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An Audit Report on

Performance Measures at the Securities Board

April 2007

Report No. 07-028



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Overall Conclusion

The Securities Board (Board) reported reliable results for 60 percent (3 of 5) of the fiscal year 2006 key performance measures audited. A result is considered reliable if it is certified or certified with qualification.

Specifically:

- Two key performance measures—Number of Investigations Opened and Number of Law Enforcement Actions Taken—were certified with qualification because the Board does not consistently document its review of the data that has been entered into the Automated Budget and Evaluation System of Texas (ABEST) before it is released.
- One key performance measure—Average Cost Per Inspection—was certified with qualification because the Board deviated from the calculation methodology contained within ABEST. However, the deviation caused less than a 5 percent difference between the number reported in ABEST and the actual performance measure result.
- Two key performance measures—Percentage of Texas Dealers and Investment Advisers Inspected and Percentage of Inspected Dealers and Investment Advisers Found Out of Compliance—were inaccurate because the actual performance was not within 5 percent of the performance reported by the Board.

Background Information

Entities report results for their key measures to the Legislative Budget Board's budget and evaluation system, which is called the Automated Budget and Evaluation System of Texas, or ABEST.

Table 1 summarizes the certification results from audit testing.

Table 1

Securities Board (Agency No. 312)			
Related Objective or Strategy, Classification, and Description of Measure	Fiscal Year	Results Reported in ABEST	Certification Results
A, Outcome, Percentage of Texas Dealers and Investment Advisers Inspected	2006	239%	Inaccurate
A, Outcome, Percentage of Inspected Dealers and Investment Advisers Found Out of Compliance	2006	65%	Inaccurate
A.4.1, Efficiency, Average Cost Per Inspection	2006	\$4,157.24	Certified With Qualification
A.1.1, Output, Number of Investigations Opened	2006	307	Certified With Qualification
A, Outcome, Number of Law Enforcement Actions Taken	2006	733	Certified With Qualification
<p>A measure is Certified if reported performance is within +/-5 percent of actual performance and if controls appear adequate to ensure accuracy for collecting and reporting performance data.</p> <p>A measure is Certified With Qualification if reported performance is within +/-5 percent of actual performance but controls over data collection and reporting are not adequate to ensure continued accuracy.</p> <p>A measure is Inaccurate when reported performance is not within +/-5 percent of actual performance or there are more than two errors in the sample tested.</p> <p>Factors Prevent Certification when actual performance cannot be determined because of insufficient documentation and inadequate controls or when there is deviation from the measure definition and the auditor cannot determine the correct result.</p>			

Summary of Management's Response

The Board agrees with the findings and recommendations in this report.

Summary of Information Technology Review

Auditors reviewed the integrity of performance measures data within the Board's Registration system and its Inspections and Compliance system.

A weakness in information technology controls can directly affect data integrity for two key performance measures: (1) Percentage of Texas Dealers and Investment Advisers Inspected and (2) Percentage of Inspected Dealers and Investment Advisers Found Out of Compliance. Specifically, the Board does not review data in both the Registration system and the Inspections and Compliance system for correctness or completeness prior to making performance measure calculations.

The Board should strengthen other information technology controls; however, none of these controls directly affects the integrity of performance measures data.

Summary of Objectives, Scope, and Methodology

The audit objectives were to determine whether the Board (1) accurately reports selected key performance measures to the Automated Budget and Evaluation System of Texas (ABEST) and (2) has adequate control systems over the collection, calculation, and reporting of selected key performance measures.

The audit scope consisted of testing five key performance measure results the Board reported for fiscal year 2006 to determine their accuracy.

The audit methodology consisted of selecting measures to audit, auditing reported results for accuracy and adherence to measure definitions, evaluating controls over the performance measures certification process and related information systems, and testing of original source documentation.

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Detailed Results

Chapter 1

The Board Reported Reliable Results for Three of Five Key Performance Measures Audited

The Board Should Improve Its Review of Performance Measures

For all performance measures tested, the Securities Board (Board) does not have sufficient controls to ensure its reported performance measures are accurate.

Specifically, the Board does not consistently document its review of the data that has been entered into the Automated Budget and Evaluation System of Texas (ABEST) before it is released to ensure accuracy.

Lack of consistent documentation of supervisory review impairs the accuracy of reported performance measures.

Recommendation

The Board should consistently document supervisory review to ensure that the reporting of performance measures results in ABEST is accurate.

Management's Response

The Agency agrees with the findings and recommendations. The Deputy Commissioner is responsible for implementing corrective action. The time lines for implementation are discussed below.

The Agency has created sufficient controls to ensure that its reported performance measures are accurate. These controls will be consistently applied and documented.

The Agency's quarterly performance reporting forms have been updated and the written procedures of each reporting division of the Agency have been clarified to ensure that all performance data is consistently and accurately measured. The Agency has created and implemented a formal written ABEST data entry procedure to document its review of data submitted to ABEST before it is released to ensure accuracy. The written procedure requires that: 1) A staff member, other than the Director of each reporting Division, compiles the quarterly performance data and attaches supporting documentation to each report confirming the accuracy of the information set

forth on the reporting form; 2) The Director of each reporting Division independently verifies that the information set forth on each reporting form is accurate; 3) The Director of the Staff Services Division checks each reporting form for accuracy, documents this review, and makes a preliminary entry of the data in ABEST; 4) The Deputy Commissioner checks the information reported on the reporting form for accuracy, documents this review, and independently confirms that the information in the ABEST report is accurate before releasing the report; and 5) A copy of the ABEST report is promptly distributed to the Securities Commissioner, members of the Audit Committee of the Board, and to Division Directors.

Key Measures

Percentage of Texas Dealers and Investment Advisers Inspected

Percentage of Inspected Dealers and Investment Advisers Found Out of Compliance

Both of these performance measures were inaccurate:

- For the Percentage of Texas Dealers and Investment Advisers Inspected, auditors identified a 218 percent variance between the recalculated performance measure and the measure the Board reported in ABEST. The Board reported this performance measure was 239 percent, but auditors recalculated it as 21 percent. This exceeded the 5 percent allowable variance; therefore, the performance measures data the Board reported for this measure was inaccurate.

Results: Inaccurate

Reported performance is not within +/-5 percent of actual performance or there are more than two errors in the sample tested.

- For the Percentage of Inspected Dealers and Investment Advisers Found Out of Compliance, auditors identified a 20 percent variance between the recalculated performance measure and the measure the Board reported in ABEST. The Board reported this performance measure was 65 percent, but auditors recalculated it as 85 percent. This exceeded the 5 percent allowable variance; therefore, the performance measures data the Board reported for this measure was inaccurate.

In addition, the Board does not have controls to ensure that performance measure calculations originating from its Inspections and Compliance Division for the Percentage of Texas Dealers and Investment Advisers Inspected and the Percentage of Inspected Dealers and Investment Advisers Found Out of Compliance measures are correct before the corresponding performance measures data is entered into ABEST.

Recommendations

The Board should:

- Implement revised policies and procedures for data entry, calculation, and reporting of performance measures results for Percentage of Texas Dealers and Investment Advisers Inspected and Percentage of Inspected Dealers and Investment Advisers Found Out of Compliance.
- Implement a supervisory review process in its Inspections and Compliance Division to ensure that the data entry, calculation, and reporting to ABEST are accurate.

Management's Response

The Agency agrees with the findings and recommendations. The Deputy Commissioner is responsible for implementing corrective action. The time lines for implementation are discussed below.

1. The ABEST report for Fiscal Year 2006 has been revised and these performance measures are now reported accurately. The Agency has implemented additional input, process, and supervision controls for the data entry, calculation, and reporting of all performance measures to ensure that all information submitted to ABEST is accurate. These controls include training, documentation, supervisory approval, independent verification, and report dissemination requirements.

2. The Agency has implemented a supervisory review process in its Inspections and Compliance Division requiring prompt entry of data by designated personnel, approval of all data entries by an Assistant Director or Director of the Division, quarterly review of all data by an Assistant Director, and written reports to the Director confirming the accuracy of data. Each quarterly performance report and documentation substantiating the information set forth in the report will be subject to an independent documented review for accuracy by the Director of the Inspections and Compliance Division, Director of the Staff Services Division and the Deputy Commissioner before the information is submitted to ABEST.

Average Cost Per Inspection

The Board's reported results for this performance measure were accurate. However, this measure was certified with qualification because the Board deviated from the measure definition by including encumbrances in the total expenditures.

Results: Certified With Qualification

Deviated from the measure definition but the deviation caused less than a 5 percent difference between the number reported to ABEST and the correct performance measure result.

The measure definition for the Average Cost Per Inspection measure per ABEST is "average cost to conduct all inspections," and the methodology is defined as "the total expenditures for the Inspections and Compliance Division for the reporting period is divided by the number of inspections conducted for the reporting period." Encumbrances should not be included in the total expenditures for this measure.

In addition, the Board did not update its policy manual for this measure when it changed the measure methodology from "total costs as manually adjusted for encumbrances" to the revised measure methodology described above (which makes no mention of making adjustments for encumbrances). However, the Board has continued to adjust for encumbrances in accordance with the outdated policy manual.

The Board also adjusts the *SIRS: ABEST/USAS Reconciliation Report*,¹ which is cumulative in nature, by backing out the amounts for prior quarters to obtain the quarterly expenditures. The Board has no documentation of this process. The lack of documentation could lead to incorrect performance measures data being entered into ABEST.

Recommendations

The Board should:

- Revise its policy manual to reflect the correct performance measure definition and methodology for Average Cost Per Inspection.
- Maintain proper documentation of calculations used to determine the total expenditures used in calculating the Average Cost Per Inspection.

Management's Response

The Agency agrees with the findings and recommendations. The Deputy Commissioner is responsible for implementing corrective action. The time lines for implementation are discussed below.

¹ SIRS refers to the State Government Accounting Internet Reporting System and USAS refers to the Uniform Statewide Accounting System.

1. The Agency has revised its performance reporting form to reflect the correct performance measure definition and methodology for Average Cost Per Inspection.

2. In accordance with the Agency's revised procedures for collecting and reporting performance data, all documentation of calculations used to determine the Average Cost Per Inspection are maintained in the performance reporting file for each quarter of the fiscal year.

Specific Information Technology Controls Should Be Improved

Auditors identified a weakness related to information technology that can directly affect data integrity for two key performance measures: (1) Percentage of Texas Dealers and Investment Advisers Inspected and (2) Percentage of Inspected Dealers and Investment Advisers Found Out of Compliance. Specifically, the Board does not review data in its Registration system and its Inspections and Compliance system for correctness or completeness prior to calculating these performance measures.

The Board also should strengthen other information technology controls to further protect the integrity of performance measures data. Specifically, the Board should correct the following issues:

- The Board does not retain e-mail documentation that would provide evidence of its reconciliations of data entered into the Registration system with data in the Inspections and Compliance system.
- The Board does not have process maps or flowcharts for its Registration system.
- Program code for applications in the Registration system and the Inspections and Compliance system is not protected from unauthorized changes.
- There are weaknesses in user access controls for the Registration system and the Inspections and Compliance system.
- There are weaknesses in the Board's protection of its computer room from fire and water damage.

Recommendations

The Board should:

- Implement the following recommendations to strengthen data integrity for two performance measures: (1) Percentage of Texas Dealers and Investment Advisers Inspected and (2) Percentage of Inspected Dealers and Investment Advisers Found Out of Compliance:
 - ♦ Review codes entered into the Registration system and Inspections and Compliance system to ensure that the report queries select the correct records. Data in the Inspections and Compliance system should be reviewed for accuracy and completeness, including both the data uploaded from the Registration system and data entered manually into the Inspections and Compliance system.

- ♦ Review report query language in the Registration system to confirm that all codes have been queried correctly for past performance measures.
- ♦ Review report query language in the Registration system any time the codes are added, changed, or deleted.
- Implement the following recommendations to strengthen overall data integrity:
 - ♦ Retain documentation to provide evidence of its reconciliations of data entered into the Registration system with data in the Inspections and Compliance system.
 - ♦ Create process maps and flowcharts for the new Registration system it plans to implement in September 2007.
 - ♦ Protect program code in its new Registration system from unauthorized changes. The Board should also institute segregation of duties for changes made to program code in the Inspections and Compliance system.
 - ♦ Strengthen user access controls to the Registration system and the Inspections and Compliance system.
 - ♦ Use detection and alarm systems to minimize the risk of fire and water damage to the Board's computer room.

Management's Response

The Agency agrees with the findings and recommendations. The Deputy Commissioner is responsible for implementing corrective action. The time lines for implementation are discussed below.

A. The Agency has taken the following steps to strengthen data integrity for two performance measures: (1) Percentage of Texas Dealers and Investment Advisers Inspected and (2) Percentage of Inspected Dealers and Investment Advisers Found Out of Compliance:

1. A process will be incorporated into the new Registration system, planned to be operational in September 2007, to review codes entered into the Registration system and Inspections and Compliance system to ensure that report queries select the correct records. The Agency has planned a revision of the Inspections and Compliance system that will allow it to operate on the same platform and share the same data as the new Registration system. The Inspections and Compliance Division has adopted new input, process, and supervision controls to ensure

that data manually entered into the Inspections and Compliance system is accurate.

2. The Agency will review relevant query language in the Registration system to confirm that all codes have been queried correctly for past performance measures. A new Registration system is being developed by the Agency that is planned to be operational in September 2007. This new system will allow for the simplified review of codes to ensure that performance measure data is queried correctly.

3. The Agency's information technology policies will be modified to include the requirement of review of query language in the new Registration system any time codes are added, changed, or deleted.

B. The Agency has taken the following steps to strengthen overall data integrity:

1. The Agency is now retaining email documentation that provides evidence of its reconciliation of registration data and has planned a revision of the Inspections and Compliance system that will allow it to operate on the same platform and share the same data as the new Registration system.

2. The Agency is presently creating process maps and flow charts as part of the programming of the new Registration system.

3. The new Registration system will have restricted access to program code. The Agency's procedures will segregate the programming duties on the Registration system and Inspections and Compliance system to the extent possible, given the limited personnel resources of the Agency.

4. The Agency's password policy requires the use of passwords of at least eight alphanumeric characters, including at least one numeric character. This policy is currently in use for access to the Inspections and Compliance database and will be required for access to the new Registration system.

5. The Agency has received a bid from an independent contractor for modifications to the Agency's computer room and is working with the Texas Building and Procurement Commission to identify suitable solutions to further protect the Agency's computer room from possible fire and water damage.

Appendix

Appendix

Objectives, Scope, and Methodology

Objectives

The objectives of this audit were to:

- Determine whether the Securities Board (Board) accurately reports selected key performance measures to the Automated Budget and Evaluation System of Texas (ABEST).
- Determine whether the Board has adequate control systems over the collection, calculation, and reporting of selected key performance measures.

Scope

Five key performance measure results the Board reported for fiscal year 2006 were audited to determine their accuracy.

Methodology

The audit methodology consisted of selecting measures to audit, auditing reported results for accuracy and adherence to measure definitions, evaluating controls over the performance measures certification process and related information systems, and testing of original source documentation.

Auditors selected measures from the population of key performance measures in ABEST for analysis. The Board completed questionnaires related to its performance measurement processes to help identify preliminary control information.

Specific tests and procedures included:

- Auditing calculations for accuracy and to ensure that they were consistent with the methodology agreed on by the Board and the Legislative Budget Board.
- Analyzing the flow of data to evaluate the existence of proper controls.
- Testing a sample of source documents to verify the accuracy of reported performance.
- Performing a high-level review of all information systems that support performance measures data.

- Reporting performance measures results in one of four categories: (1) Certified, (2) Certified With Qualification, (3) Inaccurate, or (4) Factors Prevent Certification.

Project Information

Audit fieldwork was conducted from January 2007 through February 2007. This audit was conducted in accordance with generally accepted government auditing standards.

The following members of the State Auditor's Office staff performed the audit:

- Joe K. Fralin, MBA (Project Manager)
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- Priscilla Garza (Information Systems Audit Team)
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- J. Scott Killingsworth, CIA, CGFM (Quality Control Reviewer)
- Michael C. Apperley, CPA (Assistant State Auditor)

Copies of this report have been distributed to the following:

Legislative Audit Committee

The Honorable David Dewhurst, Lieutenant Governor, Joint Chair
The Honorable Tom Craddick, Speaker of the House, Joint Chair
The Honorable Steve Ogden, Senate Finance Committee
The Honorable Thomas “Tommy” Williams, Member, Texas Senate
The Honorable Warren Chisum, House Appropriations Committee
The Honorable Jim Keffer, House Ways and Means Committee

Office of the Governor

The Honorable Rick Perry, Governor

Securities Board

Members of the Securities Board

Mr. Jack D. Ladd, Chairman
Mr. Kenneth W. Anderson, Jr.
Ms. Beth Ann Blackwood
Mr. Bryan K. Brown
Mr. William R. Smith

Ms. Denise Voigt Crawford, Securities Commissioner



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