

An Audit Report on the
**Fiscal Year 2001 Financial Statements
of the Office of the Fire Fighters'
Pension Commissioner**

June 17, 2002

Members of the Legislative Audit Committee:

In our audit report dated April 26, 2002, we concluded that the Office of the Fire Fighters' Pension Commissioner (agency) fiscal year 2001 financial statements are materially correct in accordance with accounting principles generally accepted in the United States of America. We did not note any instances of noncompliance with certain laws and regulations that would have a material effect on the agency's financial statements or any material weaknesses in internal control over financial reporting.

We did note that the agency's fiscal year 2001 administrative expenses of \$628,936 exceeded its appropriation of \$236,571. The agency's Board of Trustees is statutorily authorized to exceed its appropriations for accounting, actuarial, investment consulting, computer, or custodial services. While these administrative expenses pertained to the operation of the pension trust fund, they have increased since fiscal year 1995. We recommend that the Board of Trustees continue to evaluate whether these expenses are reasonable and necessary for the prudent management of the pension trust fund.

In addition, the agency's contract accountant does not always reconcile in a timely manner cash recorded in the agency's internal financial system with the Uniform Statewide Accounting System (USAS). The contract accountant took up to three months to prepare and review some of the monthly reconciliations for fiscal year 2001. Without prompt reconciliations, the agency cannot be sure that its internal financial system is accurate. We recommend that the agency specify in its contract with the accountant and in its policies and procedures that each month's reconciliation should be performed and reviewed by the end of the following month.

The agency does not verify market value information it receives from its investment custodian. Verification of the custodian's information will provide additional assurance of the accuracy of the financial statements. We recommend that the agency verify a sample of the market value information it receives from its investment custodian at fiscal year end. The agency should document this verification process in its investment policies and procedures.

We commend the agency for implementing last year's recommendations. The Board of Trustees adopted a policy requiring the rotation of actuarial consultants, and the agency improved segregation of duties in the Pension Administration Division.

We have provided the Commissioner and Board of Trustees with the *Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With Government Auditing Standards*.

SAO Report No. 02-053

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Management's response is attached. We appreciate the cooperation of the Commissioner and his staff. Please contact Carol A. Smith, CPA, Audit Manager, at (512) 936-9500 if you have questions.

Sincerely,

Lawrence F. Alwin, CPA
State Auditor

khm/Attachment

cc: Chair and members of the Texas Statewide Emergency Services Personnel Retirement
Fund Board of Trustees
Mr. Morris E. Sandefer, Commissioner

Management's Response



Office of
Fire Fighters' Pension Commissioner
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Morris E. Sandefer
Commissioner

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June 6, 2002

Lawrence F. Alwin, CPA
State Auditor
Robert E. Johnson Building
1501 North Congress Avenue
Austin, Texas 78701

Dear Mr. Alwin,

This letter is the management response to the Letter to Management Concerning Internal Controls at the Office of the Fire Fighters' Pension Commissioner issued in May 2002. The Opportunities for Improvement were offered in conjunction with the opinion on the Commission's financial statements for the fiscal year ended August 31, 2001.

Continue to evaluate whether administrative expenses are reasonable and necessary for the prudent management of the pension trust fund.

Recommendation:

We note that the Commissioner's fiscal year 2001 administrative expenses of \$628,936 exceeded its appropriation of \$236,571. The Board of Trustees is statutorily authorized to appropriate funds for accounting, actuarial, investment consulting, computer, or custodial services. While these administrative expenses pertained to the operation of the pension trust fund, they have steadily increased since fiscal year 1995. We recommend that the Commissioner and the Board of Trustees continue to evaluate whether these expenses are reasonable and necessary for the prudent management of the pension trust fund.

Response:

It is the position of the Office of the Commissioner and the Board of Trustees that the administrative expenses incurred over the stated period are both reasonable and necessary for the prudent management of the TSESRA Trust Fund (0976). The Commissioner and the Board does not dispute that the professional and administrative costs of the TSESRA Fund have increased since 1995. These increases have come from both methods of funding - 1) funds appropriated by the Legislature for the purpose of administering the TSESRA Program and, 2) unappropriated funds, which are statutorily appropriated by the TSESRA Board of Trustees to administer the pension fund.

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Prior to FY95, all of the expenses for administering the TSESRA Program were appropriated from General Revenue (Fund 0001). After the 1995 session, the 74th Legislature began shifting the cost of administering the Program from the General Revenue Fund to the Pension Trust Fund. After the 1999 session, the 76th Legislature shifted 100% of the expenses of administering the TSESRA Program to the Trust Fund. Also, during the 76th Legislative Session, the agency was appropriated funding to hire 2.5 additional FTEs to address management control issues that were identified by the SAO in prior audits of the agency. This, coupled with the loss of General Revenue funding, resulted in a 160% increase in appropriations from the Trust Fund for the administration of the TSESRA Program for FY00.

The unappropriated funds that are expended by the Board for the purpose of administering the Trust fund have fluctuated since 1995. This is a function mainly of one-time cost that are associated with actuarial studies, the cost of investment manager searches, and mostly, the cost of automating the TSESRA Program. Other on-going costs, such as accounting services and bank custodial services have increased only slightly. Most of the unappropriated expenses, which are approved by the Board of Trustees, are paid through contracts with the professional service providers to the Trust Fund. The Board, on an annual basis and using a comprehensive process, reviews the performance of these vendors. Those who are not performing in accordance with the contract are either put on a watch list or terminated immediately. The Board of Trustees takes its fiduciary duty seriously and does not appropriate money from the fund without formal consideration of the need for and approval of the expenditure.

Reconcile cash in a timely manner

Recommendation:

The Commissioner's contract accountant does not always reconcile, in a timely manner, cash recorded in the Commissioner's internal financial system with the Uniform Statewide Accounting System (USAS). It took up to three months to prepare and review some of the monthly reconciliations for fiscal year 2001. Without prompt reconciliations, the Commissioner cannot be sure that its internal financial system is accurate. We recommend that the Commissioner specify in its contract with the accountant and in its policies and procedures that each month's reconciliation should be performed and reviewed by the end of the following month.

Response:

The Office of the Commissioner has adopted a policy such that the cash recorded in the Commission's internal financial accounting system will be reconciled with the Uniform Statewide Accounting System (USAS) by the end of the following month. Both the Commissioner and the contract accountant will review and sign the performed reconciliation to insure that the internal financial accounting system is accurate. This policy will be incorporated as a provision in the contract between the Office of the Commissioner and the contract accountant.

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Verify market value information received from custodial bank

Recommendation:

The Commissioner does not verify market value information it receives from its custodian. Verification of the custodian's information will provide additional assurance of the accuracy of the financial statements. We recommend that the Commissioner verify a sample of the market value information it receives from its investment custodian at fiscal year end. The Commissioner should document this verification process in its investment policies and procedures.

Response:

The Office of the Commissioner has adopted a policy such that a significant sample of the market value information that it receives from its custodial bank will be verified using a third party source, such as Bloomberg Quick Quote or CNBC on MSN, at the end of each fiscal year. Both the Commissioner and the contract accountant will review the sample verification to insure that the market value information that it receives from its custodial bank is accurate. This policy will be incorporated as a provision in the contract between the Office of the Commissioner and the contract accountant.

I would like to take this time to express my satisfaction with the findings of this audit and to sincerely thank you and your staff at the State Auditor's Office. I would especially like to express my thanks to Jacqueline Shelby, Project Manager for her work on the recently completed audit at the Office of the Fire Fighters' Pension Commissioner. Her knowledge and experience of auditing procedures and governmental audit standards, as well as her willingness to assist us with information relating to the implementation of recommendations of the State Auditor's Office has been of great value to the agency and to the Board of Trustees of the Texas Statewide Emergency Services Personnel Retirement Fund. You can be assured that our job has been made easier by the dedication, service and quality of work provided by the auditors of the State Auditor's Office.

Thank you for your assistance.

Sincerely,



Morris E. Sandefer, Commissioner
Office of the Fire Fighters' Pension Commissioner