

INTERNAL AUDIT OF THE
PERSONNEL PROCESSES

AS OF AUGUST 18, 2016

AT THE

TEXAS STATE SECURITIES BOARD

(REPORT NO: TSSB001-016)



MONDAY RUFUS & CO., P.C.

CERTIFIED PUBLIC ACCOUNTANTS AND ADVISORS



MONDAY RUFUS & CO., P.C.
Certified Public Accountants & Advisors

Board Members
Texas State Securities Board
Austin, Texas

We have conducted an internal audit (audit) of the Personnel Processes at the Texas State Securities Board (Board) as of August 18, 2016. The results of our audit disclosed that the Board has procedures and controls in place related to the Personnel Processes. However, we noted an opportunity for enhancing the controls in place in the Personnel Processes.

The report that accompanies this letter summarizes our comments and recommendations.

Monday Rufus & Co., P.C.

August 18, 2016
Austin, Texas

TABLE OF CONTENTS

Executive Summary.....4

Internal Audit Results.....4

Objectives, Observations, Recommendations.....6

Appendices

 1. Objective and Scope.....9

 2. Background.....12

 3. Report Distribution.....13

Executive Summary

In 1957, the 55th Legislature created the Texas State Securities Board pursuant to the Securities Act, REV. CIV. STAT. ANN. Art.581-1 *et seq.*

The Texas State Securities Board meets the requirement of the Act, by maintaining strategies for 1) Law enforcement; 2) Registration of securities; 3) Registration of dealers, agents, investment advisors and investment adviser representatives; and 4) Inspections of registered dealers and investment advisers.

Each year the Texas State Securities Board makes a net revenue contribution to the state's General Revenue Fund. In FY 2015 the Agency's budget was approximately \$7 million. The Agency deposited approximately \$225 million in revenue from its operations, primarily from fees for the registration and filing of securities and firms and the individuals who sell securities or provide investment advice.

The Board administers the Securities Act (the "Act") which is the statutory securities law for Texas. The Act provides for the registration of securities offered or sold in Texas, and of firms and individuals who sell securities or render investment advice in the state. The Act prohibits fraud in the offeror's sale of securities in Texas and in the rendering of advice. The Act provides for administrative, civil, and criminal sanctions for violations of the provisions.

With the passage of Dodd-Frank Wall Street Reform and Consumer Protection Act, the Agency was charged with regulatory responsibility for investment advisors in Texas with less than \$100 million in investor assets under management. The Agency maintains a professional staff of attorneys, accountants, and financial examiners, to address the variety of issues presented in registration, examination, and enforcement matters.

For fiscal years 2016 and 2017 the General Appropriations Act authorized 104 Full-Time-Equivalent (FTEs) employees.

The Board's Staff Services Division performs essential administrative functions of the Agency, including budgeting, accounting, purchasing, accounts payable, inventory, personnel, employee benefits, and data processing. The division is also responsible for the preparation and distribution of reports required by state government.

The Staff Services Division's has one employee who is responsible for human resources matters and who manages the personnel files and documentation for the agency. This employee reports to the Director of Staff Services Division.

Summary of Internal Audit Results

The Board has Personnel Processes in place to provide reasonable assurance that the agency is in adherence and compliance with state and federal personnel requirements. Policies and procedures have been established and implemented for personnel functions in the State Securities Board Employee Manual (Revised May 5, 2016).

The Board can enhance its Personnel Processes by ensuring that personnel files contain copies of college or university transcripts, degree(s), or evidence which confirmed that the Minimum Qualifications of job postings were met if they required graduation from an accredited four-year college or university.

There were no other deficiencies detected in the audit of the Personnel Processes that are significant to the objectives of this audit. Any insignificant issues noted have been communicated to the management of the Commission as required by *Government Auditing Standards*.

Summary of Management's Responses

The SSB will implement procedures to document its efforts to confirm that an applicant has satisfied educational requirements stated in the job posting, with regard to graduation from an accredited four-year college or university, before formally offering employment to the applicant. Such documentation will include, but will not be limited to: transcripts, degrees, and contemporaneous notes of efforts to contact educational institutions to verify an applicant's satisfaction of the listed educational requirements.

Objectives, Observations, Recommendations, and Management's Response

The primary objectives of the internal audit were:

1. Reliability and Integrity of Information
2. Compliance with Policies, Procedures, Laws, and Regulations
3. Efficiency and Effectiveness of Operating Procedures
4. Safeguarding of Assets

RESULTS AND RECOMMENDATIONS

Internal Audit Objective 1: Reliability and Integrity of Information

Each year the Director of Staff Services evaluates and discusses with the Securities Commissioner whether the salaries offered for entry-level positions in each division of the Agency are competitive with those for the same or similar positions in state government and within the agency in accordance with Texas Government Code, Section 654.014(b).

The employee hiring and personnel action processes involve the relevant Division Director and the Director of Staff Services or designee who each review for compliance with applicable law, EEO policy, and other Agency policies and procedures. The Securities Commissioner reviews and approves the hiring of employees and personnel action decisions.

Internal Audit Objective 2: Compliance with Policies, Procedures, Laws, and Regulations

The Board is in compliance with employee Equal Employment Opportunity (EEO) Standards Training required under Texas Labor Code, Section 21.010 (c) and (d); and Texas Administrative Code, Title 40, Section 819.24 . Signed EEO training certificates are filed in each employee personnel file as required by the aforesaid Texas Labor Code and Texas Administrative Code sections.

The Board is in compliance with the Immigration and Nationality Act (INA) added by the Immigration Reform and Control Act of 1986 (IRCA) which requires that employers must complete a Form I-9 (Employment Eligibility Verification) for every new employee they hire after November 6, 1986.

Cybersecurity Awareness Training is being conducted by the Board in accordance with Government Code, 2054.134 enacted by the 84th Legislature.

The Board provides all employees who are terminating their employment access to the State Auditor's Office online exit survey as required by Texas Government Code, Section 651. 007.

New employees receive training on the Public Information Act within 30 days of being hired as required by the Board's Employee Manual.

Employee performance reviews are being conducted annually by an authorized member of the Board management.

Finding 1: Educational Transcripts or Degrees Should Be Included in Employee Files if The Minimum Qualifications of Their Job Posting Requires Graduation From an Accredited Four-Year College or University.

Criteria:

The State Securities Board Employee Manual procedures use a rating schedule to determine a job applicant's eligibility for an interview based on the measurable job-related experience and educational qualifications set forth in the job description. After applicants are interviewed the candidate with the highest cumulative score should be selected, subject to a check by the Division Director of the applicant's references, education record, and employment history.

Condition:

Three (3) of the 30 employee files tested did not have copies of college or university transcripts or degrees although the "Minimum Qualifications" included in the Job Vacancy Notices required the applicant to have graduated from an accredited four-year college or university.

Cause:

Based on the results of our testing, it appears that management failed to consistently ensure that educational supporting documentation required by the job postings and used in the selection of the top ranked applicants were not included as part of the hired applicants' personnel files.

Effect:

In personnel files without supporting graduation documents from an accredited college or university as required by the job postings minimum qualifications, it cannot be determined if the interview procedures in the Board's Employee Manual were followed, or if an applicant's education record was checked as required by the Employee manual procedures.

Recommendation:

Management should retain in the personnel files supporting college or university graduation documents such as copies of transcripts, degree (s), or other supporting documented evidence which confirmed that the applicant hired met the Minimum Qualifications of the job posting if it required graduation from an accredited four-year college or university.

Management's Response:

The SSB will implement procedures to document its efforts to confirm that an applicant has satisfied educational requirements stated in the job posting, with regard to graduation from an accredited four-year college or university, before formally offering employment to the applicant. Such documentation will include, but will not be limited to: transcripts, degrees, and contemporaneous notes of efforts to contact educational institutions to verify an applicant's satisfaction of the listed educational requirements.##

Internal Audit Objective 3: Safeguarding of Assets

There are controls in place in the hiring process of agency personnel which involve Division Directors, the Staff Services Director, and the hiring approval and signing of a Notice of Appointment form by the Securities Commissioner.

TSSB has a process in place to ensure that accessibility to the agency's computer systems is eliminated as soon as an employee terminates employment with the agency.

Internal Audit Objective 4: Efficiency and Effectiveness of Operating Procedures

Prior to contacting a job applicant for an interview the Board's Director of Staff Services will check the applicant's criminal history record information at the Texas Department of Public Safety.

The Staff Services Division provides a monthly notification on upcoming employee evaluations to the Division Directors and Securities Commissioner.

Appendix I

Objective and Scope

Objective

The audit objectives are to determine the following:

- Reliability and Integrity of Information
- Compliance with policies, procedures, laws and regulations
- Safeguarding of assets
- Efficiency and Effectiveness of Operating Procedures

Scope

The scope of the audit work included ensuring compliance with the Texas Labor Law, Government Code, State Securities Board Employee Manual, and operating policies and procedures. The scope included interviews with the Board's Director of Staff Services Division, and human resources staff. Employee files, employee training files, Board's Employee Manual, human resource forms, and other pertinent reports and documents were tested for accuracy and compliance.

Methodology

Our procedures included collecting information and documentation; performing selected tests and other procedures; analyzing and evaluating the results of the tests; reviewing operating policies and procedures, laws, and regulations, conducting interviews with the appropriate staff of the Board; testing for compliance with policies, procedures and laws; and review of other pertinent reports and documentation.

Information collected and reviewed included the following:

- List of Board employees with job titles and dates of employment
- List of Board staff involved in personnel processing functions

- Agency Employee Manual policies and procedures (05/05/2016)
- List of training conducted during fiscal year 2014 and 2015 and records of attendance
- List of terminated employees during Fiscal Year 2015
- Texas State Securities Board Website
- State Auditor's Office: Texas Human Resources Management Statutes Inventory (2016-2017) Biennium
- Agency appropriations Fiscal Years 2016-2017

Procedures and tests conducted included the following:

- Interviewed Director of Staff Services Division and human resources personnel to obtain an understanding of the personnel functions, activities, and controls in place.
- Interviewed the human resources personnel to obtain an understanding of the personnel training functions, activities, and controls in place.
- Obtained and reviewed State human resources requirements.
- Tested for compliance with personnel requirements
- Obtained and reviewed employee personnel files
- Obtained and reviewed employee training files
- Tested for accuracy and completeness of employee information in personnel files
- Tested for compliance with required state and federal employee training requirements
- Other pertinent reports and documents

Criteria Used included the following:

- State Securities Board Employee Manual
- Texas Workforce Commission Civil Rights Division , Texas Labor Code, Chapter 21 Review

- State Auditor’s Office: Texas Human Resources Management Statutes Inventory
- Texas Labor Code, Chapter 21, Employment Discrimination (EEO)
- Position Classification Act, Texas Government Code, Section 654
- Texas State Securities Board Website
- Review of Other pertinent reports and documents.

Other Information

Our internal audit was conducted 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 internal audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our internal audit objectives. Our internal audit also conforms with the Institute of Internal Auditor’s (IIA) *International Standards for the Professional Practice of Internal Auditing*.

Appendix 2

Background Information

In 1957, the 55th Legislature created the Texas State Board of Securities pursuant to the Securities Act, REV. CIV. STAT. ANN. Art.581-1 *et seq.*

The State Securities Board meets the requirement of the Act, by maintaining strategies for 1) Law enforcement; 2) Registration of Securities; 3) Registration of dealers, agents, investment advisors and investment adviser representatives; and 4) Inspections of registered dealers and investment advisers. The duties of the Board members include administrative support to each of the Agency's strategies and the development and implementation of investor education to inform the public with an emphasis on prevention and detection of fraud.

Each year the Texas State Securities Board makes a net revenue contribution to the state's General Revenue Fund. In FY 2015 the Agency's budget was approximately \$7 million. The Agency deposited approximately \$225 million in revenue from its operations, primarily from fees for the registration and filing of securities and firms and the individuals who sell securities or provide investment advice.

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With the passage of Dodd-Frank Wall Street Reform and Consumer Protection Act, the Agency was charged with regulatory responsibility for investment advisors in Texas with less than \$100 million in investor assets under management. The Agency maintains a professional staff of attorneys, accountants, and financial examiners, to address the variety of issues presented in registration, examination, and enforcement matters.

The Governor, with the advice and consent of the Senate, appoints five public members of the Board for staggered six-year terms.

The Board members appoint a Securities Commissioner who supervises the Agency's activities. The Agency's operating budget is prepared on an annual basis and reviewed by the Board members during the year. Both the budget and appropriations are reviewed and approved by the State Legislature.

The Agency is organized into the following five Divisions: Enforcement, Registration, Inspections and Compliance, General Counsel, and Staff Services.

Appendix 3

Report Distribution

As required by Gov't Code 2102.0091, copies of these reports should be filed with the following:

Governor's Office of Budget and Planning

Attn: Drew DeBerry
Phone: (512) 463-1778
budgetandpolicyreports@gov.texas.gov

Legislative Budget Board

Attn: Julie Ivie
Phone: (512) 463-1200
audit@lbb.state.tx.us

State Auditor's Office

Attn: Internal Audit Coordinator
Phone: (512) 936-9500
iaordinator@sao.texas.gov

Sunset Advisory Commission

Attn: Ken Levine
Phone: (512) 463-1300
sunset@sunset.texas.gov

Texas State Securities Board

Beth Ann Blackwood, Chair
E. Wally Kinney
David A. Appleby
Alan Waldrop
Miguel Romano, Jr.

Texas State Securities Board Management

John Morgan, Securities Commissioner

AUDIT FOLLOW-UP: INTERNAL AUDIT OF THE
INSPECTIONS AREA: CONDUCTING INSPECTIONS
AS OF AUGUST 8, 2016
AT THE
TEXAS STATE SECURITIES BOARD
(REPORT NO: TSSB002-016)



MONDAY RUFUS & CO., P.C.
CERTIFIED PUBLIC ACCOUNTANTS AND ADVISORS



MONDAY RUFUS & CO., P.C.
Certified Public Accountants & Advisors

Board Members
Texas State Securities Board
Austin, Texas

We have reviewed the status of our internal audit recommendations related to the Inspections Area: Conducting Inspections (*Original Report Date: July 24, 2015*) as of August 8, 2016.

The accompanying schedules summarize our original finding and recommendation, current status, and remarks.

We appreciate the courtesy and cooperation shown by the management of the Agency during the course of the engagement.

Monday Rufus & Co., P.C.

August 8, 2016
Austin, Texas

TABLE OF CONTENTS

Introduction and Executive Summary.....	4
Internal Audit Results.....	4
Appendices:	
1. Follow-up Schedule: Internal Audit Recommendations	5
2. Objective and Scope.....	6
3. Background Information.....	8
5. Report Distribution.....	9

Executive Summary

Inspections Area

Section 13-1 of the Texas Securities Act (Act) authorizes the Texas State Securities Board (SSB) to conduct inspections of registered broker dealers (BD) and investment advisors (IA). As such, SSB's Inspections and Compliance Division (Division) has been tasked with the responsibility of administering the inspection program, to ensure registered BD's and IA's comply with the Act and SSB's rules and regulations.

The Inspection and Compliance Division conducts periodic examinations of the books and records at the registered firms. The primary focus is on state-registered investment advisers who have main offices in Texas as well as dealers who are not members of the Financial Industry Regulatory Authority (FINRA); however all registered firms are subject to examination. Additionally the Inspection and Compliance Division investigates complaints against persons and firms registered under the Securities Act. The division reviews and investigates disciplinary information filed with the Agency to ensure that registered persons and firms remain in compliance with all applicable securities laws and regulations.

The Division is comprised of a Director, Assistant Directors, Staff Attorneys, Administrative Assistants and Financial Examiners; and, operates in the Austin office and 2 branch offices located in Dallas and Houston. The Dallas office is responsible for the Dallas-Fort Worth area; the Houston office, for the greater Houston area; and, the Austin office, for the remaining areas of Texas.

Each Assistant Director generates a listing from their database of active IAs and non-FINRA BD firms (within their jurisdiction). The listing is sorted by last inspection date and firms are first selected for inspection based on the Divisions 4 year cycle goal of inspecting each firm at least once every 4 years. An inspections risk assessment tool is available for Assistant Directors to use in finalizing the selection of firms to inspect, which considers other factors; such as, the firm's size and total assets. However, the general basis of determining which firms to inspect is the last inspection date.

Following are the types of inspections that can be performed:

- 1 Cycle – routine;
 - 2 For Cause – prompted by a complaint or other specific concern;
 - 3 Follow-Up – follow-up of an order, undertaking, or caution letter generated by a prior inspection;
- and,
- 4 Sweep Review – performed as part of an issue-based inspection sweep.

The Financial Examiner completes a pre-exam checklist prior to visiting the registrant and performing the inspection. The pre-exam checklist, which includes background and profile information of the registered BD or IA, must be approved by the respective Assistant Director before the Financial Examiner may perform the inspection.

The Division utilizes the Inspections & Compliance Case Management System (I&C Database) to track, among other information, the inspection start date and the Division's progress in meeting their annual goal. As of March 31, 2015, the Division has performed 155 and closed 140 inspections during fiscal year 2015.

Internal Audit Results

The scope of this internal audit follow-up was limited to following up on the finding and recommendation on the original report: Inspections Areas: Conducting Inspections (*Original Report Date: July 24, 2015*).

Appendix 1 summarizes and provides the status and steps taken by the management of the Board to the recommendation made in the report.

Appendix 1:

ENTITY: Texas State Securities Board

PROJECT: Follow-up on prior Internal Audit Recommendations Inspections Area – Conducting Inspections (Original Report July 24, 2015)

PRIOR FINDINGS/RECOMMENDATIONS (issued by the prior Internal Auditor)	CURRENT STATUS	AUDITORS' REMARKS
<p><u>Finding 1: Pre-Inspection Checklist</u></p> <p>The Inspection Division’s policies and procedures require that a pre-exam checklist be completed by a Financial Examiner for approval by an Assistant Director before an inspection is conducted. The pre-exam checklist which captures information for the respective IA or BD; such as, last exam date, complaints filed, disciplinary history, potential conflicts of interest, etc., is used to established the areas to be reviewed during the inspection.</p> <p>Our testing of 10 investigations files denoted 1 instance in which a pre-exam checklist was not included in the file.</p> <p><u>Recommendation:</u></p> <p>We recommend that the Inspection Division consider implementing a quality control process whereby on a periodic basis, the population of completed inspection files are sampled and reviewed to provide added assurance that all required documentation is included.</p> <p><u>Management’s Response:</u></p> <p><i>The Inspection and Compliance Division will adhere to the internal audit recommendation by immediately implementing a quality control process to assure that all required documentation is included in completed inspection files. The new process requires the relevant Assistant Director to review the exam file indicating this review has been completed. The process has been memorialized and provided to the appropriate Staff within the Division.</i></p>	<p>I</p>	<p>The internal auditor met with the Director of Inspections and Compliance and discussed the quality control processes in place. Per the Director of Inspections and Compliance, each relevant Assistant Director reviews the completed inspection file to assure that required documentation is included in the completed file. The internal auditor selected a sample of completed inspections during fiscal year 2016, and verified that the pre-exam checklist existed in the file. Additionally, the internal auditor determined that each completed file contained the signature of the Assistant Director verifying that all required documentation is included in the completed inspection file.</p> <p>No exceptions were noted in our testing. No further work is deemed necessary in this area at this time.</p>

I = Implemented

P = Partially Implemented

N = Not Implemented

Appendix 2

Objective and Scope

Objective

The objective of this internal audit follow-up was limited to following up on the finding and recommendation included in the Inspections Areas: Conducting Inspections (*Original Report Date: July 24, 2015*).

Scope

Our procedures included reviewing the previous audit report, inquiring about the status of the report's recommendation, meeting with Board's management, obtaining supporting documentation, and verifying the information.

Methodology

The internal auditors met with the Texas State Securities Board management in Austin, TX regarding the audit follow-up to determine the current status of the prior audit finding, recommendation, and corrective action(s) taken.

Information collected and reviewed included the following:

- Original Audit Reports for:
 - Internal Audit of the Inspections Area: Conducting Inspections (Dated July 24, 2015)
- Reviewed Section 13-1 of the Texas Securities Act (Act).
- Met with the Director of Inspections and Compliance and obtained an understanding of the inspection process.
- Obtained and reviewed a list of inspections conducted in the month of November 2015.

Procedures and tests conducted included the following:

- Met with Board management to discuss the current status of the prior audit report's recommendation and corrective actions.
- From the list of inspections for the month of November 2015, selected a sample of five investigation files and tested for existence of pre-inspection checklist in the file.

Criteria Used included the following:

:

- Section 13-1 of the Texas Securities Act (Act).
- Policies and procedures

Other Information

Our internal audit was conducted 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 internal audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our internal audit objectives. Our internal audit also conforms with the Institute of Internal Auditor's (IIA) *International Standards for the Professional Practice of Internal Auditing*.

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The Governor, with the advice and consent of the Senate, appoints five members of the Board for staggered six-year terms.

The Board members appoint a Securities Commissioner who supervises the Agency's activities. The Agency's operating budget is prepared and approved by the Board on an annual basis, whereas the State legislative appropriation request is determined every two years. Both the budget and appropriations are reviewed and approved by the State Legislature.

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Beth Ann Blackwood, Chair
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Texas State Securities Board Management

John Morgan, Securities Commissioner