



A Report on
The Audit of the Employees Retirement **System's**
Fiscal Year 2018 Employer Pension and Other
Post-employment Benefits
Schedules

July 5, 2019

Members of the Legislative Audit Committee:

We have issued two audit reports dated June 14, 2019, related to the Employees Retirement System's (System) pension and other post-employment benefits (OPEB) liability schedules for fiscal year 2018.

Pension Liability Schedules

We concluded that the System's Schedule of Employer Allocations and the columns titled net pension liability, total deferred outflows of resources excluding employer specific amounts, total deferred inflows of resources excluding employer specific amounts, and pension expense (specified column totals) included in the Schedule of Collective Pension Amounts and the related notes as of August 31, 2018, were materially correct and presented in accordance with accounting principles generally accepted in the United States of America (see text box for pension liability reporting requirements). The Schedule of Employer Allocations and Schedule of Collective Pension Amounts are for the following defined benefit pension plans: Employees Retirement System Plan, Law Enforcement and Custodial Officer Supplemental Retirement Plan, and Judicial Retirement System of Texas Plan 2.

OPEB Liability Schedules

We concluded that the System's Schedule of Employer Allocations for Other Post-employment Benefits (OPEB) and the columns titled net OPEB liability, total deferred outflows of resources excluding employer specific amounts, total deferred inflows of resources excluding employer specific amounts, and OPEB expense included in the Schedule of Collective OPEB Amounts and the related notes as of August 31, 2018, were materially correct and presented in accordance with accounting principles generally accepted in the United States of America (see text box for OPEB liability reporting requirements).

Pension and OPEB Liability Reporting Requirements

Pension Reporting Requirements

Governmental Accounting Standards Board Statement No. 68, *Accounting and Financial Reporting for Pensions* (GASB 68), which became 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.

OPEB Reporting Requirements

Governmental Accounting Standards Board Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* (GASB 75), which became effective for fiscal years beginning after June 15, 2017, requires governments to begin recording on the face of their financial statements a liability for OPEB plans administered through trusts, rather than disclosing those amounts in the notes to their financial statements.

Employers in the respective plans will need to recognize their portion of the reported pension and/or OPEB liability in the financial statements they produce.

The System prepared the audited schedules to help participating employers comply with requirements of GASB 68 and GASB 75. Employers may use the pension and OPEB liability schedules prepared by the System to aid them in determining their portion of the reported pension and/or OPEB liability.

Sources: GASB Statement Nos. 68 and 75, and the American Institute of Certified Public Accountants State and Local Government Expert Panel Pension Whitepapers Series, Governmental Employer Participation in Cost-Sharing Multiple Employer Plans: Issues Related to Information for Employer Reporting.

SAO Report No. 19-038

The System posted the pension liability schedules, the OPEB liability schedules, and our audit reports on its Web site at <https://ers.texas.gov/About-ERS/GASB-Requirements>.

We also issued a report on internal control over financial reporting and on compliance and other matters of the pension liability schedules as required by auditing standards. Our procedures did not identify any material weaknesses in internal control over financial reporting or any noncompliance with laws or regulations that materially affected the pension liability schedules. In addition, the major internal controls that we tested for the purpose of forming our opinions on the pension liability schedules were operating effectively.

We also issued a report on internal control over financial reporting and on compliance and other matters of the OPEB liability schedules as required by auditing standards (that report, including responses from management, is presented in the attachment to this letter). In that report, auditors determined that the System had material errors in its Schedule of Collective OPEB Amounts for the Deferred Outflows of Resources and Deferred Inflows of Resources amounts totaling \$7.54 billion. As a result, auditors identified material weaknesses in the System's internal control because the System's procedures indicated to use an incorrect table from the actuary report to prepare the Schedule. Those errors were corrected before the System finalized the Schedule.

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 this audit.

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

Sincerely,

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

Attachment

Members of the Legislative Audit Committee

July 5, 2019

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cc: The Honorable Greg Abbott, Governor
Employees Retirement System Board of Trustees
Mr. I. Craig Hester, Chair
Ms. Ilesa Daniels, Vice-Chair
Mr. Doug Danzeiser
Dr. James Kee, Ph.D.
Ms. Catherine Melvin
Mr. Porter Wilson, Executive Director, Employees Retirement System



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Attachment

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



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

Independent Auditor's Report

Employees Retirement System's Board of Trustees:

Mr. I. Craig Hester, Chair
Ms. Ilesa Daniels, Vice-Chair
Mr. Doug Danzeiser
Dr. James Kee, Ph.D.
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 Schedule of Employer Allocations for Other Post-Employment Benefits (OPEB) of the Employees Retirement System (System) as of and for the year ended August 31, 2018, and the related notes. We have also audited the columns titled net OPEB liability, total deferred outflows of resources excluding employer specific amounts, total deferred inflows of resources excluding employer specific amounts, and OPEB expense included in the Schedule of Collective OPEB Amounts for Other Post-Employment Benefits (OPEB) Fund of the System as of and for the year ended August 31, 2018, and related notes, and have issued our report thereon dated June 14, 2018 (OPEB schedules).

Internal Control Over Financial Reporting

In planning and performing our audit of the OPEB schedules, we considered the System's internal control relevant to the System's preparation and fair presentation of the OPEB schedules (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the OPEB 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.

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SAO Report No. 19-325

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.

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 material weaknesses.

Summary of Findings and Responses
Finding Number
2019-1

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System's OPEB Schedules 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 OPEB 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

The System's response to the findings 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 of the OPEB 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 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 relevant to the System's preparation and fair presentation of the OPEB schedules and compliance. Accordingly, this communication is not suitable for any other purpose.

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

June 14, 2019

Schedule of Findings and Responses

Section 1

The System Had Material Errors in Its Schedule of Collective OPEB Amounts

Reference No. 2019-1

Type of finding: Material Weakness

The Employees Retirement System (System) did not prepare its Schedule of Collective Other Post-Employment Benefits (OPEB) Amounts (Schedule) in accordance with the requirements of Governmental Accounting Standards Board (GASB) Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. As a result, auditors identified material errors in the Schedule.

The System did not accurately report the components of, and totals for, the Deferred Outflows of Resources and the Deferred Inflows of Resources amounts¹ in its Schedule for fiscal year 2018. Although the System has a process to prepare, review, and approve the Schedule amounts, the System's procedures indicated to use an incorrect table from the actuary report to prepare the Schedule. Specifically, the System recorded the changes for each component for the fiscal year instead of the total balance of the components for Deferred Outflows of Resources and Deferred Inflows of Resources, as required by GASB No. 75. As a result, the fiscal year 2018 Schedule was understated by a total of \$7.54 billion. Specifically, the System:

- Understated OPEB Deferred Inflows of Resources by \$7.53 billion.
- Understated OPEB Deferred Outflows of Resources by \$10.09 million.

GASB No. 75 requires that the total balance of the components of the Deferred Outflows of Resources and the Deferred Inflows of Resources as of the measurement date be included in the collective Deferred Outflows of Resources or Deferred Inflows of Resources related to OPEB. Additionally, the System is responsible for ensuring that it prepares the Schedule in accordance with generally accepted accounting principles as prescribed or modified in GASB statements.

¹ These were the deferred inflows/outflows of resources arising from (1) the difference between expected and actual experience, (2) net differences between projected and actual investment earnings on OPEB plan investments, and (3) the changes in assumptions.

The System corrected all recorded material errors that auditors brought to its attention before it finalized the Schedule.

Accurate preparation of the Schedule is important because the employers participating in the OPEB plan (see text box for more information) use the Schedule to calculate and report their proportionate share of the components of the Net OPEB Liability in their financial statements. Adequate preparation and review of the OPEB schedules are critical to helping ensure that they are accurate and comply with financial reporting standards.

OPEB Plan

The System administers a State Retiree Health OPEB Plan (SRHP) to provide postemployment health care, life, and dental insurance benefits in accordance with Texas Insurance Code, Chapter 1551.

The SRHP is a cost-sharing, multiple employer postemployment health care plan that covers retired state employees and other entities as specified by the Legislature.

Source: Employees Retirement System's 2018 Comprehensive Annual Financial Report for the fiscal year ending August 31, 2018.

Recommendation

The System should improve existing processes to prepare, review, and approve its Schedule to ensure that the correct actuary tables are used.

Management's Response

ERS agrees with the recommendation to continue to improve processes related to the preparation, review and approval of the Schedule of Collective OPEB Amounts (Schedule). ERS has modified its procedures to ensure the correct actuary table is used for development and review of the schedule. In addition, ERS will have the actuary prepare and include the Schedule in the next GASB 75 actuarial valuation. This will allow ERS staff more time to focus on the review of the schedule.