



Summary of Internal Audit Comments

FY2014

As Of Date	Name of Report	High-Level Audit Objective(s)
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No. Status	Condition	Cause	Criteria	Effect	Recommendation
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Management Response

09/01/2013	Administrative Services	<p>To determine that:</p> <ul style="list-style-type: none"> • Policies, procedures, and risk limits are adequate. • Internal controls are sufficient and effective. • Independent review functions are satisfactory. • Information and communication systems are adequate and accurate. 			
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01 Fully Implemented	A review of the documentation of Annual Evaluations noted that six Month Evaluations had not been documented for three employees.	These appear to be the result of error or oversight.	CPA H.R. Policy.	Noncompliance with policy.	Six month evaluations should be completely documented and signed in a timely manner in accordance with policy. Exceptions to policy should be approved in writing by executive management.
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Management agrees that compliance with H.R. policies is important and will ensure that six month evaluations for new employees are completed. In the future exceptions to policy will be documented and approved by the C.E.O.

Two of the three cited deficiencies, however, are in compliance with the spirit, if not the letter, of established policy:

- *One employee had retired after seven years with the Trust Company and was rehired four months later. He was not reviewed after six months because he returned to the same job he held for the previous seven years. His competency was known.*
- *A second employee received evaluations each month during their first six months as an employee, which management finds to be an acceptable substitute for a six-month evaluation.*

02 Fully Implemented	A review of travel expenses over the past year noted receipts were missing for six of thirty-three travel vouchers examined.	These appear to be the result of error or oversight.	CPA Employee Handbook.	Non-compliance with policy.	Travel vouchers should be properly documented and supported by valid receipts. Exceptions to policy should be approved in writing by executive management.
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Management will continue to require receipts and to remind staff to be diligent in turning in receipts; however, management notes that state policy only requires receipts for lodging, airfare, and car rental. The six receipts missing here were for parking and cab fare; furthermore, the Travel Coordinator ran a reasonableness test before reimbursing for these expenses.

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<i>Management Response</i>					

10/31/2013	Investment Management Division	The purpose of this review was to document the business processes, determine controls over these processes, identify internal control design weaknesses, and test existing controls to determine their effectiveness. Controls were evaluated according to financial industry standards and best practices			
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01 Fully Implemented	<p>A review of documentation in support of the broker dealer selection process noted the following deficiencies:</p> <ul style="list-style-type: none"> • Broker Dealer questionnaire unsigned (2). • Broker Dealer questionnaire not dated (1). • Financial Statements not current (1). • Financial Statements unaudited (1). • Current Texas Security Board Statement not documented (3). • Anti-Collusion Statement not dated (1). 	These appear to be the result of oversight.	Policy.	Decisions based on out dated or incomplete information increase the risk of unexpected events and could result in financial losses or missed opportunities.	Decisions based on out dated or incomplete information increase the risk of unexpected events and could result in financial losses or missed opportunities.
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Both dealers signed their broker dealer questionnaire (One dealer used their own letterhead with language approved by TTSTC; the other dealer's signature page was a separate document in Red Alerts). The documents kept in Red Alerts, however, were not uniform or comprehensively reviewed in all respects. Management agrees that these records should be kept in a uniform and easily accessible manner. The Compliance Officer currently confirms that all required documents are received and placed in Red Alerts, but in the future will also review each document to ensure each is current and complete in all respects.

02 Fully Implemented	Reviews of ADV Part I and II by the Compliance Officer are not documented. In addition, copies of ADVs for three managers were not documented in Red Alerts.	Documentation of the ADV reviews indicates they were performed by a paralegal. ADVs not found in Investment Research Management System appear to be due to oversight.	Investment manager monitoring and review policy.	Noncompliance with policy.	Reviews of ADV Part I and II should be completely documented, including the initials of the Compliance Officer. Copies of the ADVs should be maintained in the Code Red system.
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Management agrees that ADV reviews should be documented and all manger ADVs should be maintained in Red Alerts. In the future, the ADV summary review completed by the Compliance Officer will include a notation confirming review and all ADVs will be filed in Red Alerts.

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Management Response

10/31/2013	Unclaimed Property	<p>To determine the extent to which:</p> <ul style="list-style-type: none"> ▪ Assets transferred to and remitted by the department are properly recorded and controlled. ▪ Records are sufficient to permit an accurate accounting. ▪ Internal control procedures are adequate. ▪ Duties of the department, whether established by law or contract, are properly executed in a timely manner. 			
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01 Fully Implemented	<p>A review of SER's (Stock Explanation Requests) noted that:</p> <ul style="list-style-type: none"> • Verification of S.E.R. to original Analyst Assigned report was not documented in ten instances. • Claimant's address did not match the DTC report in one case. 	These appear to be the result of error or oversight.	Current procedure requires verification of S.E.R. to the original report in order to detect unauthorized alterations in the claim form.	Stock Explanation Requests may be altered in order to divert assets from their rightful owners. Assets may not be delivered in a timely manner to the claimant.	A second party review of claims documentation by someone independent of the claims process should be implemented.
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Management has implemented process changes so that all transfers originated by SERs have a second party verification process in place that is clearly documented as completed on each SER.

The address mismatch appears to be a data entry transposition that was not caught by the DTC Operator who entered the information, nor the second person who verified the information. Management is aware of the potential of human error related to the manual nature of the existing process and will analyze the implementation of file transfer processes when the resources become available.

02 Incomplete / Ongoing.	Movement of Unclaimed Property securities is not tracked in a timely and effective manner by the Q2 Investment Accounting system. This was a prior audit comment.	Location tracking is not easily accomplished in the Q2 Investment Accounting system. Security movement requires an entry removing a position from the system followed by an entry to create a new position, leaving no clear historical audit trail. This results in an inherent delay between movement of a security and update of the system.	Industry best practice.	Discrepancies in security listings for the vault and safe were noted as a result of timing differences which could increase the risk of loss.	An automated system, to track unclaimed property securities in a timely manner, should be acquired and implemented.
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We are currently in the requirements definition phase of a project to acquire or develop a securities safekeeping system that will accommodate Unclaimed Property needs more closely than the current Q2 system.

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01/31/2014	Alternative Investments	The purpose of this review was to document the business processes, determine controls over these processes, identify internal control design weaknesses, and test existing controls to determine their effectiveness. Controls were evaluated according to financial industry standards and best practices.			
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01 Substantially Implemented	As of the audit date, <u>01/31/14</u> , documentation supporting due diligence was found to be incomplete: <ul style="list-style-type: none"> • Site visits not sufficiently documented, no details of observations or work performed (23). • Last on site visit not performed in more than two years (5). • Current Financial Statement not documented (1). 	These appear to be the result of error or oversight.	Policy and industry best practice.	In the absence of well-documented, ongoing due diligence reviews of alternative assets, the probability of monetary losses and lost opportunities is increased. In addition, the opportunity to mitigate this exposure can be lost.	Due diligence supporting current and new investment holdings should be performed and documented in a complete and timely manner in accordance with policy.
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Management agrees that documentation of due diligence and site visits is important. With the exception of an Asian-based real estate fund of funds, all findings referenced in this IAM were performed by staff or Trust Company Consultants and have now been documented within the Investment Research Management System (IRMS). That fund is a small allocation, representing 0.2% of total endowment assets. Management will arrange for a Trust Company consultant to perform an on-site diligence visit with that fund this year.

02 Fully Implemented	Less than 60% of fund assets are invested in strategies that offer liquidity within 185 days.	As of 01-31-2014, 56.2% of fund assets were invested in strategies that offer liquidity within 185 days.	Investment Policy Statement, Texas Endowment Funds.	Noncompliance with policy.	Compliance with policy is recommended.
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Management agrees that compliance with policy is important. This was a temporary condition that was a product of a realignment of the portfolio. The Trust Company Internal Investment Committee had full knowledge of the condition and it was reported to the Comptroller's Investment Advisory Board at their March 3, 2014 meeting. The Trust Company terminated and redeemed from several managers that were out of lock-up and, thus, liquid. Those and some additional funds were put back to work with new managers requiring initial lockups beyond 185 days. This, in addition to a tactical overweighting of Private Debt gave rise to the temporary variance from required liquidity limits. The portfolio was back in compliance with its liquidity policy by March 2014. Although the fund's liquidity was temporarily below the policy liquidity threshold, there was never a risk of the endowment missing any of its required cash flow disbursements.

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Management Response

02/28/2014	Accounting and Trust Operations	<p>To determine the extent to which:</p> <ul style="list-style-type: none"> ▪ Assets transferred to the department are properly recorded and controlled. ▪ Records are sufficient to permit an accurate accounting. ▪ Internal control procedures are adequate. ▪ Duties of the department, whether established by law or contract, are properly executed in a timely manner. Included among these responsibilities are: accounting for trust assets, collecting income and principal, paying expenses, and distributing income and principal. ▪ Proper fees have been collected and recorded in a timely fashion. 			
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01 Fully Implemented	<p>As of this audit date (02/28/2014), five policies were found to be stale and may not accurately reflect current processes:</p> <ul style="list-style-type: none"> • Affirmation of Compliance with Investment Policy Statements (02/2007) • Compensatory Time / Overtime General Guidelines and Policies (10/2005) • Customer Complaint Policy (09/2007) • Distribution & Updates of Policies and Procedures (02/2007) • Fiduciary Check Disbursement Approval Policy & Procedure (08/2008) 	This appears to be the result of oversight.	<p>This comment was made in the prior audit and management stated:</p> <p><i>Management agrees that policies should be reviewed periodically and updated as necessary. Responsibility to review, establish a schedule and process for reviewing Trust Company policies has been assigned to the legal division. A schedule and process will be established by the <u>end of the fiscal year</u>.</i></p>	In the absence of current policies, management has little assurance of compliance with its directives.	<p>Policies and procedures should be periodically reviewed and updated.</p> <p>A draft of the new policy was issued during the audit.</p>
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The "Distribution and Updates of Policies and Procedures" policy was revised to include a yearly review of all policies and procedures. The revised policy was circulating for approval during the audit. The policy was adopted in March 2014, and is being followed.

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Management Response

02/28/2014	Accounting and Trust Operations (Continued)				
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02 Fully Implemented	Compliance was inconsistent with current policy, requiring segregation of duties in the disbursement process for our customers.	Test work revealed that Letters of Instruction (LOI's) were approved by, Transaction Routing Forms were initialed by, and the checks were signed by the same employee.	Disbursements should evidence the review of the transaction for validity by more than one Trust Company employee. Current policy requires that Trust Services review and approve the client's LOI and printed checks be forwarded to <u>a second staff person</u> for final review and signature.	There is an increased risk of error or misappropriation.	Policy should be established that requires segregation of the LOI approval and check signing duties.
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The processing of Letters of Instruction and checks requires the physical involvement of both the Accounting and Trust Services departments. Thus a separation of duties is in place requiring the review and processing by more than one staff member prior to execution or issuance.

Management agrees that documenting all persons involved in validating and approving a client check disbursement enhances the internal controls over this process. Approved Letters of Instruction, Transaction Routing Forms, and signed checks should reflect the actual duties of all staff involved in the process from initial validation of client request to final check disbursement. The policy and procedure for check disbursement was revised effective June 1, 2014 requiring documentation of a second review of the Letter of Instruction prior to entry into the accounting system.

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Management Response

04/30/2014	Custody Settlement	The purpose of this review was to document the business processes, determine controls over these processes, identify internal control design weaknesses, and test existing controls to determine their effectiveness. Controls were evaluated according to financial industry standards and best practices.			
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01 Fully Implemented	Wire Transfer Instruction form not documented. (03/10/2014) (2, \$550 million & \$138 million)	This is apparently the result of oversight.	Settlement and Custody Services Wire room policy.	Noncompliance with policy.	Compliance with policy is recommended.
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To management's knowledge, this is the only time a wire transfer instruction form has not been archived properly. Because of this, we do not feel it is necessary to implement any additional processes; we will work to ensure that in the future all wire transfer instruction forms are archived properly.

02 Fully Implemented	A review of documentation supporting the monitoring process over the FRB Intra Day position reports for the period of 02/01/13 through 04/30/14 noted six that were not documented.	These were not included in the documentation provided to the auditor and initialed copies could not be located.	Settlement and Custody Services policy.	Monitoring of the FRB Clearing Account Cash Position is not consistently documented in accordance with policy.	Compliance with policy is recommended.
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The FRB Intra Day Position Report, which provides our Fedwire balance at the end of each minute of the prior business day, is received via email every morning. These emailed reports are reviewed daily, along with real time Fedwire balance monitoring throughout each business day. Management will work to ensure that all initialed report copies are provided to the auditor in the future.

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Management Response

05/31/2014	Bidtex	<p>To determine:</p> <ul style="list-style-type: none"> • Deposits are properly recorded, classified, and reported. • Deposits are deposited timely in compliance with applicable laws • Deposits are performed in accordance with established written policies and procedures. • Adequate controls exist to safeguard funds from loss, errors and irregularities. • Controls are adequate to investigate and report shortages/overages in a timely manner and corrective action is taken immediately. • Interest income on state funds is maximized and collected in a timely and accurate manner. • Compliance with applicable laws, rules and regulations. 			
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01 Fully Implemented	<p>Depository banks are required by the State Depository Handbook to provide statements detailing balances, interest rates, and maturity dates. These are used to reconcile BidTex and open time deposits quarterly to the Q2 investment accounting system. Test work revealed that the responses received from the depository banks were inconsistent and incomplete.</p>	<p>Frequently bank statements are not provided and email responses are received instead. In addition, a majority of the emails fail to identify the name of the depository bank.</p>	<p>At a minimum, responses should include the name of the depository bank, balance, interest rate, and maturity date.</p>	<p>As a result, this has become a poorly documented confirmation process.</p>	<p>Confirmations should be implemented that detail the bank name, balance, interest rate, and maturity date.</p>
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Management agrees that it has been difficult to compel the depository banks to comply with the State Depository Handbook reporting requirements. Therefore, Investment Accounting implemented a new process to facilitate BidTX quarterly reconciliations. At quarter-end, an email is sent to each state depository holding BidTX or open time deposits requesting a quarterly statement or confirmation that includes bank name and the principal balance, interest rate and maturity date of all applicable deposits held by the institution. The email includes a due date that is 15 days after quarter-end and the express notice of a penalty for non-compliance – revocation of approval to participate in the program. A read receipt is used to confirm receipt of the email. If a response is not received by the due date, a reminder email will be sent to each delinquent depository with a due date that is 10 days after the initial due date. This process was implemented in July 2014.

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Management Response

08/31/2014	Systems and Support	<p>To determine that:</p> <ul style="list-style-type: none"> • Facilities are managed to provide a suitable physical surrounding, which protects the IT equipment and people against man-made and natural hazards. This is enabled by the installation of suitable environmental and physical controls, which are regularly reviewed for their proper functioning. • Systems security safeguards information against unauthorized use, disclosure or modification, damage or loss. This is enabled by logical access controls, which ensure that access to systems, data and programs is restricted to authorized users. • IT services are available as required and to ensure a minimum business impact in the event of a major disruption. This is enabled by having an operational and tested IT continuity plan, which is in line with the overall business continuity plan and its related business requirements. • System configurations are managed to account for all IT components, prevent unauthorized alterations, verify physical existence and provide a basis for sound change management. This is enabled by controls, which identify and record all IT assets and their physical location, and a regular verification program, which confirms their existence. • Data is managed in a manner to ensure its completeness, accuracy, and validity during its input, update and storage. This is enabled by an effective combination of application and general controls over the IT operations. • Problems and incidents are resolved, and the cause investigated to prevent any recurrence. This is enabled by a problem management system, which records and progresses all incidents. 			
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Government Code Section 552.136 provides that information is exempted from public disclosure under the Public Information Act if it relates to computer network security or to the design, operation or defense of a computer network. Details of issues, findings and recommendations have been privately communicated to management in a separate report.