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State Auditor

A Follow-up Audit Report on

**Ethics Policies for Trustee
Investing Practices at
the Employees Retirement
System, the Teacher Retirement
System, and the University of
Texas Investment Management
Company**

April 2013
Report No. 13-030



A Follow-up Audit Report on
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Overall Conclusion

The Employees Retirement System (ERS), the Teacher Retirement System (TRS), and the University of Texas Investment Management Company (UTIMCO) have made progress in implementing recommendations from *An Audit Report on Ethics Policies for Trustee Investing Practices at the Employees Retirement System, the Teacher Retirement System, and the University of Texas Investment Management Company* (State Auditor's Office Report No. 09-031, April 2009).

Of the 47 recommendations in that report, auditors selected 38 for follow-up, including 12 at ERS, 13 at TRS, and 13 at UTIMCO. Auditors identified the following:

- ERS fully or substantially implemented 8 (66 percent) of the 12 recommendations tested. Those recommendations were related to identifying and resolving employees' and contractors' potential conflicts of interest, strengthening processes for monitoring employees' personal securities trades and safeguarding confidential investment information, and conducting employee background checks and annual ethics training.

ERS chose not to implement recommendations related to filing board members' and executive director's financial disclosure statements with the ERS ethics compliance officer, reviewing board members' financial disclosure statements for conflicts of interest, and requiring all employees involved in investment decisions to file financial disclosure statements. Additional information on ERS's implementation of the recommendations is available in Chapter 1.

Background Information

In April 2009, the State Auditor's Office issued *An Audit Report on Ethics Policies for Trustee Investing Practices at the Employees Retirement System, the Teacher Retirement System, and the University of Texas Investment Management Company* (State Auditor's Office Report No. 09-031). Auditors selected recommendations from that report for follow-up based on each entity management's original responses to the recommendations, the entities' subsequent self-reported implementation status and implementation dates, and the level of risk.

Implementation Status Definitions

Fully Implemented - Successful development and use of a process, system, or policy to implement a prior recommendation.

Substantially Implemented - Successful development but inconsistent use of a process, system, or policy to implement a prior recommendation.

Incomplete/Ongoing - Ongoing development of a process, system, or policy to address a prior recommendation.

Not Implemented - Lack of a formal process, system, or policy to address a prior recommendation.

- TRS fully or substantially implemented all 13 recommendations tested. Those recommendations were related to identifying and disclosing board members', employees', and contractors' potential conflicts of interest, strengthening monitoring of employees' personal securities trades, safeguarding confidential investment information, obtaining ethics training, and reporting ethics violations.

TRS considered a recommendation to conduct FBI criminal background checks for job applicants and certain employees, and it substantially implemented that recommendation by enhancing its criminal background checks to include FBI background checks on new employees. Additional information on TRS's implementation of the recommendations is available in Chapter 2.

- UTIMCO fully or substantially implemented 12 (93 percent) of the 13 recommendations tested. Six of those recommendations were related to identifying and resolving employees' and contractors' potential conflicts of interest and safeguarding confidential investment information. UTIMCO also considered and substantially implemented recommendations to verify information that board members and employees disclose, obtain affirmations regarding employees' undisclosed brokerage accounts, and conduct criminal background checks on all job applicants for positions covered by its ethics policies and all existing employees covered by its investment ethics policies. In addition, UTIMCO considered and fully implemented recommendations for enhancing its controls over gifts and travel for which its vendors pay.

UTIMCO did not implement a recommendation to enforce penalties for violations of personal trading policies. Additional information on UTIMCO's implementation of the recommendations is available in Chapter 3.

It is important to note that 11 of the 38 recommendations auditors selected for follow-up were recommendations that had been offered for the entities to consider, rather than to take a specific action. For each of those recommendations, auditors determined whether an entity considered the recommendation, as well as the implementation status of the recommendation. The entities considered each of those recommendations and took action on all of them.

Summary of Management's Response

The entities agreed with the recommendations issued in this follow-up report.

Summary of Information Technology Review

Auditors conducted follow-up work on prior recommendations regarding access to confidential investment information in Bloomberg systems at ERS, TRS, and

UTIMCO. All three entities fully implemented the prior audit recommendations related to the confidential investment information in their Bloomberg systems. However, auditors did not perform a comprehensive review of any of those systems during this follow-up audit.

Summary of Objective, Scope, and Methodology

The objective of this audit was to determine the implementation status of prior State Auditor's Office recommendations and evaluate whether management has taken corrective actions to address selected recommendations in *An Audit Report on Ethics Policies for Trustee Investing Practices at the Employees Retirement System, the Teacher Retirement System, and the University of Texas Investment Management Company* (State Auditor's Office Report No. 09-031, April 2009).

The scope of this audit included reviewing ERS's, TRS's, and UTIMCO's implementation of selected recommendations from the prior audit. Auditors selected 38 of 47 prior recommendations based on responses to those recommendations, each entity's self-reported implementation status, and the level of risk. The 38 recommendations were tested for the time period from September 2009 through August 2012.

The audit methodology included identifying and collecting information on the implementation of selected prior audit recommendations. To determine the implementation status of selected recommendations, auditors conducted interviews, reviewed each entity's ethics policies and procedures, performed selected tests and procedures related to investing practices at each entity, and selected samples using non-statistical sampling methods that cannot be projected to the populations. Auditors were not able to determine whether one source of data—UTIMCO's log of vendor-paid entertainment expenses—was complete because information on actual vendor expenses was not available at UTIMCO. However, auditors reviewed UTIMCO's processes for maintaining that log, including review and approval as described in the prior audit recommendation, and determined that all items on that log were approved in accordance with UTIMCO's policies.

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Detailed Results

Chapter 1

Employees Retirement System

The Employees Retirement System (ERS) fully or substantially implemented 8 (66 percent) of 12 recommendations in *An Audit Report on Ethics Policies at the Employees Retirement System, the Teacher Retirement System, and the University of Texas Investment Management Company* (State Auditor's Office Report No. 09-031, April 2009). Those eight recommendations were related to:

- Identifying and resolving employees' and contractors' potential conflicts of interest.
- Strengthening processes for monitoring employees' personal securities trades and safeguarding confidential investment information.
- Conducting employee background checks and annual ethics training.

ERS chose not to implement four audit recommendations. ERS cited existing statutory protections, functions performed by the Texas Ethics Commission, and the fiduciary loyalty of the board members and executive director for its decision not to implement two recommendations for board members and the executive director to file financial disclosure statements with the ERS ethics compliance officer.

ERS also chose not to implement a recommendation to review board members' financial disclosure statements for conflicts of interest, citing the protections provided by the Texas Ethics Commission's review of those filings. In addition, ERS chose not to implement a recommendation to require all employees involved in investment decisions to file financial disclosure statements because employees annually affirm their compliance with the ERS investment policy and the Chartered Financial Analyst Institute's standards of professional conduct and code of ethics.

While ERS has made progress in implementing a majority of the prior audit recommendations, it should continue its efforts to conduct recurring FBI background checks for all employees covered by its investment ethics policies. ERS considered conducting those checks as the State Auditor's Office had recommended. ERS also modified its background check policies to conduct FBI criminal background checks on applicants for positions covered by its investment ethics policies. ERS chose not to conduct FBI background checks on all employees covered by its ethics policies and not to

conduct recurring FBI background checks on existing employees covered by its investment ethics policies.

Table 1 provides additional details on ERS’s implementation of prior State Auditor’s Office recommendations.

Table 1

Status of Implementation of Prior Audit Recommendations at ERS				
No.	Recommendation	Implementation Status as Reported by ERS	Implementation Status as Determined by Auditors	Auditor Comments
1	ERS should require board members to simultaneously file copies of their financial disclosure statements with both the Texas Ethics Commission and with the ERS ethics compliance officer.	Not Implemented	Not Implemented	In its management responses to the 2009 audit report, ERS stated that it did not plan to implement this recommendation. ERS stated that management did not believe it was necessary for the financial disclosure statements to be filed with the ERS ethics compliance officer because of (1) other protections offered through financial disclosure statements filed with the Texas Ethics Commission, (2) the fiduciary duty of loyalty that board members owe to ERS, and (3) the affirmations regarding conflicts of interest that board members submit. ERS also asserted that it accepts the risk associated with not implementing this recommendation.
2	ERS should regularly review board members’ financial disclosure statements for potential conflicts of interest.	Not Implemented	Not Implemented	In its management responses to the 2009 audit report, ERS stated that it did not plan to implement this recommendation. ERS stated that protections afforded by the Texas Ethics Commission’s review of the annual financial disclosure filings serve to ensure that board members fully disclose any possible issues that might create a conflict of interest. In addition, ERS cited the affirmations regarding conflicts of interest that board members submit. ERS also asserted that it accepts the risk associated with not implementing this recommendation.
3	ERS should require all employees covered by its investment ethics policies to sign annual statements affirming that they have disclosed and received approval for any outside employment or business activities.	Fully Implemented	Fully Implemented	ERS requires all members of its board of trustees and all employees covered by its investment ethics policies to annually affirm that they have disclosed and received approval for any outside employment or business activities. All 6 members of the ERS board of trustees, 7 members of the ERS investment advisory committee, and all 84 employees covered by ERS’s investment ethics policies completed the required affirmations for fiscal year 2013.

Status of Implementation of Prior Audit Recommendations at ERS

No.	Recommendation	Implementation Status as Reported by ERS	Implementation Status as Determined by Auditors	Auditor Comments
4	ERS should require the executive director to file a financial disclosure statement with the ERS ethics compliance officer at the same time that the executive director submits that statement to the Texas Ethics Commission.	Not Implemented	Not Implemented	In its management responses to the 2009 audit report, ERS stated that it did not plan to implement this recommendation. ERS stated that management did not believe it was necessary for the financial disclosure statements to be filed with the ERS ethics compliance officer because of (1) other protections offered through financial disclosure statements filed with the Texas Ethics Commission, (2) the fiduciary duty of loyalty that the executive director owes to ERS, (3) the requirements for the executive director under ERS's investment policies, and (4) an affirmation regarding conflicts that the executive director submits. ERS also asserted that it accepts the risk associated with not implementing this recommendation.
5	ERS should require all employees who are involved in investment decisions to file financial disclosure statements internally.	Not Implemented	Not Implemented	In its management responses to the 2009 audit report, ERS stated that it did not plan to implement this recommendation. ERS stated that management did not believe it was necessary to require all employees involved in investment decisions to file financial disclosure statements internally because of (1) protections offered by the requirements of ERS's investment policies, (2) the Chartered Financial Analyst Institute's standards of professional conduct and code of ethics, and (3) affirmations regarding conflicts of interest that employees submit. ERS also asserted that it accepts the risk associated with not implementing this recommendation.
6	ERS should require employees to annually affirm that they are in compliance with the ERS ethics policy.	Fully Implemented	Substantially Implemented	ERS uses the Chartered Financial Analyst Institute's code of ethics for its ethics policy, and it requires both members of its board of trustees and employees to affirm their compliance with that policy. One (16.67 percent) of the 6 members of the ERS board of trustees did not complete the required affirmation for fiscal year 2012. All 6 members of the board of trustees and all 7 members of the ERS investment advisory committee completed the required affirmations for fiscal year 2013. All 84 employees who were required to do so completed the affirmations for fiscal year 2013.

Status of Implementation of Prior Audit Recommendations at ERS

No.	Recommendation	Implementation Status as Reported by ERS	Implementation Status as Determined by Auditors	Auditor Comments
7	ERS should require employees to sign annual affirmations that they have no conflicts of interest.	Fully Implemented	Substantially Implemented	ERS requires all members of its board of trustees and employees covered by its investment ethics policies to disclose and cure conflicts of interest. One (16.67 percent) of the 6 members of the ERS board of trustees did not complete the required affirmation for fiscal year 2012. All members of the ERS board of trustees completed affirmations for this requirement for fiscal year 2013. All 84 employees who were required to do so completed the affirmations for fiscal year 2013.
8	ERS should consider tracking the receipt and disposal of all prohibited gifts it receives.	Fully Implemented	Considered and Fully Implemented	ERS developed procedures for the receipt and disposal of prohibited gifts. In addition, ERS developed a prohibited gift tracking log that tracks the date a gift was received, the employee who received the gift, a description of the gift, the vendor that provided the gift, and the method and date of disposition. Auditors also met with two employees and verified that both were knowledgeable about ERS's procedures and tracking log for prohibited gifts.
9	ERS should consider requiring an annual statement from employees, as part of the ethics compliance statement, stating that the employees do not have any undisclosed brokerage accounts and that they have not conducted any undisclosed personal securities trades. The ethics policies should clearly state the penalties for conducting personal securities trades without prior disclosure.	Fully Implemented	Considered and Fully Implemented	ERS modified its affirmations to include a requirement that all employees covered by its investment ethics policies annually disclose any brokerage accounts and whether they have conducted any personal securities trades. The affirmations also state the penalties for violations of the ERS investment policies. All 84 employees who were required to do so completed the affirmations for fiscal year 2013.
10	ERS should ensure that all employees with access to confidential trade information are required to comply with its investment ethics policy.	Fully Implemented	Fully Implemented	ERS limits access to confidential trade information through its Bloomberg system. Auditors verified that only employees covered by the ERS investment ethics policies have access to that system. ERS's investment ethics policies require those employees to confirm their compliance with those policies.
11	ERS should consider (1) conducting FBI criminal background checks on all job applicants for positions covered by their ethics policies and (2) conducting recurring FBI criminal background checks on all existing employees covered by their investment ethics policies.	Fully Implemented	Considered and Substantially Implemented	ERS considered this recommendation and modified its background check policies to include FBI criminal background checks on applicants for positions covered by its investment ethics policies. ERS chose not to conduct recurring FBI criminal background checks on all existing employees covered by its investment ethics policies.

Status of Implementation of Prior Audit Recommendations at ERS				
No.	Recommendation	Implementation Status as Reported by ERS	Implementation Status as Determined by Auditors	Auditor Comments
12	ERS should revise its ethics policy to require employees covered by its ethics policy, members of its board of trustees, and members of its investment advisory council to attend annual ethics training.	Fully Implemented	Fully Implemented	ERS modified its standards of conduct to require all employees to take annual ethics training. Auditors reviewed meeting minutes to verify that members of ERS's board of trustees and its investment advisory committee attended ethics workshops or online ethics training in fiscal years 2010 and 2011 as required.

Recommendations

ERS should:

- Require employees to annually affirm that they are in compliance with the ERS ethics policy.
- Require employees to sign annual affirmations that they have no conflicts of interest.

Management's Response from ERS



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INTER-AGENCY MEMORANDUM

To: Kels Farmer
From: Ann S. Bishop
Date: March 27, 2013
Subject: SAO Ethics Policies Follow-up – Management Responses

ANN S. BISHOP
EXECUTIVE DIRECTOR

CHERYL MACBRIDE
CHAIR

BRIAN D. RAGLAND
VICE-CHAIR

BOARD OF TRUSTEES
CYDNEY C. DONNELL
YOLANDA GRIEGO
I. CRAIG HESTER
FREDERICK E. ROWE, JR.

The Employees Retirement System of Texas (ERS) requires covered employees to affirm compliance with ERS ethics policies and conflicts of interest. The controls ERS has implemented include a software solution to record and track all required affirmations. Annually covered employees affirm to the following:

1. **CFA Code of Ethics** - affirmation that the covered employee has received and read the CFA Code of Ethics, and affirms that he/she has acted and will continue to act in compliance with these policies as they apply to the individual. Employees also affirm that they do not know of any actual or perceived personal conflicts of interest. The covered employee is expected to review the CFA Code of Ethics prior to responding to the affirmation because the software requires the employee to open the Code before the affirmation can be completed.
2. **ERS Investment Policy** - affirmation that the covered employee has received and read the ERS Investment Policy, and affirms that he/she has acted and will continue to act in compliance with these policies as they apply to the individual. Employees also affirm that they do not know of any actual or perceived personal conflicts of interest. The covered employee is expected to review the Investment Policy prior to responding to the affirmation because the software requires the employee to open the Policy before the affirmation can be completed.
3. **Insider Trading Policy** – affirmation that covered employees have received and read a copy of, and they certify that they will comply with, the ERS Insider Trading Policy. The ERS Insider Trading Policy relates to prohibiting the use or disclosure of certain material, non-public information by ERS employees and members of the ERS Board and IAC, and describes the potential civil and criminal penalties for violation of the ERS Insider Trading Policy and/or applicable laws. For ERS employees, such penalties also include the full range of disciplinary options available under ERS Personnel Policy and Procedure Manual, up to and including termination. The covered employee is expected to review the Insider Trading Policy prior to responding to the affirmation because the software requires the employee to open the Policy before the affirmation can be completed.

4. **Quarterly Transaction Accounts** – requires the covered employee to identify any brokerage accounts or other accounts in which securities may be traded (a) for themselves, or (b) for which they have indirect beneficial ownership and/or direct influence, control or discretionary authority over the timing of the trade of securities or a derivative on a security. ("Accounts" means all brokerage accounts and 401(k), 403(b), 457, IRA, or similar retirement accounts, but only those for which the covered employee has discretionary authority for any transactions.)
5. **Account Affirmation** – affirmation that the covered employee has disclosed, in accordance with the ERS Investment Policy, all brokerage accounts or other accounts (a) for themselves, or (b) for which they have indirect beneficial ownership and/or direct influence, control or discretionary authority over the timing of the trade of securities or a derivative on a security. ("Accounts" includes all brokerage accounts and 401(k), 403(b), 457, IRA, or similar retirement accounts, but only those for which the covered employee has discretionary authority for any transactions.)
6. **Outside Employment/Business Disclosure** - certification by the covered employee that any outside employment and/or business activities have been previously disclosed to and approved by their supervisor and/or division director. Covered employees further certify that all activities and relationships in which they are involved and have disclosed do not pose any actual or perceived conflict of interest with their service, relationship or employment with ERS. They also attest, under penalties of perjury, that all information provided on outside employment/business activities is complete, accurate, true and correct.
7. **Outside Directorships** – certification by the covered employee that all activities and relationships in which he/she is involved and has disclosed do not pose any actual or perceived conflict of interest with the covered employee's service, relationship or employment, as applicable, with ERS. The employees also attest, under penalties of perjury, that all information provided on outside directorships is complete, accurate, true and correct.

Periodically, affirmation Reports are generated by Internal Audit to identify any outstanding affirmations for completion. As noted in the audit report, for fiscal year 2013, all required individuals completed affirmations in compliance with ERS ethics policies.

Teacher Retirement System

The Teacher Retirement System (TRS) fully or substantially implemented all 13 recommendations that auditors issued to TRS in *An Audit Report on Ethics Policies at the Employees Retirement System, the Teacher Retirement System, and the University of Texas Investment Management Company* (State Auditor's Office Report No. 09-031, April 2009). Those recommendations were related to:

- Identifying and resolving board members', employees', and contractors' potential conflicts of interest.
- Strengthening monitoring of employees' personal securities trades and safeguarding confidential investment information.
- Requiring employees to obtain ethics training and implementing processes for employees to report ethics violations anonymously.

While TRS has fully implemented most prior audit recommendations, it should continue its efforts to improve controls related to conducting FBI criminal background checks on existing employees. TRS considered conducting those checks as the State Auditor's Office had recommended. TRS also modified its background check policies to conduct FBI criminal background checks on final candidates for positions covered by its ethics policies. However, TRS chose not to conduct recurring FBI background checks on all existing employees covered by its investment ethics policies.

Table 2 provides additional details on TRS's implementation of prior State Auditor's Office recommendations.

Table 2

Status of Implementation of Prior Audit Recommendations at TRS				
No.	Recommendation	Implementation Status as Reported by TRS	Implementation Status as Determined by Auditors	Auditor Comments
1	TRS should require board members to simultaneously file copies of their financial disclosure statements with both the Texas Ethics Commission and with the TRS ethics compliance officer.	Fully Implemented	Fully Implemented	TRS's policies and procedures require board members to file copies of financial disclosures with the Texas Ethics Commission and internally with TRS's executive director. All board members submitted financial disclosure statements as required in fiscal year 2012.
2	TRS should regularly review board members' financial disclosure statements for potential conflicts of interest.	Fully Implemented	Fully Implemented	The TRS compliance officer reviewed board members' financial disclosure statements after receiving those statements from the Texas Ethics Commission in August 2012.

Status of Implementation of Prior Audit Recommendations at TRS

No.	Recommendation	Implementation Status as Reported by TRS	Implementation Status as Determined by Auditors	Auditor Comments
3	TRS should require its executive director to file financial disclosure statements with the TRS ethics compliance officer at the same time that the executive director submits those statements to the Texas Ethics Commission.	Fully Implemented	Fully Implemented	TRS's policies and procedures require its executive director to file a financial disclosure statement with the Texas Ethics Commission, the TRS general counsel, and the TRS chief audit executive. The executive director submitted a financial disclosure statement as required in fiscal year 2012.
4	TRS should require all employees who are involved in investment decisions to file financial disclosure statements internally.	Fully Implemented	Fully Implemented	TRS's policies and procedures require employees with fiduciary responsibility to file financial disclosure statements with the executive director. All 53 employees with fiduciary responsibility submitted financial disclosure statements as required in fiscal year 2012.
5	TRS should develop procedures to ensure that it notifies all financial advisors and service providers of the statutory requirement to file an annual conflict of interest disclosure statement. TRS should track submission of these statements to ensure that all financial advisors and service providers comply, and it should consider suspending business activities with service providers that do not submit disclosures by the filing due date.	Fully Implemented	Fully Implemented	TRS has procedures to ensure that it notifies financial advisors and service providers of the statutory requirement to file an annual conflict of interest disclosure statement. TRS tracks submission of those statements to ensure that financial advisors and service providers comply. Auditors verified that all 15 financial advisors and service providers tested submitted disclosures by the due date.
6	TRS should ensure that all individuals working in the investment division are required to comply with the TRS investment ethics policy.	Fully Implemented	Fully Implemented	TRS has policies and procedures that require all TRS employees with fiduciary responsibility and certain contractors to comply with its ethics policies. Auditors reviewed 10 TRS employees and contractors with access to its Bloomberg system (TRS's trading system that contains confidential trade information) in October 2012, and all of them had a signed the ethics policies
7	TRS should consider requiring an annual statement from employees, as part of the ethics compliance statement, stating that the employees do not have any undisclosed brokerage accounts and that they have not conducted any undisclosed personal securities trades. The ethics policies should clearly state the penalties for conducting personal securities trades without prior disclosure.	Fully Implemented	Considered and Fully Implemented	TRS implemented an affirmation that requires employees and certain contractors to annually disclose any brokerage accounts or personal securities trades in accordance with its trading policy. In addition, TRS's trading policies detail sanctions that will be applied to employees who violate those policies. Auditors also verified that all 67 employees and contractors tested submitted disclosures for fiscal year 2012 as required.

Status of Implementation of Prior Audit Recommendations at TRS

No.	Recommendation	Implementation Status as Reported by TRS	Implementation Status as Determined by Auditors	Auditor Comments
8	TRS should consistently enforce penalties for violations of personal trading policies and track verbal warnings given to employees regarding their personal trades.	Fully Implemented	Fully Implemented	TRS implemented trading policies that outline sanctions for personal trading violations. TRS has implemented a tracking spreadsheet that its employees use to record and report possible violations of its trading policies, resolutions, and any associated penalties. TRS asserts that it has not assessed any monetary sanctions or penalties. However, it has investigated potential violations, required individuals involved in less significant violations of its trading policies to acknowledge that a violation has occurred, and required violators to re-read its trading policies.
9	TRS should strengthen access controls by limiting the number of system administrator accounts for the Bloomberg System.	Fully Implemented	Fully Implemented	TRS reduced the number of system administrator accounts on the Bloomberg system from five to three. Auditors reviewed each of those accounts and determined that they were reasonable.
10	TRS should ensure that only individuals who are required to comply with its investment ethics policy have access to confidential trade information.	Fully Implemented	Fully Implemented	TRS implemented trading policies that limit employees' and contractors' access to confidential information related to publicly traded securities. Auditors reviewed 10 user accounts for TRS's Bloomberg system and verified that all 10 users of those accounts had signed TRS's investment ethics policies, which include requirements for confidential trades.
11	TRS should consider (1) conducting FBI criminal background checks on all job applicants for positions covered by its ethics policies and (2) conducting recurring FBI criminal background checks on all existing employees covered by its investment ethics policies.	Fully Implemented	Considered and Substantially Implemented	TRS modified its background check policies to conduct FBI criminal background checks on final candidates for all positions. Auditors reviewed a sample of 13 employees whom TRS hired after January 1, 2011, and verified that TRS had conducted FBI background checks for all 13. However, TRS chose not to institute recurring FBI criminal background checks on all existing employees covered by its investment ethics policies.
12	TRS should revise its ethics policy to require employees covered by its ethics policy and members of its board of trustees to attend annual ethics training.	Fully Implemented	Fully Implemented	TRS changed its ethics policy to require its employees and board members to attend annual ethics training. TRS also has developed a system to track its employees' and board members' completion of online ethics training in accordance with training requirements.
13	TRS should establish and implement a process for employees to report violations of ethics policies anonymously.	Fully Implemented	Fully Implemented	TRS established a process for employees to report fraud, waste, and abuse. That process includes providing an anonymous hotline. Auditors contacted the hotline in September 2012 and verified that it was operational.

Management's Response from TRS



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Brian K. Guthrie
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March 26, 2013

State Auditor's Office
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Subject: Management Response Letter for Follow-up Audit Report on Ethics Policies for Trustee Investing Practices at the Employees Retirement System, the Teacher Retirement System, and the University of Texas Investment Management Company

The State Auditor's Office (SAO) Follow-up Audit Report on Ethics Policies for Trustee Investing Practices at the Employees Retirement System, the Teacher Retirement System, and the University of Texas Investment Management Company confirmed that of the 13 recommendations chosen for this follow-up audit, TRS had fully implemented 12 and substantially implemented one. The recommendation regarding FBI background checks was substantially implemented after the following considerations:

In response to the SAO's recommendation that TRS consider conducting FBI criminal background checks on all job applicants covered by TRS' ethics policies and recurring background checks on existing employees, TRS expanded its background check practices but in a slightly different way than recommended by the SAO. With regard to job applicants, TRS addressed the concerns raised by the SAO and determined that all final job applicants, including current employees applying for another position, must be fingerprinted by DPS and submit to an FBI criminal background check prior to final offer.

With regard to the SAO's recommendation to consider conducting recurring FBI background checks on all existing employees covered by TRS' investment ethics policy, TRS carefully considered the concerns raised by the SAO and the United States Equal Opportunity Employment Commission's guidance on using criminal background checks (see Enforcement Guidance on the Consideration of Arrest and Conviction Records in Employment Decisions Under Title VII of the Civil Rights Act of 1964, as amended, 42 U.S.C. § 2000e et seq.), which guidance urged caution in employers' use of criminal convictions. TRS also considered (1) the fact that longstanding current employees had been screened for Texas convictions, (2) employee morale, (3) TRS' fiduciary obligations, (4) legal risks to TRS, and (5) a survey of other state agencies and pension funds. Balancing these concerns, TRS determined that current employees with a hire or transfer date later than January 1, 2011, would be required to be fingerprinted by DPS and submit to a an FBI criminal background check. Once the fingerprints of all

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current employees with a hire date later than January 1, 2011 and all new hires have been submitted to law enforcement, TRS is notified by DPS and the FBI if one of these employees is arrested for any offense. Additionally, TRS also requires all employees to self-report all arrests or criminal proceedings (other than minor traffic violations) or be subject to disciplinary action. Finally, the TRS executive director has the discretion to order either or both of the DPS and FBI checks on any current employee if he deems it necessary.

TRS has always been diligent about safeguarding the integrity of the work performed by its employees. TRS reached its decisions regarding criminal background checks after carefully balancing a number of concerns. The chosen policy provides the TRS system with greater security while limiting disruptions in the workplace. TRS is grateful to the SAO for highlighting this important issue.

Thank you for this opportunity to respond.

Sincerely,



Brian K. Guthrie
Executive director

BKG:mg

The University of Texas Investment Management Company

The University of Texas Investment Management Company (UTIMCO) has fully or substantially implemented 12 (92 percent) of 13 recommendations selected for follow up from *An Audit Report on Ethics Policies at the Employees Retirement System, the Teacher Retirement System, and the University of Texas Investment Management Company* (State Auditor's Office Report No. 09-031, April 2009). Six of those recommendations were:

- Four recommendations related to identifying and resolving employees' and contractors' potential conflicts of interest.
- Two recommendations related to safeguarding confidential investment information.

UTIMCO fully or substantially implemented six prior audit recommendations that the State Auditor's Office had offered for UTIMCO's consideration. Specifically:

- UTIMCO considered and substantially implemented two recommendations to require its chief compliance officer to verify board members' and employees' financial disclosures. However, it has not developed any formal procedures for that process.
- UTIMCO considered and fully implemented two recommendations for enhancing its controls over gifts and travel for which its vendors pay.
- UTIMCO considered and substantially implemented a recommendation to develop a disclosure form that includes a statement through which employees can certify that they do not have any undisclosed brokerage accounts. However, UTIMCO does not require all employees to complete that form.
- UTIMCO considered and substantially implemented a recommendation to modify its background check procedures to require background checks on all job applicants for positions covered by its ethics policies and all existing employees covered by its investment ethics policies. However, UTIMCO decided not to use FBI criminal background checks as a part of those procedures.

While UTIMCO has made significant progress in implementing a majority of the prior audit recommendations, it did not implement a recommendation to enforce penalties for violations of personal trading policies and track verbal warnings given to employees regarding their personal trades. UTIMCO also has not developed any formal policies or procedures for that recommendation,

and it asserts it has not issued any warnings or penalties since that recommendation was issued.

Table 3 provides additional details on UTIMCO's implementation of prior State Auditor's Office recommendations.

Table 3

Status of Implementation of Prior Audit Recommendations at UTIMCO				
No.	Recommendation	Implementation Status as Reported by UTIMCO	Implementation Status as Determined by Auditors	Auditor Comments
1	UTIMCO should consider regularly reviewing public information to independently verify the completeness of the financial disclosure statements that board members submit.	Fully Implemented	Considered and Substantially Implemented	UTIMCO considered this recommendation and asserted that its chief compliance office would review public information to verify the completeness of board disclosures to the extent practical.
2	UTIMCO ethics compliance officers should consider regularly reviewing public information to independently verify the completeness of the information that employees disclose.	Fully Implemented	Considered and Substantially Implemented	UTIMCO provided evidence that it considered this recommendation and asserted that it would follow this recommendation when practical.
3	UTIMCO should require all employees covered by its investment ethics policies to sign annual statements affirming that they have disclosed and received approval for any outside employment or business activities.	Fully Implemented	Fully Implemented	UTIMCO has implemented a code of ethics that requires employees to annually disclose all outside employment and business activities. Auditors determined that six employees tested had submitted the required annual affirmation statements in 2012. Auditors also determined that two employees tested had obtained approval for outside employment.
4	UTIMCO should develop procedures to ensure that it notifies all financial advisors and service providers of the statutory requirement to file an annual conflict of interest disclosure statement. It should track submission of these statements to ensure that all financial advisors and service providers comply, and it should consider suspending business activities with service providers that do not submit disclosures by the filing due date.	Fully Implemented	Fully Implemented	UTIMCO developed procedures to notify all financial advisors and service providers of the requirement to file an annual conflict of interest disclosure. UTIMCO tracks the submission of these statements and makes follow-up requests as necessary. Auditors selected 15 financial advisors and service providers from UTIMCO's tracking sheet and verified that each one was included on UTIMCO's executive summary for fiscal year 2011. UTIMCO asserted that it considered suspending business activities with service providers that do not submit disclosures by the filing due date, but it has not decided to remove any of them from consideration for future business activities.
5	UTIMCO should consider tracking the receipt and disposal of all prohibited gifts it receives.	Fully Implemented	Considered and Fully Implemented	UTIMCO maintains a tracking log of the prohibited gifts employees received and the method of disposal. Auditors also met with seven UTIMCO employees and verified that each of them was knowledgeable about the prohibited gifts policy and received annual training that covers that policy.

Status of Implementation of Prior Audit Recommendations at UTIMCO

No.	Recommendation	Implementation Status as Reported by UTIMCO	Implementation Status as Determined by Auditors	Auditor Comments
6	UTIMCO should ensure that it distributes its list of restricted securities to all external investment managers.	Fully Implemented	Fully Implemented	UTIMCO maintains a spreadsheet to distribute its list of restricted securities to all applicable external investment managers. Auditors reviewed that spreadsheet in September 2012 and determined that it was distributed to all external investment managers.
7	UTIMCO should review and approve vendor-paid entertainment and establish a specific process for employees to request approval.	Fully Implemented	Fully Implemented	UTIMCO established procedures for its employees to request approval of vendor-paid entertainment. Auditors also reviewed 2 of the 19 travel approval forms that UTIMCO employees submitted in fiscal year 2012 and determined that both of them included vendor-paid entertainment requests that UTIMCO's chief executive officer reviewed and approved.
8	UTIMCO should consider including on its travel approval form a list of all expenses, including entertainment expenses, that will be paid for by a third party.	Fully Implemented	Considered and Fully Implemented	UTIMCO added a section to its travel approval form that lists all anticipated expenses, including entertainment expenses, for which a third party will pay.
9	UTIMCO should consider requiring an annual statement from employees, as part of the ethics compliance statement, stating that the employees do not have any undisclosed brokerage accounts and that they have not conducted any undisclosed personal securities trades. The ethics policies should clearly state the penalties for conducting personal securities trades without prior disclosure.	Fully Implemented	Considered and Substantially Implemented	UTIMCO developed a disclosure form that includes a statement that enables employees to certify they have no undisclosed brokerage accounts.
10	UTIMCO should consistently enforce penalties for violations of personal trading policies and track verbal warnings given to employees regarding their personal trades.	Fully Implemented	Not Implemented	UTIMCO asserted that it has not issued any warnings or penalties for violations of personal trading policies. However, it has not developed formal policies, procedures, or logs to track penalties and violations. Therefore, a risk continues to exist that UTIMCO may not consistently enforce penalties for violations of its personal trading policies.
11	UTIMCO should strengthen access controls by limiting the number of system administrator accounts for the Bloomberg System.	Fully Implemented	Fully Implemented	Auditors reviewed access to UTIMCO's Bloomberg system and determined that all five system administrator accounts were appropriately assigned. In addition, UTIMCO has implemented a system of administrator accounts for the Bloomberg system that are not shared.
12	UTIMCO should prohibit the use of shared accounts for the Bloomberg System.	Fully Implemented	Fully Implemented	Auditors reviewed accounts with administrator access to UTIMCO's Bloomberg system and determined they were not shared accounts.

Status of Implementation of Prior Audit Recommendations at UTIMCO

No.	Recommendation	Implementation Status as Reported by UTIMCO	Implementation Status as Determined by Auditors	Auditor Comments
13	UTIMCO should consider (1) conducting FBI criminal background checks on all job applicants for positions covered by its ethics policies and (2) conducting recurring FBI criminal background checks on all existing employees covered by its investment ethics policies.	Fully Implemented	Considered and Substantially Implemented	UTIMCO has procedures that require background checks on all existing employees and prospective employees who are expected to receive offers of employment.

Recommendation

UTIMCO should consistently enforce penalties for violations of personal trading policies and track verbal warnings given to employees regarding their personal trades, or document its decision not to implement this recommendation.

Management's Response from UTIMCO



Bruce Zimmerman
CEO and Chief Investment Officer

March 27, 2013

Mr. John Keel, CPA
State Auditor
State Auditor's Office
P.O. Box 12067
Austin, Texas 78711-2067

Subject: Management's Responses to A Follow-up report on Ethics Policies for Trustee Investing Practices at the Employees Retirement System, the Teacher Retirement System, and The University of Texas Investment Management Company

Dear Mr. Keel:

Thank you for the opportunity to provide management's responses to the follow-up report on recommendations made by your office resulting from the audit of UTIMCO's Ethics Policies for Trustee Investing Practices. The following UTIMCO Management's Responses tracks the draft copy of the Audit Report provided by your office to UTIMCO:

Recommendation

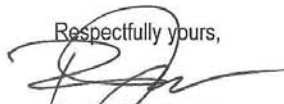
UTIMCO should consistently enforce penalties for violations of personal trading policies and track verbal warnings given to employees regarding their personal trades, or document its decision not to implement this recommendation.

Management's Response

UTIMCO continues to believe that it has consistently enforced penalties for violations of personal trading policies. UTIMCO does recognize, however, the State Auditor's concerns about the lack of a formal policy, procedures, or logs to track penalties and violations. Therefore, UTIMCO has drafted and will implement a written procedure, including the development of a log to track penalties and violations (see draft attached as Exhibit A).

Regarding the other four items the State Auditor believed that UTIMCO had substantially but not fully implemented, UTIMCO has drafted and will implement a written procedure to satisfy full implementation for items 1 and 2, amend its Ethics Compliance Statements for Employees and Key Employees in order to fully implement item 9; and further explore requiring FBI background checks for all employees to determine whether it is appropriate and consistent with our business requirements. Please see the draft of the procedure and statements attached as Exhibit B.

Respectfully yours,



Bruce Zimmerman

Tel 512-225-1600 • Fax 512-225-1680 • 401 Congress Avenue, Suite 2800 • Austin, TX 78701

THE UNIVERSITY OF TEXAS INVESTMENT MANAGEMENT COMPANY

EXHIBIT A

**The University of Texas Investment Management Company
Employee Securities Transaction Violations Procedure**

Effective Date of Procedure: April 1, 2013

The University of Texas Investment Management Company's (UTIMCO's) Code of Ethics (Code) holds all employees to high standards of conduct consistent with their special relationship of trust, confidence, and responsibility to UTIMCO. The Code anticipates that many UTIMCO employees will be active investors, either individually or on behalf of others, in the same asset categories as the funds managed by UTIMCO and only prohibits such investments to the extent necessary or appropriate to avoid conflicts of interest or otherwise conform to applicable law.

Purpose: The purpose of this Procedure is to formulate guidelines for consistent enforcement of penalties for violations of personal trading policies and track verbal warnings and penalties given to employees regarding their personal trades.

Reporting: On a quarterly basis, the Chief Compliance Officer or her designee (CCO) will accumulate and report to the CEO and Chief Investment Officer all violations of the Code with respect to preclearance of securities transactions.

Guidelines: The following table sets forth the warnings and penalties that UTIMCO will normally apply to the violations of the preclearance of securities transactions procedures described in the Code. The CEO and Chief Investment Officer (or CCO, when applicable) may decline to impose a warning or penalty or impose a lesser penalty. The CCO will document all warnings and penalties issued.

Description	Warning or Penalty
1. Isolated, inadvertent failure to comply with the preclearance of securities transactions procedures	CCO may issue verbal warning
2. Repeated, inadvertent failure to comply with the preclearance of securities transactions procedures	CCO will issue verbal warning; CEO and Chief Investment Officer may issue warning
3. Repeated failure to comply with the preclearance of securities transactions procedures	CCO will issue verbal warning; CEO and Chief Investment Officer will issue warning
4. Intentional violations of preclearance of securities transactions procedures; front running; and/or insider trading.	CEO and Chief Investment Officer will issue written warning; CEO may terminate employee; CEO will notify Board Chair and Audit and Ethics Committee Chair

Notwithstanding the warnings and penalties set forth above, any employee who violates the Code may be subject to the full range of disciplinary options under UTIMCO personnel policies and practices, including termination.

Compliance: Compliance with this Procedure will be monitored by UTIMCO's Chief Compliance Officer.

EXHIBIT B



UTIMCO ETHICS COMPLIANCE STATEMENT

The UTIMCO Code of Ethics, (the "Code"), requires that all directors and employees, including acting or interim employees, execute an ethics compliance statement on or before April 30 of each year, and within thirty days of their appointment or employment.

I hereby certify that:

- A. I have received and read a copy of the Code;
- B. I will comply with the provisions of the Code;
- C. Adherence to the Code is a condition of employment;
- D. It is my duty to disclose any conflicts of interest or violations of the Code of which I am aware;
- E. It is my duty to report any act by other directors or employees when I have knowledge of violations of the Code;
- F. To the best of my knowledge, I have not violated any provision of the Code nor am I aware of any conflicts of interest or violations of the Code, except as otherwise disclosed previously to the UTIMCO Ethics Committee or Audit and Ethics Committee of the Board;
- G. In the event that I intend to acquire a pecuniary interest (as defined by the UTIMCO Code of Ethics, Section 1.02(12)(A)-(C)) in a publicly traded company, I will confirm with UTIMCO's Chief Compliance Officer prior to that acquisition that UTIMCO has no interest in that company that would pose a conflict of interest for me;
- H. I have disclosed to UTIMCO all brokerage transactions in all accounts held in my name, my spouse's name, my minor children's and other dependent relative's names, including IRA accounts, and any other brokerage accounts I control; and
- I. I will update my financial disclosure statement if a change in circumstances occurs that requires reporting under the Code.

Signature: _____ Date: _____

Print: _____

UTIMCO 03/27/13



UTIMCO ETHICS COMPLIANCE STATEMENT

The UTIMCO Code of Ethics, (the "Code"), requires that all directors and employees, including acting or interim employees, execute an ethics compliance statement on or before April 30 of each year, and within thirty days of their appointment or employment.

I hereby certify that:

- A. I am a Key Employee of the Corporation;
- B. I have received and read a copy of the Code;
- C. I will comply with the provisions of the Code;
- D. Adherence to the Code is a condition of employment;
- E. It is my duty to disclose any conflicts of interest or violations of the Code of which I am aware;
- F. It is my duty to report any act by other directors or employees when I have knowledge of violations of the Code;
- G. To the best of my knowledge, I have not violated any provision of the Code nor am I aware of any conflicts of interest or violations of the Code, except as otherwise disclosed previously to the UTIMCO Ethics Committee or Audit and Ethics Committee of the Board;
- H. In the event that I intend to acquire a pecuniary interest (as defined by the UTIMCO Code of Ethics, Section 1.02(12)(A)-(C)) in a publicly traded company, I will confirm with UTIMCO's Chief Compliance Officer prior to that acquisition that UTIMCO has no interest in that company that would pose a conflict of interest for me;
- I. I have disclosed to UTIMCO all brokerage transactions in all accounts held in my name, my spouse's name, my minor children's and other dependent relative's names, including IRA accounts, and any other brokerage accounts I control; and
- J. I will update my financial disclosure statement if a change in circumstances occurs that requires reporting under the Code.

Signature: _____ Date: _____

Print: _____

UTIMCO 03/27/13

**The University of Texas Investment Management Company
Financial Disclosure Statement Review Procedure**

Effective Date of Procedure: April 1, 2013

The University of Texas Investment Management Company's (UTIMCO's) Code of Ethics (Code) holds all employees to high standards of conduct consistent with their special relationship of trust, confidence, and responsibility to UTIMCO. The Code anticipates that many UTIMCO employees will be active investors, either individually or on behalf of others, in the same asset categories as the funds managed by UTIMCO and only prohibits such investments to the extent necessary or appropriate to avoid conflicts of interest or otherwise conform to applicable law.

Purpose: The purpose of this Procedure is to formulate guidelines for consistent review of public information to independently verify the completeness of the financial disclosure statements that directors and key employees (as defined in the UTIMCO Code of Ethics) submit.

Guidelines: Directors and employees are required to file financial disclosure statements with the Chief Compliance Officer within 30 days of appointment and employment, respectively, and on an annual basis by April 30th. Directors are permitted to request an additional extension of time to file their financial disclosure statements from the CEO and Chief Investment Officer. In order to ensure the completeness of the statements as filed, within 90 days after the deadline for filing the statements, the Chief Compliance Officer will review and gather information from public sources, such as EDGAR and the Secretary of State, and compare the information gathered with the financial disclosure statements on file for directors and key employees. Differences between reported and gathered information will be reported to the CEO and Chief Investment Officer. Updated financial disclosure statements will be requested as necessary.

Compliance: Compliance with this Procedure will be monitored by UTIMCO's CEO and Chief Investment Officer.

Appendices

Appendix 1

Objective, Scope, and Methodology

Objective

The objective of this audit was to determine the implementation status of prior State Auditor's Office recommendations and evaluate whether management has taken corrective actions to address selected recommendations in *An Audit Report on Ethics Policies for Trustee Investing Practices at the Employees Retirement System, the Teacher Retirement System, and the University of Texas Investment Management Company* (State Auditor's Office Report No. 09-031, April 2009).

Scope

The scope of this audit included reviewing the Employees Retirement System's (ERS), the Teacher Retirement System's (TRS), and the University of Texas Investment Management Company's (UTIMCO) implementation of selected recommendations from the prior audit. Auditors selected 38 of 47 prior recommendations based on responses to those recommendations, each entity's self-reported implementation status, and the level of risk. The 38 recommendations were tested for the time period from September 2010 through October 2012.

Methodology

The audit methodology included identifying and collecting information on the implementation of selected prior audit recommendations. To determine the implementation status of selected recommendations, auditors conducted interviews, reviewed each entity's ethics policies and procedures, and performed selected tests and procedures related to investing practices at each entity. Auditors selected the following samples:

- At ERS, auditors sampled employees' outside employment and directorship disclosures, employees' ethics policy affirmations, employees' conflict of interest affirmations, and investment employees' trading account affirmations.
- At TRS, auditors sampled board members' financial disclosures, key employees' financial disclosure statements, providers' submission of conflict of interest disclosures, contractors' and key employees' submission of ethics policy affirmations, employees' trading account disclosures, and background checks performed on hired employees.

- At UTIMCO, auditors sampled employees' outside employment disclosures, financial advisors' and service providers' conflict of interest disclosures, and entertainment expenses paid by vendors.

Auditors used non-statistical sampling methods to select the samples. The results from the samples selected are not intended to be projected to the entire population.

Auditors assessed the reliability of each entity's data by (1) reconciling populations of affirmations and disclosures with employee listings at ERS, TRS, and UTIMCO; (2) reviewing access to key investing systems at TRS and UTIMCO; (3) interviewing staff to verify that they were knowledgeable of the use of logs and related procedures for tracking the receipt and disposal of prohibited gifts at ERS and UTIMCO; (4) reconciling provider conflict of interest notifications with disclosure submissions at UTIMCO; (5) verifying the total number of brokers and advisors at TRS with internal reports; and (6) reconciling restricted security notifications with UTIMCO's list of providers.

Auditors were not able to determine whether UTIMCO's log of vendor-paid entertainment expenses was complete because information on actual vendor expenses was not available at UTIMCO. However, auditors reviewed UTIMCO's processes for maintaining that log, including review and approval as described in the prior audit recommendation, and determined that all items on the log were approved in accordance with UTIMCO's policies.

Information collected and reviewed included the following:

- *An Audit Report on Ethics Policies for Trustee Investing Practices at the Employees Retirement System, the Teacher Retirement System, and the University of Texas Investment Management Company* (State Auditor's Office Report No. 09-031, April 2009) and supporting working papers.
- Investment ethics policies at ERS and TRS.
- Employee ethics policies at ERS, TRS, and UTIMCO.
- ERS covered employee policy affirmation reports.
- ERS board of trustees and investment advisory committee policy affirmation reports.
- Tracking receipt gift logs at ERS and UTIMCO.
- Listing of Bloomberg system user accounts at ERS, TRS, and UTIMCO.
- Criminal background check policies at ERS, TRS, and UTIMCO.

- TRS board member, executive director, key employee, and contractor disclosure statements.
- TRS code of ethics for contractors.
- TRS trading policy for employees and certain contractors.
- TRS personal trading violations report.
- TRS board of trustees ethics policies.
- TRS fraud, waste, and abuse policy.
- UTIMCO employee outside employment affirmations.
- UTIMCO financial advisor and service provider notifications and disclosure report.
- UTIMCO travel approval and reconciliation detail forms.
- UTIMCO transactional disclosure form.

Procedures and tests conducted included the following:

- Interviewed personnel at ERS, TRS, and UTIMCO.
- Reconciled ERS covered employees with affirmation reports for outside employment, outside directorship, Chartered Financial Analyst Institute code of ethics, ERS investment policy, account affirmations, and quarterly transactions.
- Compared ERS board of trustees and investment advisory committee members with affirmation reports for outside directorship, Chartered Financial Analyst Institute code of ethics, and ERS investment policy.
- Conducted walkthroughs with ERS investment employees to verify processes for tracking the receipt and disposal of prohibited gifts on ERS's gift log.
- Compared all ERS users with access to the Bloomberg system with a list of ERS covered employees.
- Reviewed the ERS criminal history check policy to identify the types of criminal background checks ERS conducts on employees.
- Tested TRS board members' and executive director's submission and review of financial disclosure statements with the TRS ethics compliance officer and the Texas Ethics Commission.

- Tested TRS key employees' submissions of financial disclosure statements.
- Reviewed TRS's notification and tracking of financial advisors' and service providers' submissions of conflict of interest disclosure statements.
- Tested brokers, financial advisors, and service providers to verify that they submitted investment ethics policy affirmations.
- Tested key employees' submissions of brokerage account and personal security trade disclosures.
- Reviewed TRS's trading policy reports to verify that TRS consistently enforced penalties for violations of its personal trading policies.
- Reviewed TRS's Bloomberg system administrator access to determine whether access was based on users' job duties.
- Reviewed access to investment information in TRS's Bloomberg system to determine whether users had affirmed compliance with TRS's investment ethics policies.
- Tested TRS's performance of criminal background checks on new employees.
- Reviewed TRS's process for tracking required annual ethics training for TRS employees and board of trustee members.
- Contacted TRS's fraud, waste, and abuse hotline to verify that processes exist for employees to report violations of ethics policies anonymously.
- Tested employees covered by UTIMCO's investment ethics policies for affirmations of disclosure of outside employment and business activities.
- Conducted walkthroughs with UTIMCO investment employees to verify processes for tracking the receipt and disposal of prohibited gifts on UTIMCO's gift log.
- Reconciled notifications of restricted securities with UTIMCO's external investment managers.
- Tested UTIMCO's travel procedures to verify that UTIMCO reviewed and approved vendor-paid entertainment and travel expenses.
- Tested UTIMCO investment employees' disclosure of brokerage accounts and personal securities trades.

- Reviewed UTIMCO's Bloomberg system administrator access to determine whether access was based on the users' job duties.
- Reviewed UTIMCO's Bloomberg system users to verify that shared accounts were no longer utilized.
- Reviewed the ERS criminal history checks policy to determine the types of criminal background checks ERS conducts on employees.

Criteria used included the following:

- *An Audit Report on Ethics Policies for Trustee Investing Practices at the Employees Retirement System, the Teacher Retirement System, and the University of Texas Investment Management Company* (State Auditor's Office Report No. 09-031, April 2009)
- Investment ethics policies at ERS, TRS, and UTIMCO.
- Employee ethics policies at ERS, TRS, and UTIMCO.
- Texas Government Code, Chapter 411.
- Texas Government Code, Chapter 572.
- Chartered Financial Analyst Institute code of ethics.

Project Information

Audit fieldwork was conducted from September 2012 through March 2013. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The following members of the State Auditor's staff performed the audit:

- Kels Farmer, MBA, CISA (Project Manager)
- Arthur N. Cadena
- Erin Cromleigh, CGAP
- Joe Curtis, CPA
- Anna Howe
- Michael Karnes, MBA

- Joe Kozak, CPA, CISA
- Marlen Randy Kraemer, MBA, CISA, CGAP
- Thomas Andrew Mahoney, CGAP
- Cecile Norton
- Bansari Patel, CPA
- Barrett Sundberg, CPA, CIA
- Tony White, CFE
- Michael C. Apperley, CPA (Quality Control Reviewer)
- Ralph McClendon, CISSP, CCP, CISA (Audit Manager)

Related State Auditor's Office Work

Related State Auditor's Office Work		
Number	Product Name	Release Date
09-031	An Audit Report on Ethics Policies for Trustee Investing Practices at the Employee Retirement System, the Teacher Retirement System, and the University of Texas Investment Management Company	April 2009

Copies of this report have been distributed to the following:

Legislative Audit Committee

The Honorable David Dewhurst, Lieutenant Governor, Joint Chair
The Honorable Joe Straus III, Speaker of the House, Joint Chair
The Honorable Thomas “Tommy” Williams, Senate Finance Committee
The Honorable Jim Pitts, House Appropriations Committee
The Honorable Harvey Hilderbran, House Ways and Means Committee

Office of the Governor

The Honorable Rick Perry, Governor

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Ms. Cydney Donnell
Ms. Yolanda Griego
Mr. I. Craig Hester
Mr. Frederick E. Rowe, Jr.
Ms. Ann Bishop, Executive Director

Teacher Retirement System

Members of the Teacher Retirement System Board of Trustees
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Ms. Charlotte Clifton, Vice Chair
Mr. Todd Barth
Ms. T. Karen Charleston
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Ms. Anita Smith Palmer
Ms. Nanette Sissney
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Mr. R. Steven Hicks
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Mr. James P. Wilson
Mr. Bruce Zimmerman, Chief Executive Office and Chief Investment Officer



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