



A Report on

# The Audit of the Teacher Retirement System's Fiscal Year 2021 Financial Statements

December 20, 2021

Members of the Legislative Audit Committee:

In our audit report dated November 19, 2021, we concluded that the Teacher Retirement System's basic financial statements for fiscal year 2021 were materially correct and presented in accordance with accounting principles generally accepted in the United States of America. The System published our audit report as part of its basic financial statements, which it intends to post on its website at [https://www.trs.texas.gov/Pages/about\\_archive\\_cafr.aspx](https://www.trs.texas.gov/Pages/about_archive_cafr.aspx).

We also issued a report on internal control over financial reporting and on compliance and other matters as required by auditing standards (that report, including responses from management, is presented in the attachment to this letter). In that report, auditors determined that the System should update its review processes to help ensure that hedge funds are properly classified as Alternative Investments on the financial statements.

Our procedures were not intended to provide an opinion on internal control over financial reporting or to provide an opinion on compliance with laws and regulations. Accordingly, we do not express an opinion on the effectiveness of the System's internal control over financial reporting or on compliance with laws and regulations.

Auditors communicated certain issues that were not material or significant to the audit objectives in writing to the System's management.

As required by auditing standards, we will also communicate to the System's Board of Trustees certain matters related to the conduct of a financial statement audit.

We appreciate the System's cooperation during this audit. If you have any questions, please contact Hillary Eckford, Audit Manager, or me at (512) 936-9500.

Sincerely,

Lisa R. Collier, CPA, CFE, CIDA  
State Auditor

Attachment

SAO Report No. 22-012

cc: The Honorable Greg Abbott, Governor  
Members of the Teacher Retirement System Board of Trustees  
Mr. Jarvis V. Hollingsworth, Chairman  
Ms. Nanette Sissney, Vice Chair  
Mr. Michael Ball  
Mr. David Corpus  
Mr. John Elliott  
Mr. Christopher Moss  
Mr. James Nance  
Mr. Robert H. Walls  
Mr. Brian Guthrie, Executive Director, Teacher Retirement System



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# Attachment

## Report on Internal Control Over Financial Reporting and on Compliance and Other Matters as Required by Auditing Standards



Lisa R. Collier,  
CPA, CFE, CIDA,  
State Auditor

### Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

#### Independent Auditor's Report

#### Teacher Retirement System Board of Trustees


Mr. Jarvis V. Hollingsworth, Chairman  
Ms. Nanette Sissney, Vice Chair  
Mr. Michael Ball  
Mr. David Corpus  
Mr. John Elliott  
Mr. Christopher Moss  
Mr. James Nance  
Mr. Robert H. Walls

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the major enterprise fund and the aggregate remaining funds information, consisting of the fiduciary funds of the Teacher Retirement System (System), a component unit of the State of Texas, as of and for the year ended August 31, 2021, and the related notes to the financial statements, which collectively comprise the System's basic financial statements and have issued our report thereon dated November 19, 2021.

#### Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the System's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we do not express an opinion on the effectiveness of the System's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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SAO Report No. 22-305

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify a deficiency in internal control described in the accompanying schedule of findings and responses that we consider to be a significant deficiency.

Summary of Findings and Responses
Finding Number
2021-01

#### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the System's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Auditors communicated certain issues that were not material or significant to the audit objectives in writing to the System's management.

#### **System's Response to Findings**

The System's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. The System's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

**Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control over financial reporting or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control over financial reporting and compliance. Accordingly, this communication is not suitable for any other purpose.

Lisa R. Collier, CPA, CFE, CIDA  
State Auditor

November 19, 2021

## Schedule of Findings and Responses

### ***The System Should Strengthen Controls to Help Ensure That Hedge Funds Are Properly Classified as Alternative Investments on the Financial Statements***

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Reference No. 2021-01

#### **Type of Finding: Significant Deficiency**

The Teacher Retirement System (System) should strengthen its process to ensure that hedge funds are properly classified as Alternative Investments on its Annual Comprehensive Financial Report (see text box for information about alternative investments).

Auditor's identified a significant deficiency in controls over financial reporting for the classification of hedge funds on the System's financial statements. Specifically, the System incorrectly classified two hedge funds valued at \$1.3 billion as Pooled Investments when those funds should have been classified as Alternative Investments. As a result, the investment classification for Alternative Investments were understated and Pooled Investments were overstated on the Statement of Fiduciary Net Position.

After auditors brought the error to its attention, the System corrected it before finalizing the annual comprehensive financial report for fiscal year 2021. The error was caused because the System updated its Investment Policy Statement but did not update its review processes to account for the changes made related to hedge funds.

#### **Recommendation**

The System should update its process for reviewing hedge fund investments to help ensure that they are properly classified on its Annual Comprehensive Financial Report.

#### **Alternative Investments**

Alternative Investments include privately held equity; privately held debt; absolute return; hedge funds; energy, natural resources, and infrastructure; private equity; real estate; and risk parity.

Source: Note 3 in the System's Annual Comprehensive Financial Report for Fiscal Year 2021.

### **Management's Response**

*Investment Accounting Section will enhance the current process to identify any potential incorrect investment classifications by reconciling the investment classification information in the compliance testing report from Investment Management Division to those reported in the investment holdings report from the Custodian Bank's accounting system monthly. Investment Accounting Section will also correct any misclassifications accordingly. The target completion date is January 31, 2022.*