



MARCH 2019

AUDIT PLAN FOR 2019 TO 2020

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Chapter 1: Audit Plan for 2019 to 2020

Purpose

The Texas Municipal Retirement System (TMRS) Audit Plan is designed to provide coverage of key risks, given existing staff, contracted external auditors, and approved budget. Internal Audit completed a risk assessment for the purpose of developing the Audit Plan of agency operations, as required by the Institute of Internal Auditors' *Standards*.¹ The Audit Plan incorporates the Board and management's input and risk assessment results. It is designed to provide assurance that management has established internal controls to address identified risks.

TMRS Audit Plan for Fiscal Years 2019 to 2020

The Audit Plan includes various elements, including an internal audit primary and secondary engagement list and other internal audit activities.

- The primary engagement list is internal audits, attestations, and consulting engagements to be completed by internal auditors and a third party professional services firm (see Table 1).
- The secondary engagement list is other audit engagements that may be performed if audit resources become available (see Table 2). That is, if the primary engagement list is completed because audits are completed in less time than anticipated or an audit is delayed or cancelled with Board approval, internal auditors may conduct audits from the secondary engagement list.
- The list of other internal audit activities includes activities that are mandated by professional standards and to maintain certifications, are assigned to Internal Audit in its Charter, or are expected management responsibilities (see Table 3).

Assumptions for the number of engagements and estimated hours in Table 1 includes a two-year audit period, two internal auditors, and assistance from a third-party professional services firm with specialized skills as needed (see Appendix I for more details on how the audit plan was developed).

¹ *International Standards for the Professional Practice of Internal Auditing*, Attribute Standards 1000 and 1010

Audit Plan for 2019 to 2020

Subsequent Changes to Audit Plan

The Board of Trustees, the Internal Audit Committee, and Executive Director will receive periodic status updates on Internal Audit activities. Changes that the Audit Committee deems significant deviations from the Audit Plan will be brought to the Board for approval. Any engagements that are not begun during 2019 will be re-evaluated prior to commencing 2020 engagements.

At the end of the first year, the remaining engagements in this plan will be reviewed to ensure the focus continues to be on the higher risk areas. The Audit Plan may be adjusted as a result of changes in risk, new agency priorities, or to accommodate special requested projects from the Board, the Audit Committee, and Management.

Audit Plan for 2019 to 2020

Table 1: Primary Engagement List for Fiscal Years 2019 to 2020

Topic	Background and Preliminary Scope or Objective	Hours
Risk-based Engagements		
1. Audit of Third-Party Vendor Management	<p>TMRS contracts with multiple third-parties to carry out certain operations, such as printing for annuity checks and member annual statements. In many cases, these vendors are granted access to confidential and/or sensitive information. If the third-party's services become unavailable or they experience a security breach, TMRS could suffer operational and reputational damage.</p> <p><u>Objective:</u> The objective will be to review controls to (1) ensure service disruptions, IT security, data protection, and legal risks are addressed effectively and (2) identify control gaps and areas of improvement.</p>	1,000
2. Audit of Eligible Compensation and Employee Contributions	<p>TMRS employers make contributions to employees' pension fund based on a percentage of employees' qualifying compensation. The TMRS Act defines compensation broadly. In addition to base pay, it can include—but is not limited to—overtime; vacation and sick leave; longevity, certification, and severance pay; employer pick-up of employee contributions to the System; and the cost of benefits furnished under qualified cafeteria plans.</p> <p><u>Objective:</u> The objective will be to determine if information cities report to TMRS on eligible compensation is complete and accurate.</p>	1,000
3. Audit of Overpayments due to Unreported Deaths	<p>Annuity overpayments may occur when a retiree's death is unreported or is not reported timely. Unreported or late death reports may occur due to errors in death master files, gaps in reporting processes, and fraud.</p> <p><u>Objective:</u> The objective will be to review the effectiveness of controls TMRS uses (1) to prevent and detect overpayments and (2) to recoup overpayments and write-off uncollectable payments.</p>	1,200

Audit Plan for 2019 to 2020

Topic	Background and Preliminary Scope or Objective	Hours
4. Audit of Certain Non-Core Fixed Income Investment Management Fees	<p>As TMRS has diversified its portfolio, the associated fees and expenses have grown in complexity. In 2017, Non-Core Fixed Income investments were valued at \$4,631,812,769 and were 16% of TMRS' asset allocation. The investment management fees and incentive fees were reported at about \$32.6 million.</p> <p><u>Objective:</u> Internal Audit will select and monitor a third-party professional services firm with the objective to determine whether selected Non-core Fixed Income fund managers' compensation, fees, and expenses are charged and reported to TMRS in accordance with investment agreements, including side letters and amendments.</p>	Third-party Firm
5. Audit of Private Equity Investment Management Fees	<p>Limited partners (LPs) in private equity funds--such as TMRS--are often unable to get detailed reports on all fees and expenses. This limited transparency hinders LPs' ability to exercise strong oversight over fund managers. In 2017, Private Equity investments were valued at \$286,928,118 and were 1% of the TMRS' asset allocation. The investment management fees and incentive fees were reported at about \$14.3 million.</p> <p><u>Objective:</u> Internal Audit will select and monitor a third-party professional services firm with the objective to determine whether selected fund managers' fees, expenses, and carried interest are charged and reported to TMRS in accordance with limited partnership agreements, including side letters and amendments.</p>	Third-party Firm
6. Advisory Service on Establishing a Compliance Program	<p>TMRS currently does not have an agency-wide Compliance Program. Such a program could help TMRS promote a culture that encourages ethical conduct, a commitment to compliance with laws and other requirements, and exercises due diligence to prevent and detect violations of law. The Strategic Plan the Board adopted December 2017 includes an objective on compliance.</p> <p><u>Objective:</u> Internal Audit will partner with the General Counsel to accomplish the strategic objective to implement a framework for monitoring and managing operational compliance throughout the organization (Goal 3, Objective E).</p>	200

Audit Plan for 2019 to 2020

Topic	Background and Preliminary Scope or Objective	Hours
7. Audit of Beneficiary Designation	<p>TMRS asks members to choose a beneficiary three times: upon first becoming a member, when vested, and when retiring. Beneficiaries receive payments (or refund of member deposits and interest) from retirement accounts and supplemental death benefits (depending on the city's plan) when members or retirees die. Members are also encouraged to update beneficiaries in the event of death, marriage, divorce, and birth of child. When beneficiaries are not designated, payments may be delayed or not paid in accordance with members' wishes.</p> <p><u>Objective:</u> The objective will be to assess the effectiveness of controls to have members designate and update beneficiaries.</p>	850
8. Advisory Service on Establishing an Enterprise Risk Management Framework	<p>TMRS currently has not established an Enterprise Risk Management (ERM) framework to effectively manage risk across the organization. The benefits of ERM include a more risk-focused culture, standardized risk reporting, and efficient use of resources. The Strategic Plan the Board adopted December 2017 includes an objective on risk management.</p> <p><u>Objective:</u> Internal Audit will lead the work toward accomplishing the strategic objective to adopt a framework to monitor and report on organization-wide risk (Goal 3, Objective D).</p>	300
Required by <i>International Standards for the Professional Practice of Internal Auditing (Standards)</i> and the Internal Audit Charter		
9. External Assessment (Peer Review)	<p>An external assessment (or peer reviews) is part of a Quality Assurance and Improvement Program and is required at least once every five years by a qualified, independent assessor from outside the organization.</p> <p><u>Objective:</u> The objective is to evaluate an internal audit activity's conformance with the <i>Standards</i> and the Code of Ethics.</p>	100
10. Audit of Outstanding Recommendations	<p><i>Standards</i> require that a system of monitoring the disposition of prior audit results be established.</p> <p><u>Objective:</u> The objective is to determine the status of outstanding audit recommendations and report whether management actions have been effectively implemented or senior management has accepted the risk of not taking action.</p>	300

Audit Plan for 2019 to 2020

Topic	Background and Preliminary Scope or Objective	Hours
11. Risk Assessment	<p>The internal audit activity's engagement plan must be based on a documented risk assessment, undertaken at least annually.</p> <p><u>Scope:</u> Internal Audit conducts a limited and in-depth risk assessments. After the first year, we will conduct a limited risk assessment to review and adjust the plan, as necessary, in response to changes in TMRS' business, risks, operations, programs, systems, and controls. At the end of the two-year period, we will conduct an in-depth, agency-wide risk assessment and use the results to develop an audit plan for fiscal years 2021 to 2022.</p>	300
12. Audit Plan	<p><u>Objective:</u> Internal audit must establish a risk-based plan to determine the priorities of the internal audit activity, consistent with the organization's goals. The plan and amendments must be approved by the Board.</p>	50
Total Hours		5,300

Table 2: Secondary Engagement List

If Resources are Available, Other Internal Audit Engagements		
Topic	Background and Preliminary Objective	Hours
13. Audit of Custodian Bank's Compliance with Service Level Agreements	<p>In 2017, TMRS upgraded the services its custodian bank (State Street) provides. In March 2019, TMRS finalized the Master Services Level Agreement with State Street. It covers various topics such as reporting, cash flow, and compliance services.</p> <p><u>Objective:</u> Internal Audit will select the higher risk items from the various topics covered in the SLA and determine if the agreed-upon requirements were followed.</p>	800
14. Audit Assessing Contract Administration Practices	<p>TMRS budgeted for about \$10.5 million in professional services and other goods and services (excluding investment management agreements) for 2019. The agency is in the final steps of adopting a formal procurement policy. Obtaining baseline information on the status of contract administration may be beneficial as the policy is implemented.</p> <p><u>Objective:</u> This audit would provide comprehensive information on the number, type, length, and value of contracts; the manner contracts were procured; and recommendations for improving contract administration.</p>	1,000

Audit Plan for 2019 to 2020

Other Internal Audit Activities

Other internal audit activities in Table 3 include activities that are:

- Mandated by professional standards
- Required to maintain professional certifications
- Responsibilities assigned to Internal Audit in its Charter
- Management assignments and expectations

The hours are estimates for two auditors during the two-year period.

Audit Plan for 2019 to 2020

Table 3: Other Internal Audit Activities for Fiscal Year 2019 to 2020

Other Internal Audit Activities		
Activity	Description	Hours
1. Advisory Services	Provide advice and research to Senior Management, departments, and project teams. This includes input on policies and procedures, participation on projects/teams in a non-voting capacity (e.g., monitoring the Project Steering Committee and the Pension Administration System assessment), research on benchmarks and best practices, and training.	450
2. Quality Assurance and Improvement Program	Conduct on-going monitoring and an internal assessment of the department's compliance with professional auditing standards and report results to Internal Audit Committee.	125
3. Board, Internal Audit and Other Committee Meetings	Prepare communications for and monitor Board, Internal Audit and other Committee meetings.	250
4. Professional Development	Complete continuing professional education to maintain certifications and to expand knowledge of public pension plans and investments.	200
5. External Audit Coordination	Provide support to agency staff who are undergoing an external audit, review, or inspection (see Table 4).	225
6. Administrative and Management	Participate in management meetings; submit budgets, time, and expense reports; respond to management requests for department information; and oversee audit staff.	250
7. Internal Audit Vendor Selection and Monitoring	Select qualified vendor(s) to augment staff with specialized skills or to co-source an audit with a vendor and monitor vendor's work product or evaluate vendor's deliverables.	300
Total Other Internal Audit Activities		1,800

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Table 4: External Audit Engagements

External Audit Engagements		
Subject	Description	Vendor
1. Financial Audit	Annual Financial Audit for Years Ending Dec. 31, 2018 and Dec. 31, 2019	CLA
2. System and Organization Controls (SOC)	SOC-1 Report for the Periods May 1, 2018 to April 30, 2019 and May 1, 2019 to April 30, 2020	CLA
3. IT Security	Annual Security Assessment	Securance Consulting
4. Penetration Tests	Quarterly Network Vulnerability Scans	Securance Consulting

Appendix 1: Audit Plan Development

Risk-based Methodology

The Audit Plan was developed using a risk-based methodology that included input from Board members and senior management. Internal Audit identified the TMRS audit universe, conducted a risk assessment that risk ranked potential audit topics, and developed the audit plan for management's, the Internal Audit Committee, and the Board's review (see Figure 1). For more information, see the *2019 Risk Assessment*, Report Number TMRS 19-2.

The Audit Plan assumes that internal staff includes a Director and a Senior Auditor and that contract auditors will supplement internal audit staff as needed. Those engagements to be performed by a third party do not show internal audit hours. Any internal audit staff time to hire and monitor the third party is captured under "other internal audit activities." The number of primary internal audit engagements and associated hours to complete them was estimated based on anticipated resources and the type of audit service as shown in Table 5.

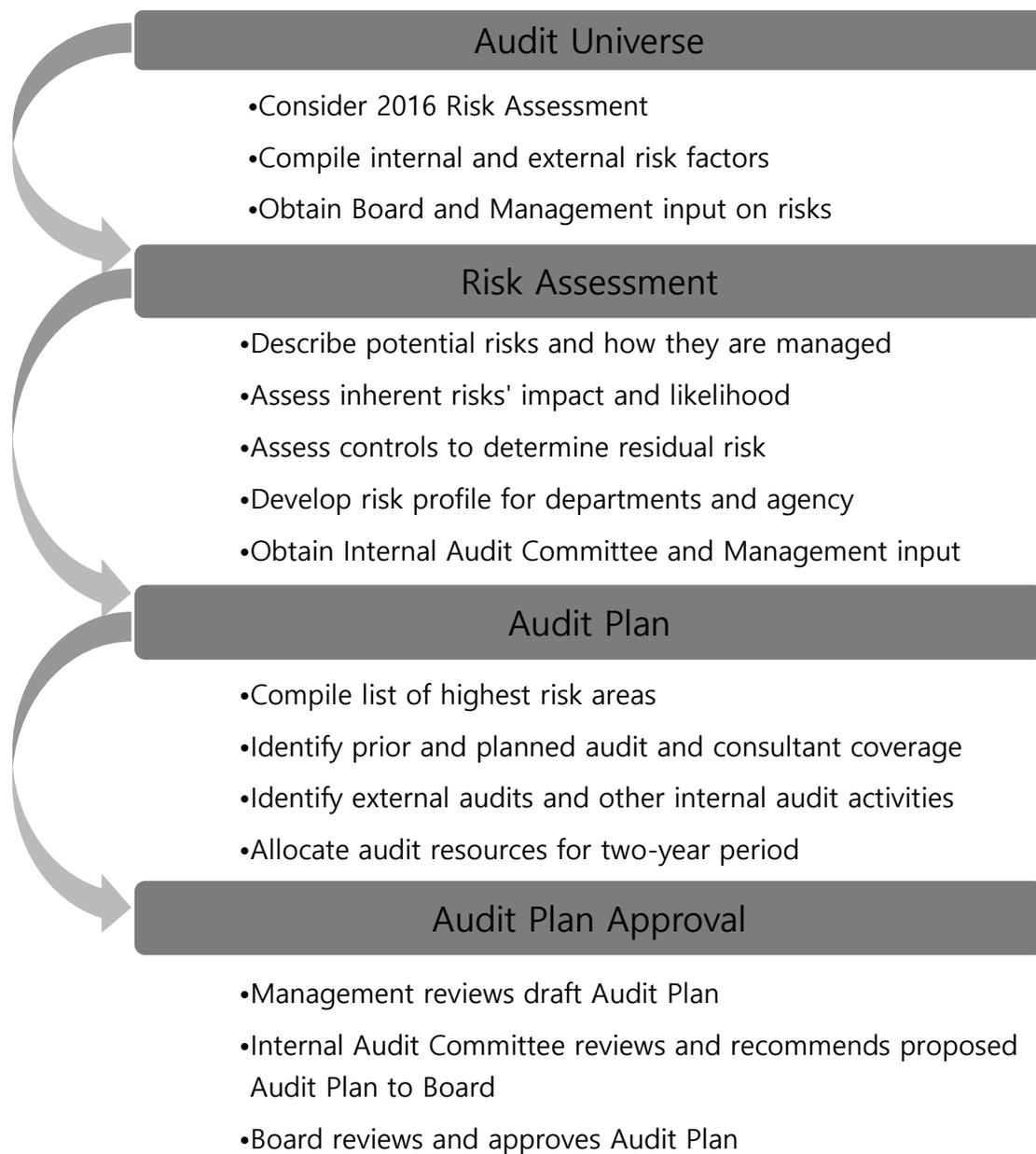
Table 5: Internal Audit Available Hours for 2-year Period²

Resource	Internal Audit Engagements	Other Internal Audit Activities	Subtotal
Director	2,300	1,250	3,550
Senior Auditor	3,000	550	3,550
TOTAL	5,300	1,800	7,100

² Total available hours per internal resources assume a 40-hour workweek and are minus holidays and other leave.

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Figure 1: Audit Plan Development Process ³



³ Inherent risk is the risk that exists before any mitigating factors or controls have been put in place to alter the risk's likelihood or impact. Residual risk is what remains after mitigating factors or controls are put in place.

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Internal Audit Services

Below are descriptions of different audit services and the expected deliverable (see Table 6).

Table 6: Types of Internal Audit Services and Deliverable

Internal Audit Services		
Service	Description	Deliverable
Audit	Objectively examines evidence to opine or conclude on an audit objective, such as the effectiveness of controls and compliance with laws and regulations.	Audit report
Attestation	Determines specific tests with management's input and agreement. An example is an agreed-upon-procedure on whether a required report is accurate and complete.	Attestation report
Advisory (Formal Consulting)	Conducts a formal study or assessment with or without recommendations at the Board or Senior Management's request.	Report, memo, or verbal briefing per requestor's preference
Advisory (Informal)	Provides input on policies and procedures, participates in activities in a non-voting capacity, identifies benchmarks and best practices, provides support on external audit engagements, and develops and conducts training.	Verbal input or brief memo to management
Investigation	Conducts internal investigation of alleged fraud, waste, or abuse at the Internal Audit Committee's request.	Confidential memo to Internal Audit Committee