

**Proposed Internal Audit Plan
For
Fiscal Years 2016 and 2017
Texas State Securities Board**



MONDAY RUFUS & CO., P.C.

CERTIFIED PUBLIC ACCOUNTANTS AND ADVISORS

TEXAS STATE SECURITIES BOARD
Internal Audit Plan – Fiscal Years 2016 and 2017

Table of Contents

	<u>Page</u>
Transmittal	2
Purpose	3
Background Information	3
Internal Audit Plan Methodology	5
Internal Audit Plan	8
Reporting	9
Appendix A: Summary of Audit Risk Assessment	10
Appendix B: Organizational Chart	11

TEXAS STATE SECURITIES BOARD
Internal Audit Plan – Fiscal Years 2016 and 2017

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

Member: American Institute of Certified Public Accountants

May 3, 2016

Audit Committee and Board Members
Texas State Securities Board
Austin, Texas

Dear Audit Committee and Board Members:

As required by the Internal Auditing Act (Texas Government Code, Section 2102.008), we have prepared the audit plan for Fiscal Years 2016 and 2017.

We prepared a risk assessment to determine the areas in the Texas State Securities Board that should be considered for audit. Based on that risk assessment, the following areas are recommended for audit in Fiscal Years 2016 and 2017, respectively:

<u>Fiscal Year 2016</u>	<u>Estimated Hours</u>
• Personnel Processes	160
• Follow-up on prior Internal Audit Recommendations: Inspections Area (<i>Report Dated July 24, 2015</i>)	60
• FY 2016 Annual Internal Audit Report	<u>10</u>
	<u>230</u>
<u>Fiscal Year 2017</u>	
• Enforcement Administration	175
• Follow-up on prior Internal Audit Recommendations	40
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• FY 2018 Internal Audit Plan	<u>40</u>
	<u>265</u>

Your approval is required to enable the internal auditor to begin the audit activities for fiscal years 2016 and 2017, respectively.

Monday Rufus & Co., P.C.

CC:

1. John Morgan, Securities Commissioner, Texas State Securities Board
2. Ronak Patel, Deputy Commissioner, Texas State Securities Board

TEXAS STATE SECURITIES BOARD
Internal Audit Plan – Fiscal Years 2016 and 2017

I. Purpose

The Purpose of this internal audit plan is to document the development, risk assessment, scope of assignments, and implementation timetable for fiscal years 2016 and 2017 internal audit activities. This document will serve as the primary tool to carry out internal audit responsibilities in an efficient manner and prioritize the audit areas based on risk assessments agreed to by the Board members of the Texas State Securities Board (the agency). Due to the nature, scope, and timing of audit procedures contemplated here, planning for specific aspects of the audits is a continuing process. Accordingly, the plan will be revised as necessary and reviewed at least annually for any significant changes.

This plan has been prepared to meet planning guidelines as required by both generally accepted governmental auditing standards and the International Standards for the Professional Practice of Internal Auditing as determined by the Institute of Internal Auditors, Inc.

II. 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 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 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 Texas Securities Act is the state law regarding the regulation of the securities industry in 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.

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.

TEXAS STATE SECURITIES BOARD
Internal Audit Plan – Fiscal Years 2016 and 2017

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

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.

A. Divisional Information

- i. **Enforcement Division** – The Enforcement Division is charged with detection and prevention of violations of the Act, including fraud committed in connection with the sale of securities, illegal sales of unregistered securities, and the sale of securities by unregistered dealers. Additionally the Enforcement Division places significant emphasis on criminal prosecution of individuals who engaged in fraud in connection with the sale of securities.
- ii. **Registration Division** – The Registration Division reviews all applications to register securities for sale in Texas. The primary function of this review is to ensure that investors have access to full and fair disclosures of all relevant investment information. The staff of the Registration Division answers questions from the public concerning securities registration requirements. Also the Registration Division reviews and processes the applications for registration and renewal for firms and individuals selling securities or offering investment advice in Texas.
- iii. **Inspection and Compliance Division** – 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.
- iv. **General Counsel Division** – The general Counsel Division helps ensure that persons subject to regulation are fairly and adequately apprised of the provisions of the Act and Board Rules governing, their activities, the general Counsel Division provides formal and informal interpretive advice addressing issues. The general Counsel Division provides internal legal advice to the Board, the Securities Commissioner, and staff regarding correct interpretations of the Act and Board rules and compliance with other appropriate state and federal laws.

TEXAS STATE SECURITIES BOARD
Internal Audit Plan – Fiscal Years 2016 and 2017

v. **Staff Services Division** – The Staff Services Division performs essential administrative functions of the Agency, including budgeting, accounting, purchasing, accounts payable, inventory, personnel, employee benefits, and data processing.

B. The Agency’s appropriations for the fiscal years 2016 and 2017 are as follows:

Protect Investors and Assure Access to Capital for Business:	<u>2016</u>	<u>2017</u>
1. Law Enforcement	\$2,808,151	\$2,806,471
Review Security Documentation For Conformity:		
1. Securities Registration	401,630	401,630
Perform Extensive Review of Applications And Submissions:		
1. Dealer Registration	450,323	450,323
Inspect Dealer & Investment Adviser Records for Regulatory Compliance.		
1. Inspect Records	1,940,754	1,940,754
Indirect Administration:		
1. Central Administration	1,350,000	1,351,200
2. Information Technology	231,702	232,183
Grand Total	<u>\$7,182,560</u> =====	<u>\$7,182,561</u> =====

For the fiscal years 2016 and 2017 the General Appropriations Act authorized 104 full-time equivalent employees (FTEs), respectively.

III. Internal Audit Plan Methodology

This section summarizes the methodology used in preparing the internal audit plan. In order to understand the Agency and develop our risk assessment process, we reviewed the Agency’s:

- Strategic plan
- Legislative Appropriations Request
- Appropriations and Riders in the General Appropriations Act
- State Auditor’s Office and Internal Audit reports
- Other documents obtained from the Agency

We made inquiries of key personnel of the Agency through a questionnaire. The main purpose of our inquiries was to obtain a generalized overview of how each function fits financially and non-financially into the framework of the Agency. One

TEXAS STATE SECURITIES BOARD
Internal Audit Plan – Fiscal Years 2016 and 2017

of the major factors in performing our inquiries, rather than relying solely on the amounts budgeted to each function in determining risk assessment, was to identify how much effect one function has on another function, thereby identifying the total impact that a particular function has on the Agency. These inquiries were standardized to achieve responses to basic questions concerning each function. Questions related to business objectives, inputs, outputs, systems, critical success factors, process activities and business risks and controls. An assessment of the function's risk was also included, based on our inquiries and review of information obtained from the Agency.

In planning internal audit procedures, financial, operational, as well as compliance issues are considered in determining processes/systems of interest. Functional areas that cross many divisions and the interaction between divisions are key criteria in the process of identifying areas of interest. Agency financial reports, planning documents, laws, rules, and regulations, in addition to soliciting input from management, were all considered in developing the list of areas of interest. Upon completion of this list, each area was subjected to our risk analysis process.

The following Agency processes/systems have been considered during the development of the areas of interest list:

- Dealer Registration applications and processing
- Fixed Assets Management
- Accounting and Budgeting
- Cash Receipts and Fee Processing
- Business Continuity
- Enforcement Administration
- Cash Disbursements and Travel Processing, Payables and Payroll
- Information Technology System Development
- Performance Measures Reporting
- Information Systems – Security
- Personnel Processes
- Legal Services
- Open Records Request
- Inspection and Compliance
- Mailroom Services
- Executive Administration
- Historically Underutilized Business (HUB) Compliance
- Securities Registration and Processing

There are numerous other areas that may be identified during the process of performing internal audit procedures over the next year. Continuing input from both the Board members and management will be essential in identifying additional or new areas of risk that should be considered in the future.

Our risk assessment was performed through the consideration of various factors, including:

TEXAS STATE SECURITIES BOARD
Internal Audit Plan – Fiscal Years 2016 and 2017

1. Exposure Level
2. Complexity of Unit
3. Materiality of Revenues and Expenditures
4. Results of Last Audit
5. Extent of other Coverage or Oversight
6. Quality of Internal Controls/Adherence to laws
7. Changes in systems and processes
8. Normal Audit Interval

Although all of the above factors were considered in the assessment of risk for each process/system, some of the factors were weighed more heavily and considered to be more critical to the Agency's internal control structure. The following critical factors were weighted more heavily in our assessment.

- Exposure Level
- Quality of Controls
- Changes in Systems and Processes

The other factors noted are not considered to be as critical to the internal control structure of the Agency. However, all factors were considered in assessing risk and were taken into consideration for each process/system as to their impact on the Agency. Once each area of interest was evaluated, it was assigned a risk factor of high, moderate or low. The following is the result of our risk assessment process.

Processes Identified as High Overall Risk

Personnel Processes
Enforcement Administration
Information System – Security

Processes Identified as Moderate Overall Risk

Legal Services
Accounting and Budgeting
Business Continuity
Dealer Registration applications and processing
Securities Registration and Processing
Performance Measures Reporting
Cash Disbursements, Travel, and Payroll
Cash Receipts and Fee Processing
Inspection and Compliance
Mailroom Services
Fixed Assets Management
Executive Administration
Historically Underutilized Business (HUB) Compliance
Information Technology System Development

TEXAS STATE SECURITIES BOARD
Internal Audit Plan – Fiscal Years 2016 and 2017

Processes Identified as Low Overall Risk

Open Records Request

IV. Internal Audit Plan

The internal audit plan is designed to provide a review of all areas based on the level of risk. Although the plan is structured in this manner, it should not prevent the review of areas on a more frequent basis, in the case of future restructuring or development of new processes/systems. Also, special reviews might be added in the future as requested by the Board members or when deemed necessary by the internal audit function after performance of in-depth review of the specific divisions/systems.

Internal audit activities will be primarily concerned with documenting, testing and evaluating each division or system's internal control policies and procedures and the quality of performance in carrying them out. This will include reporting conditions and suggestions to management and evaluating management's response and plans for corrective actions. Opportunities for improved efficiency identified as a result of performing internal audit activities will be communicated to management and the Board as part of the reporting process.

Internal Audit reviews for the fiscal years ending 2016 and 2017 are planned for the following processes/systems:

<u>Fiscal Year 2016</u>	<u>Estimated Hours</u>
• Personnel Processes	160
• Follow-up on prior Internal Audit Recommendations: Inspections Area (<i>Report Dated July 24, 2015</i>)	60
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Fiscal Year 2017

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TEXAS STATE SECURITIES BOARD
Internal Audit Plan – Fiscal Years 2016 and 2017

The audits for fiscal year 2016 will take place in June 2016 with final reporting occurring in October 2016. The audits for fiscal year 2017 will take place between September 2016 - August 2017 with final reporting occurring in October 2017. The above plan does not preclude the internal audit function from identifying and assessing risk relating to new divisions or systems added to the Agency.

These processes/systems were identified for review through risk assessment methodology. As discussed above, this methodology included inquiries, through a questionnaire of key personnel of the Agency, identifying financial and non-financial risks, identifying interaction of divisions amongst each other, identifying rules and regulations the various divisions must comply with, and identifying the volume of transactions and personnel involved within each division.

V. Reporting

In compliance with the Texas Internal Auditing Act, the annual internal audit report for the above audits will be filed with the Governor, the Legislative Budget Board, the Sunset Advisory Commission, the State Auditor, the Board members, and the Agency's Securities Commissioner by November 1, 2016 and 2017, respectively.

TEXAS STATE SECURITIES BOARD
Internal Audit Plan – Fiscal Years 2016 and 2017

Appendix A: Summary of Audit Risk Assessment

High = 38 and up
Mod = 30 – 37
Low = Less than 30

	<u>Total Risk</u>	<u>Risk Rank</u>
Accounting and Budgeting	36	5
Business Continuity Planning	36	6
Cash Disbursements, Travel and Payroll	34	10
Cash Receipts and Fee Processing	34	11
Dealer Registration applications and processing	36	7
Enforcement Administration	39	2
Executive Administration	31	15
Fixed Assets Management	32	14
Historically Underutilized Business (HUB) Compliance	30	17
Information Technology System Development	31	16
Information Systems - Security	38	3
Inspection and Compliance	34	12
Legal Service	37	4
Mailroom Services	33	13
Open Records Request	29	18
Performance Measures Reporting	35	9
Personnel Processes	40	1
Securities Registration and Processing	36	8

Appendix B: Organizational Chart

