



March 27, 2019

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Chief Innovation and Human Resource Officer
The University of Texas System Administration
210 West 7th Street
Austin, Texas 78701

JoAnn Townsend
Payroll Supervisor
The University of Texas System Administration
210 West 7th Street
Austin, Texas 78701

Dear Ms. Goonewardene and Ms. Townsend:

We have completed our audit of employer data submitted to the Teacher Retirement System of Texas (TRS). The detailed report is attached for your review.

We conducted our audit in accordance with The Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*.

We will follow up on recommendations made in this report to determine their implementation status. Any requests for extension to the implementation dates require approval from the System Administration Internal Audit Committee. This process will help enhance accountability and ensure that audit recommendations are implemented in a timely manner.

We appreciate the assistance provided by management and other personnel from the Office of Human Resources and the Payroll Office.

Sincerely,

J. Michael Peppers, CPA, CIA, QIAL, CRMA
Chief Audit Executive

cc: Scott Kelley, Ed.D., Executive Vice Chancellor for Business Affairs
Veronica Hinojosa-Segura, Associate Vice Chancellor and Controller
William Huang, Deputy Chief Information Officer
Tamra English, Senior Associate General Counsel & Managing Attorney

**The University of Texas System Administration
Teacher Retirement System Employer Self-Audit Report
FY 2019**



March 2019

**THE UNIVERSITY OF TEXAS SYSTEM AUDIT OFFICE
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**The University of Texas System Audit Office
 Teacher Retirement System Employer Self-Audit
 Fiscal Year 2019**

AUDIT REPORT

March 2019

EXECUTIVE SUMMARY

The Teacher Retirement System of Texas (TRS) is a public pension plan that provides retirement and related benefits to employees of Texas public schools, colleges, and universities. All eligible employees of The University of Texas System Administration (UT System) are automatically enrolled in TRS on their first day of employment. TRS’s pension liability is determined by an annual actuarial valuation that relies on census data collected from participating employers. To help ensure the accuracy of the data, TRS internal audit performs audits of TRS reporting entities and encourages internal auditors of public educational institutions to perform self-audit testing procedures to assist in confirming the completeness and accuracy of the data. While the completion of a self-audit is voluntary, TRS has indicated that proactive and thorough internal audit work may reduce the assessed risk level for TRS reporting entities when TRS internal audit determines which entities to select for audit. The System Audit Office elected to perform this audit as part of the fiscal year (FY) 2019 Audit Plan.

The objective of this audit was to determine the completeness and accuracy of reports and census data submitted to TRS by UT System during FY 2018. To achieve our objective, we performed detailed testing on a sample basis to verify: (1) the eligibility of employees participating in TRS and the Optional Retirement Program (ORP); (2) the accuracy of census data reported to TRS; (3) the accuracy of contributions and surcharges remitted to TRS; and (4) appropriate reporting of contracted entities and individuals that perform duties or provide services that employees would otherwise perform and should be reported to TRS.

Overall, it appears that there are adequate controls in place to ensure that TRS retirees that return to UT System as employees or contractors observe the required break in service; that TRS retirees who provide services as independent contractors are reviewed for appropriate employment classification; and that census data is accurately reported to TRS. However, we identified opportunities to strengthen processes related to (1) monitoring of independent contractors to ensure these individuals are not being treated as employees; (2) evaluating the employment status of individuals who provide contracted services but are not classified as independent contractors; (3) monitoring hourly and temporary employees who work more than half-time to determine whether they should be eligible for TRS and other UT System benefits; (4) ensuring the completeness of active employee contributions and retiree surcharges reported to TRS; and (5) consistently documenting and retaining support for ORP elections. This audit resulted in no Priority Findings, four Medium-level findings, and two Low-level findings¹.

We appreciate the support and assistance provided by the Office of Human Resources, the Payroll Office, and the Office of General Counsel.

J. Michael Peppers, CPA, CIA, QIAL, CRMA
 Chief Audit Executive

Eric J. Polonski, CPA, CIA
 Director of Audits

¹ The UT System Internal Audit finding Classification System includes Priority, High, Medium, or Low-level findings. A Priority Finding is defined as “an issue identified by an internal audit that, if not addressed timely, could directly impact achievement of a strategic or important operational objective of a UT institution or the UT System as a whole.” Non-Priority Findings are ranked as High, Medium, or Low, with the level of significance based on an assessment of applicable Qualitative, Operational Control, and Quantitative risk factors and probability of a negative outcome occurring if the risk is not adequately mitigated.



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BACKGROUND

The Teacher Retirement System of Texas (TRS) is a public pension plan that was established in 1937 to provide retirement and related benefits to employees of Texas public schools, colleges, and universities. The TRS retirement plan is a defined benefit plan governed by Internal Revenue Code Section 401(a). This designation means that retirement benefits paid to members are determined under a formula established by law. All eligible employees of The University of Texas System Administration (UT System) are automatically enrolled in TRS on their first day of employment.

As of fiscal year (FY) 2018, TRS had approximately 1.6 million members and a net position of \$154.6 billion in its Pension Trust Fund. TRS's pension liability is determined by an annual actuarial valuation that relies on census data collected from participating employers. TRS employers submit census data to TRS through the Teacher Retirement Unified System for Technology (TRUST). To help ensure the accuracy of the data, TRS internal audit performs audits to validate the completeness and accuracy of information reported to TRS. In January 2018, TRS internal audit published self-audit testing procedures to encourage internal auditors of Texas public educational institutions to assist in confirming the completeness and accuracy of information reported to TRS. While the completion of a self-audit is voluntary, TRS has indicated that proactive and thorough employer internal audit work may reduce the assessed risk level for TRS reporting entities when TRS internal audit determines which entities to select for audit.

AUDIT OBJECTIVE

The audit objective was to determine the completeness and accuracy of reports and census data submitted to TRS by UT System.

SCOPE

The audit scope was FY 2018 and we selected December 2017 and May 2018 as our test months. UT System also administers an Optional Retirement Program (ORP)², which is a defined contribution plan and available only to employees in positions designated as ORP-eligible. To ensure correct enrollment into either the TRS or ORP retirement plans, testing the eligibility of employees participating in ORP was included as part of this audit.

CRITERIA

Applicable criteria are established in Title 34 of the *Texas Administrative Code*, formal guidance published by TRS, and applicable UT System policies and procedures.

METHODOLOGY

To achieve our objective, we performed detailed testing on a sample basis to:

- Verify the eligibility of active employees participating in the TRS and ORP retirement programs;
- Verify the accuracy of census data reported to TRS;
- Recalculate creditable compensation, contributions, and applicable retiree surcharges; and
- Ensure appropriate reporting of contracted entities or individuals that perform duties or provide services that employees would otherwise perform and should be reported to TRS.

We conducted our audit in accordance with the guidelines set forth in the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*.

² The ORP is authorized by Chapter 830 of the *Texas Government Code* and is governed by Internal Revenue Code Section 403(b).



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AUDIT RESULTS

Employment After Retirement

All TRS retirees must observe a break in service from employment with a TRS-covered employer of one complete calendar month after their retirement date in order to have an effective retirement. After the break in service, the retiree may return to work on a half-time or less basis. If the retiree wishes to work full-time, he or she must observe a break in service of 12 consecutive calendar months following retirement³. Failure to observe an appropriate break in service could result in the retiree revoking their retirement or forfeiting their monthly annuity payment. Effective September 1, 2017⁴, retirees are considered employees during the first 12 consecutive-calendar-months following retirement, if they are performing duties or providing services for a TRS-covered employer that an employee of the institution would otherwise perform, even if the retiree is working as a volunteer or independent contractor.

While TRS retirees who provided services to UT System as employees or contractors during FY 2018 observed the required break in service, we observed instances in which former employees provided contracted services to the same departments for which they previously worked and may have provided services that an employee would otherwise perform. Consequently, we identified opportunities to strengthen processes related to classification and monitoring of retirees who provide contracted services to ensure they do not meet TRS’s definition of “employee.”

Monitoring of Independent Contractors

For independent contractors, the Office of Human Resources (OHR), Office of General Counsel (OGC), and Office of Contracts & Procurement coordinate to develop the scope of work for their respective contracts. However, there is no process in place to monitor the working relationships of the independent contractors with applicable department managers to ensure the independent contractors are being treated as described in agreed upon statements of work and not being treated as employees. This increases the risk that the employment status of these independent contractors could be challenged by TRS, Texas Workforce Commission (TWC), or the Internal Revenue Service (IRS).

The observation described above is considered a **medium-level** finding in accordance with UT System’s Internal Audit finding classification system¹.

Recommendation 1: OHR should work with OGC and Contracts & Procurement to develop policies and procedures for the supervision and monitoring of independent contractors to ensure those contractors are being treated as described in agreed upon statements of work and not being treated as employees.

Management’s Response: *OHR will form a task force to formally establish a comprehensive contractor employment process in compliance with all federal and state requirements. The task force will be comprised of representatives from the UT System OHR, OGC and Office of Contracts & Procurement. The desired outcomes of the task force are implementation of the following: a UT System policy (HOP), process improvement, training resources and an internal communication plan.*

Anticipated Implementation Date: *September 1, 2019*

³ Individuals who retired from TRS prior to January 1, 2011, are not required to observe the 12-month break in service.

⁴ The *Texas Administrative Code* was amended by Senate Bill 1663.



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Employee vs Contractor Classification

OHR, OGC, and Contracts & Procurement also coordinate to evaluate the appropriate classification as employee versus contractor for independent contractors. However, individuals who provide contracted services, but are not classified as independent contractors, do not appear to be subject to similar evaluation, even when those individuals are former employees. This increases the risk that contractors may be incorrectly classified.

The observation described above is considered a **medium-level** finding in accordance with UT System's Internal Audit finding classification system¹.

Recommendation 2: OHR should work with OGC and Contracts & Procurement to develop a consistent procedure for evaluating the employment status of all contractors to facilitate compliance with IRS, TWC, and TRS requirements. This process should incorporate elements of the TWC 20-factor test, include consideration of the TRS retirement status of potential contractors, and be applied consistently to all contractors (including those who provide services through a UT System vendor or UT System institution).

Management's Response: *OHR will form a task force to formally establish a comprehensive contractor employment process in compliance with all federal and state requirements. The task force will be comprised of representatives from the UT System OHR, OGC and Office of Contracts & Procurement. The desired outcomes of the task force are implementation of the following: a UT System policy (HOP), process improvement, training resources and an internal communication plan.*

Anticipated Implementation Date: *September 1, 2019*

Employee After Retirement Reports & TRS Surcharges

TRS employers are required to submit monthly Employment After Retirement (EAR) reports to TRS. In accordance with TRS requirements, the EAR reports must include compensation received and actual hours worked for TRS retirees who worked or received pay during the reporting period. As defined in the Title 34, *Texas Administrative Code*, Chapter 31, when a TRS retiree who retired after September 1, 2005 works more than half-time in the calendar month, the employer is required to pay surcharges to TRS. For FY 2018, the surcharge was 14.5% of compensation earned by the retiree in the reported month.

We identified omissions and inaccuracies in the EAR reports submitted to TRS. Specifically, the EAR report did not include all retirees and did not reflect actual hours worked as recorded on the employees' timesheets. As a result, surcharges remitted to TRS for one employee totaling \$3,489 were not appropriately credited to the employee's account. Additionally, surcharges for two employees were underpaid by \$1,260. The employees' records were initially flagged by TRS as having potential errors and were rejected. UT System then inadvertently omitted the records from the final EAR report.

The observation described above is considered a **medium-level** finding in accordance with UT System's Internal Audit finding classification system¹.

Recommendation 3: The Payroll Office should work with Shared Information Services to ensure that the query used to prepare the EAR report includes all TRS retirees and captures actual hours worked by TRS retirees and ensure that employees are not inadvertently dropped from reports due to TRS kicking back error records. Additionally, UT System should remit any surcharges due to TRS.



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Management's Response: *The Payroll Office will work with Shared Information Services to create a more inclusive query that includes all TRS retirees and all hours worked by TRS retirees. A monthly manual review will prevent TRS retirees being dropped from the report. UT System has remitted all surcharges due to TRS as of 3/25/2019.*

Anticipated Implementation Date: *September 1, 2019*

Active Employees

TRS Eligibility

All employees who meet the following criteria are eligible for TRS membership:

- Work more than half-time (20 hours or more per week)
- Work 4½ months of the year
- Are compensated at a rate comparable to the rate of compensation for other persons employed in similar positions

All active TRS members in our sample met these eligibility requirements. However, we identified two hourly employees classified as ineligible for employee benefits that may have been eligible for TRS membership and other UT System benefits. Currently, OHR monitors time records for hourly employees in order to identify individuals with part-time appointments who consistently work more than 19 hours per week. This monitoring is limited to ensuring compliance with Affordable Care Act (ACA) requirements and is not designed to identify hourly or temporary employees who meet eligibility requirements for TRS and other UT System benefits.

The observation described above is considered a **medium-level** finding in accordance with UT System's Internal Audit finding classification system¹.

Recommendation 4: OHR should develop a process to monitor hourly and temporary employees for TRS eligibility and UT System benefits eligibility, similar to or concurrent with the process currently in place to monitor compliance with the ACA. Any employees who meet eligibility requirements should be offered the opportunity to participate in employee benefits programs.

Management's Response: *Using internal (current ACA process) and external benchmarks (UTShare institutions) OHR will establish processes which will monitor 1) TRS eligibility and 2) UT System benefits eligibility (specifically for classified hourly/wages employees). OHR will need to accurately identify the employee pool to monitor i.e. classified hourly and return to work retirees. Additional consideration will be given to the appropriate methodology for identifying this pool systemically such as modifying job codes. Further consideration will be given to documenting and communicating a formal process to hiring classified hourly employees.*

Anticipated Implementation Date: *September 1, 2019*

Employee Contributions

TRS employers are required to submit monthly Regular Payroll (RP) reports to TRS. In accordance with TRS requirements, the RP report should include the monthly TRS-eligible compensation and retirement contributions of each TRS-eligible employee. Compensation subject to TRS contributions (creditable compensation) includes payments made by an employer to a member for salary or wages. Contribution rates are set annually by the Texas



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legislature. For FY 2018, the member contribution rate was 7.7% and the state contribution rate was 6.8%. The state contribution portion is remitted to TRS by the employer and can be funded from Educational or General Local funds (E&G), non-E&G funds, or Federal or private grant funds. The funding source used for the employer contribution should be the same funding source used to fund the employee's creditable compensation. For the purposes of the RP report, the employer contribution must be classified as New Member (during an employee's first 90 days of TRS membership) or based on funding source (e.g., E&G, non-E&G funds, or Federal/private grant⁵).

UT System accurately reported creditable compensation, member contributions, new member contributions, E&G, and non-E&G contributions. However, the RP report did not include all TRS members. As a result, contributions remitted to TRS for two excluded employees totaling \$1,295 were not appropriately credited to the employees' TRS accounts. The employees' records were initially flagged by TRS as having potential errors and were rejected. UT System then inadvertently omitted the records from the final RP report.

The observation described above is considered a **low-level** finding in accordance with UT System's Internal Audit finding classification system¹.

Recommendation 5: The Payroll Office should work with Shared Information Services to ensure that the query used to prepare the RP report includes all TRS participants and ensure that employees are not inadvertently dropped from reports due to TRS rejecting records with potential errors.

Management's Response: *The Payroll Office will work with Shared Information Services to improve the queries used to prepare RP reports. We will also take advantage of enhanced access to TRS files in order to verify that employees are not inadvertently dropped from reports.*

Anticipated Implementation Date: *September 1, 2019*

Administration of the Optional Retirement Program (ORP)

As defined in UT System's ORP Plan Document, ORP-eligible positions include certain faculty members, specialized professionals, athletic coaches, senior administrators, and other eligible positions. Individuals holding these positions are provided a one-time, irrevocable opportunity to enroll in the ORP in lieu of TRS. This election must be made within 90 days of becoming eligible and is documented on TRS Form 28 - Election to Participate in Optional Retirement Program (TRS Form 28).

All ORP participants for whom we obtained TRS 28 forms, made their elections within the 90-day election period. However, support for ORP elections, including designation of ORP-eligible positions and eligibility of participants at the time of election, was not consistently documented and retained. Additionally, we observed inconsistencies with eligibility and election dates recorded in TRS records and UT System records. Specifically, the dates recorded did not always agree to what was documented on TRS 28 forms.

The observation described above is considered a **low-level** finding in accordance with UT System's Internal Audit finding classification system¹.

⁵ UT System does not fund any employee salaries with federal or private grant funds.



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Recommendation 6: OHR should:

- Develop a process to ensure that ORP-eligible positions are properly designated as such in PeopleSoft and that only ORP-eligible employees enroll in the ORP;
- Retain supporting documentation that enrolled employees were eligible at the time of their election; and
- Develop a consistent process for recording ORP eligibility and election dates in PeopleSoft and reporting those dates to TRS. This process should align with the UT System ORP Plan Document.

Management's Response: *In partnership with Shared Information Services, OHR has recently finalized process design documents specifically named "Complete Candidate Processing." This process design document includes management of ORP-eligible positions and is being applied to a PeopleSoft "modernization" initiative. OHR will create a team to revisit the processes applicable to an ORP-eligible position and will include, but not limited to, review of position management, hiring process (state service verifications), and PeopleSoft entry/documentation in accordance with UT System ORP plan document.*

Anticipated Implementation Date: *September 1, 2019*

Employee Census Data

In accordance with TRS requirements, TRS employers must periodically report census data (including Social Security number, name, date of birth, gender, and hire date) to TRS for all active employees on the Employee Demographic (ED) Report. The UT System submits an annual ED Report including all employees at the beginning of the fiscal year. Any additions (such as new employees) or changes are reported on a monthly basis. Overall, UT System accurately reported census data on the ED Report.