

TEXAS DEPARTMENT OF BANKING
Austin, Texas

ANNUAL INTERNAL AUDIT REPORT

Fiscal Year 2013



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Annual Internal Audit Report
Fiscal Year 2013

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Garza/Gonzalez & Associates

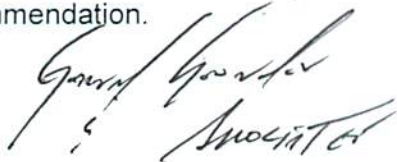
CERTIFIED PUBLIC ACCOUNTANTS

Finance Commission Members and
Finance/Audit Committee Members
Texas Department of Banking
Austin, Texas

We performed tests of management's assertion about the effectiveness and efficiency of the internal control structure over the Prepaid Funeral Contracts and the Corporate Activities Division of the Texas Department of Banking (DOB) and its compliance with applicable state requirements and DOB's established policies and procedures, for the year ended August 31, 2013.

The results of our tests disclosed that such controls were adequate and no material instances of noncompliance were noted; however, we noted a certain matter in the Corporate Activities Division, which is included in this report that is an opportunity for strengthening internal controls and complying with DOB's established policies and procedures. We also performed a follow-up of the prior year internal audit report and this report reflects the implementation status of those matters, and includes all information required for the Annual Internal Audit Report.

We have discussed the comment, recommendation, and implementation status with various DOB 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 recommendation.



May 9, 2013 – Prepaid Funeral Contracts

June 26, 2013 – Corporate Activities

June 26, 2013 – 2013 Follow-Up

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INTRODUCTION

The Texas Department of Banking (DOB) operates under the oversight of the Texas Finance Commission, and is an agency of the State of Texas. DOB performs functions designed to maintain a financial regulatory system for Texas that promotes a consistent banking environment, and provides the public with convenient, safe, competitive banking and other stable financial services.

DOB operates pursuant to the authority of various provisions of the Texas Finance Code, the Texas Trust Company Act, the Texas Public Information Act, Texas Government Code, Chapter 552, and the Texas Administrative Code. DOB regulates state banks, foreign bank branches, agencies, and representative offices, trust companies, prepaid funeral benefit contract sellers, perpetual care cemeteries, money service businesses, private child support enforcement agencies, and check verification entities.

The major functions of DOB are to:

- Charter, regulate, and examine all state banks, foreign bank branches, agencies, representative offices, and trust companies;
- Charter, examine and regulate trust departments of commercial banks and trust companies;
- License, regulate, and examine sellers of prepaid funeral contracts;
- License, regulate, and examine perpetual care cemeteries;
- License, regulate, and examine money services businesses;
- Register and investigate complaints of private child support enforcement agencies; and
- Register check verification entities.

DOB was granted Self-Directed, Semi Independent (SDSI) status in the 81st Legislative Session. As an SDSI agency, DOB is not required to have their budget approved by the Legislature; however, the Finance Commission is responsible for setting DOB's spending authority or limits. DOB's entire operating funds are generated from fees assessed to the businesses it supervises and are used to fund both direct and indirect costs. General revenue funds are not used to support DOB's operations.

2013 Internal Audit Plan

We have been engaged to perform internal audits of the following areas/divisions identified in DOB's Internal Audit Plan for fiscal year 2013:

- Prepaid Funeral Contracts
- Corporate Activities
- Follow-up of Prior Year Internal Audits
- Other tasks as may be assigned by the Finance Commission or the Finance/Audit Committee during the year.

The report on the Prepaid Funeral Contracts was issued on May 9, 2013. This report contains the results of our audit of the Corporate Activities Division, reflects the follow-up performed in the current year, and meets the Annual Internal Audit Report requirements.

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 the audit area's system of internal control and the quality of performance in carrying out assigned responsibilities. The audit scope includes 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.

EXECUTIVE SUMMARY

Corporate Activities

Background

The Corporate Activities Division (CAD) is comprised of a Director, who reports to a Deputy Commissioner, four (4) Corporate Analysts, one (1) Program Specialist, and two (2) Administrative Assistants.

The Director oversees the acceptance and completion of all applications and filings of corporate documents and directly supervises all CAD staff. The Corporate Analysts (CAs) are primarily responsible for reviewing, evaluating, and processing all filings filed by financial institutions, businesses, and members of the public seeking to do business that is covered by applicable Texas State rules, statutes, and regulations. The Program Specialist assists in evaluating applications for expedited branch, home office, and branch relocation applications for banks and trusts. The Administrative Assistants responsibilities include logging and imaging all filings, maintaining division information systems including CATS, assisting with preparation of letters, certificates, and other correspondence.

The CAD ensures that entities with public deposits and assets meet minimum qualifying criteria in terms of financial and business capacity and good character. The CAD performs two key functions: (1) the review and processing of all application and notice filings by state-chartered, licensed, or registered banks, foreign banks, trust companies, bank holding companies, money services businesses, and Private Child Support Enforcement Agencies that operate in Texas; and (2) the receipt and review of all statutory filings (i.e., Articles of Association, Articles of Merger, Amendments to Articles of Association) for banks and trust companies.

The CAD processes applications and collects fees as required under the various chapters of the Texas Administrative Code and the Texas Finance Code, as follows:

- a. **Banks and Holding Companies** are regulated by Chapters 32 and 202 of the Texas Finance Code and Chapter 15 of the Texas Administrative Code.
- b. **Foreign Banks** are regulated by Chapter 204 of the Texas Finance Code and Chapter 3 of the Texas Administrative Code;
- c. **Trust Companies** are regulated by Chapter 182 of the Texas Finance Code and Chapter 21 of the Texas Administrative Code;
- d. **Money Service Businesses** are regulated by Chapter 151 of the Texas Finance Code and Chapter 33 of the Texas Administrative Code;
- e. **Private Child Support Enforcement Agencies** are regulated by Chapter 396 of the Texas Finance Code and Chapter 31 of the Texas Administrative Code; and
- f. **Check Verification Entities** are regulated by Chapter 11 of the Texas Finance Code and Chapter 35 of the Texas Administrative Code.

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The application process begins when the applicant submits the proper forms related to the application/filing requirements. The applicable forms can be found on the DOB website. Filings and applications are submitted to the DOB by personal delivery; mail; fax; Corporate Application Filing Entry System (CAFE); or other approved electronic transmission. Once the application is received it is stamped with the date of receipt by mail room staff or the Administrative Assistance (AA). The application is then forwarded to the CAD Director. The CAD Director will, review the applications and assign the file to a CA (Corporate Analyst) based on the type of filing, complexity, level of experience of the CA, and the current workload of the CA. The AA will then prepare an acknowledgement form, log the filings into CATs, prepare a letter acknowledging the receipt of the application and image the file. The processing of the applications is very complex and diverse; each filing type has its own statutory requirements.

To ensure that applications are processed in accordance with the Texas Administrative Code (TAC) deadlines, the CA tracks the status of corporate applications through its Corporate Activities Tracking System (CATS), which serves as the database from which status reports are generated. Upon receipt of the application an initial review is performed by the CA. The review includes, a determination of appropriate fees and whether they have been paid for the type of filing pursuant to the appropriate "rule", a review of information in CATS to ensure that the information is correct, determination of applicable statutory time limits, evaluation on the overall condition of the filing, and an assessment of the necessary steps needed to make a determination on the application. Applications are considered complete when all requested information is received, (e.g. application fee, financial, biographical, personal information, etc.) Upon receipt of all information, the application is considered "accepted for filing", at which time the CAD has a certain number of days (as stipulated in the Texas Administrative Code) in which to issue the decision to approve or deny the application from the "received" or "filed" date. The number of days may be from 15 in the case of expedited requests to 180 days for charter applications.

Once a determination on the application or filing is made a "Summary" is prepared by the CA. The "Summary" is emailed to the Deputy Commissioner, and other pertinent personnel involved in the review and approval of the applications. The "Summary" is prepared to inform senior management and the banking staff about filings and to solicit input related to regulation and examinations. The "Summary" includes a recommendation of approval, denial, no objection, no comment, and/or acknowledgment letter based on compliance with the statutory and regulatory factors. The "Summary" may also include ratings, financial ratios, and summarize the basic components of the proposed transaction. The Parties included in the email have a chance to respond to the email requesting conditions of approval to the application, additional questions or information regarding the transaction, or a statement of approval. Applications may be approved by the Commissioner, Deputy Commissioner(s), or Director, depending on the type of application, or filing. Once the CAD has reached a decision based on this process to approve or deny the application, a letter is sent to the applicant notifying the institution of DOB's decision.

Based on an annual estimate for fiscal year 2013 the CAD is expected to process a total of 268 bank and trust applications, notices, and filings; money services businesses applications; and private child support enforcement agency registration and renewal applications.

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The total number of applications received by the CAD for the period September 1, 2012 through March 31, 2013 was 211 which is 79% of the annual estimated volume. The types processed were as follows:

| Entity | Application | Notice | Filing | Total |
|---|-------------|-----------|-----------|------------|
| Bank | 59 | 57 | 7 | 123 |
| Money Service Business | 18 | 1 | 7 | 26 |
| Private Child Support Enforcement Agency | 1 | - | 10 | 11 |
| Trust | 5 | 2 | - | 7 |
| Check Verification Entity | 3 | 1 | - | 4 |
| Other – Use of Name | 38 | - | - | 38 |
| Misc | - | - | 2 | 2 |
| Total | <u>124</u> | <u>61</u> | <u>26</u> | <u>211</u> |

Audit Scope

The scope of our audit was to gain an understanding of the Corporate Activities Division (CAD) to determine whether the applicable statutes, rules, policies, and procedures are consistently applied in a timely, efficient, and equitable manner.

The procedures performed to achieve the scope of our audit were as follows:

- Obtained an understanding of the laws and regulations provided in the Texas Administrative Code (TAC) and Texas Finance Code, as related to application processing performed by the CAD division.
- Reviewed established policies and procedures, collected various documents, and conducted interviews to obtain an understanding of the CAD division's processes and current practices in place.
- Selected a sample of applications received to test for compliance with policies, procedures, rules and regulations, and current practices.
- Reviewed the CAD division's reconciliation process in place for the collection of fees.
- Reviewed CAD performance measures submitted to the Texas Finance Commission.

I. Internal Audit Plan for Fiscal Year 2013

The Internal Audit Plan (Plan) includes 2 audits to be performed during the 2013 fiscal year. The Plan also includes a follow-up of the prior year audit recommendations, other tasks as may be assigned by the Finance Commission, and preparation of the Annual Internal Audit Report for fiscal year 2013.

Risk Assessment

Utilizing information obtained through the inquiries and background information reviewed, 19 audit areas were identified as potential audit topics. A risk analysis utilizing our 8 risk factors was completed for each individual audit topic and then compiled to develop an overall risk assessment.

Following are the results of the risk assessment performed for the 19 potential audit topics identified:

| HIGH RISK | MODERATE RISK | LOW RISK |
|----------------------------|--------------------------------|--------------------------------|
| Corporate Activities | Prepaid Funeral Contracts | Imaging & Records Management |
| Payroll & Human Resources | Prepaid Funeral Guaranty Funds | Perpetual Care Cemeteries |
| Purchasing | Fixed Asset Management | IT Examinations |
| Revenue Accounting Process | Travel | Money Service Businesses |
| Bank Examinations | | Trust Examinations |
| Foreign Bank Examinations | | Financial Reporting |
| | | Management Information Systems |
| | | Risk Management |
| | | Performance Measures |

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

Fiscal Year 2012:

- Bank Examinations
- Prepaid Funeral Guaranty Funds

Fiscal Year 2011:

- Revenue Accounting Process
- Trust Examinations
- Financial Reporting

Fiscal Year 2010:

- Money Service Businesses
- IT Examinations
- Management Information Systems

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The areas recommended for internal audits for fiscal year 2013 are as follows:

1. Prepaid Funeral Contracts
2. Corporate Activities Division
3. Follow-up of Prior Year Internal Audits
4. Other Tasks as may be assigned by the Finance Commission during the fiscal year.

II. External Quality Assurance Review

The internal audit department's most recent *System Review Report*, dated October 26, 2012, indicates that its system of quality control has been suitably designed and conforms with applicable professional standards in all material respects.

III. List of Audits Completed by High Level Audit Objectives

| Report No. | Report Date | Name of Report | High Level Audit Objectives |
|------------|-------------|---------------------------|---|
| 1 | 5/9/13 | Prepaid Funeral Contracts | To determine whether PFC permits were issued and examinations performed in accordance with statutory requirements and established policies and procedures. |
| 2 | 6/26/13 | Corporate Activities | To determine whether the controls in place within the CAD provide reasonable assurance that applicable statutes, rules, policies, and procedures are consistently applied to all applicants and filings of corporate documents. |

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IV. 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 |
|------------|-------------|----------------------|---|--|--|
| 2 | 6/26/13 | Corporate Activities | <p>1. Filing Documentation</p> <p>The Corporate Activities Division (CAD) processes applications and filings from regulated entities. We selected and reviewed 15 applications and/or filings. In one instance an entity filing an application, had previously filed a separate application which included documents required for the selected application tested. These documents were filed under a different file number. However, the file number selected for testing made no reference to the location of the required documents or to the separate application.</p> <p>In addition, documents that are not received with the applications and filings submitted are filed in a different electronic document in the chronological order of the date received. The documents may include multiple large documents which ranged up to 300 pages in our selections; however, there is no listing of the documents received or the date that the documents were received.</p> <p>Recommendation We recommend CAD adopt a practice of listing the location of documents that are required for a subject file which have been received but are not located in the subject file to provide the location of the document.</p> <p>In addition, the CAD should consider preparing a listing of the documents received that includes the date received in order to provide a reference to the documents provided.</p> <p>Management's Response</p> <p>Procedures in the Corporate Division's Filing Processing Manual have been updated to require all documents necessary to complete a filing to be imaged with other documents related to that filing in Document Manager. The procedures alternatively provide that a Corporate Analyst may depend upon documents imaged with another filing to be considered as part of the filing under review if a note is made in the Filing Facts field in Corporate Applications Tracking System (CATS) cross referencing the filing number where the other documents can be located.</p> <p>The Corporate Division has implemented a per-filing tracking mechanism to reflect the date that documents are received in response to requests for additional information. The tracking mechanism includes the date that the document was received.</p> | | Improve document management and compliance with the Texas Finance Code |

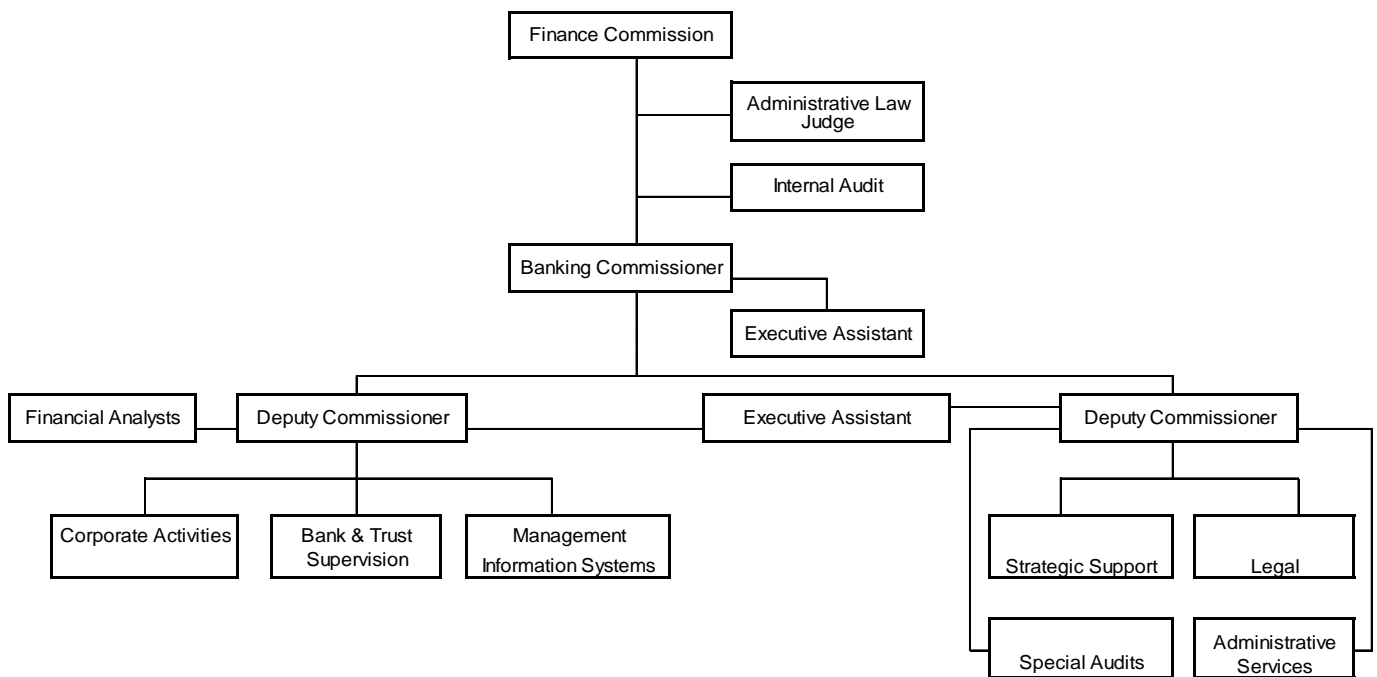
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|------------|-------------|----------------|--|--|--|
| | 7/12/12 | 2013 Follow Up | <p>Follow Up of Prior Year Audits</p> <p>Following is the status of the recommendations made during fiscal year 2012 that had not been fully implemented.</p> <p><u>Bank Examinations</u></p> <p>1. Training</p> <p>Implement a process to verify, with the Training Coordinator, that the required courses have been completed prior to advancement or ensure approval from the Director, for advancements where the examiner has not completed the required core courses, be obtained and documented prior to advancement.</p> | Fully Implemented | To ensure compliance with DOB's training policy. |

V. List of Consulting Engagements and Non-audit Services Completed

The internal auditor was not involved in any consulting engagements, as defined in *The International Standards for the Professional Practice of Internal Auditing* or in any non-audit services, as defined in the *Government Auditing Standards, December 2011 Revision*, Sections 3.33-3.58.

VI. Organizational Chart



VII. Report on Other Internal Audit Activities

The internal auditor was not involved in any internal audit projects beyond those outlined in the 2013 audit plan, or in any other special projects during the year.

VIII. Proposed Internal Audit Plan for Fiscal Year 2014

The risk assessment performed during the 2013 fiscal year was used to identify the following *proposed* areas that are recommended for internal audits for fiscal year 2014. The Internal Audit Plan for Fiscal Year 2014 will be developed and presented to the Finance Commission at a meeting to be determined at a later date.

- Imaging and Records Management
- Perpetual Care Cemeteries
- Follow-up of Internal Audits
- Other tasks as may be assigned by the Finance Commission during the fiscal year.

IX. External Audit Services Procured in Fiscal Year 2013

DOB procured the internal audit services in fiscal year 2013.

X. Reporting Suspected Fraud and Abuse

DOB has provided information on their 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. DOB has also developed a Fraud Prevention Policy that provides information on how to report suspected fraud.