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**AUDIT COMMITTEE MEETING
EMPLOYEES RETIREMENT SYSTEM OF TEXAS**

**August 16, 2016
ERS Board Room
ERS Building – 200 E. 18th Street
Austin, Texas 78701**

TRUSTEES PRESENT

I. Craig Hester, Chair
Doug Danzeiser, Vice-Chair
Ilesa Daniels, Member
Cydney Donnell, Member
Brian Ragland, Member
Jeanie Wyatt, Member

IAC PRESENT

Vernon Torgerson, Member

ERS STAFF PRESENT

Porter Wilson, Executive Director
Catherine Terrell, Deputy Executive Director
Paula A. Jones, Deputy Executive Director and General Counsel
Shack Nail, Special Projects and Policy Advisor
Tony Chavez, Internal Auditor
Jordan Hajovsky, Co-Director Operations Support
Robin Hardaway, Director of Customer Benefits
Wendy McAdams, Co-Director of Operations Support
Tom Tull, Chief Investments Officer
Chuck Turner, Chief Information Officer
Kelley Davenport, Executive Office
Liz Geise, Benefits Communications
Beth Gilbert, Internal Audit
Jennifer Jones, Governmental Affairs
Sharmila Kassam, Deputy Chief Investment Officer
Robert Lee, Investments
Ricardo Lyra, Investments
Nick Maffeo, Investments
Betty Martin, Investments
Pamela Maas, Benefit Contracts
Roger Nooner, Benefits Communications
Becky O'Brien, Finance
Davis Peacock, Investments
Jonathan Puckett, Internal Audit
Karen Norman, Internal Audit
Pablo de la Sierra Perez, Investments
Bernely Tharp, Benefit Contracts
Tommy Williams, Information Systems

ALSO PRESENT

Keith Barnes, Blue Cross Blue Shield of Texas
Andrew Clark, Speaker's Office
Michael Clayton, State Auditor's Office
Kristen Doyle, Aon Hewitt
Brittany George, Weaver & Tidwell

Yves-Laurent Khoury, Blue Cross Blue Shield of Texas
Gabriel Puente, SPI
Ben Reyfritz, State Auditor's Office
Steve Von, Aon Hewitt
Karen K. Wilson, Northrop Grumman

Meeting of the ERS Board of Trustees' Audit Committee

Mr. Craig Hester, Chairman of the Board of Trustees of the Employees Retirement System of Texas (ERS), noting a quorum was present, called the meeting to order and read the following statement:

"A public notice of the Board of Trustees meeting containing all items on the proposed agenda was filed with the Office of the Secretary of State at 10:56 a.m. on Thursday, August 4, 2016 as required by Chapter 551, Texas Government Code, referred to as "The Open Meetings Law."

The Board of Trustees convened as a committee of the whole at 8:00 a.m. to consider Audit Committee agenda items.

I. REVIEW AND APPROVAL OF THE MINUTES TO THE MAY 17, 2016 ERS AUDIT COMMITTEE MEETING

Ms. Cydney Donnell, Audit Committee Chair opened the floor for a motion on the approval of the minutes from the Audit Committee Meeting held May 17, 2016. Mr. Hester recommended two revisions.

MOTION made by Mr. Brian Ragland, seconded by Mr. Doug Danzeiser, and carried unanimously by the present members of the Audit Committee to approve the corrected minutes to the meeting held on May 17, 2016.

II. PRESENTATION, DISCUSSION AND CONSIDERATION OF AUDIT COMMITTEE AGENDA ITEMS:

a. External Audit Reports - Audit Committee Chair Cydney Donnell, introduced ERS Director of Internal Audit Tony Chavez. Mr. Chavez introduced Michael Clayton and Ben Reyfritz with the State Auditor's Office (SAO) to report on their findings from the external audit of the ERS Incentive Compensation Plan for Plan Year 2015, presented in Exhibit A.

Mr. Clayton and Mr. Reyfritz presented some background information on the Incentive Compensation Audit. The audit's objective was to determine whether ERS correctly calculated and paid incentive compensation for Plan Year 2015 in accordance with state policies and procedures. One employee received an overpayment resulting from a miscalculation based on an incorrect date. ERS Internal Audit's work papers were used in conjunction with the SAO audit. The SAO concluded that ERS generally awarded and paid incentive compensation in accordance with its policies and procedures for Plan Year 2015. ERS was rated as a low risk by SAO. After some questions from the board, Ms. Donnell thanked the SAO auditors for their work.

b. Internal Audit Reports - Mr. Chavez introduced Jonathan Puckett, Internal Auditor. Mr. Puckett reported the objective of the Disability Retirement Program audit was to determine if ERS processes disability benefits in accordance with regulatory requirements. The overall assessment of the program

was satisfactory. Observations noted were 1) monitoring activities provide limited assurance for continued participation in the program and 2) follow-up was not performed on information in application packets that may impact eligibility.

Craig Hester, Board Chair, asked about procedures for monitoring the 5% of recipients who live out of state. Mr. Chavez explained current monitoring best practices and the level of risk factors considered. Ms. Donnell noted that the controls are good and this audit would help improve these processes.

Mr. Chavez reported on Quarterly Investment Agreed-Upon Procedures. Nothing unexpected was noted. The procedures and test results are noted in Exhibit B.

Mr. Chavez introduced Beth Gilbert, Internal Auditor, who reported on the Status of Audit Recommendations, Exhibit C. Ms. Gilbert reported that all management action plans were implemented and highlighted the development of a database administration governance document and procedures by the Information Systems Division.

Mr. Chavez reviewed Internal Audit Risk Assessment and the Proposed FY2017 Annual Audit Plan. Mr. Chavez reviewed the development of the risk assessment, including revised risk factors and the audit universe. Internal Audit collaborated with the Board, Executive Management, Senior Management and staff for the proposed FY2017 Annual Audit Plan.

Mr. Porter Wilson, Executive Director, noted the proposed plan is robust and includes contingency audits that anticipate additional audit staff. Both Ms. Donnell and Mr. Hester commended the Internal Audit Plan. Ms. Donnell asked that the audit frequency be included in the Board information.

Ms. Donnell asked for a motion on this action item. Mr. Danzeiser moved that the Board of Trustees approve and adopt the proposed Fiscal Year 2017 ERS Internal Audit Plan as listed in Exhibit A of this agenda item.

MOTION made by Mr. Doug Danzeiser and seconded by Mr. Brian Ragland and carried unanimously by the present members of the Audit committee.

As required by statute, Mr. Chavez reaffirmed the independence of the ERS internal audit function.

III. **EXECUTIVE SESSION** – In accordance with Section 551.076, Texas Government Code, the Audit Committee of the Board of Trustees, a committee of the whole of the Board, will meet in executive session to deliberate: (1) the deployment, or specific occasions for implementation, of security personnel or devices; and (2) a security audit. Thereafter, the Board may consider appropriate action in open session.

At 8:27 a.m. on August 16th, 2016, Craig Hester, Chair of the ERS Board of Trustees, announced the Audit Committee of the Board would meet in executive session in accordance with Section 551.076, Texas Government Code, the Audit Committee of the Board of Trustees, a committee of the whole of the Board, will meet in executive session to deliberate: (1) the deployment, or specific occasions for implementation, of security personnel or devices; and (2) a security audit. Thereafter, the Board may consider appropriate action in open session. The Board recessed for the Executive session and was presented an audit of ERS data security.

After the executive session, at 9:09 a.m. on August 16th, 2016, the Audit Committee of the Board of Trustees reconvened in open session. Mr. Hester stated for the record that no action, decision or vote was taken by the Board in Executive session.

- IV. **ADJOURNMENT OF THE ERS BOARD OF TRUSTEES AUDIT COMMITTEE AND RECESS OF THE BOARD OF TRUSTEES**– Following a temporary recess, the Board of Trustees will reconvene with the Investment Advisory Committee to take up the following Joint Board of Trustees and Investment Advisory Committee agenda items.