January 14, 2008

Members of the Legislative Audit Committee:

In our audit report dated December 18, 2007, we concluded that the Office of the Fire Fighters’ Pension Commissioner’s (Office) basic financial statements for fiscal year 2007 were materially correct and presented in accordance with accounting principles generally accepted in the United States of America.

We also issued a report on internal control over financial reporting and on compliance and other matters as required by auditing standards. Our procedures were not intended to provide an opinion on internal control over financial reporting or to provide an opinion on other laws and regulations. Our procedures did not identify any instances of noncompliance that materially affected the financial statements.

However, we identified deficiencies related primarily to controls over cash and investment reconciliations that, when combined, represent a significant weakness in internal control over financial statement reporting. On September 1, 2007, the Legislature appropriated to the Office $8.8 million for the present value of its unfunded actuarial accrued liability, thus increasing the amount of investment funds over which the Office has stewardship. These investments provide the basis for all future benefit payments. Should the deficiencies identified below not be corrected, they may become a material weakness in internal control as these investments grow.

The Office Should Ensure That All Cash and Investment Accounts Are Reconciled on a Timely Basis and Receive Management-level Reviews

The Office contracts with an independent certified public accounting (CPA) firm to provide agency accounting functions. The Office also contracts with a third-party bank to maintain custody over and provide detailed transaction data for the Texas Emergency Services Retirement System’s investments. All reporting, processing, and executing of disbursements and receipts are performed by one individual at the CPA firm. This same individual also performs all reconciliations.

However, investment reconciliations between the Office’s accounting systems and the custodial records from the third-party bank are not done on a timely basis nor are they reviewed by management. As a result,
investment transactions are not recorded in the Office’s accounting systems when they occur, which decreases the reliability of the Office’s financial data. For 8 of the 12 months in fiscal year 2007, investment income transactions were recorded at least 4 months after they occurred. Cash reconciliations are reviewed by management; however, the reconciliations are not performed in a timely manner. For example, the reconciliation of activity for September 2006 was not performed or reviewed until January 2007.

Investment and cash held in trust should be recorded on the accounts and reconciled on a monthly basis to ensure appropriate fiduciary stewardship and financial management control over pension funds. When transactions are not recorded in the accounting systems when they occur, and when they are not reconciled and reviewed by management on a timely basis, there is increased risk that material misstatements will not be prevented or detected. In addition, this situation provides an opportunity for theft by fraud. However, we found no instances of fraud or other illegal activity.

Recommendations

The Office should ensure that:

- Transactions are recorded in the accounting systems on a timely basis and are posted to the month in which they occur.

- All reconciliations are performed and documented within a reasonable amount of time after the end of each month.

- Management-level reviews of all reconciliations are performed and documented.

The Office agrees with the recommendations in this report, and its responses are included in the attachment. If you have any questions, please contact Lisa Collier, Audit Manager, or me at (512) 936-9500.

Sincerely,

John Keel, CPA
State Auditor

Attachment
cc: Members of the Texas Emergency Services Retirement System Board of Trustees
    Mr. Frank Torres, Chairman
    Mr. Allen J. Scopel, Vice Chairman
    Mr. Paul V. Loeffler, Secretary
    Mr. Blevins (Oscar) Choate, Jr.
    Mr. Kyle A. Donaldson
    Ms. Gracie G. Flores
    Mr. Patrick Hull
    Mr. Rex W. Klesel
    Mr. Maxie L. Patterson

    Ms. Lisa Ivie Miller, Commissioner, Office of the Fire Fighters’ Pension Commissioner
January 8, 2008

Ms. Mary Wise, CPA, CFE
Senior Auditor
Texas State Auditor's Office
P.O. Box 12067
Austin Tx 78701

RE: Management Response
      Report on the Audit of the Office of the Fire Fighter’s Pension Commissioner’s
      Fiscal Year 2007 Financial Statements

Dear Ms. Wise:

In accordance with the Texas Government Code, Section 321.0131, please accept this letter as our
response to A Report on the Audit of the Office of the Fire Fighter’s Pension Commissioner’s Fiscal Year
2007 Financial Statements. We rely upon your finding that the audit did not detect fraud or other illegal
activity and that the financial statements for fiscal year 2007 were materially correct and presented in
accordance with the accounting principles generally accepted in the United States of America.

Management Response:

We recognize that the report was critical of agency procedures and delays in reconciling cash and
investment accounts. We agree that cash reconciliations are not performed timely during the first several
months of each fiscal year due to the time demands of completing the unaudited and audited financial
statements for the previous fiscal year.

It has historically been our opinion that the delay in updating agency investment accounts does not
represent a material weakness in internal control. The agency relies upon a contract custodial bank to
provide global custody and accounting of the System’s investments on a trade-by-trade basis. The System
investment consultant also conducts a performance review of the investment accounts. We are confident
in their technical expertise and their procedure for investment accounting. As a result, it has been standard
operating practice for many years to complete the update of agency investment accounts by the end of the
fiscal year.

We will make the following changes to respond to your finding that all cash and investment accounts be
reconciled on a timely basis and receive management-level reviews. The following procedures will be
implemented immediately:

- The contract accountant will perform monthly cash reconciliations within 20 days after the close of
  the preceding month.
- The contract accountant will update our agency investment accounts to reflect the custodial bank
  accounting records not later than 20 days after the close of the preceding month.
- The managing partner of the CPA firm will conduct a documented review of the cash and
  investment reconciliations not later than 30 days after the close of the preceding month and forward
  a signed reconciliation summary report to the Commissioner.
Management Response  
January 8, 2008  
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- The Commissioner will review the CPA’s reconciliation summary report and document the receipt and review.

We want to thank you and your staff for the thoroughness of the audit and the opportunity to respond to this report. If you have questions, please do not hesitate to contact this office.

Sincerely,

Lisa Ivie Miller  
Commissioner

CC: Board of Trustees