



State Teachers Retirement System of Ohio

Enterprise Risk Management — Fiduciary Audit Recommendations

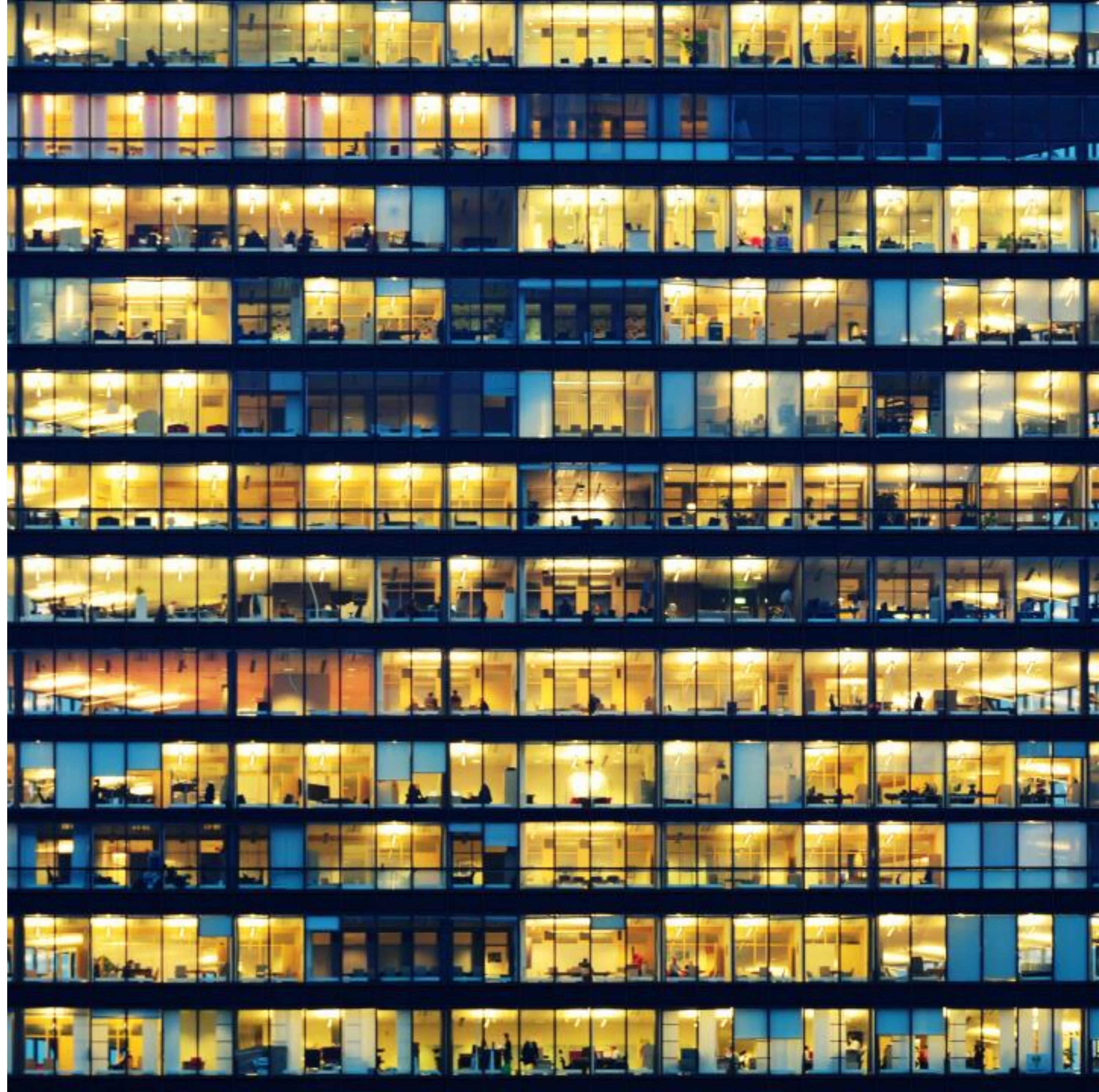
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Introduction

In November 2023, the Board discussed, among other fiduciary audit topics, key performance indicators (KPIs) at a high level.

Last month, Staff presented the Enterprise Risk Management (ERM) Annual Update. As part of its annual process, the CFO and chief actuary met with each deputy and department head to assess impact, probability and velocity of the identified risks before reporting to the Board.

The fiduciary audit contains several ERM related recommendations. The purpose of today's presentation is to summarize those recommendations and to discuss the required time, resources and efforts needed to effectuate implementation of all the recommendations.

Fiduciary Audit Commentary regarding Risk Management & Controls

The fiduciary audit recommends that STRS adopt a holistic approach to move from its current ERM framework to an Enterprise Performance Risk Management (EPRM) framework.

The audit noted that the current risk assessment process can be improved, as it can be viewed as subjective, is a “snapshot” limited to the time period it is taken and has no clear linkage to the strategic plan.

The benefits of a holistic approach, as outlined in the audit, include:

- Situational awareness of what’s vitally important, what’s changed or changing, and the implications for direction and policy
- Improved Board insight for direction and oversight
- Board establishment of appetites/tolerances for risk
- Exception based reporting
- Creation of a KPI dashboard

Fiduciary Audit Commentary regarding Risk Management & Controls

The fiduciary audit concluded that STRS has the essential building blocks to move to a more systematic and coherent approach to risk management.

Staff is generally in favor of the recommendations; however, implementation will involve significant Board and staff involvement as metrics, targets, and tolerances are developed and approved by the Board, and dashboards are built out.

We recommend that the Board first establish its new strategic plan and have continuing discussions of implementation of the fiduciary audit recommendations related to enterprise risk.

Staff will continue to identify, assess and manage enterprise-level risks.

Fiduciary Audit Recommendations

5 Risk Management and Controls

5.1 Holistic View of Risk

R5.1.1 Adopt a Basel-based definition of risk, i.e., risk is the potential for an unacceptable difference between actual and expected performance regardless of cause.

R5.1.2 Develop an integrated performance risk framework for strategy, operations, reporting and compliance.

R5.1.3 Ensure performance risk management (EPRM) is built into the way STRS runs its business.

R5.1.4 Approve vital signs for vital functions and increase situational awareness throughout the organization about what's vitally important.

R5.1.5 Require updates based on the volatility of the vital sign metrics.

R5.1.6 Clearly establish and approve risk appetite for all strategic goals as currently done with asset allocation decisions.

R5.1.7 Clearly establish tolerances for performance objectives, i.e., how much variability (positive and negative) the Board is willing to accept re: actual vs. expected performance.

Fiduciary Audit Recommendations

5 Risk Management and Controls

R5.1.8 Cease to require subjective “guestimates” of impact, probability and velocity (inevitably biased).

R5.1.9 Perform an annual assessment of the internal control environment.

R5.1.10 Conduct as least annual risk awareness training for all staff and Board.

5.2 Reporting to the Board

R5.2.1 Adopt exception-based performance risk reporting and require timely escalation of exceptions.

R5.2.2 Use exception-based dashboards to provide a comprehensive overview of performance and trends for key metrics and reduce the volume of information presented to the Board while improving its utility and insights.

R5.2.3 Require visible, timely feedback on performance and risk at all levels of the organization, which, in turn, will contribute to faster organizational learning.

R5.2.4 Increase transparency and accessibility by requiring “drill down” capabilities from high-level executive summaries and exception-based dashboards to supporting detail and prior reports, as appropriate.

Fiduciary Audit Recommendations

5.2 Reporting to the Board

R5.2.5 Require quarterly reports on vital signs for vital function and thereby create a more dynamic and consistent reporting process. Management should identify opportunities for automation of reporting.

R5.2.6 Require that reports be consistently linked to the strategic plan and strategic objectives.

R5.2.7 Require that exception reports (positive and negative) provide a variance analysis that describes why performance is outside the expected “normal range” and management’s response.

R5.2.8 Require a Root Cause Analysis of all significant exceptions and identify significant direction and policy implications.

R5.2.9 Periodically review all regular reports with staff and identify opportunities to improve or streamline reporting and eliminate unnecessary reports.

R5.2.10 Require that all performance reports to the Board be periodically independently reviewed by the internal audit function (or other independent reassurance source) to determine their reliability especially regarding reports that indicate “normal” or expected performance.

Fiduciary Audit Recommendations

5.2 Reporting to the Board

R5.2.11 Require that Board members continuing education topics include pension system financial requirements, risk management , and the importance of consistent and reliable controls within the system.

5.3 Financial controls, Financial Statements, and Purchasing Policy

R5.3.1 Each Key Risk Indicator (KRI) should have one or more associated Key Performance Indicators (KPIs) and emphasize the status of performance rather than the risk.

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