

**TEXAS STATE SECURITIES BOARD**  
Austin, Texas

**ANNUAL INTERNAL AUDIT REPORT**

Fiscal Year 2018



TEXAS STATE SECURITIES BOARD  
Austin, Texas

Annual Internal Audit Report  
Fiscal Year 2018

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# Garza/Gonzalez & Associates

CERTIFIED PUBLIC ACCOUNTANTS

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

We performed tests of management's assertion about the effectiveness and efficiency of the Texas State Securities Board's (SSB) internal control structure over the Processing Dealer Applications area (area) and its established policies and procedures, as applicable to the area, for the purpose of determining SSB's compliance with applicable laws and regulations provided in the Texas Securities Act and the Texas Administrative Code, for the 9 months ended May 31, 2018.

The results of our tests disclosed that SSB's internal control structure over the area and its established policies and procedures were generally adequate and no material instances of noncompliance were noted; however, we did identify certain matters included in this report, that are opportunities for strengthening internal controls and ensuring compliance with state requirements and SSB's established policies and procedures. Based on the degree of risk or effect of these matters in relation to the audit objective(s), these matters were rated as either Priority, High, Medium, or Low, which is further described in the "Summary and Related Rating of Observations/Findings and Recommendations", which is included in page 13 of this report.

We also performed a follow-up of the findings and recommendations that were presented in the prior year annual internal audit report and this report reflects the results and implementation status of our follow-up procedures performed; and, includes all information required for compliance with the State of Texas Internal Audit Annual Report requirements.

We have discussed the comments and recommendations from the audit of the area; and, the implementation status from the follow-up performed, with various SSB personnel; and, we will be pleased to discuss them in further detail; to perform an additional study of these matters; or, to assist you in implementing the recommendations made.



July 27, 2018

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## INTRODUCTION

The State Securities Board (SSB) is charged with the administration and enforcement of the Texas Securities Act (the Act). SSB's mission is to protect Texas investors. Consistent with that purpose, SSB seeks to encourage capital formation, job formation, and free and competitive securities markets and to minimize regulatory burdens on issuers and persons subject to the Act, especially small businesses. SSB investigates suspected violations of the Act and ensures that administrative, civil, or criminal enforcement actions are taken in appropriate circumstances. SSB also registers securities sold in Texas and the firms and individuals who sell securities or render investment advice in the state.

SSB was created in 1957 pursuant to the Act passed by the 55th Texas Legislature. This legislation was the culmination of four earlier statutes dating back to 1913. 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. In certain circumstances a particular security or transaction may be exempt from the registration requirements of the Act. Whether or not an exemption from the registration provisions is available, the Act prohibits fraud in the offer or sale of securities in Texas.

SSB is overseen by a Board composed of five members appointed by the Governor, with the advice and consent of the Senate, for six-year overlapping terms. The Board adopts and periodically updates rules to ensure that investors are adequately protected and that unreasonable burdens on legitimate capital-raising activities are avoided. The Board appoints a Securities Commissioner, who serves at its pleasure, and serves as SSB's chief administrative officer and supervises the day-to-day activities of the staff.

SSB is organized into the following Divisions: Enforcement, Registration, Inspections and Compliance, Office of General Counsel, and Staff Services.

### **2018 Internal Audit Plan**

Following are the internal audits and other functions performed, as identified in SSB's 2018 Internal Audit Plan, dated March 8, 2018 and, approved by SSB's Board members on May 16, 2018:

- Processing Dealer Applications
- Follow-up of Prior Year Internal Audits
- Other Tasks

This report contains the results of our audits of the Processing Dealer Applications area; reflects the results of the follow-up procedures performed in the current year of the findings that were presented in the prior year annual internal audit report; and, meets the State of Texas Internal Audit Annual Report requirements.

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### INTERNAL AUDIT OBJECTIVES

In accordance with the **International Standards for the Professional Practice of Internal Auditing**, the audit scope encompassed the examination and evaluation of the adequacy and effectiveness of SSB's system of internal control and the quality of performance in carrying out assigned responsibilities. The audit scope included the following objectives:

- **Reliability and Integrity of Financial and Operational Information** – Review the reliability and integrity of financial and operating information and the means used to identify, measure, classify, and report such information.
- **Compliance with Policies, Procedures, Laws, Regulations and Contracts** – Review the systems established to ensure compliance with those policies, procedures, laws, regulations, and contracts which could have a significant impact on operations and reports, and determine whether the organization is in compliance.
- **Safeguarding of Assets** – Review the means of safeguarding assets and, as appropriate, verify the existence of such assets.
- **Effectiveness and Efficiency of Operations and Programs** – Appraise the effectiveness and efficiency with which resources are employed.
- **Achievement of the Organization's Strategic Objectives** – Review operations or programs to ascertain whether results are consistent with established objectives and goals and whether the operations or programs are being carried out as planned.

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### I. **Compliance with Texas Government Code 2102: Required Posting of Internal Audit Information**

To comply with the provisions of Texas Government Code, 2102.015 and the State Auditor's Office, within 30 days after approval by SSB's Board, SSB will post the following information on its website:

- An approved fiscal year 2019 audit plan, as provided by Texas Government Code, Section 2102.008.
- A fiscal year 2018 internal audit annual report, as required by Texas Government Code, Section 2102.009.

The internal audit annual report includes any weaknesses, deficiencies, wrongdoings, or other concerns raised by internal audits and other functions performed by the internal auditor as well as the summary of the action taken by SSB to address such concerns.

### II. **Consulting and Nonaudit Services Completed**

The internal auditor did not perform any consulting services, as defined in the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing* or any nonaudit services, as defined in the *Government Auditing Standards, December 2011 Revision*, Sections 3.33-3.58.

### III. **External Quality Assurance Review**

The internal audit department's most recent *System Review Report*, dated October 7, 2015, indicates that its system of quality control has been suitably designed and conforms to applicable professional standards in all material respects.

### IV. **Internal Audit Plan for Fiscal Year 2018**

The approved Internal Audit Plan (Plan) included one audit to be performed during the 2018 fiscal year. The Plan also included a follow-up of the prior year audit recommendations, other tasks as may be assigned by the Board, and preparation of the Annual Internal Audit Report for fiscal year 2018.

### **RISK ASSESSMENT**

Utilizing information obtained through the completed questionnaires received and background information reviewed, 14 audit areas were identified as potential audit topics. A risk analysis, utilizing 8 risk factors, was completed for each of the 14 potential audit topics and then compiled to develop an overall risk assessment.

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Following are the results of the risk assessment performed for the 14 potential audit topics identified:

HIGH RISK	MODERATE RISK	LOW RISK
Processing Dealer Applications Processing Securities Applications Enforcement Accounting and Financial Reporting Fixed Assets/ Property Accounting Processing Cash Receipts/ Disbursements/ Travel	Conducting Inspections	Information Technology Registration and Filing Fees Payroll and Human Resources Purchasing/ Contracting for Services Customer Service Performance Measures Records Management

In the prior 3 years, internal audits were performed in the following areas:

Fiscal Year 2017:

- Enforcement Administration
- Follow-Up of the Prior Year Internal Audits

Fiscal Year 2016:

- Payroll Processes
- Follow-Up of the Prior Year Internal Audits

Fiscal Year 2015:

- Conducting Inspections
- Follow-Up of Post Payment Audit Dated December 9, 2014
- Follow-Up of the Prior Year Internal Audits

The internal audit and other tasks performed for fiscal year 2018 were as follows:

Report No.	Audits/Report Titles	Report Date
1.	Processing Dealer Applications <i>Objective:</i> To determine whether SSB's policies, procedures, and processes in place, as applicable to the Processing Dealer Applications area (area), are sufficient to ensure compliance with applicable laws and regulations.	7/27/2018
1.	Annual Internal Audit Report – Follow-Up of Prior Year Internal Audits	7/27/2018
-	Other Tasks Assigned by the Board	None

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### V. Executive Summary

#### **Processing Dealer Applications**

##### **BACKGROUND**

Firms and individuals offering or selling securities or rendering investment advice in Texas, for compensation, must meet minimum qualifications set forth by the Texas Securities Act (Act) and be registered or notice-filed<sup>1</sup> with SSB as dealers and agents; and/or, investment advisers (IA) and IA representatives, unless exempted by the Act. SSB reviews registration applications for these firms and individuals; and, processes notice filings of federal covered IAs and their representatives.

The Registration Division (Division), which is managed by 2 assistant directors who report to the Deputy Securities Commissioner, is responsible for the Processing Dealer Applications area (the area), and the Processing Securities Applications area, which is a separate auditable area. The assistant directors, an attorney, and 3 financial examiners support the Division; while, 4 administrative assistants are assigned solely to the area.

This report provides the results for only the Processing Dealer Applications area of the Division, and includes processing registration applications, amendments, and renewals for dealers and agents, IAs and IA representatives; and, branch offices, in accordance with the Act and the Texas Administrative Code (TAC).

##### **Financial Industry Regulatory Authority (FINRA) Participation**

SSB participates in the Central Registration Depository (CRD) system and the Investment Adviser Registration Depository (IARD) system, which are both operated by FINRA. These systems allow dealers and agents; and, IAs and IA representatives, to register or notice-file in all desired states from a single electronic platform. All IA applicants are required to register online through the IARD system; IA representatives and FINRA-member dealers and their agents are required to register online through the CRD system; and, non-FINRA dealers and their agents register directly with SSB.

FINRA also collects registration-related fees on behalf of the states, and electronically transmits the collected fees to the State Treasury on a daily basis.

##### **Dealer Registration System (Dealer System)**

The Dealer System is an in-house application used by SSB to manage dealer and IA registration. The Dealer System's task tracking functionality helps ensure timely registration application processing, and is also utilized in the issuance of the Certificate of Registration for registered dealers and IAs.

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<sup>1</sup> An investment adviser who is registered with the Securities and Exchange Commission (SEC) under the Investment Advisers Act of 1940 (15 U.S.C. §80b-1 et seq.), as amended, is classified as a "federal covered investment adviser." A federal covered investment adviser is not required to be registered pursuant to the Act and only has to notice-file with the state. In general, investment advisers that manage less than \$100 million in assets are required to register with the state while those that meet the \$100 million threshold register with SEC.

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### Dealer Application Processing

#### Dealer and Agent Application Requirements

TAC §115.2(a) requires dealer applicants to submit the following information:

- Form BD (Uniform Application for Broker-Dealer Registration);
- Form U4 (Uniform Application for Securities Industry Registration) for the designated officer<sup>2</sup>; and, a Form U4 for each agent to be registered;
- Certified documents that indicate the form of organization; such as, articles of incorporation or partnership agreement; and,
- Balance sheet, prepared in accordance with GAAP by an independent CPA or attested by the principal financial officer, dated no more than 90 days prior to the date of filing.

FINRA members submit Form BD and Form U4 through the CRD system and designate Texas as a jurisdiction; pay the registration fee through FINRA; and, submit all other information directly to SSB. Non-FINRA members submit all forms, information, and the fee directly to SSB.

#### IA and IA Representative Requirements

TAC §116.2(a) requires IA applicants to submit the following information:

- Form ADV (Uniform Application for Investment Adviser Registration) Parts 1 and 2;
- Form U4 for the designated officer; and, a Form U4 for each IA representative or solicitor to be registered;
- Certified documents that indicate the form of organization; such as, articles of incorporation or partnership agreement;
- Balance sheet, prepared in accordance with GAAP by an independent CPA or attested by the principal financial officer, dated no more than 90 days prior to the date of filing;
- Copy of the IA's standard advisory contract; and,
- Fee schedule.

IAs that are required to register with the state, submit Form ADV and Form U4 through the CRD/IARD systems and designate Texas as a jurisdiction; pay the registration fee to FINRA; and, submit all other information directly to SSB.

Federal covered IAs must notice-file with SSB by filing Form ADV, and Form U4 for each of its IA representatives, through the IARD system; select Texas for notice-filing; and, pay the appropriate fees through FINRA.

#### Branch Office Requirements

Each Texas branch office of a registered dealer/IA must be separately registered with SSB, and a branch office supervisor must be named. A dealer branch office supervisor is not required to be registered with FINRA, but must be registered in Texas as an agent, and may only supervise those activities for which he/she is qualified based on the examination taken. An IA branch office supervisor must satisfy the examination qualification required of an IA.

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<sup>2</sup> Each dealer and IA that is a sole proprietorship, corporation, L.L.C., or partnership must register an individual as the firm's designated officer. The designated officer must be an officer, partner, or the sole proprietor of the dealer or IA and have completed the necessary registration and examination requirements. TAC §115.2(b) and §116.2(b).

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Branch office registration may be included in the initial dealer/IA registration application, or later added by requesting an amendment to the current registration. A Dealer/IA must file a Form BR (Uniform Branch Office Registration Form) and pay the branch office registration fee. FINRA-member firms must submit the form and related fee through the CRD/IARD systems; while, non-FINRA firms submit the form and the fee directly to SSB.

### Processing Initial Applications

Initial applications and fees are generally received through the CRD/IARD systems operated by FINRA. Registration application forms submitted through the CRD/IARD systems are available to SSB staff for review through the regulators' interface in the systems. On a daily basis, FINRA deposits the collected application fees to the General Revenue Fund with the State Treasury (Comptroller) and provides SSB with a detailed report of the applications and corresponding fees paid. Applications and fees from non-FINRA firms are mailed directly to SSB. An administrative assistant sets up a registration file in the Dealer System for each applicant firm. Within 14 days of receiving an application, the administrative assistant prepares an initial letter (the *Deficiency Letter*) advising the applicant to submit additional required documents listed in the applicable *Checksheet* available from SSB's website.

Upon receipt of additional required documentation from the applicant, a financial examiner performs a detailed review of the application, utilizing the *Broker Dealer Checklist* or the *Investment Adviser Checklist*, as applicable. The financial examiner obtains the DPS criminal background check results and the CLEAR investigation report, when appropriate; and, follows up with the applicant and others to evaluate regulatory disclosures. History of correspondence and follow-up with the applicant; such as, the *Comment Letter*, are documented in the Dealer System. The financial examiner must make a recommendation to grant or deny registration within 14 days of receiving a complete application. The recommendation must be approved by an assistant director; staff attorney, and the Deputy Commissioner if the recommendation is to deny an application.

### Registration Renewals

All registrations and notice filings expire each year on December 31. FINRA members and associated persons using the CRD/IARD system renew registrations by paying the renewal fee to FINRA; and, non-FINRA firms and individuals to SSB. In the fall, FINRA notifies their members of the upcoming registration renewal, and request that the payments be made before the deadline, in mid-December. Renewal fees timely collected by FINRA are electronically submitted to the General Revenue Fund with the State Treasury in late December. SSB receives a renewal report from FINRA and a cash deposit report from the Comptroller. For non-FINRA members, SSB provides registrants a written notice of impending expiration of the registration at least 30 days before the expiration date. Dealers and agents; and, IAs and their representatives with an expired registration may not sell securities or render investment advice. However, they have up to 2 years to late-renew their registration by paying all unpaid renewal fees for years lapsed, as well as a late fee shown below:

<u>Time Lapsed from December 31<sup>st</sup></u>	<u>Late Fee</u>
1 to 90 Days	1/2 of original application fee
91 Days to less than 2 Years	Full original application fee

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A Registration expired for 2 or more years becomes non-renewable, and a new registration application and fees must be submitted and approved to register.

### Registration Amendments

Any changes in the information contained in the initial registration application; such as, office address and the designated officer or supervisor, must be submitted to SSB within 30 days of the change throughout the year. TAC §§115.9 and 116.9. To meet the requirement, FINRA-member registrants must submit the amended Form BD or ADV with applicable fees via the CRD/IARD system, while non-FINRA members submit the amended form and fees directly to SSB. Upon receipt of the amended Form and fee either directly or from FINRA, an administrative assistant makes necessary changes in the Dealer System, which updates the firm's Certificate of Registration, if applicable.

### Fee Schedule

In accordance with the Act Sec. 35, the fiscal year 2018 registration and notice filing fees related to dealers, agents, IAs, and IA representatives, were as follows:

Fee Type	2018 Current Fees	Fees per Securities Act Sec. 35.	
		Maximum	Required
Filing an original application for dealer or IA registration	\$ 75	\$100	--
Filing a renewal application for dealer or IA registration	\$ 40	\$100	--
Notice filing for a federal covered IA	\$ 75	\$100	--
Renewal notice filing for a federal covered IA	\$ 40	\$100	--
Filing an original application for each agent, officer, or IA representative	\$ 35	\$100	--
Filing a renewal application for each agent, officer, or IA representative	\$ 20	\$100	--
Notice filing for each representative of a federal covered IA	\$ 35	\$100	--
Renewal notice filing for a representative of a federal covered IA	\$ 20	\$100	--
Amendment to a registration certificate of a dealer or IA or evidence of registration of an agent or IA representative	\$ 25	--	\$ 25
Issuance of a duplicate certificate or evidence of registration	\$ 25	--	\$ 25
Filing a branch office registration	\$ 25	--	\$ 25
Filing a request to take the Texas Securities Law Examination	\$ 35	--	\$ 35

SSB's Accounting department is responsible for the daily reconciliation of FINRA's fee collection report and the Comptroller's deposit summary report.

The Act Sec. 36, allows SSB to refund all or part of a registration fee if determined appropriate by SSB. All refund requests must be made by the registrant, in writing, to SSB; and, are manually processed in SSB's Money System application.

During the 9-month period from September 1, 2017 through May 31, 2018, SSB reported that it had processed 444,423 dealer applications, notice filings, amendments, and renewals; and, collected \$8,012,205.50 in fees, net of refunds totaling \$2,132.50.

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### AUDIT OBJECTIVE, SCOPE, AND METHODOLOGY

#### Objective

The objective of our audit was to determine whether SSB's policies, procedures, and processes in place, as applicable to the Processing Dealer Applications area (the area), are sufficient and operating effectively to ensure compliance with applicable laws and regulations provided in the Act and TAC.

#### Scope

The scope of our audit was to review SSB's established policies and procedures and the processes and controls in place over the area; and, relevant activities performed during the 9-month period from September 1, 2017 through May 31, 2018 (audit period).

#### Methodology

The audit methodology included a review of applicable laws and regulations, policies and procedures, and other internal and external documentation; an interview and correspondence with SSB employees; to include, the Commissioner, the Assistant Directors of Registration, the Assistant Director of Staff Services, and the Programmer; and, a review of sample applications and reports.

We obtained and/or reviewed the following documentation:

1. The Act, effective September 1, 2017; and, TAC Title 7, Part 7, Chapters 104, 115, and 116.
2. Organizational chart and job descriptions for employees of the Registration Division, Dealer Section.
3. SSB Dealer Procedures updated July 2018.
4. Various checklists, to include:
  - Checksheet for Dealer Registration
  - Checksheet for Investment Adviser Registration
  - Broker Dealer Checklist
  - Investment Adviser Checklist
5. Uniform application forms: Form ADV, Form BD, Form U4, and Form BR.
6. The following listings/reports for the audit period:
  - Original registration applications and notice-filings.
  - On-time and late renewals.
  - Amendments
  - Refunds

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7. Current SSB fee schedule.
8. Registration Quarterly Performance Reports for Q1 through Q3, 2018, and supporting documentation; and, ABEST reporting for Q3 2018.
9. The following sample reports:
  - CRD or IARD System Report – *Disbursement Detail Report and Download*
  - Comptroller of Public Accounts *Deposit Detail Report*

We performed various procedures within our audit scope, to achieve the objective of our audit; to include, the following:

1. Updated our understanding of the applicable laws and regulations provided in the Act and the TAC.
2. Reviewed the area's written policies and procedures, collected available documentation, and conducted interviews, to document the formal and informal processes and controls in place.
3. Reviewed Forms BD, ADV, and U4 to verify inclusion of the requirements of the Act Sec. 13.A and B, relating to the registration application form for dealers, agents, IAs and IA representatives; and, Sec. 18., relating to the registration of agents and IA representatives.
4. Reviewed a list of registration and notice filing fees assessed by SSB, as posted on their website, to ensure compliance with the Act Sec. 35.
5. Selected a sample of 20 registration applications approved during the audit period to test for the following attributes:
  - (1) Applicant submitted all required documentation either through the CRD/IARD systems or directly to SSB.
  - (2) Correct registration fees were assessed and collected.
  - (3) A Form U4 was filed for a designated officer in connection with the registration of a dealer or IA.
  - (4) A qualified supervisor was designated and registered in connection with the registration of a branch office.
  - (5) Agent and IA representative applicant passed all required examinations.
  - (6) The Certificate of Registration was issued and accurate.
  - (7) Broker Dealer Checklist or Investment Adviser Checklist was completed by a financial examiner and approved by an assistant director.
  - (8) A deficiency letter, comment letter, and final decision were timely issued in accordance with TAC §104.5.
6. Selected a sample of 5 registration-related investigations against individuals opened during the audit period and verified proper approval from a financial examiner; and, if applicable, an assistant director.
7. Selected a sample of 5 firm amendments and 5 branch amendments to verify that changes submitted through the CRD/IARD systems were accurately reflected in the Dealer System; and, that correct fees were collected.

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8. Selected a sample of 15 timely renewals to verify that a renewal notice was provided to registrants at least 30 days before the expiration date; and, that correct fees were collected.
9. Selected a sample of 3 late-renewals to test for the following attributes:
  - (1) Late renewal fee was properly calculated in accordance with the Act. Sec. 19.C.
  - (2) In the CRD/IARD systems and the Dealer System—
    - a. The statuses for the firm and its agent/representative were properly updated to “Approved.”
    - b. Firm’s registration effective date was properly amended to the late-renewal date.
    - c. The fact of late renewal was properly documented in the systems.
10. Selected a sample of 5 application refunds to test for the following attributes:
  - (1) Agreement of the payment and payee information in the following documents: (a) Application for Texas ID Number, as completed by the payee; (b) refund request in the Money System; and, (c) Comptroller’s USAS report.
  - (2) Refund request was substantiated and properly approved by the Registration division and the Staff Services division.
  - (3) Support for the refund was properly retained in the registration file.
11. Observed the CLEAR Reports folder in the Registration Drive of SSB’s internal network drive to assess whether SSB’s CLEAR Report deletion procedure is consistently followed.
12. Traced the following performance measures included in the Registration Quarterly Performance Report for Quarter 2, 2018 to supporting documentation to verify accuracy:
  - (1) Number of Applications and Submissions Processed
  - (2) Revenues Deposited to State Treasury from Applications and Submissions
  - (3) Average Time (Days) for Deficiency Letters on Dealer and Investment Adviser Applications
13. Agreed the “Number of Apps/Submissions Processed” for Q1, Q2, and Q3 reported in the Q3 2018 ABEST reporting to the Registration Quarterly Performance Report for the respective quarter. Additionally, verified that preparation and approval of the Quarterly Performance Reports; and, entry and approval of ABEST reporting, were properly documented.

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**VI. Observations/Findings and Recommendations**

SUMMARY and RELATED RATING of OBSERVATIONS/FINDINGS and RECOMMENDATIONS

As SSB's internal auditors, we used our professional judgment in rating the audit findings identified in this report. The rating system used was developed by the Texas State Auditor's Office and is based on the degree of risk or effect of the findings in relation to the audit objective(s). The table below presents a summary of the findings in this report and the related rating.

<b>Summary of Observations/Findings &amp; Recommendations and Related Ratings</b>		
<b><i>Finding No.</i></b>	<b><i>Title</i></b>	<b><i>Rating</i></b>
1	Late Renewals	Medium
2	Duplicate Application Fee Refunds	Low
3	Communication of Final Decision	Low
4	CLEAR Report Deletion	Low
<b>Observation No.</b>	<b>Title</b>	<b>Rating</b>
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	<p style="text-align: center;"><u>Description of Rating</u></p> <p>A finding is rated <i>Priority</i> if the issues identified present risks or effects that if not addressed could critically affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern and reduce risks to the audited entity.</p> <p>A finding is rated <i>High</i> if the issues identified present risks or effects that if not addressed could substantially affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern and reduce risks to the audited entity.</p> <p>A finding is rated <i>Medium</i> if the issues identified present risks or effects that if not addressed could moderately affect the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern and reduce risks to a more desirable level.</p> <p>A finding is rated <i>Low</i> if the audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.</p>	

**OBSERVATIONS/FINDINGS and RECOMMENDATIONS**

Report No.	Report Date	Name of Report	Observations/Findings and Recommendations	Current Status (Fully Implemented, Substantially Implemented, Incomplete/Ongoing, or Not Implemented) with brief description if not yet implemented	Fiscal Impact/Other Impact
1	7/27/2018	Processing Dealer Applications	<p><b>1. Late Renewals</b></p> <p>(1) Performance Reporting</p> <p>SSB maintains an Excel spreadsheet (spreadsheet) to document approved late renewals, which are combined with other numbers obtained from the CRD and Dealer Systems to calculate the key performance measure: <i>Number of Applications and Submissions Processed</i>. The Q2 2018 Performance Report included the following approved late renewals from the spreadsheet:</p> <ul style="list-style-type: none"> <li>• Total Number of firms that Late Renewed: 28</li> <li>• Total Number of individuals that Late Renewed: 48</li> </ul> <p>However, our testing indicated that the numbers reported from the spreadsheet were duplicated since in most instances, those numbers were already included in other reports generated from the CRD system. In reviewing the spreadsheet and the CRD Report further, we identified the following exceptions:</p> <ul style="list-style-type: none"> <li>• 1 IA firm and 1 IA representative were erroneously omitted from the spreadsheet but included in the CRD Report. Thus, no effect to the numbers reported in the Performance Report or the duplicated count.</li> <li>• 1 firm and 1 individual were included in the spreadsheet but not in any other report. Thus, since these numbers were only included in the spreadsheet and excluded from the CRD Report, they were properly reported in the Performance Report and reduce the duplicate count for both, firms and individuals by 1.</li> <li>• 2 firms and 4 individuals were included in the spreadsheet but not in the Quarter 2 CRD Report. Instead, they were included in the Quarter 3 CRD Report due to the difference in the cut-off period between the spreadsheet and CRD Report. Thus, since these numbers were only included in the spreadsheet and excluded from the CRD Report, they were properly reported in the Performance Report and reduce the duplicate count for firms and individuals by 2 and 4, respectively.</li> </ul> <p>Based on the above, the net overstatement reported in the Q2 Performance Report was 25 for the "Total Number of firms that Late Renewed" and 43 for the "Total Number of individuals that Late Renewed".</p>		Improve accuracy of performance measure reporting.

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Report No.	Report Date	Name of Report	Observations/Findings and Recommendations	Current Status (Fully Implemented, Substantially Implemented, Incomplete/Ongoing, or Not Implemented) with brief description if not yet implemented	Fiscal Impact/Other Impact
1	7/27/2018	Processing Dealer Applications	<p><b>Recommendation</b>  We recommend that SSB review the current method for gathering information for performance measure reporting related to late renewals and revise as appropriate to improve accuracy.</p> <p><b>Management's Response</b>  The Staff agrees with the recommendation. Staff has reviewed its current method of reporting related to late renewals and has eliminated an unnecessary redundancy that resulted in the overstatement.</p> <p>Late renewals are a component of applications and submissions processed by the division. During the 9-month period from September 1, 2017 through May 31, 2018, SSB reported that it had processed 444,423 dealer applications, notice filings, amendments, and renewals.</p> <p>(2) Late Renewal Fee Waiver</p> <p>According to FINRA Regulatory Notice 17-35 dated October 31, 2017, the 2018 renewal payment deadline for FINRA-members was December 18, 2017, with a late fee assessed if not received by that date.</p> <p>Our review of 3 late renewals disclosed 1 instance where the registration for an IA firm and its IA representative expired on December 31, 2017; and, the Registration Division waived the late renewal fee totaling \$55.00 when it approved the late renewal on January 4, 2018. The registrant requested the late renewal fee be waived since it was unable to renew through the CRD/IARD systems in late December 2017 and indicated that it captured a screenshot as evidence.</p> <p>In the absence of written procedures and/or guidance of waiving late renewal fees during the audit period, the Registration Division retained the registrant's waiver request; however, did not document justification for granting the waiver or obtain the said screenshot from the registrant.</p> <p><b>Recommendation</b>  We recommend that SSB implement controls to comply with their newly developed <i>Policy and Procedures for Waiving a Dealer Registration Required Fee</i> that became effective August 22, 2018, and properly document any waivers to justify they are granted consistently and in accordance with the policy and procedures.</p> <p><b>Management's Response</b>  The Staff agrees with the recommendation. Under current practice as amended September 20, 2018, the fee waiver recommended and approved by the Assistant Director must subsequently be approved and documented by the Deputy Commissioner or Commissioner.</p>		Late renewal fee waiver is justified, granted consistently, and properly documented.

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1	7/27/2018	Processing Dealer Applications	<p><b>2. Duplicate Application Fee Refunds</b></p> <p>Our review of SSB's Money System (System) report indicated that on March 12, 2018, SSB issued a duplicate \$75 application fee refund. The cause of the duplicate refund was due to the refund request, which was entered in the System in February 2016, being denied (on the refund approval sheet) by a former assistant director on February 8, 2016, noting possible duplicate entries; however, the matter was not followed up on and the requests remained pending in the System. In December 2017, a current assistant director who was unaware of the previously raised concern approved both refund requests, which were processed by the Accounting department.</p> <p>Note: Subsequent to the audit field work, SSB recovered the \$75 from the payee and deposited the funds to the State Treasury on August 7, 2018.</p> <p><b>Recommendation</b>  We recommend that SSB strengthen controls over application fee refunds to ensure refund requests are processed within a reasonable time period; and, that long outstanding, unusual pending, and/or processed requests are identified and researched in a timely manner.</p> <p><b>Management's Response</b>  The Staff agrees with the recommendation. In regard to a duplicate fee refund in 2<sup>nd</sup> Quarter, FY 2018:</p> <ul style="list-style-type: none"> <li>- Staff identified the potential duplicate refund while collecting the sample for the auditor, reported the potential error to the auditor, and began a review of the transactions in question.</li> <li>- Staff is assessing an automated internal system patch that would flag potential duplicates.</li> <li>- Staff instituted additional staff reviews of "active refunds" prior to processing.</li> <li>- Staff initiated a review of fee refunds for FY 2016 and 2017 and determined there was no actual processing of duplicate refunds during those fiscal years.</li> </ul>		Accurate and timely application fee refund.

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1	7/27/2018	Processing Dealer Applications	<p><b>3. Communication of Final Decision</b></p> <p>TAC §104.5(f) requires that the final decision to grant, deny, or allow withdrawal of the application, must be made and communicated to the applicant within 14 days of the latter of: (a) the division's recommendation; or, (b) receipt by SSB of complete responses to any pending comments. To comply with this requirement, the Registration Division emails the applicant of the approval and the effective date, and retains the email record as evidence of compliance. Our testing of 20 registration applications disclosed 1 instance where, although the approval of the application was timely, we were unable to determine whether timely <i>communication</i> of approval took place since the email record was not retained in the registration file.</p> <p><b>Recommendation</b>          We recommend that SSB retain all types of communication records in registration files as evidence of compliance with the Act and TAC.</p> <p><b>Management's Response</b>          The Staff agrees with the recommendation and will update procedures to identify the types of documentation required to be maintained to reflect the registration decision.</p>		Evidence of compliance with TAC §104.5 is retained.

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1	7/27/2018	Processing Dealer Applications	<p><b>4. CLEAR Report Deletion</b></p> <p>Financial examiners and the Registration Division's attorney utilize the CLEAR Report to conduct investigations of registration applicants who have regulatory disclosures or other relevant concerns. The CLEAR Report is downloaded from a vendor web portal and saved in the Registration Drive; however, due to the highly sensitive nature of the information included in the CLEAR Report, the Registration Division has developed safeguarding procedures, which prohibit users from printing them and requiring that they be deleted after 14 days of receipt.</p> <p>On July 13, 2018, we observed 22 CLEAR Reports saved in the Registration Drive. Of the 22 CLEAR Reports, 11 had a file save date ranging from June 12, 2018 to June 26, 2018, exceeding the 14-day deletion timeframe by 3 to 17 days.</p> <p><b>Recommendation</b>          We recommend that SSB implement a quality control procedure that will ensure CLEAR Reports are deleted within the required timeframe; or, if a longer retainage period is required, a notation of the revised deletion date should be made.</p> <p><b>Management's Response</b>          The Staff agrees with the recommendation and will implement a quality control procedure to ensure CLEAR reports are timely deleted. Staff is also reviewing the necessity of its 14-day retainage period and may establish a longer period.</p>		SSB's procedures for safeguarding sensitive information are consistently followed.



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### VII. External Audit Services Procured in Fiscal Year 2018

SSB procured the internal audit services documented in the approved Internal Audit Plan for fiscal year 2018. No other external audit services were performed.

### VIII. Reporting Suspected Fraud and Abuse

SSB has provided information on their website home page on how to report suspected fraud, waste, and abuse to the State Auditor's Office (SAO) by posting a link to the SAO's fraud hotline. SSB has also developed a Fraud Prevention Policy that provides information on how to report suspected fraud, waste, and abuse to the SAO.

### IX. Proposed Internal Audit Plan for Fiscal Year 2019

The risk assessment performed during the 2018 fiscal year was used to identify the following *proposed* area that is recommended for internal audit and other tasks to be performed for fiscal year 2019. The Internal Audit Plan for Fiscal Year 2019 will be developed and presented to the Audit Committee and/or Board, for acceptance and approval, at a meeting to be determined at a later date.

- Processing Securities Applications
- Follow-up of Prior Year Internal Audits
- Other Tasks Assigned by the Board

**X. Organizational Chart**

