

**Leslie Wilks Garcia, C.P.A., M.Jur.**  
*First Assistant County Auditor*

**Errika Perkins, C.P.A., C.I.A.**  
*Chief Assistant County Auditor*  
*Audit Division*



1001 Preston, Suite 800  
Houston, Texas 77002-1817  
(832) 927-4600

Fax (713) 755-8932  
Help Line (832) 927-4558

**MICHAEL POST, C.P.A., M.B.A.**  
**HARRIS COUNTY AUDITOR**

August 27, 2021

Dear David Berry, County Administrator and County Budget Officer:

The Harris County Auditor's Office Audit Division has completed an audit of the Financial Management Investment Procedures for the Fourth Quarter of Fiscal Year 2021. The results of our audit are included in the attached report.

We appreciate the time and attention provided by you and your staff during this engagement. Please anticipate an email request to complete the Audit Division's Post Engagement Survey. We look forward to your feedback. If you have any questions, please contact me or Errika Perkins, Chief Assistant County Auditor, 713-274-5673.

Sincerely,

A handwritten signature in blue ink that reads "Michael Post". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Michael Post  
County Auditor

Report Copies:

District Judges  
County Judge Lina Hidalgo  
Commissioners:  
R. Jack Cagle  
Rodney Ellis  
Adrian Garcia  
Tom Ramsey  
Christian D. Menefee

AUDIT REPORT  
**FINANCIAL MANAGEMENT INVESTMENT PROCEDURES Q4 FY2021**  
AUGUST 27, 2021

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## Executive Summary

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### OVERALL CONCLUSION

Based on the procedures performed, Financial Management was compliant with Texas Government Code Chapter 2256, *Public Funds Investment Act*; Texas Government Code Chapter 2257, *Public Funds Collateral Act* and the Harris County Investment Policy. However, an opportunity for improvement exists with vendor contract language regarding proper testing and communication of system upgrades prior to implementation. Additionally, an opportunity for improvement exists with regards to Financial Management consistently entering investment transactions into the County's investment tracking system (APS2) in a timely manner. Management has developed action plans that will address the issues identified by October 31, 2021.

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### SCOPE AND OBJECTIVE

The Audit Division conducted an audit of Financial Management's investment procedures and investment activity to test for compliance with the following objectives:

- Selectively test whether Financial Management complied with Texas Government Code Chapter 2256, *Public Funds Investment Act*, Texas Government Code Chapter 2257, *Public Funds Collateral Act*, the County's Investment Policy, and Financial Management's internal procedures.
- Compare investment purchases and sales pricing to transactions reported in the Trade Reporting and Compliance Engine (TRACE) for appropriateness.

The audit scope timeframe included a review of transactions for the period of December 1, 2020, through February 28, 2021 (Fourth Quarter of Fiscal Year 2021).

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### SUMMARY OF AUDIT ISSUES

- A system update to APS2 disabled the automatic posting of interest, calls, and maturities into the system.
- Financial Management is not consistently entering investment transactions into APS2 in a timely manner.

The audit issues, management's action plans to address the issues, and background information regarding this audit are discussed in more detail on the following pages.

## AUDIT ISSUES

### **ISSUE #1: APS2 System Update Disabled Certain System Functionality**

**What is the Issue:** A system update to APS2 disabled the automatic posting of interest, calls, and maturities into the system.

**Why it Happened:** The update to APS2 was implemented without proper testing by the vendor to ensure the update did not disable system controls. The vendor also did not communicate this update to Financial Management personnel so they could validate system controls were not impacted.

**Why it Matters:** Eight investment maturity transactions totaling \$178.46M were not timely recorded in APS2. They were recorded between 32 and 39 days after the settlement date. We confirmed that these transactions were appropriately excluded from the 4th Quarter Investment Report presented to Commissioners Court since they matured and were no longer County investments.

**What is Expected:** It is best practice to test system updates in a test environment to ensure the update will not disable or have unintended changes to system controls before implementation.

**What Action(s) are Suggested:** With the implementation of a new investment tracking system currently in progress, Financial Management should consider adding language to the contract requiring proper testing and communication of system updates prior to implementation. In the interim, Financial Management should communicate the following requirements to the County's current investment system vendor:

1. Properly test all system updates to APS2 to ensure the update does not disable or have unintended changes to system controls before implementation.
2. Communicate all future updates to Financial Management personnel so they can monitor system controls for unintended changes.

### **MANAGEMENT'S ACTION PLAN**

**Responsible Party:** FIS APS2 Programmer

**Management Action Plan:** The following steps have been made by FIS in APS2 to remediate the problem from occurring again:

- FIS corrected the preference setting on 12/13/2020.
- FIS created/maintains a daily log of their posting process and are saved for future reference (added on 01/12/21)
- FIS will automatically generate an email for any posting errors found in APS2.
- FIS has changed the run dates of the Income Projection Posting Script to cover the "first day of last month" instead of "current day" in order to cover any investments which might have been entered with a later settlement date. The previous run dates only covered "current day" and "tomorrow" only. (changed on 01/12/21)

Financial Management has also requested via email on 8/5/21 from FIS APS that they test all system updates to APS prior to implementation and communicate all future updates to us.

**Due Date:** October 31, 2021

## **ISSUE #2: Untimely Entry of Transactions into APS2**

**What is the Issue:** Financial Management is not consistently entering investment transactions into APS2 in a timely manner. Specifically, five investment transactions were entered late as follows:

- Two called investment transactions with a total book value of \$600K were both entered into APS2 33 days after the transaction settlement date.
- Two purchased investment transactions with a total book value of \$1.05M were both entered into APS2 8 days after the transaction settlement date.
- One partially called investment transaction with a book value of \$85K was entered into APS2 7 days after the transaction settlement date.

We confirmed that all of the above investment transactions were appropriately included or excluded from the 4th Quarter Investment Report presented to Commissioners Court, as applicable.

**Why it Happened:** The manual control designed to ensure all investment transactions are entered timely, accurately, and completely into APS2 was not performed.

**Why it Matters:** Failure to timely enter investment transactions into APS2 could result in a misstatement of the Quarterly Investment Report presented to Commissioners Court and/or the County's Annual Comprehensive Financial Report.

**What is Expected:** Financial Management's internal procedures require investment transactions to be recorded into APS2 on the settlement date. In addition, a review to ensure all investment transactions are timely, accurately, and completely recorded in APS2 is required to be performed.

**What Action(s) are Suggested:** Management should implement a process of signing off on the manual control to ensure it is performed.

## **MANAGEMENT'S ACTION PLAN**

**Responsible Party:** Cadence Bank and Financial Management

**Management Action Plan:** Called Security Issues: On 5/4/21, Cadence Bank updated their procedures to notify Financial Management immediately of the following:

- Cadence Bank, who receives notification from their corporate action group at Reliance, will send a notification to Financial Management via email notifying of a CUSIP in which 'Corporate Action' is taking place. The corporate action notices are usually a notice for a '**Full Call**' or '**Partial Call**.' (The information on calls are sent to the corporate action group, once the issuer of the security gives them notice. Because the notice is dependent on the issuer, this notice can be sent out days or weeks in advance of the call.) Financial Management will be notified as soon as the corporate action group receives notice of the call, via email. The email generated contains a few details of the corporate action, i.e. Date of Notice, CUSIP, Event Type (Full or Partial), and accounts effected. The date for the call can be found on Bloomberg.
- Financial Management is NOT notified of **units hit by the lottery in a partial call** on the "Corporate Action" email notice. In the event of a partial call, Cadence will notify Financial Management by email of the units hit by the lottery within two business days.

Financial Management's internal procedures have been updated to include Cadence Bank's new procedures. The updated procedures also allow Financial Management adequate time to enter and review securities entered in the portfolio software and to reconcile at the end of each month.

**Due Date:** October 31, 2021

## BACKGROUND

Financial Management is comprised of the Cash Management Section, the Investment Management Section, and the Debt Management Section. The Cash Management Section is responsible for bank relations and assuring all funds on deposit with the County depositories are fully collateralized in accordance with the Policy and Chapter 2257 of the Texas Government Code. The Investment Management Section is responsible for developing and implementing portfolio-investing strategies in accordance with the Policy and Chapter 2256 of the Texas Government Code. The Debt Management Section is responsible for all debt issuance of the County, including bonds, certificates of obligation, notes, and commercial paper. Financial Management acts as the investment agent for the Harris County 9-1-1 Emergency Network, Community Supervision & Corrections Department, Harris County Juvenile Board, Harris Health System, Harris County-Houston Sports Authority, and the Harris County Sports & Convention Corporation. Each of these entities prepares and approves its own investment policy; thus, these entities are not included in the scope of this engagement.

The Director of Financial Management serves as the County Investment Officer (CIO) reporting to Commissioners Court. The Director of Financial Management, the Investment Manager, and other designees from within Financial Management represent the approved County designees who can initiate and approve investment transactions. The CIO, as well as the County designees, are responsible for the investment activities and compliance with state statutes and the Policy. Investment advisory services are provided by Hilltop Securities, Inc.

The County's investment and collateralization requirements are established by Texas Government Code Chapters 2256 and 2257, which are referred to as the Public Funds Investment Act and the Public Funds Collateral Act, respectively. The Public Funds Investment Act requires both a written Investment Policy and an Investment Strategy. The Investment Policy and Investment Strategy examined during the engagement period are contained in a single document (Policy) adopted by Commissioners Court on September 29, 2020. The Policy covers areas such as the County's investment objectives, authorized investment instruments, the system of internal controls, bid solicitation requirements, allowable maturity maximums by fund type, portfolio weighted average maturity maximums, and diversification and risk tolerance guidelines. Additionally, it includes specific investment strategies for fund groups that address each groups' investment options, and it describes the priorities for suitable investments as well as collateralization requirements in accordance with the Public Funds Collateral Act. The appendices to the Policy include a list of County Designees authorized to approve County investment transactions and a list of approved financial institutions.

As required by Section 5.05 of the Investment Policy, Financial Management has a formal system of management level and internal accounting controls governing investments. These controls are intended to prevent losses of public funds arising from fraud, employee error, misrepresentation by third parties, unanticipated changes in financial markets, or imprudent actions by employees and officials of the County. Examples of these controls include controls to avoid or detect collusion, segregation of duties, segregation of transaction authority from accounting and recordkeeping, custodial safekeeping, avoidance of bearer-form securities, clear delegation of authority, specific limitations regarding security losses and remedial actions, approved written confirmation of telephone transactions, minimization of authorized investment personnel, documentation of transactions and strategies, and adherence to ethics standards. The design and operating effectiveness of these controls is not in the scope of this engagement.

## ACCOUNTABILITY

We conducted our audit in accordance with the International Standards for the Professional Practice of Internal Auditing (“Standards”). The Standards require that we comply with the Code of Ethics and obtain reasonable assurance that significant risks to the activity are minimized to an acceptable level.

The engagement’s scope did not include a detailed inspection of all transactions. There is a risk that fraud or errors were not detected during this engagement. Therefore, the official retains the responsibility for the accuracy and completeness of their financial records, and for ensuring sufficient controls are in place to detect and prevent fraud, errors, or omissions.