



A Report on

# The Audit of the Employees Retirement System's Fiscal Year 2015 Financial Statements

John Keel, CPA

December 11, 2015

Members of the Legislative Audit Committee:

In our audit report dated November 16, 2015, we concluded that the Employees Retirement System's (System) basic financial statements for fiscal year 2015 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 [http://www.ers.state.tx.us/About\\_ERS/Reports/Overview/](http://www.ers.state.tx.us/About_ERS/Reports/Overview/).

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 determined that the System should strengthen controls to help ensure the completeness and accuracy of the active employees' census data that state entities submit.

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 2015 (see text box for the key data elements tested) as part of this audit. The completeness and accuracy of that data is important because the System's actuary uses that data to calculate the System's pension liability. Auditors selected a random sample of the System's members (including contributing and non-contributing state employees) for fiscal year 2015 census data testing as required by American Institute of Certified Public Accountants (AICPA) guidance. That resulted in auditors selecting members from 30 participating state agencies for which census data was tested. (A list of the state agencies that employed the members selected for testing is presented in the attachment to this letter.) Testing included reviewing documentation to verify that the census data that the employers submitted to the System was accurate.

### Census Data Tested

Census data is key demographic data that affects the actuarial estimate of the pension liability amount that the System presents in the notes to its financial statements.

Auditors identified and tested the following key data elements for the System's census data:

- Name.
- Date of birth.
- Years of service.
- Eligible compensation.
- Gender.

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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 2015. For fiscal year 2014, auditors tested the System's census data using the same methodology described above and concluded that the data was materially complete and accurate.

Additionally, auditors will be issuing an opinion later this fiscal year on the System's fiscal year 2015 pension liability allocation schedules. Those schedules provide employers with the information they need to record their share of the pension liability in their financial statements, in accordance with AICPA requirements. Auditors previously issued an opinion on the System's pension liability allocation schedules for fiscal year 2014. The System published our audit report, along with the schedules, on its Web site at [http://www.ers.state.tx.us/About\\_ERS/Reports\\_and\\_Studies/GASB\\_Requirements/](http://www.ers.state.tx.us/About_ERS/Reports_and_Studies/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 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 Verma Elliott, Audit Manager, or me at (512) 936-9500.

Sincerely,

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

cc: The Honorable Greg Abbott, Governor  
Members of the Employee Retirement System's Board of Trustees  
Mr. I. Craig Hester, Chair  
Mr. Doug Danzeiser, Vice-Chair  
Mr. Ilesa Daniels  
Ms. Cydney Donnell  
Mr. Brian D. Ragland  
Mr. Frederick E. Rowe, Jr.  
Mr. Porter Wilson, Executive Director, Employees Retirement System



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# Attachment

Section 1

## List of 30 State Agencies That Employed the Members Selected for Census Data Testing

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Table 1 lists the 30 state agencies that employed the selected members for which auditors tested the census data to determine whether that data was materially complete and accurate to support the Employees Retirement System plans' financial statement amounts.<sup>1</sup>

Table 1

List of 30 Selected for Census Data Testing for Fiscal Year 2015
<ul style="list-style-type: none"><li>▪ Court of Criminal Appeals</li><li>▪ Department of Aging and Disability Services</li><li>▪ Department of Assistive and Rehabilitative Services</li><li>▪ Department of Criminal Justice</li><li>▪ Department of Family and Protective Services</li><li>▪ Department of Motor Vehicles</li><li>▪ Department of Public Safety</li><li>▪ Department of State Health Services</li><li>▪ Department of Transportation</li><li>▪ Eighth Court of Appeals District-El Paso</li><li>▪ First Court of Appeals District-Houston</li><li>▪ Fourteenth Court of Appeals District-Houston</li><li>▪ Health and Human Services Commission</li><li>▪ Judiciary Section, Comptroller's Department</li><li>▪ Juvenile Justice Dept.</li><li>▪ Military Department</li><li>▪ Ninth Court of Appeals District-Beaumont</li><li>▪ Office of the Attorney General</li><li>▪ Office of the Comptroller of Public Accounts</li><li>▪ Parks and Wildlife Department</li><li>▪ Second Court of Appeals District-Fort Worth</li><li>▪ Seventh Court of Appeals District-Amarillo</li><li>▪ State Board of Dental Examiners</li><li>▪ State Pension Review Board</li><li>▪ Supreme Court of Texas</li><li>▪ Texas Education Agency</li><li>▪ Texas House of Representatives</li><li>▪ Texas Senate</li></ul>

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<sup>1</sup> Auditors followed the American Institute of Certified Public Accountants' sampling guide methodology and selected a representative population of employees selected for testing.

**List of 30 Selected for Census Data Testing  
for Fiscal Year 2015**

- Texas Workforce Commission
- Thirteenth Court of Appeals District-Corpus Christi-Edinburg

## 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 Financial Statements Performed in Accordance with Government Auditing Standards

#### Independent Auditor's Report

Employees Retirement System's Board of Trustees

Mr. I. Craig Hester, Chair

Mr. Doug Danzeiser, Vice-Chair

Mr. Ilesa Daniels

Ms. Cydney Donnell

Mr. Brian D. Ragland

Mr. Frederick E. Rowe, Jr.

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 and the aggregate remaining fund information of the Employees Retirement System (System) as of and for the year ended August 31, 2015, 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 16, 2015.

#### **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. 16-306

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
2015 - 1

#### **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.

#### **The System's Response to Finding**

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, CIDA  
First Assistant State Auditor

November 16, 2015



## Schedule of Findings and Responses

### Section 1

### **The System Should Strengthen Controls to Help Ensure the Completeness and Accuracy of the Active Employees' Census Data That State Entities Submit**

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Reference No. 2015-1

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

The Employees Retirement System (System) should strengthen controls over its active employees'<sup>1</sup> census data to help ensure that the data is complete and accurate for the following defined benefit pension plans: the Employees

Retirement System Plan (ERS), the Law Enforcement and Custodial Officers Supplemental Retirement Plan (LECOS), and the Judicial Retirement System of Texas Plan II (JRS II). More than 110 agencies and 17 courts participate in one of those plans. The completeness and accuracy of active employees' census 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 employees' census data are not sufficient to ensure that the data is complete and accurate. Specifically, the System does not always accurately update some employees' service credit when it receives the State's and employees' monthly contributions. Auditors identified instances in which the pension system froze an employee's service credit, even though the System collected the contributions. The errors identified during auditors' initial testing of the census data file as of February 28, 2015, were not material to the System's total service credit. However, 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.<sup>2</sup>

#### **Contributing and Noncontributing Employee Census Data**

Active employee census data is key demographic data that affects the actuarial estimate of the pension liability amount that the System presents in its financial statements.

Key data elements include:

- Gender.
- Date of birth.
- Salary.
- Years of service.

Source: American Institute of Certified Public Accountants February 2014 white paper entitled *Single-Employer and Cost-Sharing Multiple-Employer Plans: Issues Associated with Testing Census Data in an Audit of Financial Statements*.

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<sup>1</sup> For purposes of this report, "active employees" are both (1) current state employees and (2) employees who separated from state employment, had participated in one of the System's pension plans, and did not withdraw their funds upon separation.

<sup>2</sup> 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*.

Auditors performed additional testing of the active employees' census data at the end of fiscal year 2015 and determined that the errors in the service credit data for the census data file as of August 31, 2015, did not materially affect the calculation of the System's pension liability for fiscal year 2015.

Based on the small sample errors, auditors projected and determined that 0.1 percent of contributing members for the System as of August 31, 2015, had incorrect service credit accounts. All the tested service credit accounts with errors were associated with former state employees who were refunded their pension accounts upon separation and then subsequently returned to work for the State. Because there were no errors in the sample of noncontributing members that auditors tested, auditors projected that all noncontributing members as of August 31, 2015, had correct service credit accounts. As a result, the projection of the percent of accounts that had service credit errors for all members (contributing and noncontributing) as of August 31, 2015, was 0.06 percent.<sup>3</sup>

#### **Recommendation**

The System should:

- Consider developing procedures at the payroll system level to ensure the completeness and accuracy of service credit data because census data is provided to the System from payroll systems.
- Develop procedures to identify service credit accounts that are frozen and correct them.
- Perform periodic reviews of service credit data to verify the completeness and accuracy of that data.

#### **Management's Response**

*ERS agrees with the recommendations. ERS made significant progress in strengthening controls to ensure the completeness and accuracy of active member census data during Fiscal Year 2015 and will continue those efforts in Fiscal Year 2016 including a determination of whether additional procedures at the payroll system level would assist in ensuring completeness and accuracy of service credit data for valuation purposes.*

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<sup>3</sup> Auditors followed guidance issued in the AICPA's *Sampling Guide* (2012) when designing the sampling procedures and evaluating the sampling results in this report.

*It is important to note when a member decides to retire, the member's account is reconciled at that time to ensure the accuracy of the service credit.*

*During FY 2016, ERS will develop procedures to identify service credit accounts that are frozen and not identified through existing procedures and correct them. ERS will also determine the frequency for conducting periodic reviews of the service credit data and begin performing those reviews.*

*Implementation Date: August 31, 2016*

*Responsible Position: Interim Chief Financial Officer*

*Chief Information Officer*

*Customer Benefits Director*