirement System (System), a component unit of the State of Texas, as of and for the year ended August 31, 2019, and the related notes to the financial statements, which collectively comprise the System's basic financial statements and have issued our report thereon dated December 20, 2019.

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.

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SAO Report No. 20-314

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 have not been identified. We did identify certain deficiencies in internal control described in the accompanying schedule of findings and responses that we consider to be a material weakness.

Summary of Findings and Responses
Finding Number
2019-1

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System’s 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 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.

Lisa R. Collier, CPA, CFE, CIDA
First Assistant State Auditor

December 20, 2019

Schedule of Findings and Responses

Section 1

The Employees Retirement System Had a Significant Error in Its Unsettled Investment Payables and Receivables Line Items

Reference No. 2019-1

Type of finding: Material Weakness

The Employees Retirement System (System) incorrectly recorded an offsetting entry of \$440,547,375 to the unsettled investment payable and unsettled investment receivable line items in its fiscal year 2019 financial statements (see text box for more information about receivable and payable). The entry recorded did not represent an actual investment purchase or sale transaction. According to the System, the entry was made to reclassify uninvested cash balances. As a result, the unsettled investment payable and unsettled investment receivable line items for the defined benefit funds (fiduciary funds) were both overstated by \$440,547,375.

The System's custodian bank recorded the offsetting entry based on incorrect guidance it received from the System's investment operations staff. The System's investment accounting staff subsequently communicated that same guidance on recording the transaction to the custodian bank (see text box for more information about the custodian bank). Both the System's investment operations staff and its investment accounting staff are authorized to make investment accounting directives to the System's custodian bank that can result in certain transactions being recorded. Therefore, the System should ensure that investment-related transactions are properly reflected on the financial statements.

For the entry noted above, no funds are owed from or due to the System based on recorded transactions. Auditors verified that the System corrected the errors before issuing its fiscal year 2019 financial statements.

Receivable and Payable

According to the Office of the Comptroller of Public Accounts, a receivable is an asset account reflecting amounts owed to an entity from private persons or organizations for goods and services furnished. A receivable is an amount expected to be collected, while a payable is a liability reflecting amounts owed for goods and services received that are expected to be paid.

Source: The Office of the Comptroller of Public Accounts' *Reporting Requirements for the Annual Financial Reports of State Agencies and Universities*.

Custodian Bank

The System is contracted with Bank of New York Mellon Asset Servicing to serve as the custodian for the System's investments and is its book of record for investments. The custodian assists the System with managing and servicing its investments.

Source: The System's 2019 *Comprehensive Annual Financial Report*.

Recommendation

The System should strengthen financial reporting controls to ensure that transactions affecting the general ledger balance are appropriate and have been properly recorded by the custodian bank in the System's ledger.

Management's Response

ERS agrees that we should ensure investment-related transactions are properly reflected on the financial statements. We will evaluate our financial reporting controls to determine additional procedures necessary to provide that assurance.

Employers Selected for Census Data Testing

Table 1 lists the 23 employers for which auditors tested the accuracy of pension and other postemployment benefit census data to determine whether that data was materially complete and accurate to support the Employees Retirement System’s financial statement amounts.¹

Table 2 on the next page lists the 16 additional employers for which auditors tested the accuracy of only other postemployment benefit census data to determine whether that data was materially complete and accurate to support the System’s financial statement amounts.¹

Table 1

List of 23 Employers Selected for Pension and Other Postemployment Benefit Census Data Testing for Fiscal Year 2019
<ul style="list-style-type: none"> ▪ Department of Criminal Justice ▪ Department of Family and Protective Services ▪ Department of Insurance ▪ Department of Licensing and Regulation ▪ Department of Public Safety ▪ Department of State Health Services ▪ Department of Transportation ▪ Fifth Court of Appeals District, Dallas ▪ Fourteenth Court of Appeals District, Houston ▪ Fourth Court of Appeals District, San Antonio ▪ Health and Human Services Commission ▪ House of Representatives ▪ Judiciary Section, Comptroller’s Department ▪ Juvenile Justice Department ▪ Office of the Attorney General ▪ Office of the Comptroller of Public Accounts ▪ Parks and Wildlife Department ▪ Preservation Board ▪ Texas Office of Consumer Credit Commissioner ▪ Texas Workforce Commission ▪ Third Court of Appeals District, Austin ▪ Twelfth Court of Appeals District, Tyler ▪ Veterans Commission

¹ Auditors followed the American Institute of Certified Public Accountants’ sampling guide methodology and selected a representative sample of state employees participating in the Employees Retirement System. Tables 1 and 2 list the employers of those selected for testing.

Table 2

List of 16 Additional Employers^a Selected for Other Postemployment Benefit Census Data Testing for Fiscal Year 2019
<ul style="list-style-type: none">▪ Alamo Community College▪ Dallas County Community College▪ El Paso Community College▪ Laredo Community College▪ Lone Star College System▪ Midwestern State University▪ Stephen F. Austin State University▪ Tarrant County College District▪ Texas State Technical College System▪ Texas Tech University▪ Texas Tech University Health Sciences Center▪ University of Houston▪ University of Houston - Downtown▪ University of Houston - Victoria▪ University of North Texas▪ University of North Texas Health Science Center at Fort Worth
<p>^a Some higher education entities participate in the System's other postemployment benefit plan instead of the Teacher Retirement System's plan.</p>