



# Audit Committee Meeting Minutes

August 21, 2019



**Presented for Review and Approval**

**December 10, 2019**

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**AUDIT COMMITTEE MEETING  
EMPLOYEES RETIREMENT SYSTEM OF TEXAS  
August 21, 2019  
TRS Board Room, E513  
TRS Building - 1000 Red River Street  
Austin, Texas 78701**

**TRUSTEES PRESENT**

I. Craig Hester, Board Chair  
Ilesa Daniels, Board Vice Chair  
Doug Danzeiser, Member  
Jim Kee, Member  
Catherine Melvin, Member

**ERS DIRECTORS PRESENT**

Porter Wilson, Executive Director  
Cathy Terrell, Deputy Executive Director  
Paula A. Jones, Deputy Executive Director & General Counsel  
William Nail, Special Projects & Policy Advisor  
Jennifer Chambers, Director of Government Relations  
Tony Chavez, Director of Internal Audit  
Bernie Hajovsky, Director of Enterprise Planning Office  
Robin Hardaway, Director of Customer Benefits  
Diana Kongevick, Director of Group Benefits  
Machelle Pharr, Chief Financial Officer  
Gabrielle Schreiber, Director of Procurement and Contract Oversight  
Tom Tull, Chief Investment Officer  
Chuck Turner, Chief Information Officer  
Keith Yawn, Director of Strategic Initiatives

**ERS STAFF PRESENT**

Jason Avants, Information Systems  
Glenna Bowman, Finance  
Kelley Davenport, Executive Office  
Juli Davila, Investments  
Christ Davis, Customer Benefits  
Blaise Duran, Group Benefits  
Tressie Landry, Internal Audit  
Betty Martin, Investments  
Roger Nooner, Benefits Communications  
Karen Norman, Internal Audit  
Aris Oglesby, Investments  
Jonathan Puckett, Internal Audit  
Matt Riemersma, Information Systems  
Susie Ramirez, Executive Office  
Tanna Ridgway, Investments  
Mary Jane Wardlow, Executive Office  
Ariana Whaley, Government Relations

**ALSO PRESENT**

Brian Barth, Texas Department of Transportation  
Elena Diaz, Retired State Employees Association  
Bill Hamilton, Retired State Employees Association  
Kelley Ngaide, State Auditor's Office  
Reema Parappilly, Weaver  
Mallory Sumner, Blue Cross and Blue Shield of Texas

## Meeting of the ERS Board of Trustees' Audit Committee

### 1. CALL TO ORDER

#### 1.1 Call Meeting of the ERS Board of Trustees' Audit Committee to Order

Ms. Catherine Melvin, Chair of the Board of Trustees Audit Committee of the Employees Retirement System of Texas (ERS), noting a quorum was present, called the meeting to order at 8:00 a.m. and read the following statement:

"A public notice of the ERS Board of Trustees Audit Committee meeting containing all items on the proposed agenda was filed with the Office of the Secretary of State at 8:18 a.m. on Monday August 12, 2019, as required by Chapter 551 Texas Government Code, referred to as the Open Meetings Law."

### 2. MINUTES

#### 2.1 Review and Approval of the Minutes to the May 22, 2019 ERS Audit Committee Meeting – (ACTION)

Ms. Melvin opened the floor for a motion on the approval of the minutes from the May 22, 2019 ERS Audit Committee meeting.

**Move** that the ERS Board of Trustees Audit Committee of the Employees Retirement System of Texas approve the minutes to the meeting held on May 22, 2019.

**Motion** by Craig Hester, second by Jim Kee

Final Resolution: Motion Carries

Aye: Craig Hester, Doug Danzeiser, Ilesa Daniels, Catherine Melvin, Jim Kee

### 3. AUDIT ITEMS

#### 3.1 Review of External Audit Reports

Mr. Tony Chavez, Director of Internal Audit, introduced Kelley Ngaide and Hillary Eckford with the State Auditor's Office (SAO) to present their review and audit of the pension and other post-employment benefit schedules. The schedules are separate from the Consolidated Annual Financial Report (CAFR) and are prepared on behalf of other state agencies so they can report their liability.

Ms. Ngaide provided background, reiterating that ERS prepares the schedules in compliance with Government Accounting Board standards, Statements 68 (pension) and 75 (other post-employment benefits (OPEB)). State agencies and institutions of higher education use these schedules prepared by ERS to determine their proportion of the pension and OPEB liabilities. They must recognize that portion on their financial statements.

The SAO issued an unmodified or clean opinion for the Fiscal Year 2018 pension and OPEB schedules.

The SAO also issued a report on internal control and compliance as required by standards. A material weakness was noted in that report due to material errors in the schedule of collective OPEB amounts for both the deferred outflows and deferred inflows of resources. The error was \$7.54 billion, but prior to finalization the error was corrected on the schedules.

Ms. Ngaide concluded her presentation. Mr. Hester sought clarification that the error was corrected prior to the issuance of the schedules and noted that there was confusion in that year with the requirements. Ms. Ngaide stated that one of their recommendations is to ensure the correct table from the actuary report is used to compile the schedules.

Ms. Melvin inquired if the SAO auditors felt that the agency has controls in place to prevent such an error in the future. Ms. Ngaide stated that while they recommended updating procedures to ensure compliance, the control will be tested next year when the audit is performed again.

### 3.2 Review of Internal Audit Reports

Mr. Tony Chavez, Director of Internal Audit informed the board of two completed engagements: Audit of HealthSelect<sup>(SM)</sup> of Texas Contract Management and a Status of Audit Recommendations report. Mr. Chavez introduced Tressie Landry, audit manager, and Karen Norman, audit lead.

Mr. Chavez clarified that the HealthSelect engagement is for the self-insured medical program and does not include the prescription drug program. He noted that page 23 of the included report has a list of related audits, one of which is an audit of the prescription drug program and the procurement process that led to the selection of the current HealthSelect medical program administrator.

Ms. Norman introduced the audit with background information including that HealthSelect of Texas is one of the largest plans with about 428,000 participants and over 70,000 providers in the provider network. This plan is self-funded, which means that the members and state cover the expenses incurred, not an insurance company. ERS does use a third party administrator (TPA) to process claims, oversee the provider network, and provide other services.

The audit objective was to determine if contract management over the plan ensures member benefits are properly delivered. The audit had two scope areas of monitoring activities, or what steps the agency is taking to ensure members are receiving benefits, and from those activities, what information the agency is using to manage performance of the program, or performance management activities. Two observations are included in the report:

- Performance measures have not been established to evaluate, and
- Monitor non-financial effectiveness and improve third-party review procedures to better align with non-financial program risks and objectives

For the first scope area, monitoring activities, controls were in place and working as intended to ensure the TPA is delivering services as contractually required. All activities are compliant with the Texas Procurement and Contract Management Guide and included activities such as meetings, site visits, and performance guarantees, or contracted standards. The key control to ensure the accuracy of the information reported by the TPA is an independent review that is conducted each plan year.

To review the alignment of this program with the agency's strategic direction (as a pyramid), we start at the top with the agency's mission to offer competitive benefits to enhance the lives of its members, which is carried out through the strategic goals related to retirement and benefits offered. One of the largest health benefit plans that the agency manages in order to facilitate the mission is the HealthSelect of Texas plan (81% of eligible participants), which has its own objectives and goals. The bottom of the pyramid would be the operations of the program. Performance measures would be reflected at the strategic level in the program objectives and goals while performance guarantees are reflective of the operational level.

Performance measures and performance guarantees sound very similar, but while both are necessary, they provide very different information. Performance measures focus on the program, track progress towards meeting goals and objectives, and is a good way to inform stakeholders how the program is performing. Performance guarantees focus on the TPA and monitors the contract standards. Performance measures are more strategic while performance guarantees are operational.

Another way to look at the pyramid is addressed in Appendix A or page 14 of the report, which breaks down the strategic crosswalk. There are four columns which list the reporting mechanism and each of the performance measures included in that mechanism. Member satisfaction is the only measure that is consistent across the Legislative Budget Board reports, ERS Strategic Plan, HealthSelect of Texas Goals, and list of performance guarantees. None of the measures are tied directly to the HealthSelect of Texas program goals.

This leads to the first observation – Performance measures are not established. The HealthSelect of Texas program goals are:

- Accessible, high-quality network
- Customer service
- Communications
- Disease management

As stated earlier, no performance measures are linked to the goals to measure the outcome. Ms. Norman stated that she is presenting a deeper review of the goal for an accessible, high-quality network. Accessibility of the network is measured during the TPA or vendor selection process. ERS has accessibility standards for driving distance, which are based on the standards required by the Texas Department of Insurance, but are more stringent. ERS also breaks out the standard between rural and urban areas. These standards were used to evaluate bidders during the vendor selection process, but after the vendor is selected, accessibility is not included in monitoring activities.

Measuring accessibility is not a risk for urban areas, Ms. Norman referred to a table of six geographic areas of the State that were reviewed during the procurement phase. These areas are some of the largest areas of the state, all of which met the accessibility standard; however if you look at two areas, which have similarly sized populations of participants, one area has twice the number of primary care physicians than the other. The higher risk is accessibility during the contract period, questions that should be asked include, what is the relative strength of these regions, and how is it being measured? For example, when we do add providers to the network in an area, was it needed, and how does that impact that area? This also relates to the work by staff in their efforts to expand the network. Without having information on accessibility, it is hard to communicate the work that is performed.

Best practices use two types of measures to measure the quality of a provider network – accessibility, which is driving distance, and adequacy, which is the actual number of providers in an area. These best practices measures include PCP-to-participant ratios, specialists-to-participant ratios, and then geography of participants in how regions may have different needs across the state.

Many things are communicated about the HealthSelect of Texas program, and in the past 12 months strategic initiatives have been presented to the Board of Trustees. Performance Guarantees are presented annually. However, when compared to the goals of the program, it is hard to align the information presented about the program, the work performed by the staff, and the goals of the program.

For example, ERS' strategic plan has measures for participant satisfaction, in-network utilization and condition management. The TPA has provided adequacy and accessibility measure information to ERS throughout the year, but the information is not communicated to all stakeholders and the presentation of the information covers a single year instead of over multiple periods such that the stakeholder could assess the progress of the program in meeting goals and objectives. The graph presented by Ms. Norman showed participant satisfaction (with HealthSelect of Texas) over the past six years. By graphing it over time, the stakeholder can understand how changing the TPA vendor affects the level of satisfaction.

Mr. Kee inquired about the design of the survey. Ms. Norman explained that the survey is sent by the TPA to participants who can volunteer to complete and return it. Ms. Norman was unaware of the exact number of survey responses received, but that it was under 2,500. Mr. Chavez noted that they were not aware of the exact response rate, but the TPA must meet a minimum response rate to meet their performance guarantee.

Ms. Norman discussed the observations and recommendations. The first recommendation is to establish performance measures for the HealthSelect of Texas program, including identifying key program areas that are important and developing key performance indicators for those areas and calculation methodologies. These measures and results should be communicated to stakeholders at a frequency deemed appropriate by management.

The second observation noted improvements needed in the third-party review over the TPA. This review is an agreed-upon-procedures (AUP) engagement. While the engagement is performed under auditing standards, ERS is responsible for assessing risk and deciding which areas to test, developing the procedures the auditor is to perform. Finally, ERS is responsible for formulating a conclusion based

on the auditor's work. This is different from an audit where the auditor is responsible for risk assessment, procedure design, and concluding on the results of work performed. Being responsible for the design of the procedures also means that ERS is responsible for the quality and sufficiency of evidence necessary to gather the results. There was some inconsistency in the review of performance guarantees with some reviewed by the auditor and others not reviewed because the procedures were not clear. Appendix D, page 17, of the report provides a list of all the performance guarantees and which were reviewed by the independent auditors.

The recommendation for the second observation is for management to re-evaluate the purpose and timing of the review by first clarifying its purpose and then ensuring the engagement time matches the assurance level necessary or required by ERS. A risk assessment should be performed with procedures to address the high-risk areas. Management should also look for items that could be performed in-house to make the validation of TPA information more efficient.

Mr. Danzeiser asked if the recommendation for performance measures for the program could be the same as the performance guarantees the agency would want to use to measure the TPA's performance. Mr. Chavez responded yes, but it depends on how management wants the measures to be aligned. The decisions to be made are what do we want to measure, and how do we want to measure that? Performance guarantees are more of a measurement of service delivery. For example, some of the performance guarantees relate to timeliness of report submission, processing, and things of that nature which would measure the performance of the TPA, but not the performance of the program itself. Internal Audit's recommendation is to identify what is important to measure, such as the provider network, and identify how that will be measured. There could be some overlap because some of the performance guarantees could be performance measures, but they should be designated as measures of the program and identified through a collaborative effort between the division management, executive office, and the Board of Trustees.

Mr. Danzeiser asked Mr. Porter Wilson to confirm that staff are going to perform an analysis of any additional performance measures they want to assess. Mr. Wilson confirmed, but stated that he believes the performance guarantees in the contract are appropriate, but there should be a discussion about what information beyond those guarantees should be presented to the Board. There will be a process to go through to identify what kind of data would be useful to convey the success of the program and part of that is input from the Board as what information would be helpful to assess the quality and success of the program.

Mr. Wilson stated that if any of the Board members have feedback or ideas he would be interested in hearing them. He noted that there will be a presentation later in the day on the HealthSelect program in general that will include some ideas already identified. Mr. Wilson went on to state that he believes the information recommended by Internal Audit to be presented to the Board is currently evaluated internally, but is not being presented as overtly as it should be to the Board.

Mr. Danzeiser said that these are difficult things to measure. If you just try to increase the number of providers who are contracted, you are going to have to pay them more to get more contracted and that would increase costs for the program, so you have to balance the number of providers with efficiency and cost to the program.

Ms. Melvin added that something that is fundamentally important to her is ensuring that the interests of vendors, especially primary vendors, are aligned with the goals and objectives of the Board so the things ERS cares about are the things they care about. The interests cannot just be cost containment; it can't be hitting certain numbers to the detriment of other things. Quality is always an elusive thing to try to capture, but as the management team looks deeper to find performance measures they should ensure that they really align to our ultimate outcomes, not just outputs. She inquired about whether this would require a change or amendment to the contract.

Mr. Wilson stated that they could have a conversation with the vendors, in this case Blue Cross and Blue Shield of Texas, about the information reported. In regard to changing any of the performance guarantees, those are contracted terms which would require a change to the contract.

Mr. Danzeiser asked about a chart in the report that appeared to be disputed by the division. Mr. Wilson stated and Ms. Diana Kongevick confirmed that there was a timing difference between when the information was reported to the Legislative Budget Board (LBB). The information was correct, however, there was an update that was not communicated to the LBB. Ms. Kongevick also stated that her division does have performance measures and they intend to add to them and improve them to make them more visible.

Mr. Blaise Duran clarified that the customer satisfaction result reported to the LBB represented about three quarters of the year and that due to the timing of when the LBB performance measure is required to be reported, they reported the information they had at the time. Mr. Duran explained that there is a normal dip in customer satisfaction every time a new TPA is selected and this is reflected in the graph included in the report.

Mr. Kongevick said that less than 1% responded to the customer satisfaction surveys and there are various reasons why that occurs. There was further discussion about the response rate and satisfaction levels. The third quarter of 2019 response rate increased to 6%, which included responses by phone, online and mail. There were about 81,000 contacts sent and about 490 of those were completed. The participants are asked for their satisfaction with the HealthSelect program (81.1%) and the satisfaction with Blue Cross and Blue Shield of Texas (87.2%).

Mr. Chavez clarified that the program did have updated information, but for the audit, and to be consistent, the information reported to the LBB was used to create the graph in the report. In addition, Mr. Chavez stated that the discussion about the trend of customer satisfaction matches the intent of the recommendation. The graph was presented not necessarily to discuss customer satisfaction, but to demonstrate the kind of conversations stakeholders can have when information is presented in a way that shows progress towards results over time.

Ms. Tressie Landry then discussed a second report on the results of a verification of management action plans. She explained that the Internal Audit Office follows up with management on their status of completing management action plans in response to recommendations included in Internal Audit reports. In this cycle, one recommendation was eligible for verification. Management reports the status of their management response on the action plan and Internal Audit reviews the status and limited documentation, asks additional questions and verifies the status. The status levels are categorized as implemented, partially implemented, no action taken or management accepting that risk and taking no further action.

In this period, there was a recommendation from the Benefits Coordinator Training Program Audit and the recommendation was partially implemented. Benefits Coordinators are employees at state agencies that enter hirings, terminations, employee personal information and other employee changes into ERS' online system. The recommendation was that the Group Benefits Division use data they have available to modify training of these coordinators in order to focus the training on questions received from benefits coordinators, making the process more efficient by reducing the number of inquiries they receive. Thus far, the division has identified data elements and automated some data collection and tracking and are currently using that information to target training to coordinators.

Steps outstanding include the creation of report cards for agencies to show the performance level of their benefits coordinators. Completion of this project will require more automated information in order to efficiently create those report cards for the more than 200 agencies. The new deadline is the end of 2019.

The results will be reported again to the Board until the management action plan is either implemented or management has accepted the risk and does not plan to take further action.

### 3.3 Review and Consideration of Audit Administrative Items: Internal Audit's Proposed Fiscal Year 2020 Annual Audit Plan – (ACTION)

Mr. Chavez reviewed the process for creating the Annual Internal Audit Plan. State statute requires a risk based audit plan and the plan is designed to provide coverage over key program risks given the existing staff and approved budget. The plan begins with looking at the areas that can be audited and risk



ranking those areas, then prioritizing the highest ranked areas. Mr. Chavez wanted to highlight some changes to the plan over the past several years:

- The audit universe is no longer based on organizational structure
- Risk criteria has been added that focuses on program risk, not of control failure risk
- The audit universe presentation has been changed from a list format to a graphical format with some new, hierarchical categories started with strategic areas, functional areas and programs
- Color coding of areas covered by previous audits or external audits has been added to the graphical presentation of the audit universe

Mr. Chavez then introduced a heat map to show the agency's highest ranked areas. The ranking is subjective, but it does facilitate conversations with management and Board members to identify the higher prioritized risks. Major inputs into the rankings are the importance of the program to the agency, input from Board members and discussions at Board meetings and other meetings such as the Investment Advisory Committee meetings. Finally, he considers how many hours his staff can dedicate to performing audits and the estimated hours it will take to complete each.

Mr. Chavez presented a historical trend of audit employees' time spent on audit work and administrative work. He noted that administrative work has increased due to a transition of the manager position and will continue to be elevated this year because the office is due for a peer review, which is required by standards every three years, and two solicitations led by Internal Audit. Peer reviews are independent assessments of our quality control program. The last review was led by the Internal Audit Director of the Teacher Retirement System of Texas. The report will be presented to the Board at the December 2019 Audit Committee meeting.

Mr. Danzeiser inquired about the efficiency of the duplication of auditing Incentive Compensation since the State Auditor's Office and Internal Audit performs an audit of it every year. Mr. Chavez reported that there is some overlap between the two audits, but Internal Audit focuses more on the control environment while the State Auditors focus more on the accuracy of the calculations.

The group discussed whether to leave the audit of the Incentive Compensation Plan on the Internal Audit Annual Plan and discussed the possibility that one of the contingency audits (Investment Diversification Limits, Retirement Account Withdrawals or Business Continuity) could be moved to the plan in place of the Incentive Compensation Plan audit, but decided to leave the plan as it was presented and consider changing the plan for 2021.

The Board then took the following action:

**Move** that the ERS Board of Trustees Audit Committee of the Employees Retirement System of Texas approve the Fiscal Year 2020 Internal Audit Annual Plan.

**Motion** by Doug Danzeiser, second by Jim Kee

Final Resolution: Motion Carries

Aye: Craig Hester, Doug Danzeiser, Ilesa Daniels, Jim Kee, Catherine Melvin

### 3.4 Review of Audit Administrative Items: Annual Internal Audit Independence Assessment

Ms. Tressie Landry presented the Annual Internal Audit Independence Assessment. The annual assessment is a requirement of the ERS Internal Audit Charter. Internal Audit is required by Texas Government Code to adhere to professional standards which are the Standards for the Professional Practice of Internal Auditing and the Generally Accepted Government Audit Standards.

The government audit standards provides a framework by which the office reviews their independence, which is performed annually as well as at the beginning of every engagement. Assessments look for threats to independence such as self-interest or self-review. An example of a threat that occurs most often is that an auditor might have a relative working in an area to be audited. Another is avoiding becoming part of management decision-making when providing advisory services.

The results from this year's assessment is that the office has maintained its independence individually and organizationally. In the accompanying report there is a list of safeguards for advisory services for instances identified as areas that might create opportunities to impair independence.

Mr. Danzeiser asked about the percentage of work that is non-audit services and if Mr. Chavez thinks there is too much time spent on non-core audit services. Mr. Chavez responded that in the past year about 90% of Internal Audit's time is spent on audits and 10% on advisory services, which is comparable to other audit offices and in his opinion is an appropriate mix.

Mr. Hester inquired about the sufficiency of the number of staff for the internal audit division. Mr. Chavez reported that he believes he has sufficient staff to execute the annual audit plan without adversely impacting operations.

#### **4. EXECUTIVE SESSION**

4.1 Executive Session – In accordance with Section 551.089, Texas Government Code, the Board of Trustees will meet in executive session to discuss: (1) security assessments or deployments relating to information resources technology; (2) network security information as described by Section 2059.055(b); or (3) the deployment, or specific occasions for implementation, of security personnel, critical infrastructure, or security devices and/or (4) a security audit. Thereafter the Board may consider appropriate action open session.

Mr. Craig Hester stated that is was 9:10 a.m. on August 21, 2019. The ERS Board of Trustees, a committee of the whole (Audit Committee), will meet in executive session in accordance with Section 551.089, Texas Government Code, to discuss: (1) security assessments or deployments relating to information resources technology; (2) network security information as described by Section 2059.055(b); or (3) the deployment, or specific occasions for implementation, of security personnel, critical infrastructure, or security device and/or (4) a security audit. Thereafter, the Board may consider appropriate action in open session.

Upon returning from executive session, Mr. Hester announced it was 10:11 a.m. on August 21, 2019, and the Board is now in open session. No action, decision, or vote was taken by the Board as the Audit Committee while in executive session.

#### **5. ADJOURNMENT**

5.1 Adjournment of the ERS Board of Trustees Audit Committee meeting

The Audit Committee adjourned at 9:30 a.m. on August 21, 2019.

5.2 Recess of the ERS Board of Trustees. Following a temporary recess, the Board of Trustees will reconvene its meeting with the investment Advisory Committee to take up the following Joint Board of Trustees and Investment Advisory Committee agenda items.