OKLAHOMA TEACHERS RETIREMENT SYSTEM

BOARD OF TRUSTEES

SPECIAL MEETING

MARCH 26, 2013

MEETING MATERIALS

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TEACHERS' RETIREMENT SYSTEM OF OKLAHOMA
Special Board Meeting
Tuesday, March 26, 2013 – 11:45 AM
TRS Administration Board Room
2500 N. Lincoln Blvd., 5th Floor, Oklahoma City, OK

AGENDA

1. **ROLL CALL FOR QUORUM**

2. **DISCUSSION AND POSSIBLE ACTION ON AUDIT COMMITTEE REPORT**

3. **DISCUSSION AND POSSIBLE ACTION ON REVIEW AND UPDATE OF OTRS STRATEGIC PLAN**
   A. Board Planning and Development
   B. Processes
   C. Internal Audit
   D. Investments
   E. Legislative

4. **DISCUSSION AND POSSIBLE ACTION ON LEGISLATION AND LEGISLATIVE PROPOSALS**

5. **QUESTIONS AND COMMENTS FROM TRUSTEES**

6. **ADJOURNMENT**

2013 Risk Assessment Results and Proposed Audit Plan

Oklahoma Teachers Retirement System

Stinnett & Associates

MANAGING RISK. IMPROVING PERFORMANCE.

Executive Summary

Using a structured interview approach, Stinnett & Associates met with certain Teachers Retirement System (OTRS) staff members to discuss inherent risks and challenges facing the organization. These discussions involved a detailed exploration of both enterprise and department specific risks. Participants in the risk discussions were as follows:

James Wilbanks *Executive Director*	**Joe Ezzell** *Assistant Executive Director*	**Dixie Moody** *Director of Client Services*	**Rocky Cooper** *Director Information Technology*
Kim Bold *Director of Human Resources*	**Josh Richardson** *Strategic Initiatives & Risk Management*	**Grant Soderberg** *Investment Analyst*	**Becky Wilson** *Executive Assistant*
Debra Plog *Client Services Manager-Information Center*	**Lisa Giles** *Client Services Manager-Communication & Education*	**Debra Schmitt** *Client Services Manager-Retirement Counseling*	**Donna Spurrier** *Business Manager*
Lisa Van Liew *Senior Financial Accountant*	**Gary Trennepohl** *Trustee Chairman*	**James Dickson** *Trustee Vice-Chair*	**Stewart Meyers** *Trustee, Audit Committee Chair*
Beth Kerr *Trustee, Audit Committee Member*	**Roger Gaddis** *Trustee, Audit Committee Member*	**Garrett Morelock** *Cole & Reed, External Auditors*	

Based on these discussions, the following risk assessment analysis report was developed. This report includes:

1) an assessment of inherent risks to OTRS,
2) a ranking of the impact and likelihood of the inherent risks without consideration of internal controls and processes which may currently be in place to mitigate each risk event,
3) a proposed internal audit plan designed to test whether sufficient controls and processes exist at OTRS to mitigate the impact and likelihood of the occurrence of specific risk events.

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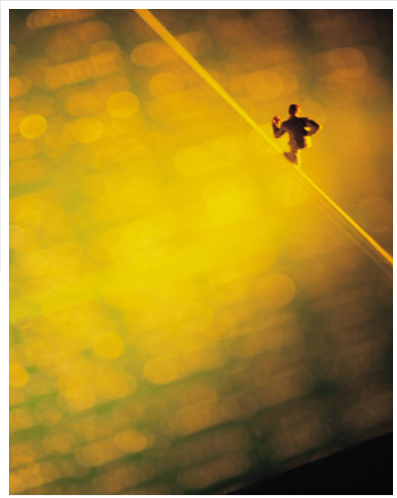
Risk Analysis Results



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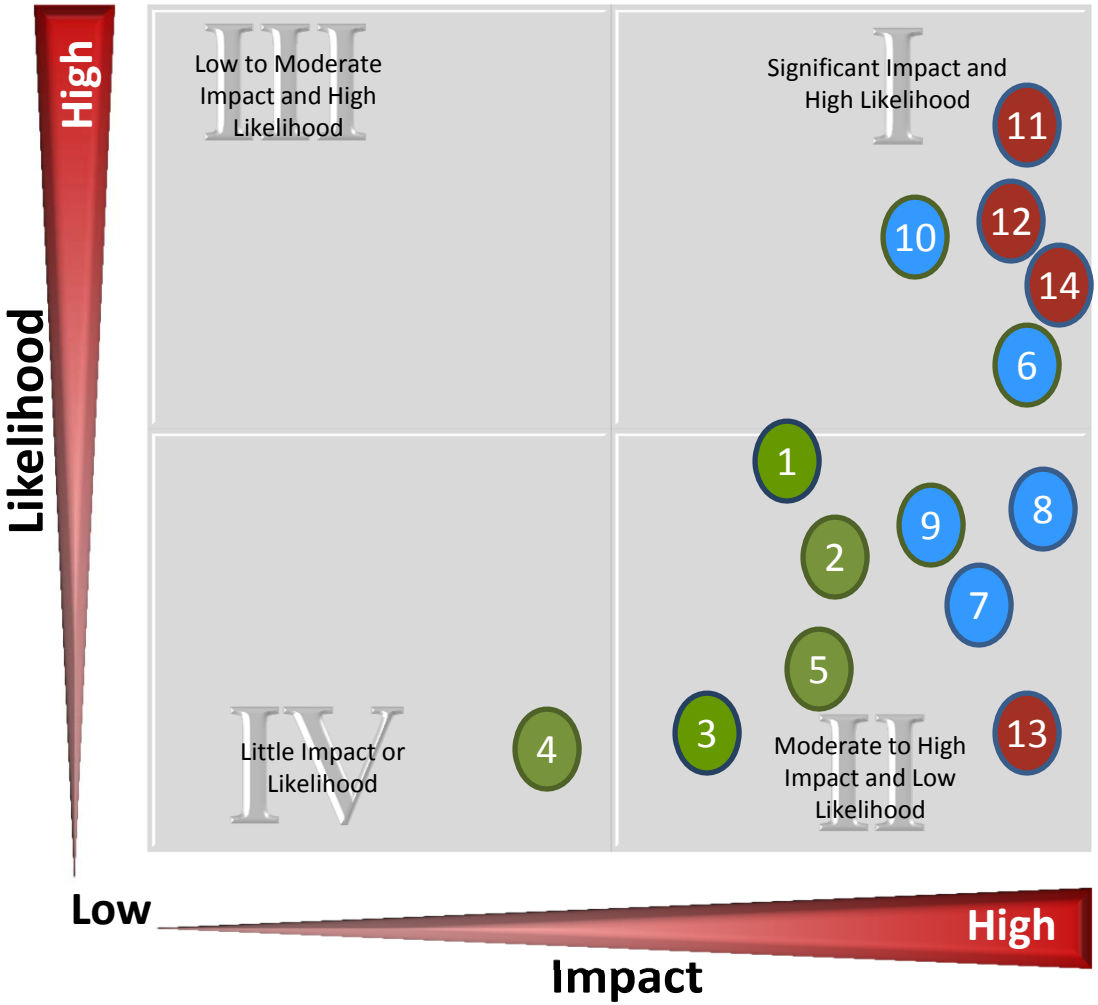
Inherent Risk Rankings-Governance & Strategic Risks



1	Ethical Behavior	Governance
2	Succession Planning	
3	Organizational Culture	
4	Trustee Activities	
5	Trustee Training	
6	Reputation Risk	Strategic – Internal
7	Strategic Partnerships	
8	Business Continuity	
9	Risk Management	
10	Change Initiatives & Transformation	
11	Economic	Strategic – External
12	Client Expectations	
13	Catastrophic Loss	
14	Legislative/Consolidation	

Note: The risk rankings do not consider mitigating internal controls that may be in place.

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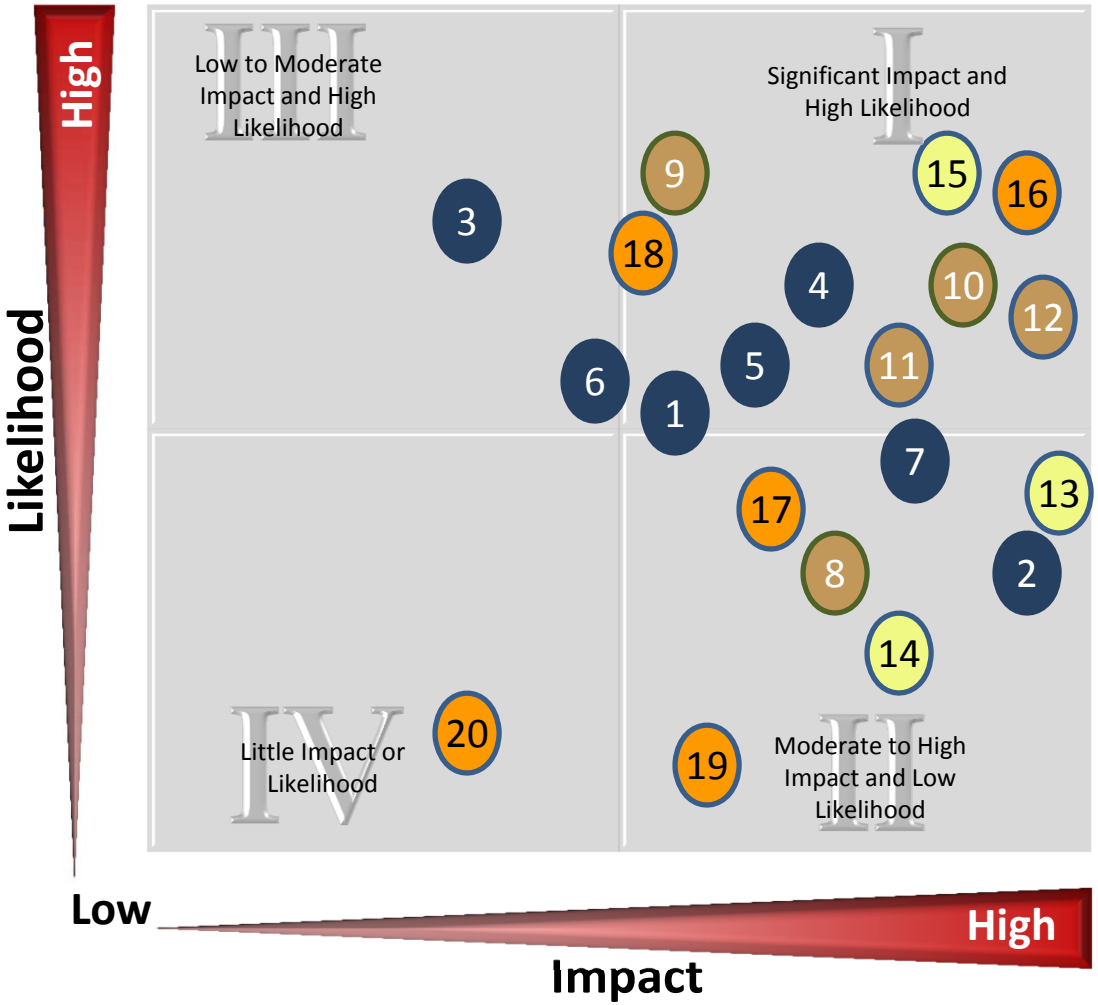
Inherent Risk Rankings – Operational Risks



1	Staff Recruitment & Training	Administrative
2	OTRS Accord	
3	Contracting for Goods & Services	
4	Segregation of Duties	
5	Records Management	
6	Policies & Procedures Compliance	
7	Legal Compliance	
8	Enrollment	Client Services
9	Communication	
10	Benefits	
11	Maintenance of Client Information	
12	Contributions	
13	Legislative Changes	Investment
14	Investment Policy	
15	Monitoring	
16	Information Systems	IT / Finance & Accounting
17	Expenditure Cycle	
18	Financial Reporting	
19	Budgeting	
20	Property, Plant, & Equipment	

Information Systems rankings are based on an aggregate ranking of various sub-risks within the IT risk area.

Note: The risk rankings above do not consider mitigating internal controls that may be in place.

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Inherent Risk Impact Definitions			
Impact	Impact measures the degree of the financial materiality that a process has on OTRS's expenses, investments, contributions received, operations, etc. Operational impact considers the extent to which OTRS operations are disrupted, stakeholder relationships are affected and other similar operational concerns.		
Likelihood	The probability that a risk event will occur during the next 24 months assuming no discretionary resources or controls are in place.		
Risk Area	**Risk Event(s)**	**Potential Risk Event Consequence**	**Inherent Risk Ranking L - M - H**
Strategic Risks			
Reputation	The perception that OTRS is a strong steward of client funds is diminished or OTRS receives negative publicity regarding its business practices.	- Reduced contributions due to legislative changes allowing alternative retirement choices. - Key employees leave the organization. - Legislative changes are introduced aimed at efforts to "consolidate" the State's various retirement plans.	**H**
Strategic Partnerships	Strategic partnerships are not properly managed to take full advantage of resources, competencies, knowledge-sharing, and other opportunities.	- OTRS does not align itself with other similar organizations to aid in making good strategic and economic decisions. - OTRS does not select appropriate "business partners" to help achieve increased investment returns, internal process efficiencies, etc.	**M**
Business Continuity	A business continuity plan is not developed, the plan does not cover all critical processes, or the plan has not been tested.	- OTRS is not able to conduct its operations and maintain its level of service to stakeholders.	**M**
Risk Management	OTRS fails to identify and monitor risks.	- Stakeholder trust and confidence in OTRS management is diminished. - Legislation is enacted that negatively impacts OTRS. - Financial loss - Fraudulent activity occurs.	**M**
Change Initiatives and Transformation	Process, service or IT system improvements are not implemented quickly enough to keep pace with changes in the OTRS operating environment.	- OTRS implementations are not completed in a timely fashion resulting in inefficient operations or a potential disruption of business. - Internal processes are not modified as a result of legislative/OTRS rule changes, IT system implementations, new initiatives, or changes in OTRS organizational structure resulting in inefficient or ineffective operations.	**H**

Risk Definitions & Rankings

Risk Area	Risk Event(s)	Potential Risk Event Consequence	Inherent Risk Ranking L - M - H
Strategic Risks (continued)			
Economic	Significant economic changes, in particular an economic downturn, may result in a reduction in clients, reduced investment returns or other economic effects.	- Hiring at local school districts and other employers is reduced affecting the number of clients participating in OTRS. - Investment returns are reduced.	**H**
Client Expectations	Client expectations are not appropriately managed, resulting in a decline in client confidence.	- Clients lobby for or seek alternative retirement choices reducing participation in OTRS. - Reputation issues result in increased legislative scrutiny or oversight.	**H**
Catastrophic Loss	Inability to sustain operations, provide essential services or products or recover operating costs as a result of a major disaster.	- Infrastructure, applications and/or data are not available in the required time after a disaster to continue operations.	**L**
Legislative / Consolidation	The State's pension systems are consolidated into a single system.	- OTRS in it's present form and structure ceases to exist.	**H**
Governance Risks			
Ethical Behavior	OTRS fails to establish, maintain and execute appropriate policies related to ethics.	-Employees engage in fraudulent activity or unethical, unacceptable behavior.	**M**
Succession Planning	Failure to identify and plan for changes in executive and senior management.	- OTRS is not able to operate in an effective and efficient manner as expected by stakeholders. - Loss of organizational history (i.e. tribal knowledge.)	**M**
Organizational Culture	OTRS fails to establish and maintain a culture that promotes behavior consistent with it's core values, missions and objectives	-Employees engage in fraudulent activity or unethical, unacceptable behavior.	**L**
Trustee Activities	The Trustee's and management fail to actively engage in discussions of strategy and risks or provide appropriate oversight of OTRS activities with integrity and vision.	-OTRS does not achieve its mission or goals.	**L**
Trustee Training	Trustees do not receive adequate training to perform their duties and responsibilities.	- Trustees are not able to fulfill their fiduciary responsibilities. - Statutes or OTRS rules are violated.	**M**
Administrative Risks			
Staff Recruitment and Training	Recruitment efforts fail to attract and identify qualified candidates. Training/mentoring practices do not provide sufficient professional development to ensure competency among all staff.	- Reputation of OTRS is damaged due to poor client perception of staff. - Staff provide inaccurate information to clients and other stakeholders.	**M**
OTRS Accord	Trustees, management, and/or departments do not work together to achieve the OTRS mission.	- Trustee and/or management initiatives or directives are not communicated to staff. - Conflict exist and/or persist among staff.	**M**
Contracting for Goods and Services	Significant contracts are not periodically re-bid. Contracts/Vendors are not adequately monitored to ensure compliance and acceptable service levels.	- The partnership between OTRS and contractor is eroded over time decreasing the effectiveness of services. - OTRS is not receiving the most favorable goods, services, or terms available.	**M**

Risk Definitions & Rankings (continued)

Risk Area	Risk Event(s)	Potential Risk Event Consequence	Inherent Risk Ranking L - M - H
Administrative Risks (continued)			
Segregation of Duties	Duties are not adequately segregated to limit erroneous and inappropriate actions.	- Employees participate in fraudulent or inappropriate transactions or activities. - Client assets are misappropriated.	**H**
Records Management	Records which support compliance requirements, business decisions, or legal filings are not adequately maintained.	- Client records are not adequately maintained or safeguarded. - OTRS reporting is not supported by appropriate documentation. - information is not available to make and/or support business decisions.	**M**
Policies & Procedures Compliance	Documented policies and procedures are not followed or policies and procedures are not documented.	-Failure to comply with or maintain policies and procedures may result in inefficiencies in processes or inaccuracies in reporting of information.	**M**
Legal (Laws & Regulations)	Procedures and/or controls designed to ensure compliance with federal, state or local regulations are not in place.	-Fines, penalties, criminal or civil claims may be levied against the OTRS which may damage the OTRS reputation and cause financial loss.	**M**
Information System Risks			
Access	Inappropriate access to information (data or programs) or systems is granted. Such risk encompasses segregation of duties, integrity of data and databases, and information confidentiality.	- Roles defined within the system create or inherently contain segregation of duties conflicts. - Access to client data is compromised. - A security breach damages the reputation of OTRS.	**H**
Change Management	Inadequate or undocumented change management policies and procedures or the failure to comply with established policies and procedures result in unpredictable activities or results.	-Unauthorized changes to applications or configurations are implemented into production resulting in errors. -Due to lack of sufficient testing, errors or other problems are introduced into production. -System problems negatively impact operations and records-keeping accuracy, reliability, and security.	**H**
IT Governance	IT policies and procedures are not documented, or the IT strategy is not in alignment with OTRS goals and objectives.	- IT is not responsive to the needs of OTRS, diminishing its reputation with OTRS management and stakeholders. - IT is not achieving optimum use of its resources.	**M**
Infrastructure	Effective information technology infrastructure (e.g. hardware, software, networks, personnel and processes) is not maintained to effectively support the current and future needs of OTRS in an efficient, cost-effective and well-controlled fashion.	- Changes to programs are not performed in a controlled matter, resulting in potential errors or inaccuracies in processing. - Physical access and operational controls are inadequately designed, managed, or monitored which results in loss of data or critical processing. - IT is not adequately linked to the business or strategic plans of OTRS to ensure that future planning of resources and tools will meet OTRS needs.	**M**

Risk Definitions & Rankings (continued)

Risk Area	Risk Event(s)	Potential Risk Event Consequence	Inherent Risk Ranking L - M - H
Information System Risks (continued)			
Availability	Information is not available when needed due to loss of communications (cut cables, phone system outage, etc.), loss of basic processing capability (fire, flood, electrical outage) or operational difficulties (disk drive breakdowns, operator errors, etc.)	- Required data or financial information is not available on a timely basis. - Data will be lost and may not be recoverable.	**M**
Backup and Recovery	Routine backups of critical servers, applications, and data are not performed.	-Lost or corrupted critical systems or data cannot be sufficiently restored in a timely manner to support operational needs.	**M**
Integrity	Application systems do not process, summarize or report transactions accurately and completely.	- Client information is not accurately recorded and/or reported. - Data entered into the system is not accurate or is misstated.	**H**
Investment Risks			
Legislative Changes	Overly restrictive limits on the types of assets OTRS owns are enacted. Contribution rates from employers or employees are significantly reduced.	- Investment choices or the amounts available for investment are reduced; thus, diminishing returns.	**M**
Investment Policy	An investment policy is not followed or the policy is not documented.	-Failure to comply with policy may result in poor management of the portfolio leading to poor returns and/or excess risk-taking.	**L**
Monitoring	An investment compliance monitoring program is not in place or is not effective. Failure to perform proper due diligence on investment managers or custodians. Data used in the monitoring function is not accurate, available, or timely. Reconciliations between the external managers and custodian are not performed.	- OITRS is not in compliance with Policy or other requirements and regulations increasing exposure to potential legal or monetary penalties. - Asset managers do not meet OTRS performance expectations or benchmarks. - Results of the compliance monitoring program are not correct. - Lack of reconciliations of investment accounts results in misstated investment balances. - Fraud is perpetrated upon OTRS by investment consultant and/or investment managers.	**H**
Client Service Risks			
Client Enrollment	Inadequate or undocumented policies and procedures or the failure to comply with established policies and procedures result in inaccuracies in enrolling new clients into OTRS.	- Eligible clients are not enrolled or are improperly enrolled. - Ineligible individuals are enrolled.	**M**
Communication	Stakeholders do not receive adequate or timely information about the plan or information provided contains incorrect information. Retirement planning consultants are not properly trained and provide incorrect or inconsistent information to stakeholders.	- Stakeholders make adverse decisions regarding their retirement planning. - Incorrect information misleads Stakeholders and harms the OTRS reputation. - Stakeholders communications are not effective.	**H**

Risk Definitions & Rankings (continued)

Risk Area	Risk Event(s)	Potential Risk Event Consequence	Inherent Risk Ranking L - M - H
Client Service Risks (continued)			
Benefits	An incorrect benefit payment is made due to an incorrect benefit formula or calculation error, or benefits are paid to unauthorized individuals. Service credit is not recorded or is calculated incorrectly. Benefits are not paid or are not paid timely.	- Clients do not receive their full benefit due or OTRS loses funds due to the overpayment of benefits. - Clients encounter financial hardships due to incorrect payments or delayed payments.	**H**
Maintenance of Client Information	Client information is not properly maintained, updated, or safeguarded.	- Clients or their beneficiaries may not receive benefits. - Client information is lost, destroyed, or stolen due to inadequate safeguards or insecure system access. - Client information is lost due to inadequate system back-up.	**M**
Client Contributions	Client contributions from employers are not made or are made incorrectly and these errors are not detected. Client contributions are recorded to the wrong account.	- Clients do not receive their full benefits due. - Client information is entered in the client account incorrectly which produces inaccurate reports and other client information. - OTRS is not adequately funded to pay benefits due to clients.	**H**
Financial & Accounting Risks			
Expenditure Cycle	Inadequate or undocumented policies and procedures or the failure to comply with established policies and procedures result in inaccuracies in recording expenditures of OTRS.	- Inaccurate information is recorded and reported in the OTRS financial statements. - Risk of loss due to fraudulent activities. - Inappropriate expenditures result in inefficient use of funds.	**M**
Financial Reporting	Financial statements and other financial reports are not prepared timely, accurately, or in accordance with GAAP.	- Poor business decisions are made because financial information is not available or is not accurate. -Damaged reputation with clients, Trustees, Legislators, state agencies, and other stakeholders.	**H**
Budgeting	Timely, accurate budgets utilizing appropriate assumptions regarding operations, changes in environment, etc. are not prepared.	-Damaged reputation with clients, Trustees, Legislators, state agencies, and other stakeholders. - Opportunity for long-term success is reduced.	**L**
Property, Plant & Equipment	Inadequate or undocumented policies and procedures or the failure to comply with established policies and procedures result in inaccuracies in recording PP&E of OTRS.	- Unauthorized and inappropriate purchases and sales - Misappropriation of assets - Assets not tracked or physically accounted for - Leases not communicated to accounting and financial reporting or incorrectly classified	**L**

Risk Definitions & Rankings (continued)

Proposed Audit Plan

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MANAGING RISK. IMPROVING PERFORMANCE.

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This chart is intended to illustrate the more direct relationships between planned reviews and certain risks.

Proposed 2013 Proposed Audit Plan (through December 31, 2013)	Ethical Behavior	Organizational Culture	Reputation	Strategic Partnerships	Business Continuity	Risk Management	Client Expectations	Segregation of Duties	Records Management	Policies & Procedures	Client Services	Investments	Information Tech.	Finance & Accounting
Risk Assessment and Audit Plan Development (est. 175 hours)														
Entity Level Controls/Governance Policy Review (est. 300 hours)	✓	✓	✓	✓	✓	✓	✓		✓	✓		✓		✓
IT General Controls and Segregation of Duties (est. 250 hours)					✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Investment Policy and Procedures Review (est. 450 hours)	✓		✓	✓		✓	✓	✓	✓	✓		✓	✓	✓

Relationship of Proposed Plan to Risks

Proposed 2013 Internal Audit Plan

The chart and table below illustrate the proposed audit mix for the 2013 Audit Plan, demonstrating anticipated levels of effort by category. Please see the following slide for the proposed Internal Audit Plans for 2014 and 2015.

2013 Audit Plan	Estimated Hours	Percent to Total
Risk Assessment and Audit Plan Development	175	15%
Operational Reviews	750	64%
Information Technology	250	21%
Total Estimated	1,175	100%

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This chart is intended to illustrate the more direct relationships between planned reviews and certain risks.

	Ethical Behavior	Organizational Culture	Reputation	Strategic Partnerships	Business Continuity	Risk Management	Client Expectations	Segregation of Duties	Records Management	Policies & Procedures	Client Services	Investments	Information Tech.	Finance & Accounting
Proposed 2014 Proposed Audit Plan														
Business Continuity Planning Review			✓	✓	✓	✓	✓		✓	✓	✓		✓	✓
Finance and Accounting Process Review								✓	✓	✓			✓	✓
Review of Employer Reporting and Payment Process			✓	✓		✓	✓		✓	✓	✓			
Follow-up/Implementation Status for Previously Completed Reviews and Recommendations														
Proposed 2015 Proposed Audit Plan														
Spreadsheet Criticality and Control Review						✓		✓	✓	✓	✓		✓	✓
Client Services /Benefit Payments Review	✓		✓	✓		✓	✓		✓	✓	✓			
Fraud Risk Assessment Workshop	✓	✓	✓			✓	✓							
Risk Assessment Update														
Follow-up/Implementation Status for Previously Completed Reviews and Recommendations														