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State Auditor

An Audit Report on

**Incentive Compensation at the
Permanent School Fund, General Land
Office, Teacher Retirement System,
and Employees Retirement System**

August 2022
Report No. 22-041



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Incentive Compensation at the Permanent School Fund, General Land Office, Teacher Retirement System, and Employees Retirement System

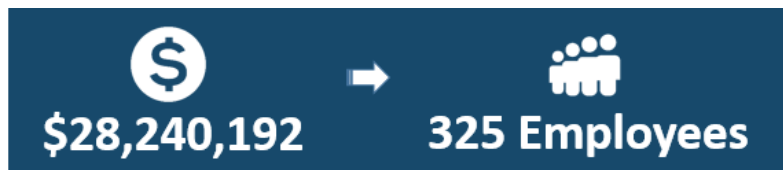
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Overall Conclusion

The Permanent School Fund Division (PSF Division) of the Texas Education Agency, the General Land Office (GLO), the Teacher Retirement System (TRS), and the Employees Retirement System (ERS) calculated and paid incentive compensation in accordance with their policies and procedures for plan year 2021. Figure 1 summarizes the entities' incentive compensation awards.

Figure 1

Through their incentive compensation plans for the plan year 2021, the PSF Division, GLO, ERS, and TRS awarded a total of:



Specifically:



This audit was conducted in accordance with Texas Government Code, Section 321.0131 and 321.0132.

For more information regarding this report, please contact Michael Clayton, Audit Manager, or Lisa Collier, State Auditor, at (512) 936-9500.

Table 1 presents a summary of the findings in this report and the related issue ratings. (See Appendix 2 for more information about the issue rating classifications and descriptions.)

Table 1

Summary of Chapters/Subchapters and Related Issue Ratings		
Chapter/ Subchapter	Title	Issue Rating ^a
1	The PSF Division Calculated and Paid Plan Year 2021 Incentive Compensation in Accordance With Its Policies and Procedures	Low
2	GLO Calculated and Paid Plan Year 2021 Incentive Compensation in Accordance With Its Policies and Procedures	Low
3	TRS Calculated and Paid Plan Year 2021 Incentive Compensation and Executive Performance Incentive Compensation in Accordance With Its Policies and Procedures	Low
4	ERS Calculated and Paid Plan Year 2021 Incentive Compensation in Accordance With Its Policies and Procedures	Low

^a A chapter is rated **Priority** if the issues identified present risks or effects that if not addressed could critically affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern(s) and reduce risks to the audited entity.

A chapter is rated **High** if the issues identified present risks or effects that if not addressed could substantially affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern(s) and reduce risks to the audited entity.

A chapter is rated **Medium** if the issues identified present risks or effects that if not addressed could moderately affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Action is needed to address the noted concern(s) and reduce risks to a more desirable level.

A chapter is rated **Low** if the audit identified strengths that support the audited entity's ability to administer the program(s)/function(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

Audit Objectives and Scope

The objective of this audit was to determine whether the PSF Division, GLO, TRS, and ERS calculate and pay incentive compensation in accordance with policies and procedures.

The scope of this audit covered incentive compensation plan years ending September 30, 2021, at the PSF Division; June 30, 2021, at GLO; September 30, 2021, at TRS; and August 31, 2021, at ERS.

Contents

Detailed Results

Chapter 1	
The PSF Division Calculated and Paid Plan Year 2021 Incentive Compensation in Accordance With Its Policies and Procedures	1
Chapter 2	
GLO Calculated and Paid Plan Year 2021 Incentive Compensation in Accordance With Its Policies and Procedures	4
Chapter 3	
TRS Calculated and Paid Plan Year 2021 Incentive Compensation and Executive Performance Incentive Compensation in Accordance With Its Policies and Procedures	6
Chapter 4	
ERS Calculated and Paid Plan Year 2021 Incentive Compensation in Accordance With Its Policies and Procedure.....	10

Appendices

Appendix 1	
Objective, Scope, and Methodology	14
Appendix 2	
Issue Rating Classifications and Descriptions.....	18
Appendix 3	
Internal Control Components	19
Appendix 4	
Related State Auditor’s Office Reports	20

Detailed Results

Chapter 1

The PSF Division Calculated and Paid Plan Year 2021 Incentive Compensation in Accordance With Its Policies and Procedures

Chapter 1
Rating:

Low ¹

The Permanent School Fund Division (PSF Division) of the Texas Education Agency calculated and paid incentive compensation for its plan year ending September 30, 2021, in accordance with its policies and procedures.

The PSF Division awarded a total of \$4,628,062 in incentive compensation to 61 employees. Its chief investment officer received the largest incentive compensation award of \$349,529 payable over three years. This amount represented 7.6 percent of the total incentive compensation awarded by the PSF Division in plan year 2021.

Plan Information

The PSF Division calculates incentive compensation based on an employee's achievement of performance goals related to total fund performance and the performance of the employee's assigned asset classes, as applicable. With the exception of the performance of certain asset classes, both fund and asset class performance are calculated based on three-year rolling historical performance data. The PSF Division calculates incentive compensation awards using investment performance data reported on a net-of-fees basis (see text box for more information on gross-of-fees and net-of-fees).

The PSF Division awards incentive compensation if the performance of the total fund or the individual asset classes, as applicable, meets or exceeds selected benchmarks. Total fund investment performance exceeded the target benchmark by 0.45 percent (45 basis points) (see text box for additional information

Gross-of-Fees and Net-of-Fees Basis

Gross-of-fees indicates that the return on investment does not include the effect of fees. *Net-of-fees* indicates that the return on investment does include the effect of fees.

Source: 2020 *Global Investment Performance Standards [GIPS] for Asset Owners*.

Basis Points

One basis point is 0.01 percent or one one-hundredth of a percentage point.

Source: Morningstar, Inc. website at <https://www.morningstar.co.uk/uk/glossary/98015/basis-point.aspx>.

¹ The risk related to the issues discussed in Chapter 1 is rated as Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/function(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

on basis points) for the three-year period from October 1, 2018, to September 30, 2021.

The PSF Division awards incentive compensation for a plan year in installments over three years. An employee may receive an incentive compensation payment that consists of partial awards from three plan years. Figure 2 shows the PSF Division’s installment schedule for incentive compensation payments.

Figure 2

PSF Division Three-Year Installment Schedule for All Participants

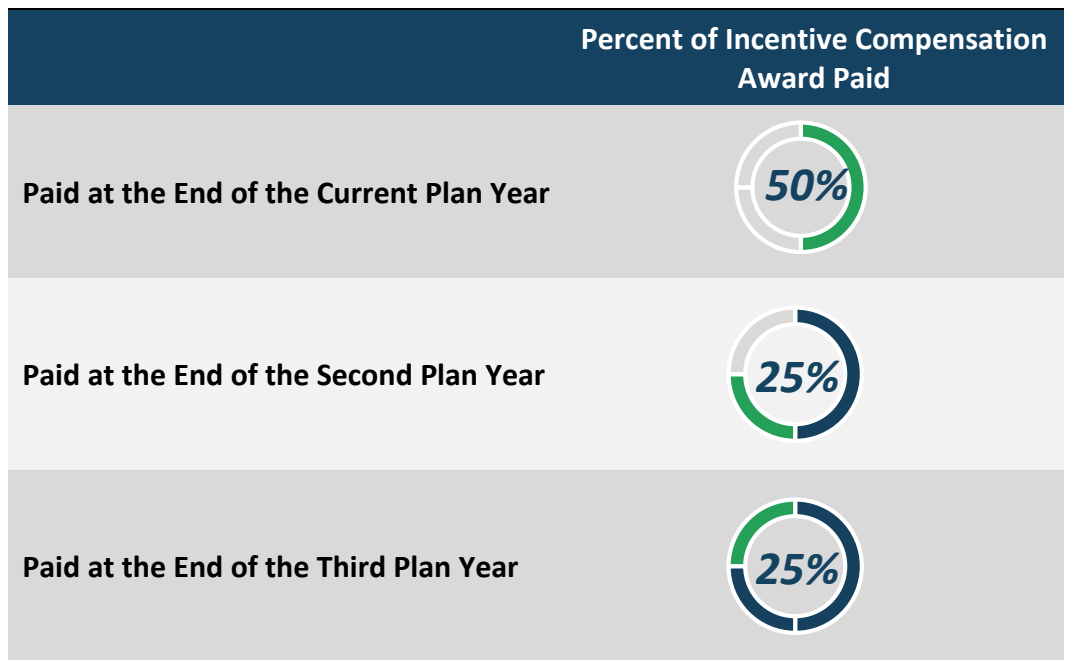


Table 2 on the next page lists the positions eligible to earn incentive compensation according to the PSF Division’s incentive compensation plan, as well as the incentive compensation award, or award range, for each eligible position for plan year 2021.

Table 2

PSF Division Incentive Compensation Awards for Plan Year 2021	
Eligible Position	Incentive Compensation Award or Award Range ^a
Chief Investment Officer	\$349,529
Deputy Chief Investment Officer and Director of Fixed Income	\$268,839
Director of Private Markets	\$262,705
Investment Side Managing Directors	\$43,074 to \$171,157
Director of Equities	\$150,162
Deputy Executive Administrator	\$137,818
Portfolio Manager II - IV	\$95,027 to \$118,241
Operations Side Managing Directors	\$41,165 to \$99,285
Investment Analyst IV	\$24,328 to \$90,295
Director of Global Risk Control Strategies	\$78,812
Director I - IV	\$41,123 to \$78,150
Systems Analyst VII	\$57,364 to \$70,344
Attorney V	\$67,157
Investment Analyst I - III	\$41,804 to \$66,000
Business Analyst III - IV	\$34,782 to \$42,497
Financial Analyst III - IV	\$17,440 to \$38,721
Accountant VII	\$30,391
Attorney II	\$27,796
Financial Analyst II	\$21,415 to \$24,649
Systems Analyst IV	\$21,022
Program Specialist V	\$19,096
Staff Services Officer III	\$13,113 to \$13,954
Accountant VI	\$7,413
^a Award range applies to multiple employees in an eligible position.	

Source: PSF Division.

GLO Calculated and Paid Plan Year 2021 Incentive Compensation in Accordance With Its Policies and Procedures

**Chapter 2
Rating:**

Low ²

The General Land Office (GLO) calculated and paid incentive compensation for its plan year ending June 30, 2021, in accordance with its policies and procedures.

GLO awarded a total of \$285,743 in incentive compensation to 4 employees. Its chief investment officer received the largest incentive compensation award of \$221,453 payable over two years. This amount represented 77.5 percent of the total incentive compensation awarded by GLO in plan year 2021.

Plan Information

GLO's incentive compensation plan compares investment performance of the total fund against a target benchmark on a one-year, three-year, and five-year performance period basis. GLO calculates incentive compensation based on an employee's achievement of an investment performance component (60 percent) and a qualitative performance component (40 percent).

For the investment performance component, GLO calculates incentive compensation using data reported on a net-of-fees basis (see text box for more information). The investment performance of the total fund exceeded the target benchmark; therefore, GLO awarded incentive compensation for plan year 2021. Total fund investment performance:

- Exceeded the target benchmark by 7.43 percent (743 basis points) for the one-year period from July 1, 2020, to June 30, 2021.
- Underperformed the target benchmark by 0.89 percent (89 basis points) for the three-year period from July 1, 2018, to June 30, 2021.
- Exceeded the target benchmark by 3.73 percent (373 basis points) for the five-year period from July 1, 2016, to June 30, 2021.

**Gross-of-Fees
and Net-of-Fees Basis**

Gross-of-fees indicates that the return on investment does not include the effect of fees. *Net-of-fees* indicates that the return on investment does include the effect of fees.

Source: 2020 Global Investment Performance Standards [GIPS] for Asset Owners.

² The risk related to the issues discussed in Chapter 2 is rated as Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/function(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

GLO awards incentive compensation for a plan year in installments over two years. An employee may receive an incentive compensation payment that consists of partial awards from two plan years. Figure 3 shows GLO’s installment schedule for incentive compensation payments.

Figure 3

GLO Two-Year Installment Schedule for All Participants

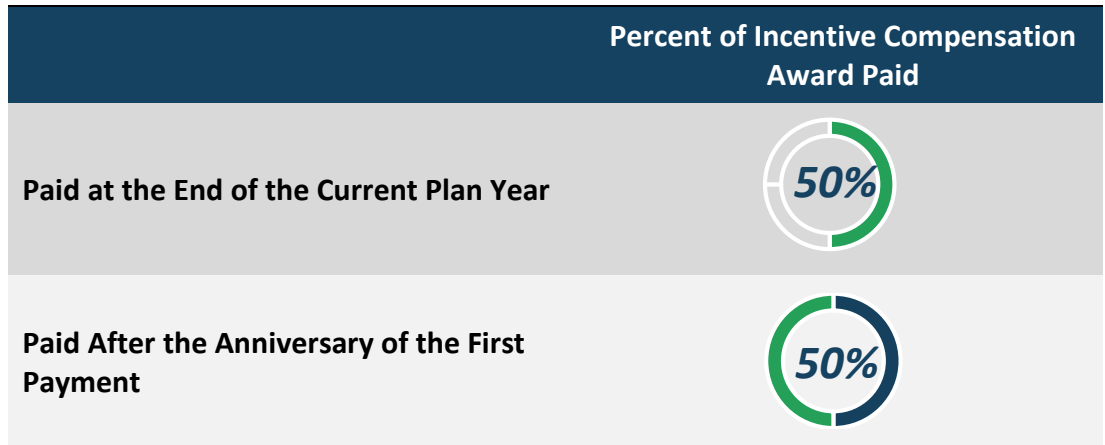


Table 3 lists the positions eligible to earn incentive compensation awards according to GLO’s incentive compensation plan and the incentive compensation award, or award range, for each eligible position for plan year 2021.

Table 3

GLO Incentive Compensation Awards for Plan Year 2021	
Eligible Position	Incentive Compensation Award or Award Range ^a
Chief Investment Officer	\$221,453
Senior Investment Analyst	\$10,698 to \$34,080
Investment Portfolio Specialist	\$19,512
^a Award range applies to multiple employees in an eligible position.	

Source: GLO.

TRS Calculated and Paid Plan Year 2021 Incentive Compensation and Executive Performance Incentive Compensation in Accordance With Its Policies and Procedures

**Chapter 3
Rating:
Low ³**

Incentive Compensation Plan

The Teacher Retirement System (TRS) calculated and paid incentive compensation for its plan year ending September 30, 2021, in accordance with its policies and procedures.

TRS awarded a total of \$17,092,791 in incentive compensation to 180 employees (excluding \$47,460 awarded to the executive director as part of the separate executive performance incentive pay plan). A senior managing director received the largest incentive compensation award of \$467,242 payable over two years. This amount represented 2.7 percent of the total incentive compensation awarded by TRS for plan year 2021.

TRS awards incentive compensation based on an employee's achievement of investment performance and qualitative performance components. The investment performance component consists of two categories: performance measured against established benchmarks (50 percent) and performance measured against selected peer groups (30 percent). The qualitative performance component (20 percent) measures an employee's performance in a variety of areas, such as interpersonal relationship skills, accountability, and teamwork.

TRS's plan measures investment performance for both the benchmark and peer group categories on a one-year (33 percent) and three-year (67 percent) performance period basis. TRS awards incentive compensation if investment performance exceeds selected benchmarks or peer group performance for the one-year or three-year performance periods.

For the investment performance component, TRS calculates incentive compensation awards using data reported on a net-of-fees basis for performance measured against established benchmarks and a blend of both gross-of-fees and net-of-fees for performance measured against selected

³ The risk related to the issues discussed in Chapter 3 is rated as Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/function(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

peer groups, depending on the asset class (see text box for more information on gross-of-fees and net-of-fees). The total fund investment performance:

- Exceeded the target benchmark by 2.77 percent (277 basis points) for the one-year period from October 1, 2020, to September 30, 2021.
- Exceeded the target benchmark by 0.17 percent (17 basis points) for the three-year period from October 1, 2018, to September 30, 2021.

Gross-of-Fees and Net-of-Fees Basis

Gross-of-fees indicates that the return on investment does not include the effect of fees. *Net-of-fees* indicates that the return on investment does include the effect of fees.

Source: 2020 Global Investment Performance Standards [GIPS] for Asset Owners.

TRS awards incentive compensation for a plan year in installments over two years. An employee may receive an incentive award payment that consists of partial awards from two plan years. Figure 4 shows TRS’s installment schedule for incentive compensation payments.

Figure 4

TRS Incentive Compensation Plan – Two-Year Installment Schedule for All Participants

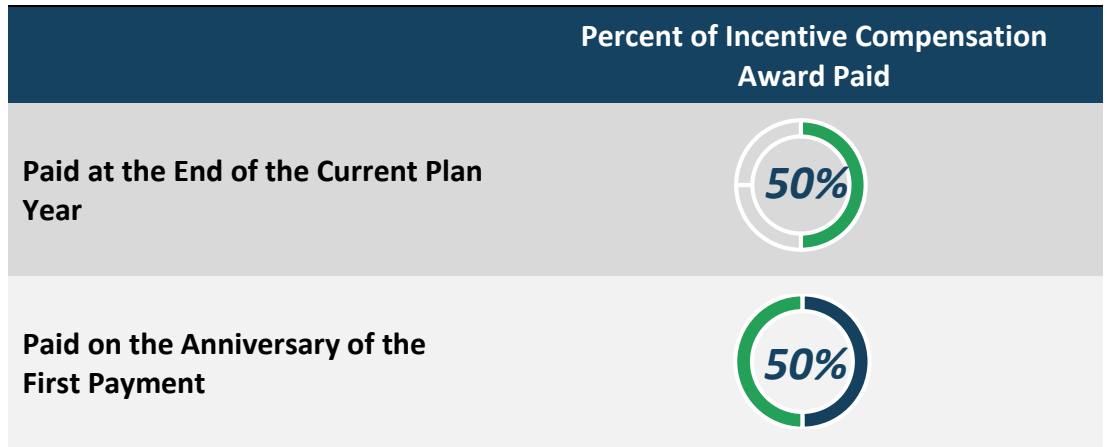


Table 4 lists the positions eligible to earn incentive compensation according to TRS’s incentive compensation plan and the incentive compensation award, or award range, for each eligible position for plan year 2021.

Table 4

TRS Incentive Compensation Awards for Plan Year 2021	
Eligible Position	Incentive Compensation Award or Award Range ^a
Senior Managing Director	\$258,804 to \$467,242
Chief Investment Officer	\$436,680
Senior Director	\$185,628 to \$378,868
Managing Director	\$331,772
Director	\$133,140 to \$294,815
General Counsel & Chief Compliance Officer / Senior Associate	\$126,637
Investment Manager	\$19,269 to \$107,736
Senior Associate	\$21,429 to \$82,520
Senior Associate - Investment Management Division (IMD) Legal & Compliance	\$59,095
Associate	\$9,190 to \$55,716
Analyst - IMD Legal & Compliance	\$33,050 to \$36,325
Senior Analyst	\$4,690 to \$28,102
Analyst	\$2,653 to \$19,782
Junior Analyst - IMD Legal & Compliance	\$6,314 to \$13,724
Junior Analyst	\$7,083
Administrative Assistant	\$917 to \$1,898
^a Award range applies to multiple employees in an eligible position.	

Source: TRS.

Executive Performance Incentive Pay Plan

TRS calculated and paid executive incentive compensation for its plan year ending September 30, 2021, in accordance with its policies and procedures.

The executive director’s award for plan year 2021 was composed of an investment oversight award of \$47,460; no leadership award was earned. The TRS executive director was the only executive plan participant for the plan year.

- **Leadership Award.** TRS awards executive incentive compensation for the leadership component based on an eligible participant’s total evaluation, which comprises four main qualitative performance categories. Those

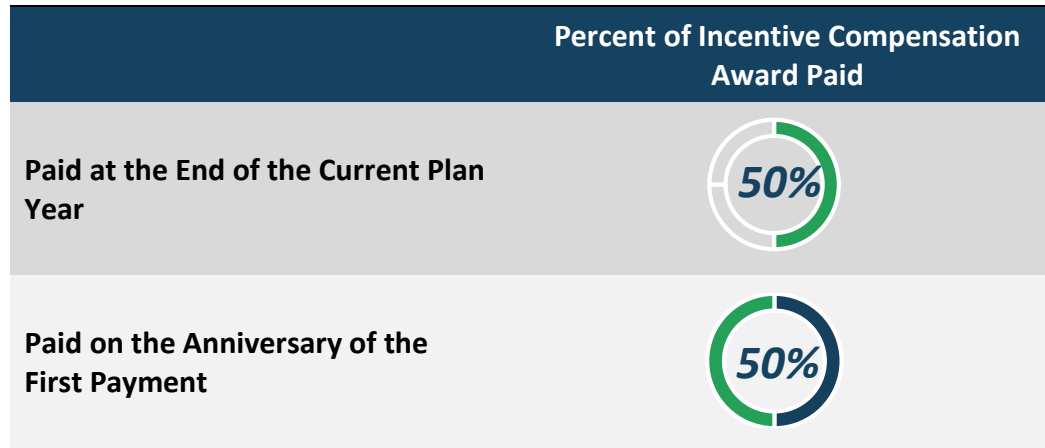
performance categories are (1) leadership effectiveness, (2) strategic foresight, (3) culture and engagement, and (4) operational effectiveness.

- **Investment Oversight Award.** TRS awards executive incentive compensation for the investment oversight component based on the one-year and three-year investment performance of the total fund.

TRS awards executive incentive compensation for each component in installments over two years. For both components, TRS pays 50 percent of an incentive compensation award the first year and the remainder on the first anniversary of the first payment. Figure 5 shows TRS’s payment installment schedule for the executive performance incentive compensation awards.

Figure 5

TRS Executive Performance Incentive Pay Plan – Two-Year Installment Schedule



ERS Calculated and Paid Plan Year 2021 Incentive Compensation in Accordance With Its Policies and Procedure

**Chapter 4
Rating:**
Low ⁴

The Employees Retirement System (ERS) calculated and paid incentive compensation for its plan year ending August 31, 2021, in accordance with its policies and procedures.

ERS awarded a total of \$6,186,136 in incentive compensation to 79 employees. Its executive director received the largest incentive compensation award of \$316,117 payable over three years. This amount represented 5.1 percent of the total incentive compensation awarded by ERS for plan year 2021.

Plan Information

ERS awards incentive compensation based on an employee's achievement of qualitative and quantitative performance goals. The qualitative performance goal represents 25 percent of the employee's overall participant goals. The quantitative performance goals represent the remaining 75 percent of that employee's overall participant goals, with a minimum of 25 percent of the overall participant goals to be evaluated based on relative trust fund performance.

For the executive director, the overall participant goals consist of a quantitative component (50 percent) based on relative trust fund performance and a qualitative component (50 percent) reflecting performance in overall agency leadership, management, communications, policy matters, staff development, and the implementation of agency strategic initiatives.

For the investment performance component, ERS calculates incentive compensation awards using data reported on a net-of-fees basis (see text box for more information on gross-of-fees and net-of-fees). ERS calculates the investment performance goals based on (1) an employee's achievement of benchmarks related to the relative trust fund performance and (2) the performance of the employee's assigned asset classes or individual

Gross-of-Fees and Net-of-Fees Basis

Gross-of-fees indicates that the return on investment does not include the effect of fees. Net-of-fees indicates that the return on investment does include the effect of fees.

Source: 2020 Global Investment Performance Standards [GIPS] for Asset Owners.

⁴ The risk related to the issues discussed in Chapter 4 is rated as Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/function(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

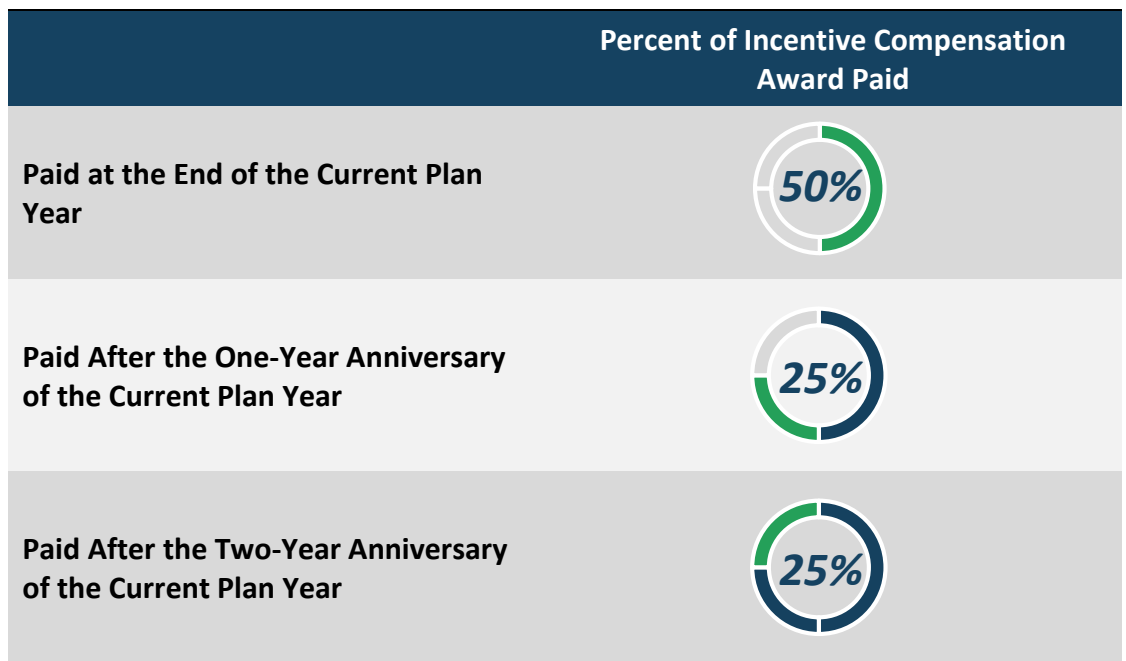
portfolios for one-year, three-year, and five-year periods, depending on the employee’s length of service. The total relative trust fund investment performance:

- Exceeded the target benchmark by 6.85 percent (685 basis points) for the one-year period from September 1, 2020, to August 31, 2021.
- Exceeded the target benchmark by 1.51 percent (151 basis points) for the three-year period from September 1, 2018, to August 31, 2021.
- Exceeded the target benchmark by 1.47 percent (147 basis points) for the five-year period from September 1, 2016, to August 31, 2021.

ERS pays most incentive compensation awards for a plan year in installments over three years. An employee may receive an incentive award payment that consists of partial awards from three plan years.⁵ Figure 6 below and Figures 7 and 8 on the following page show ERS’s installment schedules for the incentive compensation payments, depending on eligible position.

Figure 6

Majority of ERS Plan Participants – Three-Year Installment Schedule



⁵ For investment operations specialists and operational due diligence specialists, ERS pays 50 percent of an incentive compensation award after the performance period for the current plan year, and it pays the remaining 50 percent of that award after the next plan year. For investment administrative support staff, ERS pays 100 percent of an incentive compensation award after the performance period for the current plan year.

Figure 7

ERS Investment Operations Specialists and Operational Due Diligence Specialists ^a – Two-Year Installment Schedule

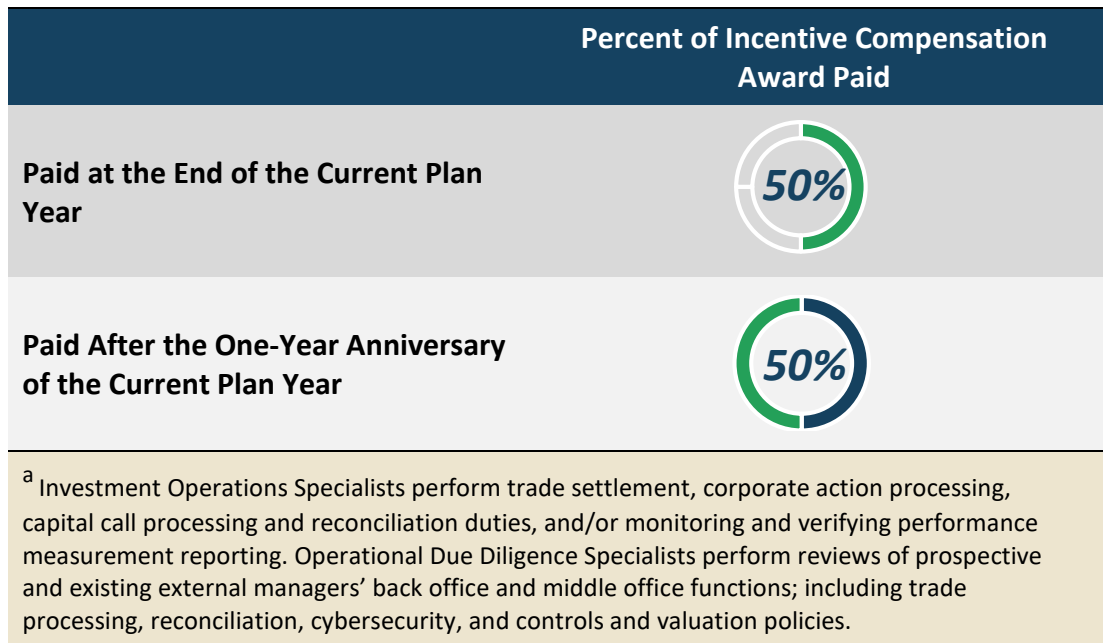


Figure 8

ERS Investment Administrative Support ^a – One-Year Installment Schedule

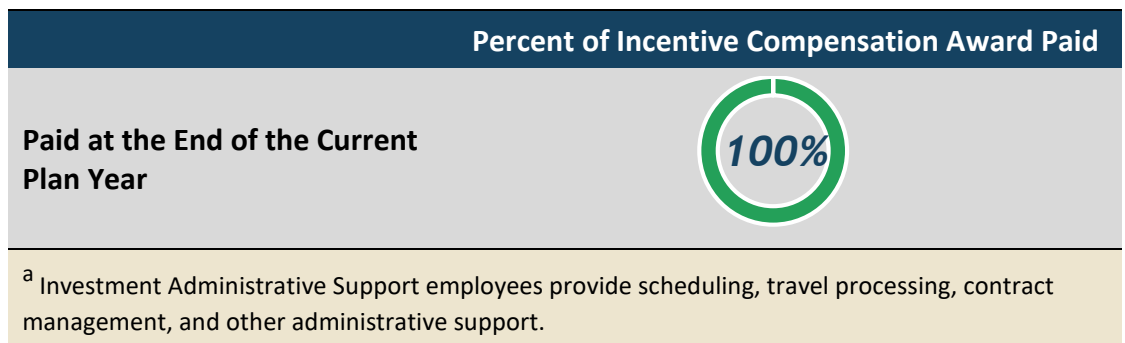


Table 5 on the next page lists the positions eligible to earn incentive compensation according to ERS's incentive compensation plan and the incentive compensation award, or award range, for each eligible position for plan year 2021.

Table 5

ERS Incentive Compensation Awards for Plan Year 2021	
Eligible Position	Incentive Compensation Award or Award Range ^a
Executive Director	\$316,117
Asset Class Director	\$156,436 to \$251,283
Director of Risk Management & Applied Research	\$208,678
Director of Investment Services	\$182,312
Investments and Securities, Attorney	\$117,544 to \$125,264
Supervising Portfolio Manager	\$106,792 to \$117,835
Portfolio Manager I - V	\$43,526 to \$111,239
Chief Trader II	\$103,375
Investment Analyst III - V	\$24,665 to \$76,669
Trader II - III	\$28,175 to \$74,392
Investment Operations Manager	\$69,159
Financial Analyst III - IV (Investment Operations Specialist and Operational Due Diligence Specialist)	\$17,625 to \$26,543
Investment Analyst I - II	\$12,512 to \$24,248
Investments and Securities, Paralegal	\$22,418
Investment Administrative Support	\$919 to \$4,051
^a Award range applies to multiple employees in an eligible position.	

Appendices

Appendix 1

Objective, Scope, and Methodology

Objective

The objective of this audit was to determine whether the Permanent School Fund Division (PSF Division) of the Texas Education Agency, the General Land Office (GLO), the Teacher Retirement System (TRS), and the Employees Retirement System (ERS) calculate and pay incentive compensation in accordance with policies and procedures.

Scope

The scope of this audit covered incentive compensation plan years ending September 30, 2021, at the PSF Division; June 30, 2021, at GLO; September 30, 2021, at TRS; and August 31, 2021, at ERS. The scope also included a review of significant internal control components related to determining whether the PSF Division, GLO, TRS, and ERS calculate and pay incentive compensation in accordance with policies and procedures (see Appendix 3 for more information about internal control components).

Methodology

The audit methodology included collecting information and documentation from the audited agencies; reviewing incentive compensation plans, policies, procedures, and other guidance related to incentive compensation; and analyzing and evaluating data and the results of tests. In addition, during the audit, matters not required to be reported in accordance with *Government Auditing Standards* were communicated to ERS and TRS management for consideration.

Data Reliability and Completeness

Auditors assessed the reliability of the incentive compensation award data used in this audit by tracing the data to supporting documentation and by reviewing access to the data. Auditors verified the completeness of the incentive compensation award data by comparing pay calculation information in the incentive compensation award spreadsheets that the audited agencies used to calculate payments to payment data in the Standardized Payroll/Personnel Reporting System. Auditors determined that the incentive compensation award data was sufficiently reliable for the purposes of this audit.

Sampling Methodology

Auditors selected nonstatistical samples of incentive compensation awards for testing based on risk for the PSF Division, TRS, and ERS incentive compensation plans. These sample designs were chosen to address specific risk factors identified in the populations and items were selected because they had a high potential for error. The sample items were generally not representative of the populations for the entities; therefore, it would not be appropriate to project the test results to those populations.

Auditors tested the entire population of incentive compensation awards for the TRS executive performance incentive pay plan and the GLO incentive compensation plan.

Information collected and reviewed included the following:

- Incentive compensation plan documentation at the PSF Division, GLO, TRS, and ERS, including policies and procedures for calculating and paying incentive compensation.
- TRS and ERS boards of trustees meeting minutes.
- Incentive compensation payment calculation spreadsheets and related data input source data for incentive compensation plan years ending September 30, 2021, at the PSF Division; June 30, 2021, at GLO; September 30, 2021, at TRS; and August 31, 2021, at ERS.
- Incentive compensation recipients' personnel documentation.
- Payroll data for incentive compensation payments.
- Investment performance reports from custodian banks.

Procedures and tests conducted included the following:

- Interviewed management and key personnel at the PSF Division, GLO, TRS, and ERS.
- Tested and recalculated recipients' incentive compensation awards, to determine whether the payments complied with plan provisions, for incentive compensation plan years ending September 30, 2021, at the PSF Division; June 30, 2021, at GLO; September 30, 2021, at TRS; and August 31, 2021, at ERS.
- Verified that incentive compensation award payments matched award calculations.

- Tested compliance with the audited agencies' policies and procedures.
- Tested access controls, including segregation of duties, over the spreadsheets and data that GLO, TRS, and ERS used to calculate incentive compensation.
- Reviewed agreed-upon procedures for ERS.

Criteria used included the following:

- Section 44, Article III, Texas Constitution and related statutes.
- Rider 13, page III-39, and Rider 20, page III-10, General Appropriations Act (86th Legislature).
- Texas attorney general opinions related to incentive compensation.
- The PSF Division's *Performance Incentive Pay Plan*, effective October 1, 2020.
- The PSF Division's *Performance Incentive Compensation Process Procedures*.
- The PSF Division's *Investment Procedures Manual*, amended November 2020.
- GLO's *Performance Incentive Pay Plan*, effective July 1, 2020.
- GLO's *Performance Incentive Plan Procedures*.
- TRS's *Performance Pay Plan*, effective October 1, 2020.
- TRS's *Performance Pay Plan: Policy/Procedures*.
- TRS's *Executive Performance Incentive Pay Plan*, for both the leadership performance period and the investment oversight performance period, effective October 1, 2020.
- TRS's *Executive Performance Plan: Policy/Procedures*.
- ERS's *Incentive Compensation Plan for Key Investment Professionals and Leadership Employees*, effective September 1, 2020.
- ERS's *General Procedure Reference ERS Incentive Compensation Plan*.

Project Information

Audit fieldwork was conducted from March 2022 through June 2022. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The following members of the State Auditor's staff performed the audit:

- Taylor L. Huff, CFE (Project Manager)
- Robert Pagenkopf, MBA, CFE (Assistant Project Manager)
- Robert H. (Rob) Bollinger, CPA, CGMA, CFE (Team Member)
- Sarah Oreoluwa Kade (Team Member)
- Dana Musgrave, MBA, CFE (Quality Control Reviewer)
- Michael Owen Clayton, CPA, CISA, CFE, CIDA (Audit Manager)

Issue Rating Classifications and Descriptions

Auditors used professional judgment and rated the audit findings identified in this report. Those issue ratings are summarized in the report chapters/sub-chapters. The issue ratings were determined based on the degree of risk or effect of the findings in relation to the audit objective(s).

In determining the ratings of audit findings, auditors considered factors such as financial impact; potential failure to meet program/function objectives; noncompliance with state statute(s), rules, regulations, and other requirements or criteria; and the inadequacy of the design and/or operating effectiveness of internal controls. In addition, evidence of potential fraud, waste, or abuse; significant control environment issues; and little to no corrective action for issues previously identified could increase the ratings for audit findings. Auditors also identified and considered other factors when appropriate.

Table 6 provides a description of the issue ratings presented in this report.

Table 6

Summary of Issue Ratings	
Issue Rating	Description of Rating
Low	The audit identified strengths that support the audited entity's ability to administer the program(s)/function(s) audited <u>or</u> the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.
Medium	Issues identified present risks or effects that if not addressed could <u>moderately affect</u> the audited entity's ability to effectively administer the program(s)/function(s) audited. Action is needed to address the noted concern(s) and reduce risks to a more desirable level.
High	Issues identified present risks or effects that if not addressed could <u>substantially affect</u> the audited entity's ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern(s) and reduce risks to the audited entity.
Priority	Issues identified present risks or effects that if not addressed could <u>critically affect</u> the audited entity's ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern(s) and reduce risks to the audited entity.

Internal Control Components

Internal control is a process used by management to help an entity achieve its objectives. The U.S. Government Accountability Office's *Government Auditing Standards* require auditors to assess internal control when internal control is significant to the audit objectives. The Committee of Sponsoring Organizations of the Treadway Commission (COSO) established a framework for five integrated components of internal control, which are listed in Table 7.

Table 7

Internal Control Components	
Component	Component Description
Control Environment	The control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure.
Risk Assessment	Risk assessment is the entity's identification and analysis of risks relevant to achievement of its objectives, forming a basis for determining how the risks should be managed.
Control Activities	Control activities are the policies and procedures that help ensure that management's directives are carried out.
Information and Communication	Information and communication are the identification, capture, and exchange of information in a form and time frame that enable people to carry out their responsibilities.
Monitoring Activities	Monitoring is a process that assesses the quality of internal control performance over time.

Source: Internal Control - Integrated Framework, Committee of Sponsoring Organizations of the Treadway Commission, May 2013.

Related State Auditor's Office Reports

Table 8

Related State Auditor's Office Reports		
Number	Report Name	Release Date
20-040	<i>An Audit Report on Incentive Compensation at the Permanent School Fund, General Land Office, Teacher Retirement System, and Employees Retirement System</i>	August 2020
19-048	<i>An Audit Report on Incentive Compensation at the Permanent School Fund, General Land Office, Teacher Retirement System, and Employees Retirement System</i>	August 2019
19-003	<i>An Audit Report on Incentive Compensation at the Permanent School Fund, General Land Office, Employees Retirement System, and Teacher Retirement System</i>	September 2018
18-001	<i>An Audit Report on Incentive Compensation at the Permanent School Fund, General Land Office, Employees Retirement System, and Teacher Retirement System</i>	September 2017
16-030	<i>An Audit Report on Incentive Compensation at the Permanent School Fund, General Land Office, Employees Retirement System, and Teacher Retirement System</i>	June 2016
15-032	<i>An Audit Report on Incentive Compensation at Selected Agencies</i>	May 2015

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