

Operational Review

State Board of Administration of Florida

March 2004



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PROJECT ORIGINATION AND BACKGROUND

At the direction of the Executive Director, on November 7, 2003, the State Board of Administration of Florida (SBA) issued an Invitation to Negotiate (ITN) for the purpose of hiring a qualified external company to conduct an operational review of the SBA's organizational structure and staffing level and assess the operational controls of the SBA. The SBA was in search of an external company that possessed appropriate expertise and specialized knowledge in public and private institutional investors' investment processes. The engagement was a limited-purpose project requiring written recommendations consistent with applicable law, regulation, leading practices, and the SBA's fiduciary standards of care. In addition, appropriate strategies for implementation of recommendations on SBA's organizational structure, staffing levels and operational control environment were also a requirement of the ITN.

As a result of the ITN process and review of candidate qualifications, KPMG LLP (KPMG) was selected to perform the operational review and control assessment. KPMG has assisted a broad range of public, private, and not-for-profit institutions in evaluating the quality and efficiency of their organizational structure and resources as well as the design and efficacy of their control environment. The KPMG list of clients includes: small, mid-sized and large external institutional investment managers; small and large public investment managers and bank owned investment managers. KPMG also has investment management experience in all asset classes including equity, fixed income, hedge funds, alternative investments and real estate. Relevant representative engagements performed by KPMG include the following:

- Reviewed and evaluated the internal global fixed income trading, fiduciary risk and control environment, resource levels and qualifications as well as external managers' control environments for a western state investment board.
- Assisted a large global custodian with the assessment of the internal control structure of their securities services businesses, resulting in the creation of a gap analysis measuring current operations risks and controls against industry leading practices. The scope of the project included a review and assessment of the controls residing in key operational areas as follows: trade initiation, trade settlement, corporate actions, asset assignment, income collections, cash and depository reconciliations.
- Assisted a large global custodian with re-engineering the trade processing activities of their securities services business. The project encompassed identifying and developing re-engineering initiatives for the following key processes: security master file set-up and maintenance, disbursement processing, income collections, capturing trades, settling trades and reconciling positions.
- Assisted a third party service provider in the development and field-testing of a web-based operational and fiduciary risk assessment tool used by large corporate pension funds in their evaluation of existing and prospective external investment managers.



- Prepared risk, regulatory, and control gap analyses as well as remediation strategies/plans for a large US bank's fiduciary services division, in response to severe regulatory criticism.
- Conducted a fiduciary and operational risk assessment of the large Alternative Investment – Private Equity Division for a Western State, focusing on the internal investment management processes and control environment as well as the efficacy of the Division's oversight of external Private Equity managers and related due-diligence, valuation and other outsource service providers.
- Assisted the State Board of Administration of Florida in performing an analysis of their securities lending program to identify operational and investment risks associated with their program.
- Reviewed and evaluated the (internal) equity trading and control environment, resource levels, and resource qualifications as well as the external manager due diligence/selection and ongoing evaluation processes for a large private philanthropic endowment.
- Evaluated the investment analysis, due diligence, decision, execution and pricing/monitoring processes as well as conducting a control and resource assessment for the fixed income lines of a large east coast mutual fund company.
- Assessed both internal and outsourced securities lending activities resident in the Investment Management, Custody and Capital Markets divisions of a top five U.S. bank holding company and provided management with options and strategies for consolidation and/or capturing synergies and economies of scale.
- Conducted extensive, multi-line fiduciary risk, efficiency and controls reviews for two of the largest US-based asset management organizations, including not only their investment management processes but also related operations, risk management, information technology, accounting and reporting, and performance measurement activities.

In addition to the selected engagement qualifications described above, KPMG's Investment Management team's skills and qualifications are supplemented by acting as specialist resources in internal audits, SAS 70 reviews and traditional financial statements audits conducted by KPMG for investment managers, mutual fund and related securities services entities.



PROJECT OBJECTIVES AND SCOPE SUMMARY

The objectives of this operational review were to assess the organizational structure, staffing levels and operational controls of the SBA, identifying opportunities to increase efficiency and to improve controls.

This review focused principally, though not exclusively, on the organization, staffing levels and operational controls within the Chief Investment Office and the Chief Operating Office. Offices of the General Counsel, Internal Audit, Inspector General and Defined Contribution Plans were subjected to higher-level, limited scope reviews. The major areas of scope included:

- Investment management (asset classes, PEORP and various non-FRS mandates)
- Proxy voting
- Custody relationships
- Investment operations and accounting
- Performance measurement and reporting
- Administrative and technology support
- Human capital practices and SBA organization

The Securities Lending Program, which KPMG reviewed in late 2001, was specifically excluded from scope -- as were certain other areas and topics, including the SBA's performance and asset allocation policies, its more general investment policies and details of their execution, and other matters for which the SBA has previously engaged or retained specialist consultants.



PROJECT METHODOLOGY

KPMG's project methodology consists of *three phases* as follows: **Phase I** Define Missions and Constraints / Plan Phase II Execution, **Phase II** Conduct Extensive Interviews and Walkthroughs, and **Phase III** Prepare Initial Draft Report / Conduct Exit Conference, as detailed below.

Phase I

Define Missions and Constraints / Plan Phase II Execution - develop clear definitions of the SBA's mission and the legal, regulatory, and fiduciary constraints that further define and limit its activities by performing the following steps:

- ***Step 1 - Document Request and Review:*** Request and reviewing relevant documentation, including, but not limited to¹:
 - Policies and Procedures
 - Organization Charts
 - Governance Documents
 - Roles and responsibilities
 - System flow charts
 - Principal systems and functionality
 - List of vendors
 - List of relevant committees: governance, operating and/or supervisory
 - List of relevant investment management information and background
- ***Step 2 - Preliminary Interviews:*** In order to supplement our review of the documents requested in Step 1 and to further our insight into SBA's mission and constraints, KPMG conducted an initial series of preliminary, high-level interviews with key management leaders in the investment, operational and support units of the SBA. The initial interviews permitted KPMG personnel to ensure that key management leaders were informed about engagement processes and objectives. In addition, SBA leaders identified the most appropriate subordinates to be interviewed during Phase II.
- ***Step 3 – Identification of Interviewees and Focused Interview Questions:*** Based on our understanding of mission, constraints, and high-level process developed in Steps 1 and 2, SBA management and KPMG identified individuals that should be interviewed to achieve the engagement objectives which concluded Phase I.

The list of individuals interviewed during Phase I include:

- Gwenn Thomas, COO
- Barbara Jarriel, CIO
- David Villa, CIO
- Jim Francis, Senior Investment Policy Officer & Economist
- Kevin SigRist, SIO DC Programs

¹ The list of documents requested has been abbreviated to provide the reader with a sample of the items requested. It is not inclusive of all the documents requested and reviewed.



- Florida Rivera-Alsing, Chief of Internal Audit
- Bruce Meeks, Inspector General
- Linda Lettera, General Counsel
- Robert Copeland, SOO Accounting & Financial Operations
- Susan Schueren, SIO Domestic Equities
- Scott Seery, SIO Global and International Equities
- William James, SIO Alternative Investments
- Robert Smith, SIO Fixed Income
- Douglas Bennett, SIO Real Estate
- Memi Turkington, Director of Accounting
- Lori Guido, Director of Financial Operations
- Eric Nelson, SOO Planning, Policy & Administrative Services

Phase II

Conduct Extensive Interviews and Walkthroughs - conduct a series of focused interviews to better define our understanding of the organizational structure and control environment in place. The interviews were pre-scheduled and questions/agendas were provided to interviewees in advance in an effort to expedite the review process and to minimize the diversion of resources from their normal duties. Specifically, questions were directed toward the actual roles and responsibilities of the individual, peak and routine workflow levels, decision and process delays, inadequate and/or excessive or redundant controls, as well as other related issues. To the extent possible, interviews were conducted “from the inside out”.

- First, with core Investment unit(s) (the principal activity supported),
- Then, with the close Operational support and control units (which enables and, to a lesser extent, helps control investment activity), and
- Lastly, with independent control and support units such as Audit, Inspector General, Legal and General Counsel (which independently serve to monitor/control/constrain and, to a lesser extent, directly support investment activity.)

To further understand a specific function, KPMG also scheduled a series of walkthroughs, in which a particular process was observed and discussed in detail. In total, KPMG conducted more than 60 interviews and walkthroughs.

Phase III

Prepare Initial Draft Report / Conduct Exit Conference - analyze all the information and data gathered, to draft observations and recommendations and to prepare the draft report for delivery to the Steering Committee. Throughout the Phases, KPMG worked closely with the Steering Committee to provide updates and progress reports. The Steering Committee, in turn, provided guidance, suggestions and insights to KPMG to ensure that the project stayed focused on the identified goals and objectives.



PROJECT TIMELINE

Task Description	1/19/04	1/26/04	2/2/04	2/9/04	2/16/04	2/23/04	3/1/04	3/8/04	3/15/04
PHASE 1: Define Mission and Constraints / Plan									
Phase 2 Execution									
Document Request & Review	█	█							
Preliminary Interviews - CIO & COO	█	█							
Identification of Key Subordinates & Focused Interview Questions		█							
PHASE 2: Conduct Extensive Detailed Interviews / Walkthroughs									
Schedule Interviews, Prepare Agendas & Conduct Interviews	█	█	█	█	█	█			
Chief Investment Office:									
SIO's & Key Personnel		█	█	█	█				
Sr. Inv. Policy Officer & Economist		█	█	█					
Chief Operating Office:									
SOO's	█	█	█	█					
Dir. Of Information Technology		█	█	█					
Operations Managers			█	█	█	█			
Key Process Walkthroughs			█	█	█	█			
Independent Control & Support Personnel			█	█					
Status Meetings	█	█▲	█★	█▲	█★	█★			
PHASE 3: Prepare Initial Draft Report / Exit Conference / Final Presentation									
Prepare Initial Draft Report					█	█			
Circulate Report to Steering Committee							█		
Present Draft Report at Exit Conference								█	
Deliver Final Report									█

3/5 Circulate draft report to Steering Committee

3/10 Closing meeting with Steering Committee

3/19 Finalize Report and forward to SBA

Brief Status Meeting ▲

Full Status Meeting ★



SUMMARY OBSERVATIONS: AN OVERVIEW

Organizational Structure

The organizational structure of the SBA appears appropriately aligned with its mission, and supports and enforces an appropriate segregation of duties. The SBA's core investment activities are executed within the Asset Classes, whose leaders report to the Chief Investment Officer (CIO)– while units that provide close operational support and execute segregated control functions for the core investment activities report independently to the Chief Operating Officer (COO). In addition to the CIO and COO, two newly established direct reports to the Executive Director – a dedicated Chief of Internal Audit (CIA) and Inspector General (IG)– have been established to periodically test the efficacy of the control environments within both the Chief Investment and Chief Operating Offices, as well as other functional areas within the SBA.

COO positions exist in virtually every private financial services organization. The broad responsibilities of the SBA's COO are often shared with a Chief Information Officer and/or a Chief Financial Officer in other public and private organizations. Nonetheless, in organizations comparable in size to the SBA, a unified COO-structure can function effectively when the incumbent has a strong accounting/financial background and their senior managers have appropriate experience and expertise in information technology and financial reporting/accounting.

CIO positions are the norm within private asset management firms and typically larger public investment organizations. We believe the SBA will realize substantial benefits from focusing an experienced investment executive on the supervision of investment activities within the various Asset Classes as well as execution of overall investment plans for the SBA's multiple mandates. At the same time, the continued separation of investment implementation (i.e., CIO) from investment policy (i.e., Investment Policy and Economics) appears consistent with the SBA's commitments to continuous self-assessment and improvement in its investment processes, including considering new investment strategies from both policy and implementation perspectives.

Finally, while dedicated compliance (IG) functions are required in private investment management firms, they less frequently exist in public investment organizations. A dedicated Internal Audit function is the norm within the larger private investment management firms and public investment organizations. These dedicated *independent* control functions can provide the SBA, its Executive Director, and its Trustees with additional levels of assurance enjoyed by few of its peers.

Although we have identified several opportunities to rationalize current resource alignments within Financial Operations and Accounting, the benefits we anticipate potentially resulting from the recommended organizational realignments are principally enhancements of the control environment or eliminations of redundant controls.



Staffing Levels

Aggregate staffing levels appear slightly elevated in several areas, but may be low in other areas. Staffing levels should be monitored while management undertakes a number of the internal assessments recommended in this report. Investment professional staffing levels should be assessed in Domestic Equities and, to a lesser extent, in Fixed Income to determine if these areas have excess staff. Staffing levels in selected Financial Operations and Accounting functions should also be assessed, (e.g., those involved in replication and reconciliation of external investment portfolio data) to determine if there is excess staff. Real Estate, Alternative Investments and International asset classes should be assessed to determine if they are adequately staffed considering additional investment mandates.

Control Activities

Several important control improvements are recommended in Operations and Technology. Otherwise, existing layers of controls appear to provide a generally sound control environment, although certain risk mitigating functions may be over-controlled. Consequently, we have recommended that management conduct internal assessments of specific control-related activities. We believe that a risk-based assessment and rationalization of certain control activities, including replication and reconciliation of external investment portfolio data and performance reporting, may yield measurable efficiencies without degrading the related controls or fiduciary standards of care.



SUMMARY OBSERVATIONS: OPERATIONAL CONTROL ENVIRONMENT

Key interrelated components of a sound control environment, based on both widely accepted Committee on Sponsoring Organizations (COSO²) Principles as well as our own industry experience are clearly present at the SBA.

Control “Tone at the Top”: Executive and Senior Management have positively impacted the control consciousness of employees at all levels. Most employees have a clear understanding of their role within the internal control framework. Management’s operating style stresses the highest fiduciary standards, integrity, ethical values and competence, and its commitments to continuous self-assessment and improvement of the control environment are institutionalized and facilitated within the Offices of the Inspector General and Internal Audit.

Risk-Based Approaches: The SBA’s dedicated Internal Audit function employs a risk-based approach to prioritize its activities, to prepare its audit plan, and to prioritize and communicate its findings to management and the Audit Committee. More generally, management typically and appropriately conducts control/process risk analyses before implementing contemplated changes within the organization, as evidenced by many of the management responses within this report.

Control Activities and Continuous Monitoring: Control activities including, but not limited to, approvals and authorizations, reconciliations, reviews of operating performance, and segregation of duties are generally in place. The design, effectiveness and monitoring of the SBA’s internal controls is management’s responsibility and is periodically tested by Internal Audit and the Inspector General. In addition, specialist consultants are periodically engaged to supplement SBA’s internal activities by performing independent reviews.

Fiduciary Standards: Standards for fiduciary care are set high, and they are widely and broadly communicated. Staff at all levels display a keen awareness of their fiduciary roles and responsibilities. Decisions regarding investment strategies and control processes are implemented only after focused – often lengthy – internal deliberation and analysis. External specialist consultants are frequently engaged to supplement or validate internal analyses and conclusions. Finally, external specialists are appropriately engaged to supplement and assist internal resources in activities such as system implementations, where certain required skill sets are not SBA core competencies.

² COSO principles are defined in Appendix B of this document.



HIGH PRIORITY OBSERVATIONS: OPERATIONAL CONTROLS

The four technology and operations-related control observations that appear below are highlighted in this executive summary because we believe they identify potentially significant unmitigated risks to the operational control environment. Although we found no evidence of operational control failures to date, we recommend that the recommendations be addressed as high priority findings.

Developer Access to the Production Environment: IT application developers have unrestricted and unmonitored access to the production environment, potentially exposing the organization to accidental or purposeful program changes, theft of proprietary data, and/or fraud. IT management should identify a system librarian with authority to move approved changes into the production environment and a system administrator to monitor and control any required emergency access to production.

Absent Wire Transfer Authorization Limits: Authorization levels/limits for wires based on their dollar amounts have not been established, potentially exposing the organization to the risks of large erroneous or fraudulent funds transfers. Wire authorization limits, particularly for large dollar amounts, should be established by management and implemented as part of the wire transfer control process.

Prepaid College Tuition Plan Payment Change Control: There is currently no oversight to ensure that frequent changes to data file information – including recipient names and dollar amounts – have been appropriately authorized and accurately recorded. An added level of oversight should be implemented to review change requests for authenticity and accuracy.

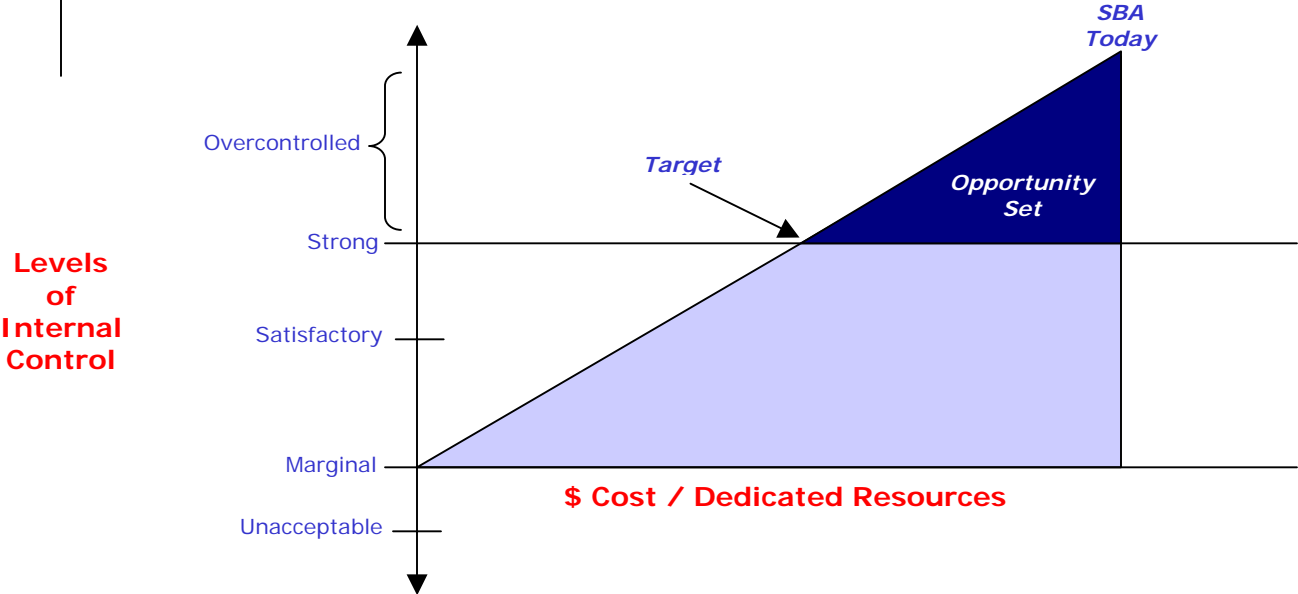
Data Center Fire Suppression System: The SBA Data Center is currently equipped with a water sprinkler system for fire suppression. In the event of fire, water would likely damage or destroy hardware located in the Data Center. SBA should install a fire suppression system that will not damage or destroy its hardware.

These observations as well as a number of medium and low priority operational control findings are fully detailed in the body of this report. Each observation is followed by KPMG's recommendation and SBA Management's response.



HIGH PRIORITY OBSERVATIONS: EFFICIENCY OPPORTUNITIES

The Efficiencies “Opportunity Set”: Since the SBA is unalterably committed to maintaining the highest standard of fiduciary care and the strong operational controls required to support it, we understand that proposed modifications to operational processes must yield measurable efficiencies without unacceptably degrading the SBA’s controls or standards of fiduciary care. Since we believe certain SBA risks may be, in fact, **overcontrolled**, the illustration below helps define in large measure our efficiencies “opportunity set.”



In the remaining pages of this executive summary, we synopsize what we believe may be significant opportunities to gain efficiencies, in many cases by eliminating process features that overcontrol certain risks. However, please note that other identified efficiency opportunities – those that do *not* necessarily follow from a relaxation of overcontrol – must also be subjected to the same in-depth risk assessment and analysis by management before any implementation decision is made.



HIGH PRIORITY OBSERVATIONS: EFFICIENCY OPPORTUNITIES

Three potentially significant opportunities to capture efficiencies are highlighted in this executive summary. One opportunity is principally “owned” by the Chief Investment Office and two are “owned” by the Chief Operating Office – but any process modifications that may be contemplated by either Office will likely impact both sides of the SBA.

1. Eliminate Unnecessary Replication and Reconciliation of Externally Managed Portfolios

Financial Operations and Accounting currently dedicate substantial resources to recording, reconciling, and maintaining external investment managers’ transactions and positions on the SBA’s GPVS accounting system, effectively replicating work performed by other fiduciaries: SBA’s external investment managers and custodians. Frequently cited reasons for the replication of externally managed portfolios include supporting performance measurement and analytics activities within the Asset Classes, supporting State of Florida reporting requirements, and “safekeeping the assets.” However, we have observed that:

- Asset and cash positions required to support in-house performance measurement activities are available from custodians, from individual external asset managers and/or from a database managed within Policy and Economics;
- The State of Florida requires only aggregate level reporting from the SBA, and we have found no evidence that the State requires individual security-level detail;
- The responsibility for safekeeping assets has been outsourced to other fiduciaries, the SBA’s custodians;
- Custodians reconcile asset positions to the depositories, and investment managers reconcile all accounts with the designated custodian. Both fiduciaries are responsible for promptly identifying, reporting, aging, and clearing out-of-balance conditions; and
- Most reconciling items identified by Operations and Accounting result from timing differences, and we have been unable to identify any reconciling items that would not have been identified and resolved by the custodian in the regular course of business.

Therefore, although it certainly provides a very high level of assurance, we believe the replication of external manager/custodian tasks and records likely over-controls risks mitigated by other fiduciaries.

Recommendation: Subject current replication and reconciliation practices to a thorough risk assessment, with an eye to abandoning the costly replication control strategy in favor of more conventional assurance processes adopted by most peers, including spot checks and sample testing, independent SAS 70 examinations, and periodic direct audits of custodians’ controls.



2. Rationalize Performance Measurement and Reporting

Over time, the Asset Classes have developed unique performance measurement practices, standards and reporting formats, and they continue to dedicate substantial resources to performance measurement and reporting activities, despite the facts that:

- State Street Analytics has been engaged as the SBA's official and independent performance computation and reporting agent; and
- A database and reporting programs currently maintained by Policy and Economics can provide electronic access to databases and “canned” performance data that probably meets most of the Asset Classes’ high-level return-based reporting needs.

Consequently, the Asset Classes:

- May be needlessly replicating many activities conducted by the official performance measurement agent or by Policy and Economics;
- May be maintaining unnecessary IT/database-specialist technology and/or analytic resources within the Asset Classes to support performance measurement; and
- May apply inconsistent performance standards and methodologies in computing, reconciling and reporting their own performance or that of their external investment managers.

Recommendation: Conduct a thorough assessment of performance measurement data and reports *actually required / utilized* by the SBA and by the individual Asset Classes, and rationalize the performance measurement and reporting processes to avoid costly duplication of efforts and to ensure the application of correct and consistent methodologies across all Asset Classes and FRS and non-FRS mandates.

3. Consider Consolidating Custody with a Single Vendor

The SBA currently utilizes three different custodians to service its FRS and non-FRS mandates: State Street, Bank of America, and Northern Trust. Custody fees are currently based on three unique pricing models, and SBA may not be realizing cost savings typically available from consolidating custody services with a single vendor. Further, under the current multi-vendor model, potential benefits and efficiencies that might be gained from uniform custodian reporting across all SBA mandates are not currently realized.

Recommendation: SBA should assess potential cost savings and other benefits that may be realized by implementing a single-vendor custody services model across all mandates.



4. *Consider Dependencies Among Efficiency Opportunities*

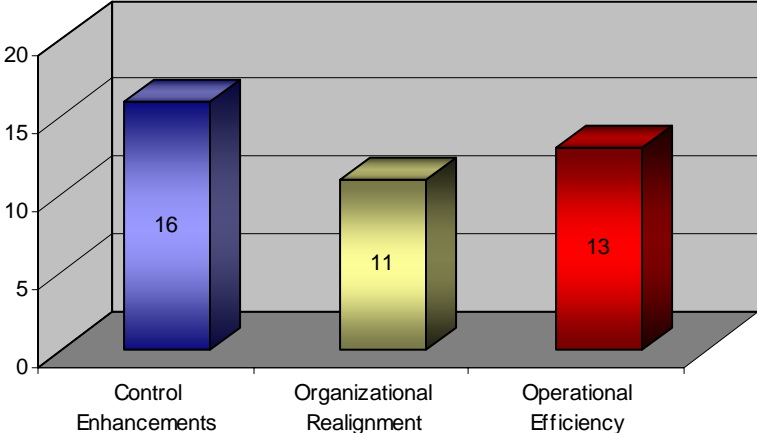
We believe it is worthwhile to note that there are important dependencies among the three opportunities described above. While each opportunity may certainly be considered or exploited in isolation, we believe that the opportunity set is more likely optimized if they are risk-assessed and considered together. For example, the adoption of a single-vendor custody model might well facilitate the rationalization of performance measurement and reporting across Asset Classes and all SBA mandates – as well as simplifying the prospective abandonment of replication as a control strategy. Nonetheless, whether these opportunities are considered separately or as a group, it is imperative that SBA leadership conducts thorough risk assessments to ensure that the efficiencies captured by exploiting *any* of these opportunities does not negatively impact the operational control environment *anywhere* within the SBA.



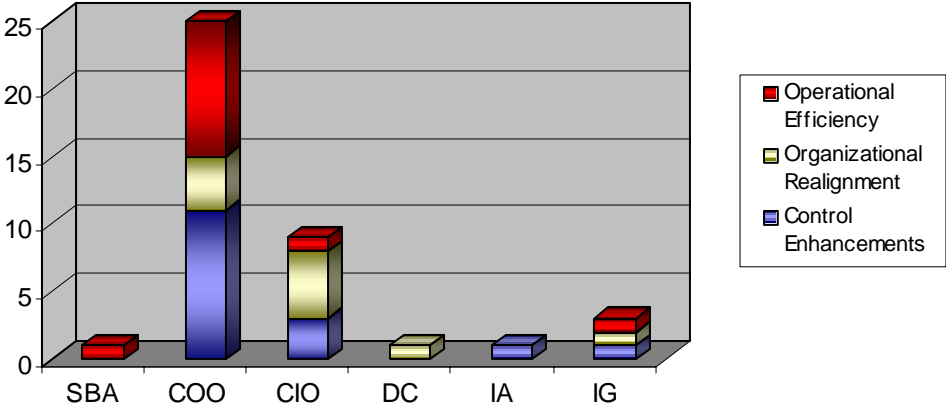
CATEGORIZED SUMMARY

The following represents categorized summaries of observations and recommendations identified during the operational review.

Observations across the SBA



Observations by Business Group





Observations & Recommendations

The observations and recommendations that appear in the body of this report were developed through interviews, walkthroughs, and document reviews and were not the result of an audit or audit-related procedures.

The High, Medium or Low ratings were assigned to help prioritize the recommendations. The ratings are based on the perceived level of risk and/or the value to the SBA.



Organization-Wide

High priority observations and recommendations

Observation (Operational Efficiency)	Recommendation	SBA Response / Action to Date
<p>1 Custody Services:</p> <p>The SBA currently utilizes three different custodians to service its FRS and non-FRS mandates: State Street, Bank of America, and Northern Trust. Custody fees are currently based on three unique pricing models, and SBA may not be realizing cost savings typically available from consolidating custody services with a single vendor. Further, under the current multi-vendor model, potential benefits and efficiencies that might be gained from uniform custodian reporting across all SBA mandates are not currently realized.</p>	<p>SBA should assess potential cost savings and other benefits that may be realized by implementing a single-vendor custody services model across all mandates.</p>	<p>We will assess this recommendation in conjunction with our review of the master custody contract that will be conducted in the last six months of 2004.</p>



Chief Operating Office

High priority observations and recommendations

Observation (Operational Efficiency)	Recommendation	SBA Response / Action to Date
<p>2 Reconciliations:</p> <p>Frequently stated reasons for the replication of data from externally managed funds include performance measurement, analytics within the asset classes, reporting to the State of Florida and for safekeeping of assets. However, we have noted the following:</p> <ul style="list-style-type: none"> ▪ Asset and cash positions for in-house performance measurement and analytics are available from State Street through directed feeds into their analytics system(s) or from the database managed within Policy and Economics; ▪ The reporting of information to the State is at an aggregate level. We have not seen any evidence that the State requires the SBA to report individual asset positions; and ▪ The responsibility for the safekeeping of assets has been outsourced to the custodians hired by the SBA. <p>SBA does not rely upon the work performed and the services provided by their external parties including the custodians and investment managers. The custodians and investment managers are responsible for reconciling both cash and asset positions on a regular frequency. <i>Continued on next page</i></p>	<p>A comprehensive reconciliation risk assessment should be performed for both internally and externally managed accounts considering the following factors:</p> <ul style="list-style-type: none"> ▪ Reconciliation type (cash vs. asset); ▪ Internal vs. externally managed; ▪ Purpose of reconciliation; ▪ Data sources for reconciliation; ▪ Frequency of reconciliation; ▪ Frequency of activity within the account; ▪ Users of reconciled information; and ▪ Out-of-balance thresholds. <p>Based on this analysis, a rating of High, Medium, or Low risk should be assigned to the account to provide oversight guidance regarding frequency, out-of-balance thresholds, etc. For example, a high rating could include cash reconciliations for all internally managed funds and investment manager transitions, where a low rating should be applied to externally managed funds. The risk ratings should also dictate the frequency with which the reconciliation needs to occur.</p>	<p>When we have completed our systems enhancements, we will develop a comprehensive reconciliation risk assessment to review the feasibility of modifying our current reconciliation procedures.</p>



Chief Operating Office

Observation	Recommendation	SBA Response / Action to Date
<p>The custodians are reconciling their asset positions (on an aggregate level) to the depository while the investment managers are reconciling (on an account basis) with the custodian. Both are responsible for identifying, reporting, aging, and clearing out-of-balance conditions.</p> <p>As a result of not considering potential reliance or direct use of this information on the services provided by external parties, over 40,000 manual reconciliations are being performed on an annual basis for both internally and externally managed funds. The reconciliations include approximately 170 daily cash reconciliations between the custodian(s) to GPVS and the external managers to GPVS. For each account, there are approximately 170 monthly asset (inventory) reconciliations that are also being performed. In addition, the reconciling items identified, are usually a result of timing differences between the custodian and GPVS such as purchase and sale activity. Based on inquiry, we have not identified any instances where the reconciling items resulted in a financial gain / loss that would otherwise not have been identified and resolved by the custodian.</p> <p><i>Continued on next page</i></p>	<p>For instance, a high rating may warrant a daily or weekly reconciliation where a low rating may only warrant oversight or reasonableness checks which include the following:</p> <ul style="list-style-type: none"> ▪ Review of external manager reconciliations (account positions vs. custody positions); ▪ Request and review of SAS 70 reports supplied by key vendors; and ▪ Directed audits of the custodians performed by SBA's Internal Audit group. <p>It should be noted that the DC plan does not currently replicate the books / records of the custodian or investment managers, rather, reasonableness checks are performed. Given the size of the investable funds at the SBA, it is reasonable to expect vendors to provide customized reporting which the SBA could utilize to conduct oversight activities. Additionally, once a risk based reconciliation approach is adopted a scorecard should be developed that enables management to monitor the completeness, accuracy and timeliness over the reconciliation process.</p>	



Chief Operating Office

Observation	Recommendation	SBA Response / Action to Date
	<p>Under this risk-based approach, there are also additional opportunities for efficiency such as eliminating the replication of information into the GL, the reconciliation of that information, and the correction voucher process for GPVS. The COO should consider FTE reductions or employee redeployment upon full implementation of a risk-based reconciliation approach.</p>	



Chief Operating Office

High priority observations and recommendations

Observation (Operational Efficiency)	Recommendation	SBA Response / Action to Date
<p>3 Reconciliations:</p> <p>intelliMATAch is currently being programmed to facilitate the movement from manual reconciliations to an automated reconciliation format. One of the key factors in determining how the matching of transactions should occur is the dollar amount and security position thresholds. Currently, the cash out-of-balance thresholds appear to be very stringent, ranging from one cent to one dollar.</p>	<p>Current practice should be analyzed to determine whether the costs of clearing small reconciling items exceed the benefits. Out-of-balance thresholds should be reviewed and redefined based on the perceived level of risk. If the thresholds are not established feasibly within intelliMatch, then the SBA will not gain any efficiency in the auto recon process. Additionally, the use of intelliMatch should be considered for all reconciliations performed within the SBA.</p>	<p>We will review our out-of-balance thresholds to determine whether or not raising the threshold limits would be cost benefit justified.</p> <p>In phase two of the implementation, we plan to make intelliMATCH available to the rest of the organization.</p>



Chief Operating Office

High priority observations and recommendations

Observation (Control Enhancement)	Recommendation	SBA Response / Action to Date
<p>4 Information Technology:</p> <p>Application developers have unrestricted and unmonitored access to the production environment, exposing the organization to unauthorized program changes, theft of proprietary data and/or fraud.</p>	<p>Application developers' access to the production environment should be immediately revoked. The IT department should identify a system librarian who has the authority to safely move approved changes into the production environment. In the event that emergency changes are required, they should be made under strict supervision using an emergency ID or Fire Call ID that is controlled by a system administrator.</p>	<p>We agree with this recommendation and will implement it by allowing application developers' access to be read only. Additionally, when/if emergency changes are required, supervision and control will be used by a system administrator.</p>



Chief Operating Office

High priority observations and recommendations

Observation (Control Enhancement)	Recommendation	SBA Response / Action to Date
<p>5 Information Technology:</p> <p>The SBA's Data Center does not have an appropriate fire prevention system to safeguard the equipment. The Data Center is currently only equipped with a water sprinkler system. In the event of a fire, water would likely damage or destroy the hardware located in the Data Center.</p>	<p>The SBA should install a fire suppression system that will not damage or destroy the hardware located in the Data Center, such as FM-200, FE-13 or INERGEN.</p>	<p>Based on this recommendation, Facilities Management staff is currently evaluating fire prevention systems to determine the most appropriate course of action to address this observation.</p>



Chief Operating Office

High priority observations and recommendations

Observation (Control Enhancement)	Recommendation	SBA Response / Action to Date
<p>6 Prepaid College Tuition Plan:</p> <p>There is a lack of oversight to ensure that changes to the disbursement file, such as names, dollar amounts, addresses etc. have been approved and are accurately captured.</p>	<p>Unless the number of changes can be minimized, an added level of oversight should be implemented to review and approve disbursement change requests for authenticity and accuracy.</p>	<p>This recommendation has been implemented by Financial Operations which has notified the PrePaid college management group that change notices will require their signoff.</p>



Chief Operating Office

High priority observations and recommendations

Observation (Control Enhancement)	Recommendation	SBA Response / Action to Date
<p>7 Wires:</p> <p>Outgoing wire transfer authorization limits have not been established to help mitigate the high inherent risk typically associated with outgoing wire transfer activities. The only systematic constraint is that the custodian bank funds transfer systems typically have a limit in the number of digits that can be typed into the wire transfer amount field (e.g., most bank funds transfer systems only limit the transfer to an amount of \$999,999,999). Wire transfer limits serve as a key preventive control designed to mitigate the risks of fraudulent or erroneous outgoing wire transfers.</p>	<p>We recommend that management establish wire transfer authorization limits within each of the custodian bank wire transfer systems (e.g., Encore, Prime Meridian, etc.). These limits should be established at a reasonable threshold to ensure that normal wire transfer processing is not interrupted, while providing a safety net to help ensure that the risk associated with a fraudulent or erroneous outgoing wire transfer is appropriately mitigated.</p>	<p>We agree with this recommendation and will establish reasonable wire transfer limits, which we expect to be in place by June 30, 2004. These limits will be established in conjunction with the migration to the web based versions of Prime Meridian and Bank Of America Direct (Encore).</p>



Chief Operating Office

Medium priority observations and recommendations

Observation (Organizational Realignment)	Recommendation	SBA Response / Action to Date
<p>8 Organizational Structure:</p> <p>The financial and accounting functions for the SBA, such as the GL, purchasing, budget, etc. are dispersed throughout the COO organization. As a result of the current organizational structure, the SBA does not have a centralized financial group that has oversight and provides guidance to SBA management on all financial and accounting topics.</p> <p>Private companies including investment managers typically have a controller whose responsibilities include the GL, budgeting, etc. for the organization. This individual is separate from the operational activities and investment side of the house.</p>	<p>Consideration should be given to developing a controller position that would be responsible for the financial statement accounting, accounts payable, accounts receivable, purchasing, budgeting, forecasting, GL entry approval, manager and fee bill audit, and PCard monitoring. The creation of this unit will lend itself to increased oversight and enhanced communications regarding how and where money is spent.</p>	<p>We will consider repositioning these units within the organization structure to determine the best fit for the SBA.</p>



Chief Operating Office

Medium priority observations and recommendations

Observation (Control Enhancement)	Recommendation	SBA Response / Action to Date
<p>9 Reconciliations:</p> <p>Individual account reconciliations do not contain an aging summary detailing the age of outstanding items. Failure to include an aging of outstanding reconciling items on the reconciliation increases the operational risk that aged items do not receive appropriate attention for clearance and/or consideration for charge-off.</p>	<p>Each reconciliation should include a summary of aged reconciling items. The summary should include the date of the out-of-balance, description of the security / transaction causing the out-of-balance, and the associated financial risk (dollar amount of cash out-of-balance or cost of replacing an asset). Aging parameters may include 0-30, 31-60, 61-90, 91-180, and items over 180 days. These parameters are typical of how the financial services industry records, tracks and measures its reconciling items. An aging summary provides a snapshot of the age of outstanding items within the reconciliation, and it also helps direct management's attention to those items that are most significant in terms of age and potential loss – dollars and shares. Additionally, the out-of-balances should be tracked to identify any trends or areas for improvement. For instance, if dividends are continually posted incorrectly then this information should be shared with the custodian to determine an acceptable course of action to resolve the recurring errors.</p>	<p>We agree with the recommendation and will implement procedures to age and review reconciling items. These procedures will be in place with the implementation of the new system in the 3rd quarter of 2004.</p>



Chief Operating Office

Medium priority observations and recommendations

Observation (Organizational Realignment)	Recommendation	SBA Response / Action to Date
<p>10 Reconciliations:</p> <p>All but one position within the reconciliation group in Accounting are required to “meet eligibility requirements to sit for the CPA or possess a CPA”. Based on the clerical nature of the reconciliation activities, this level of accreditation and experience may not be necessary. Additionally, the CPA requirement makes it difficult to find qualified associates to fill open positions, as well as creating an increased salary expense.</p>	<p>Management should evaluate the “CPA eligible or CPA’s” requirement for manager and associate-level personnel with the reconciliation area.</p>	<p>This observation/recommendation is directed at the five positions within the Financial Reconciliation group and after we have completed our review as noted in Observation #2, we will consider this recommendation.</p>



Chief Operating Office

Medium priority observations and recommendations

Observation (Operational Efficiency)	Recommendation	SBA Response / Action to Date
<p>11 Disbursements:</p> <p>Currently, when outstanding invoices are presented for payment and when Prepaid College payment requests are received, investments are liquidated and funds are allocated to the General Account at Bank of America. These funds remain on deposit at the bank until checks are presented for payment. Bank of America sweeps any funds remaining in the General Account at the end of each day into an overnight investment vehicle. As the current cash management process is primarily passive in nature, there appears an opportunity to gain greater returns by adopting a more active cash management strategy.</p> <p><i>Continued on next page</i></p>	<p>Management should assess the feasibility of developing a controlled disbursement account (cash management relationship) with its primary financial institution. Use of controlled disbursement accounts are a common industry practice, allowing companies to optimize cash management activities by only transferring funds from a funding account to the disbursement account to cover the checks actually presented for payment. This process enhances opportunity for continuous investment of disbursed funds until checks are actually presented for payment.</p> <p>Based on current annual dollar volume of check disbursements at the SBA (Check disbursements of \$2.6MM for AP and \$6.5MM for Prepaid in October 2003), additional investment income could be realized assuming that, on average, a check will not be actually presented for payment by the payee at the depository bank until 7-10 days after the check is written and mailed by the SBA.</p>	<p>Based on this recommendation we are currently working with Bank of America to evaluate the impact of modifying our existing account to a controlled disbursement account or opening a new controlled disbursement account from which payments would be processed. We will complete our evaluation by December 31, 2004.</p>



Chief Operating Office

Observation	Recommendation	SBA Response / Action to Date
	<p>As a result, the SBA could earn higher returns during the entire “float” period for each AP check written. A full analysis of the expected additional incremental revenue should be performed to validate the actual dollar amount of additional investment income that could be earned by implementing active cash management through a controlled disbursement account.</p>	



Chief Operating Office

Medium priority observations and recommendations

Observation (Operational Efficiency)	Recommendation	SBA Response / Action to Date
<p>12 Information Technology:</p> <p>The selection of the Eagle/Pace system was driven by an immediate need to replace GPVS, which is no longer supported by its vendor. Typically, however, a project feasibility study would be conducted to estimate productivity gains, identify and quantify the cost savings associated with a new system, and estimate a payback schedule for costs incurred as a result of implementing a new system. Moreover, post-implementation reviews and audits would be scheduled as part of the implementation acceptance process. Finally, it is evident from our discussions with operations managers and staff that anticipated system-related process improvements have not been widely communicated and that an analysis of FTE impact has not been performed.</p>	<p>The project management team should identify the processes that will be improved, how they will be improved, and the associated impact to FTEs. Further, we recommend that a post-implementation review be performed to verify that the new system has been designed and developed per predefined specifications. Internal Audit should conduct an independent review to ensure appropriate controls exist and are functioning as intended in the new post-implementation control environment. The post-implementation should also address at a minimum:</p> <ul style="list-style-type: none"> ▪ The adequacy of the system measured against user requirements, system specifications, and management's objectives; ▪ The adequacy and appropriate implementation of access controls; ▪ The projected cost benefits or return on investment (ROI) measurements; and ▪ Any identified post-implementation system inadequacies or deficiencies. 	<p>Albeit under tight timelines, the SBA worked with a consultant (i.e., InvestTech) to conduct a thorough business requirements study, which identified and documented several areas where efficiencies could be gained. A number of decisions regarding implementation have yet to be made and we are continuing to examine processes for potential efficiency enhancements, including recognizing any impact to FTE's. Additionally, six months after its implementation, the Office of Internal Audit will conduct a post implementation audit of the Eagle System to ensure that appropriate controls are in place and are functioning as intended.</p>



Chief Operating Office

Medium priority observations and recommendations

Observation (Control Enhancement)	Recommendation	SBA Response / Action to Date
<p>13 Information Technology:</p> <p>Currently, there is no formal process to manage change requests received internally. The change request / change management processes should support budget discipline and help mitigate risks to the IT control environment.</p>	<p>The IT department should document and implement a standard system development life cycle for making changes to application systems. This process should include formalized project requests that include specifications and development effort estimates, cost/benefit analysis, requesting business unit manager approval, project tracking (through a proven automated tool such as Microsoft project), and standardized documentation of changes.</p>	<p>We agree with this recommendation and will develop a formal change management policy that will document the manner in which changes are implemented and deployed. This policy will be completed by November 1, 2004.</p>



Chief Operating Office

Medium priority observations and recommendations

Observation (Control Enhancement)	Recommendation	SBA Response / Action to Date
<p>14 Information Technology:</p> <p>Currently, the formal written policies and procedures for Information Technology (IT) appear to be outdated. The lack of comprehensive and up-to-date written IT policies and procedures exposes the organization to various operational and financial risks, including the loss or manipulation of critical data and fraud.</p>	<p>IT policies and procedures should be comprehensive and up-to-date. Management should prioritize the IT areas / functions to be addressed and begin the revision of policies and documentation of procedures as soon as possible. We recommend that critical IT functions such as access to the network and applications, information security, incident response, data backup, application development methodology, and password management be addressed first.</p>	<p>We agree with this recommendation and have scheduled the policies and procedures to be updated and/or completed by November 1, 2004. The current policies and procedures for IT are out of date.</p>



Chief Operating Office

Medium priority observations and recommendations

Observation (Control Enhancement)	Recommendation	SBA Response / Action to Date
<p>15 Information Technology:</p> <p>The SBA does not currently have an Internal Audit IT resource, and its open IT auditor position has proven difficult to fill. Nationwide, there is strong competition among financial services organizations for <i>qualified</i> IT auditors.</p>	<p>Strongly support the Chief of Internal Audit's current search for a qualified IT audit resource.</p>	<p>We agree with this recommendation and will work with the Chief of Internal Audit to hire a qualified IT audit resource.</p>



Chief Operating Office

Medium priority observations and recommendations

Observation (Operational Efficiency)	Recommendation	SBA Response / Action to Date
<p>16 Information Technology:</p> <p>Communication between the IT Department and the rest of the organization is limited and should be enhanced. Currently, meetings between IT and the business units are conducted primarily on a project basis, and do not involve strategic planning areas.</p>	<p>Strongly consider establishing an IT Steering Committee with representation from IT management and key managers from the user community. The committee should meet periodically to discuss current technology issues and opportunities relevant to both IT and user groups.</p>	<p>We agree with this recommendation and will implement it in conjunction with our Strategic Planning Session in October 2004.</p>



Chief Operating Office

Medium priority observations and recommendations

Observation (Operational Efficiency)	Recommendation	SBA Response / Action to Date
<p>17 Prepaid College Tuition Plan:</p> <p>The disbursement information received from the Prepaid College Tuition vendor (“vendor”) is often incomplete and requires numerous changes to either the school or to individuals. The vendor hired by the Prepaid Agency sends a file listing the disbursements, while the Prepaid Agency sends numerous change requests to the SBA for processing. The change requests include changing dollar amounts, listing alternate addresses for disbursement of funds, deleting individuals, etc. The team supporting this function process the requested changes and balance the file to the disbursement total provided by the Agency. The risk that someone is paid incorrectly or not paid at all is high due to the manual intervention that is currently required to process the numerous change requests.</p>	<p>The Prepaid file received should be complete and reconciled when submitted by the vendor. The SBA should only review the format of the file, process the file, and disburse the funds. It is recommended that the SBA work closely with the Prepaid Agency to minimize the number of change requests submitted. The SBA should consider charging additional fees based on the number of manual change requests processed. This recommendation is contingent on the contract of services between the SBA and the Prepaid College Tuition Program.</p>	<p>Based on this recommendation, we are currently working with PrePaid management to have the records administrator make programming changes to the file which should reduce the number of manual changes. However, we do expect that all potential changes to the file data will be eliminated. Changes to the file will be properly authorized by PrePaid management prior to processing the changes.</p>



Chief Operating Office

Medium priority observations and recommendations

Observation (Control Enhancement)	Recommendation	SBA Response / Action to Date
<p>18 Wires:</p> <p>Incoming telephone wire transfer requests for the Local Government Pool are received on a dedicated phone number. However, the associated phone lines do not record the content of the wire transfer requests. Failure to record telephone wire transfer requests, a commercially reasonable security measure widely adopted in the financial services industry, increases operational risk relating to resolution of potential disputes regarding the accuracy of wire amounts.</p> <p>Callbacks to persons other than the initiators of wire transfer requests are not performed for wire requests received by fax or on the dedicated telephone number. Failure to perform callbacks for these types of wire transfer requests increases operational risk that the request is not authentic or properly authorized.</p> <p><i>Continued on next page</i></p>	<p>Management should implement a process for recording wire transfer requests received on the dedicated phone number. Recording wire instructions and applicable callbacks provides a mechanism for resolving potential disputes that may arise regarding the accuracy of wire amounts. Financial institutions typically archive these recorded telephone wire transfer requests for 6 months. Management should consult the record retention guidelines for the State of Florida for further guidance.</p> <p>Management should consider implementing additional controls including callbacks to someone other than the initiator for wire transfer requests received by telephone or fax, where feasible. Callbacks are an important component of an internal control system designed to ensure the accuracy and authenticity of wire transfer requests. Calling back an authorized individual other than the initiator is a widely adopted control within the financial services industry to authenticate wire requests.</p>	<p>Based on this recommendation, we are currently researching the feasibility and cost effectiveness of having recorded lines for incoming deposit/withdrawal requests.</p> <p>Additionally, we will consider implementing additional controls for wire transfer requests received by telephone or fax, where feasible.</p>



Chief Operating Office

Observation	Recommendation	SBA Response / Action to Date
	<p>In addition, the callback should also be recorded and archived. When considering the implementation of additional wire transfer controls, management may wish to adopt a risk-based approach considering attributes such as the dollar amount of the transfer request and staffing levels at the requesting entity.</p>	



Chief Operating Office

Medium priority observations and recommendations

Observation (Control Enhancement)	Recommendation	SBA Response / Action to Date
<p>19 PCard:</p> <p>Internal controls for approval of purchases made by check versus Procurement Card (PCard) are not consistent. While all invoices submitted to AP to be paid by check must be supported by signatory approval of someone with budgetary authority or their designee, no such approval process exists for PCard purchases. Inconsistent controls surrounding disbursement activities increases operational risk that disbursements are not properly authorized by management.</p>	<p>We recommend that management improve internal controls surrounding PCard purchases by requiring the same level of budgetary authority approval that is required for payments by check. Controls surrounding PCard purchases will become more critical with the increased usage of the PCard for SBA purchases.</p>	<p>Effective immediately, all purchases, both check and PCard, will require budgetary approval prior to processing by the Accounts Payable unit.</p>



Chief Operating Office

Medium priority observations and recommendations

Observation (Operational Efficiency)	Recommendation	SBA Response / Action to Date
<p>20 Accounts Payable:</p> <p>The SBA currently runs the Accounts Payable (AP) process on Tuesday and Thursday of each week. This payment frequency may result in inefficient AP processing by paying bills near the date of receipt rather than accumulating invoices and running the AP cycle less frequently. Although many bills received are “due upon receipt”, payment of open invoices within 30 days would typically be considered paying “current”.</p>	<p>We recommend that management perform an analysis of the current AP system’s capabilities in handling payment dates in the future and consider reducing the accounts payable payment cycle to bi-weekly, at a minimum. This will increase process efficiency by reducing the number of times the AP and check printing processes occur. Management should consider analyzing the timeframe when bills received are processed for payment. Where practical, management should develop a process to pay bills more in line with their payment due date or within 30 days in the absence of a stated due date.</p>	<p>Based on this recommendation, accounts payable is currently working to set up an aging process for invoices. We will evaluate the possibility of changing our payment process to once a week for administrative invoices and once a week for PrePaid invoices.</p>



Chief Operating Office

Low priority observations and recommendations

Observation (Organizational Realignment)	Recommendation	SBA Response / Action to Date
<p>21 Organizational Structure:</p> <p>Currently 2 FTEs within Travel Services report directly to the SOO for Accounting and Financial Operations. This appears to be an organizational misalignment, since Travel Services is not a core financial or accounting activity at the SBA.</p>	<p>Management should consider transferring the responsibility for management and oversight of Travel Services to the SOO Planning, Policy & Administrative Services. The administrative nature of this function would be better aligned organizationally within this area since it is not a core financial or accounting function. This will also allow the SOO Accounting and Financial Operations to redirect his focus to the core mission of oversight of Accounting and Financial Operations.</p>	<p>We concur with this recommendation</p>



Chief Operating Office

Low priority observations and recommendations

Observation (Organizational Realignment)	Recommendation	SBA Response / Action to Date
<p>22 Accounting Information Systems:</p> <p>The following job functions currently performed within the Accounting Information Systems do not appear to be aligned with the unit's business mission of providing user support and serving as the security administrator for core IT applications such as PeopleSoft, GPVS, STAR/PACE, and FLAIR:</p> <ul style="list-style-type: none"> ▪ System Reconciliations: <ul style="list-style-type: none"> • Accounts Payable (Payables to GL) reconciliation; • Property (Asset Management to GL) reconciliation; • Investment to GL (GPVS to PeopleSoft; Star/Pact to PeopleSoft) reconciliations; and • Pool subsystem to Recordkeeper (GPVS, Star) reconciliation. ▪ Florida Prepaid College: <ul style="list-style-type: none"> • Daily cash reconciliations (for Prepaid program); and • Monthly inventory reconciliations (for Prepaid program). 	<p>The Accounting Information Systems unit should not perform operational duties such as account/system reconciliations. Management should consider transferring these reconciliation activities to the Financial Reconciliation section of the Accounting Department. This will help ensure better organizational alignment along core business functions and provide a more centralized point of control for the SBA's reconciliation activities.</p>	<p>As we complete the implementation of our new systems the role of this unit will be refined. The new data steward role taken on by this unit will not allow for any excess capacity, therefore these reconciliation activities will be addressed and reassigned as appropriate. The reconciliation activities are currently performed in this unit due to capacity_and prior expertise considerations.</p>



Chief Operating Office

Low priority observations and recommendations

Observation (Control Enhancement)	Recommendation	SBA Response / Action to Date
<p>23 Reconciliations:</p> <p>There is no standardized monthly reconciliation management report for the overall status of the reconciliation function. Failure to provide periodic management reporting on the overall status of the reconciliation function increases operational risk that significant issues may not be escalated to senior management in a timely manner.</p>	<p>A monthly reconciliation control report should be developed and presented to management to further enhance internal controls surrounding the reconciliation process. This report should include items such as timeliness of reconciliation preparation and review, aged outstanding reconciling items, items past clearance parameters that should be reserved for charge off, and charge offs. This report should also identify and report any systemic or recurring issues that may be creating an increase in reconciling items as the result of a process change, change in a vendor relationship, or other factors. This process adds a critical control following the implementation of a risk-based reconciliation process, ensuring that exceptions are identified and resolved on a timely basis.</p>	<p>With the implementation of IntelliMATCH, we will have the ability to produce, on demand, a summary report of all outstanding reconciling items. This report will be produced no less than weekly and reviewed by the Reconciliation Manager.</p>



Chief Operating Office

Low priority observations and recommendations

Observation (Operational Efficiency)	Recommendation	SBA Response / Action to Date
<p>24 Wires:</p> <p>The current processes used by Front Office personnel to provide wire instructions to Financial Operations are not standardized. Each asset class has developed its own method and/or forms for submitting wire requests to Financial Operations for processing. Failure to standardize the method for submitting wire instructions increases operational risk and creates inefficiencies in the wire transfer approval and release processes.</p>	<p>We recommend that individuals from Financial Operations and the Front Office co-develop a standardized wire transfer instruction form to help ensure consistency of the format and content of wire instructions provided to Financial Operations. This will provide consistency and improve the efficacy of the wire transfer activities of the SBA.</p>	<p>We will consider this recommendation and if determined to improve the efficacy of the wire transfer process, Financial Operations and the Front Office staff will co-develop this standardized form.</p>



Chief Operating Office

Low priority observations and recommendations

Observation (Operational Efficiency)	Recommendation	SBA Response / Action to Date
<p>25 Records Retention:</p> <p>While the SBA has made significant progress in reducing the quantity of documents retained beyond their statutory requirements, we noted the following issues surrounding records retention and management:</p> <ul style="list-style-type: none"> ▪ The SBA has had document imaging capabilities for a number of years. However, electronic document storage is not an integral part of the SBA's document retention and management program. Failure to incorporate available electronic document storage capabilities into the records retention and management process may result in inefficient and/or unnecessary storage of paper documents; and ▪ Retention of electronic communications such as emails and voicemails has not been included in the SBA's overall records retention and management program. Retention management for these electronic records currently resides within IT and Facilities Management, respectively. Failure to incorporate retention of electronic communications in the overall retention program may result in the premature deletion of information that is required under applicable law. 	<p>In order to enhance the efficacy of the records retention and management process, we recommend that management implement the following:</p> <ul style="list-style-type: none"> ▪ Revisit the records retention assessment previously performed by Information Technology Decisions and implement the relevant recommendations based on feasibility and practicality of storing certain documents in electronic format, as permitted under statute, in order to more fully realize the benefits of electronic document retention and retrieval; and ▪ The records management activities surrounding email and voicemail content should be coordinated through the records retention department to ensure that these electronic communications are archived in accordance with applicable laws. 	<p>Please See Attachment A. (Pages 72 – 73)</p>



Chief Operating Office

Low priority observations and recommendations

Observation (Operational Efficiency)	Recommendation	SBA Response / Action to Date
<p>26 Asset Setup:</p> <p>Currently, the asset setup function for GPVS is not centralized within one unit.</p>	<p>The Financial Operations group should be the only authorized group to perform asset setup. The group should work closely with each asset class to ensure that the asset shell is setup correctly and thoroughly. The group also needs to be sensitive to the timeliness of the setup and prioritize the workflow to ensure that trades do not fail because assets are not setup timely within GPVS.</p>	<p>We concur with this recommendation and will implement in conjunction with the switch to our new STAR/PACE investment management system.</p>



Chief Investment Office

High priority observations and recommendations

Observation (Operational Efficiency)	Recommendation	SBA Response / Action to Date
<p>27 Performance Measurement & Reporting:</p> <p>Over time, the Asset Classes have developed unique performance measurement practices, standards and reporting formats, and they continue to dedicate substantial resources to performance measurement and reporting activities, despite the facts that:</p> <ul style="list-style-type: none"> ▪ State Street Analytics has been engaged as the SBA's <u>official</u> and independent performance computation and reporting agent; and ▪ A database and reporting programs currently maintained by Policy and Economics can provide electronic access to databases and “canned” performance data that probably meets most of the Asset Classes’ high-level return-based reporting needs. <p>Consequently, the Asset Classes</p> <ul style="list-style-type: none"> ▪ May be needlessly replicating many activities conducted by the official performance measurement agent or by Policy and Economics; ▪ May be maintaining unnecessary IT/database-specialist technology and/or analytic resources within the Asset Classes to support performance measurement; and ▪ May apply inconsistent performance standards and methodologies in computing, reconciling and reporting their own performance or that of their external investment managers. 	<p>Conduct a thorough assessment of performance measurement data and reports <i>actually required/utilized</i> by the SBA and by the individual Asset Classes, and rationalize the performance measurement and reporting processes to avoid costly duplication of efforts and to ensure the application of correct and consistent methodologies across all Asset Classes and mandates.</p>	<p>We agree with this recommendation.</p>



Chief Investment Office

Medium priority observations and recommendations

Observation (Organizational Realignment)	Recommendation	SBA Response / Action to Date
<p>28 Proxy:</p> <p>We concur with Auditor General's January 2004 recommendation (Report No.2004-084 – SBA Corporate Governance) that the SBA consider outsourcing its proxy voting function. A limited study conducted by SBA staff in early 2003 indicated that outsourcing proxy voting might achieve valuable cost savings. While outsourcing would not preclude appropriate SBA attention/activism with respect to any particular shareholder proposal of special importance to FRS beneficiaries, we believe it would likely deal more efficiently and accurately with the large majority of decisions in which a straightforward application of periodically updated voting guidelines would suffice.</p>	<p>Strongly consider the cost/benefit of outsourcing proxy voting.</p>	<p>We agree with this recommendation. A decision will be made by end of fiscal year 2003-2004.</p>



Chief Investment Office

Medium priority observations and recommendations

Observation (Organizational Realignment)	Recommendation	SBA Response / Action to Date
<p>29 Staffing:</p> <p>With respect to the Domestic Equity and Fixed Income Asset Classes, we have observed at a very high level that:</p> <ul style="list-style-type: none"> ▪ Domestic Equities' recent termination of the internally managed Special Situations Portfolio has eliminated the principal responsibilities of one portfolio manager and has reduced the associated analytics burden; ▪ Outsourcing the asset allocation rebalancing function to Northern Trust has reduced the in-house demand for both equity and fixed income trading and associated analytics. While the recent retirement of the Domestic Equities Director of Operations has reduced dedicated equity trading resources to one, current activity levels do not fully occupy even a single trader; ▪ Simplified reporting formats may relieve the Asset Classes of a significant reporting-related burden. <p><i>Continued on next page</i></p>	<p>There are no recommendations to reduce staff at this time. However, staffing levels should be closely monitored and possibly reduced, depending on future circumstances.</p>	<p>We agree with this recommendation.</p>



Chief Investment Office

Observation	Recommendation	SBA Response / Action to Date
<p>Consequently, in the current state environment:</p> <ul style="list-style-type: none">▪ The current compliment of 9 Domestic Equities professionals below the SIO level (5 portfolio managers, 3 analytics resources, and one trader) appears somewhat high; and▪ The current compliment of 6 Long Term Fixed Income professionals below the SIO level (3 portfolio managers and 3 analytics resources) appears marginally high.		



Chief Investment Office

Medium priority observations and recommendations

Observation (Organizational Realignment)	Recommendation	SBA Response / Action to Date
<p>30 Incentive Compensation:</p> <p>The retention of key investment professionals and the successful recruitment of highly qualified new/replacement personnel may both be impeded by SBA's current, sometimes uncompetitive compensation ranges. Recruitment and retention efforts in all Asset Classes are affected. For example:</p> <ul style="list-style-type: none"> ▪ The Alternative Investments SIO is in DROP, and growing demand for alternative investments specialists by sell-side / GP firms has increased the risk that some or all of the SIO's professional subordinates will depart the SBA for increasingly lucrative positions in the private sector, potentially leaving this portfolio of long-term, illiquid investments temporarily under the supervision of insufficient and/or inadequately experienced resources; and ▪ To a lesser, but nonetheless significant extent, more lucrative external opportunities exist for specialist real estate resources and could expose the SBA to similar risks. <p><i>Continued on next page</i></p>	<p>The Trustees may want to consider adopting an incentive compensation plan that is based on investment performance.</p>	<p>We agree with this recommendation. The Executive Director will propose an incentive compensation plan for the Trustees' consideration.</p>



Chief Investment Office

Observation	Recommendation	SBA Response / Action to Date
<p>Finally, and more generally, the education, experience and skill levels required to maintain the highest standards of fiduciary care in the selection, monitoring and evaluation of external managers are comparable to those required by investment professionals who actually manage internal or external investment portfolios. Consequently, the same compensation-related challenges that may impede the recruitment and retention of individuals who directly invest portfolio funds will similarly impede the recruitment and retention of appropriately qualified internal portfolio managers whose primary duties are the selection, ongoing monitoring, and evaluation of active external investment managers.</p>		



Chief Investment Office

Medium priority observations and recommendations

Observation (Organizational Realignment)	Recommendation	SBA Response / Action to Date
<p>31 Staffing:</p> <p>The asset allocations of the Real Estate and Alternative Investments Asset Classes have recently been increased, from 4% to 7% and 3% to 5% respectively. Both units express the objective of being fully funded within 2-3 years, but optimally “growing” these asset classes within the targeted timeframes may require additional portfolio management and/or analytical resources.</p>	<p>Staffing levels within Real Estate and Alternative Investments should be monitored, considering recent increases in asset allocations and work flow.</p>	<p>We agree with this recommendation.</p>



Chief Investment Office

Medium priority observations and recommendations

Observation (Control Enhancement)	Recommendation	SBA Response / Action to Date
<p>32 Wire Initiation:</p> <p>Currently, it appears that a wire initiated in the Asset Classes for any dollar amount and for any purpose will be processed by Financial Operations if it is approved by the relevant SIO.</p>	<p>The CIO may wish to consider specifying particular payment purposes and/or wire dollar thresholds that will automatically require his approval in addition to the approval of the relevant SIO. Any developed authorities and specifications should be communicated to Financial Operations for implementation.</p>	<p>The CIO will work with the Chief of Internal Audit to determine the appropriate threshold. This will be in place before the end of the fiscal year 2003 – 2004.</p>



Chief Investment Office

Medium priority observations and recommendations

Observation (Organizational Realignment)	Recommendation	SBA Response / Action to Date
<p>33 Trade Execution:</p> <p>A limited number of International equity trades are currently executed by a portfolio manager within the asset class rather than being routed through the equity trading desk. The Asset Class staff believes that market “color” and insights gained during their direct interaction with dealers improves their understanding of the challenges and opportunities faced by their external managers and, consequently, improves their ability to monitor and assess manager performance.</p>	<p>Weigh the perceived benefits of executing trades within the Asset Class against the marginal control enhancement to be gained from routing them to the trading desk for execution, and determine whether the current practice should be permitted to continue. At a minimum, monitor the volume and frequency of such trades and, if they increase significantly in the future, strongly consider requiring execution by the equity trader.</p>	<p>We agree with this recommendation.</p>



Chief Investment Office

Medium priority observations and recommendations

Observation (Control Enhancement)	Recommendation	SBA Response / Action to Date
<p>34 Fixed Income Documentation:</p> <p>While we have <i>no reason</i> to believe any unethical trading behavior has ever occurred at the SBA, we observe that the financial services industry has been plagued by frauds that involve trading fixed income securities at off-market prices or simply concentrating transactions with unscrupulous commission salespersons at dealer firms. No totally reliable detective controls exist to expose such behavior, particularly in low-volume, high-ticket-value environments like the SBA's Fixed Income unit. However, portfolio managers who execute their own trades and control personnel should take pains to guard against even the appearance of impropriety.</p>	<p>Fixed income traders should always briefly document and retain rationales for broker selections and execution prices, particularly for large transactions in less liquid markets, and the Fixed Income unit should utilize existing system capabilities to periodically provide summaries of transaction volumes by dealer.</p>	<p>CIO will work with the Chief of Internal Audit to create appropriate audit trail for these activities. This will be in place before the end of the fiscal year 2003 – 2004.</p>



Chief Investment Office

Low priority observations and recommendations

Observation (Control Enhancement)	Recommendation	SBA Response / Action to Date
<p>35 Taped Telephone Lines:</p> <p>Taped telephone lines are not used to record fixed income and equity trades that are executed verbally with securities dealers.</p>	<p>Weigh the costs of installing and maintaining taped telephone lines versus the marginal protection afforded by maintaining taped records of transactions with counterparties that almost invariably <i>also</i> tape trading/sales conversations.</p>	<p>We agree with this recommendation and the CIO will study this recommendation further.</p>



Inspector General

Medium priority observations and recommendations

Observation (Control Enhancement)	Recommendation	SBA Response / Action to Date
36 Inspector General: Annual financial disclosure procedures generally fail to detect employee fraud.	Consider supplementing financial disclosure procedures with periodic supplementary procedures including non-intrusive "lifestyle checks."	We agree that supplemental fraud detection procedures should be considered.



Inspector General

Low priority observations and recommendations

Observation (Organizational Realignment)	Recommendation	SBA Response / Action to Date
<p>37 Inspector General:</p> <p>As the number of participants in the DC Plan increases in the future, it is likely that the demand for informal complaint hearings before the Inspector General (IG) will likewise increase and potentially consume an unacceptable proportion of the IG's time.</p>	<p>In consultation with the IG, Senior Management should consider a long-term plan to appropriately resource the informal hearing process, as necessary, when participation in the DC Plan increases.</p>	<p>We agree with this recommendation. The current trend of increased participation has not correlated to increased requests for informal hearings.</p>



Inspector General

Low priority observations and recommendations

Observation (Control Enhancement)	Recommendation	SBA Response / Action to Date
<p>38 Inspector General:</p> <p>“Hotlines” that permit employees to report suspicious or unethical behaviors in strict confidence/anonymously to Internal Auditors, Inspectors General or their institutional equivalents have helped identify serious fiduciary risks in a number of private sector investment management institutions. The SBA currently has no such facility.</p>	<p>Consider implementing such a “hotline” or an alternative confidential reporting mechanism under the auspices of the Inspector General. The office of the IG is used to evaluating and, if necessary, investigating sensitive matters and involving Internal Audit and/or Senior Management resources if/when necessary.</p>	<p>We agree that a publicized hotline, or alternative confidential reporting mechanism or program has merit in prevention and early detection of fraud or other abuses. The pros & cons of a confidential reporting mechanism will be evaluated and an appropriate course of action determined.</p>



Internal Audit

Medium priority observations and recommendations

Observation (Control Enhancement)	Recommendation	SBA Response / Action to Date
<p>39 The establishment of an Internal Audit function within the SBA exemplifies Executive Management's ongoing commitment to increased transparency and the maintenance of a superior control environment, and the Executive Director reiterated that commitment to all SBA staff during his recent series of mini-town hall meetings. However, implementing a new Internal Audit function within a mature institution presents unique challenges, and despite strong support from Executive Management, anecdotal evidence suggests that not all implementation challenges have yet been surmounted.</p> <p><i>Continued on next page</i></p>	<p>Throughout the ongoing implementation process, members of Senior Management as well as line managers should continue to clearly and consistently communicate to relevant subordinates:</p> <ul style="list-style-type: none"> ▪ Their expectations for cooperation with Internal Audit personnel. ▪ Their commitment to the Internal Audit function as well as the values, opportunities and protections it can deliver to the institution and its employees, and <p>In turn, Internal Auditors should:</p> <ul style="list-style-type: none"> ▪ Anticipate that line managers are unfamiliar with the internal audit process, and ▪ Continuously reiterate their process and expectations to auditees in a collegial and non-confrontational manner throughout the audit process. <p>Specifically, and without criticism of efforts to date, we urge Internal Audit and Senior Managers to strongly consider adopting certain practices common to many private firms where Internal Audit positively impacts the enterprise and its control environment:</p> <ul style="list-style-type: none"> ▪ Senior Managers include audit-related performance expectations in the annual goals and objectives of line managers, including, for example: <ul style="list-style-type: none"> • Appropriate attention to the audit process, including participation in kickoff and exit meetings; • Timely and appropriate written responses to audit findings, • Timely clearing of audit issues (implementation of agreed management action plans). ▪ Senior Managers make their intentions known to give considerable weight to audit-related performance versus expectations when considering promotions, compensation adjustments, and (if relevant) incentive compensation. 	<p>We agree with the observation and the recommendations. We would like to reiterate that Senior Managers support the internal audit function initiative of the Executive Director. However, to ensure that this support is clearly and universally communicated to relevant subordinates, we will determine as soon as practicable how we will include audit-related performance expectations in the annual goals and objectives of line managers. As the SBA performance appraisal forms at all levels are currently under review, we will consider incorporating this recommendation in the line managers performance appraisal form.</p>



Internal Audit

Observation	Recommendation	SBA Response / Action to Date
	<ul style="list-style-type: none"> ▪ Internal Audit develops, establishes, <i>and communicates</i> policies that clearly <ul style="list-style-type: none"> • Specify the maximum time permitted for all auditees' written responses to audit findings, • Specify procedures for requesting – as well as criteria for approving – extensions on agreed management actions, and that otherwise • Generally ensure consistency and efficiency in all audits as well as fairness and equal treatment for all auditees in both appearance and fact. ▪ Internal Audit carefully prioritizes its audit findings, <ul style="list-style-type: none"> • Including only high-risk / high value findings in written reports, • Combining similar / related issues into broader findings, • Making judicious use of management “side letters” to communicate low-risk / lower value findings to management (<i>not requiring</i> written responses and immediate remediation), and • Being prepared to explain and justify the reasonableness and prioritization of its findings, as necessary, to earn and maintain the full confidence and support of Senior Management. ▪ Internal Audit provides periodic reports of both auditor and auditee performance to Executive Management and the Audit Committee, including at minimum: <ul style="list-style-type: none"> • <i>Timeliness of Auditee Responses:</i> auditee compliance with policy regarding timely written responses to audit findings, • <i>Management Action Tracking Exceptions:</i> past-due audit response implementations (and ageing report), • <i>Internal Audit Efficiency:</i> day count from the kickoff meeting until draft report issuance for each audit (versus plan), and • <i>Internal Audit Efficiency:</i> progress against the approved annual Audit Plan. 	<p>The Office of Internal Audit (OIA) has already adopted most of the abovementioned practices of internal audit departments common to many private firms. Practices that have been considered in the past such as the use of side letters and management action tracking exceptions will be adopted immediately.</p>



Defined Contribution Program

Medium priority observations and recommendations

Observation (Organizational Realignment)	Recommendation	SBA Response / Action to Date
<p>40 Staffing:</p> <p>We concur with the assessment of the SIO for Defined Contribution Programs that his unit is overstaffed in the near term because employee participation in the recently introduced DC program has fallen short of the pre-implementation estimates upon which initial staffing levels were based. However, we also believe the many attractive features of the DC plan may make it the plan of choice for a growing number of existing employees and new hires in the longer term.</p>	<p>A reduction in staff should be implemented without prejudicing future requests for additional resources to meet the needs of a growing participant population in the longer term.</p>	<p>We concur with KPMG's observation and recommendation. The SBA staff and an external investment consultant (i.e., EnnisKnupp) conducted extensive research to develop recommendations on the management structure of the PEORP, which includes defined contribution administration, investments, FRS-wide educational services and FRS enrollment. These recommendations were delivered to a March 22, 2002 meeting of the SBA Investment Advisory Council and subsequently embedded in the budget approved by the SBA Trustees later that Spring. EnnisKnupp recommended 9 positions and the Office of Defined Contribution Programs (ODCP) was created with that level of staffing on July 1, 2002. Currently, ODCP has 6 FTE, with two positions having been eliminated (the most recent effective February 27, 2004) and 1 vacant administrative assistant position (as of March 5, 2004). ODCP will carefully review this latter position and others in preparing the FY2004-05 budget this Spring in order to explore further efficiencies.</p>



Interview Log

Interviewee	Title	KPMG Team	Agenda Sent	Meeting Date	Status
Barbara Jarriel / David Villa	Chief Investment Officer	Dick, John & Jennifer	01/22/2004	01/23/2004	Completed 1/23/04
Susan Schueren	Senior Investment Officer - Domestic Equities	Dick, Jennifer & Marcy	01/22/2004	01/26/2004	Completed 1/26/04
Martha Hurdle	Director of Operations	Dick, Jennifer & Marcy	N/A	01/27/2004	Completed 1/27/04
Trent Webster	Senior Portfolio Manager	Dick and Marcy	02/03/2004	02/04/2004	Completed 2/4/04
Joseph Wnuk	Portfolio Manager	Dick and Marcy	02/03/2004	02/04/2004	Completed 2/4/04
Jason Buchholz	Sr. Equity Trader	Dick and Marcy	02/06/2004	02/09/2004	Completed 2/9/04 Walkthrough
Scott Seery	Senior Investment Officer - Global & International Equities	Dick and Jennifer	01/22/2004	01/27/2004	Completed 1/27/04
Janice Yecco	Dir. Of Investment Strategy	Dick and Marcy	02/06/2004	02/09/2004	Completed 2/9/04
William James	Senior Investment Officer - Alternative Investments	Dick and Jennifer	01/26/2004	01/28/2004	Completed 1/28/04
Frank Fernandez	Sr. Portfolio Manager	Dick and Jennifer	02/09/2004	02/10/2004	Completed 2/10/04
Jim Treanor	Portfolio Manager	Dick and Jennifer	02/09/2004	02/11/2004	Completed 2/11/04
Robert Smith	Senior Investment Officer - Fixed Income	Dick and Jennifer	01/27/2004	01/29/2004	Completed 1/29/04
Lynn Thompson	Director of Short-Term Investments and Operations	Dick and Jennifer	01/27/2004	01/29/2004	Completed 1/29/04
Anita Pumphrey	Portfolio Manager	Dick and Marcy	02/03/2004	02/04/2004	Completed 2/4/04
Mike Lombardi	Sr. Portfolio Manager	Dick	02/12/2004	02/18/2004	Completed 2/18/04 Walkthrough
Amy Crumpler	Portfolio Manager	Dick and Marcy	02/04/2004	02/05/2004	Completed 2/5/04
Tom Fernald	Manager of Credit and Research	Dick and Marcy	02/09/2004	02/11/2004	Completed 2/11/04
Debby McCoy	Manager Of Portfolio Strategy	Dick and Marcy	02/04/2004	02/05/2004	Completed 2/5/04
Douglas Bennett	Senior Investment Officer - Real Estate	Dick and Jennifer	01/27/2004	01/30/2004	Completed 1/30/04
Stephen Spook	Sr. Acquisitions manager	Dick and Jennifer	02/09/2004	02/10/2004	Completed 2/10/04
Jeff Smith	Sr. Portfolio Manager	Dick and Jennifer	02/09/2004	02/10/2004	Completed 2/10/04
Michael McCauley	Director of Investment Services	Dick and Jennifer	02/13/2004	02/17/2004	Completed 2/17/04



Interview Log

Interviewee	Title	KPMG Team	Agenda Sent	Meeting Date	Status
Gwenn Thomas	Chief Operating Officer	John, Jennifer & Marcy	01/21/2004	01/22/2004	Completed 1/22/04
Robert Copeland	Senior Operating Officer Accounting & Financial Operations	John, Jennifer	01/22/2004	01/23/2004	Completed 1/23/04
Lori Guido	Director of Financial Operations	Glenn, Jennifer & Marcy	01/26/2004	01/28/2004	Completed 1/28/04
Donna Payne	Financial Operations Control Manager	Glenn, John & Jennifer	02/02/2004	02/04/2004	Completed 2/4/04
Mike Turkington	Sr. Treasury Operations Specialist III	Glenn & Jennifer	02/18/2004	02/19/2004	Completed 2/19/04 Walkthrough
Gail Koss	Sr. Accounts Payable Specialist III	Glenn & Jennifer	02/09/2004	02/10/2004	Completed 2/10/04 Walkthrough
Nina Sellers	Investment Operations Manager	Glenn, John & Jennifer	02/02/2004	02/05/2004	Completed 2/5/04
Kelly Skelton	Senior Accountant	Glenn & Jennifer	02/11/2004	02/12/2004	Completed 2/12/2004 Walkthrough
Denise Kidd	Treasury Operations Specialist II	Glenn & Jennifer	02/11/2004	02/12/2004	Completed 2/12/2004 Walkthrough
Christine Haney	Financial Examiner/Analyst II	Glenn & Jennifer	02/11/2004	02/17/2004	Completed 2/17/04 Walkthrough
Janie Knight	Debt Service Fund Manager	Glenn, John & Jennifer	02/06/2004	02/09/2004	Completed 2/9/04
Anthony Doheny	Senior Accountant	Glenn	02/10/2004	02/12/2004	Completed 2/12/04 Walkthrough
Memi Turkington	Director of Accounting	Glenn, Jennifer & Marcy	01/26/2004	01/27/2004	Completed 1/27/04
Jane Zody	Accounting Information Systems Manager	Ed and John	02/04/2004	02/05/2004	Completed 2/5/04
Donna Senn	Accounting Manager	Glenn, John & Jennifer	02/09/2004	02/18/2004	Completed 2/18/04
Rose Wilson	Financial Reconciliation Manager	Glenn, John & Jennifer	02/05/2004	02/06/2004	Completed 2/6/04 Walkthrough
John Bradley	Financial Analyst II	Glenn & Jennifer	02/11/2004	02/12/2004	Completed 2/12/2004 Walkthrough
Karen Glogau	Senior Accountant	Glenn	02/04/2004	02/05/2004	Completed 2/5/04 Walkthrough
Chuck Bunker	Senior Operating Officer Special Projects Coordinator	Glenn, Ed & Jennifer	02/06/2004	02/09/2004	Completed 2/9/04
Eric Nelson	Senior Operating Officer Planning, Policy & Administrative Services	Glenn, John & Marcy	01/29/2004	02/02/2004	Completed 2/2/04
Teresa Butler	Budget Manager	Glenn & Jennifer	02/06/2004	02/09/2004	Completed 2/9/04
James Linn	Facilities Management Manager	Glenn & Jennifer	2/10/042/9/04	02/11/2004	Completed 2/11/04
Elaine Knight	Records Specialist	Glenn	02/12/2004	02/17/2004	Completed 2/17/04 Walkthrough



Interview Log

Interviewee	Title	KPMG Team	Agenda Sent	Meeting Date	Status
Greg Mathes	Director of Information Technology	Ed and Glenn	1/28/2004	2/2/2004	Completed 2/2/04
Judy Smith	Support Services Manager	Ed, Glenn and Marcy	1/28/2004	2/3/2004	Completed 2/3/04
Cheryl Garnett	Applications & Development Manager	Ed, Glenn and Marcy	1/28/2004	2/3/2004	Completed 2/3/04
Susan Maurer	Sr. Computer Project Analyst III	Ed	2/9/2004	2/10/2004	Completed 2/10/04 Walkthrough
Douglas Koren	Sr. Computer Project Analyst III	Ed	2/9/2004	2/10/2004	Completed 2/10/04 Walkthrough
William (Chuck) Pollock	Network Services Manger	Ed and Glenn	1/28/2004	2/4/2004	Completed 2/4/04
Eddie McEwen	Sr. Network Workstation Support Analyst III	Ed	2/6/2004	2/9/2004	Completed 2/9/04 Walkthrough
Robert Thompson	Sr. Network Workstation Support Analyst III	Ed	2/6/2004	2/9/2004	Completed 2/9/04 Walkthrough
Dorothy Melton	Human Resource Manager	Glenn, John & Marcy	1/29/2004	2/3/2004	Completed 2/3/04
Kimbril Stivers	Senior Accountant	Glenn and Jennifer		2/18/2004	Completed 2/18/04



Interview Log

Investment Policy & Economics

Interviewee	Title	KPMG Team	Agenda Sent	Meeting Date	Status
James Francis	Senior Investment Policy Officer & Economist	Dick and Jennifer	01/29/2004	02/02/2004	Completed 2/2/04

Limited Scope Direct Reports to the Executive Director

Interviewee	Title	KPMG Team	Agenda Sent	Meeting Date	Status
Linda Lettera	General Counsel	Dick and Jennifer	02/02/2004	02/03/2004	Completed 2/3/04
Kevin SigRist	Senior Investment Officer DC Programs	Dick and Jennifer	01/29/2004	02/03/2004	Completed 2/3/04
Bruce Meeks	Inspector General	Dick and Marcy	02/04/2004	02/05/2004	Completed 2/5/04
Flerida D. Rivera-Alsing	Chief of Internal Audit	Dick and John	02/05/2004	02/06/2004	Completed 2/6/04



COSO Principles

The Committee on Sponsoring Organizations (“COSO”) of the Treadway Commission provides a general framework for assessing the internal control environment of an organization. In the broadest sense, internal control is process designed to provide reasonable assurance regarding the achievement of objectives surrounding:

- Effectiveness and Efficiency of Operations;
- Reliability of financial reporting; and
- Compliance with applicable laws and regulations.

Specifically, the internal control environment consists of 5 interrelated components:

- Control Environment – The control environment sets the control “tone” of an organization, thus influencing the control consciousness of the employees. Factors include the integrity, ethical values and competence of the organization’s people; management’s philosophy and operating style; the way management assigns authority and responsibility and organizes and develops its people; and the attention and direction provided by a board of directors or trustees. We noted that the SBA has institutionalized a control environment that has been designed to help ensure the achievement of management’s objectives.
- Risk Assessment – Every organization faces a variety of risks from external and internal sources that must be assessed. Risk assessment is the identification and analysis of relevant risks to the achievement of the organization’s business objectives, thereby forming a basis for determining how the risks should be managed. We reviewed the SBA’s internal audit department risk assessment and noted that it contained the necessary components to adequately assess risk.
- Control Activities – Control activities are the policies and procedures developed to help ensure that management’s directives are carried out. They include a range of activities including approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets, and segregation of duties. Control activities should occur throughout the organization, at all levels and in all functions. On an internal control continuum, we noted that in many instances the level of internal control design at the SBA leans toward more rather than less control.



COSO Principles

- Information and Communication – Pertinent information must be identified, captured, and communicated in a form and timeframe that enable people to carry out their responsibilities. For communication to be effective, it must flow down, across, and up the organization. All personnel must receive a clear message from top management that control responsibilities must be taken seriously. Employees must understand not only their own role in the internal control system, but also how their individual activities relate to the work of others. Management at the SBA has communicated to management and employees the importance of internal controls in performance of their duties.
- Monitoring – Internal control systems need to be monitored – a process that assesses the quality of the system’s performance over time. This may be accomplished through ongoing monitoring activities, separate evaluations or audits, or a combination of the two. Ongoing monitoring activities include regular management and supervisory activities. The scope and frequency of separate evaluations or audits depends primarily on the risk assessment and the effectiveness of ongoing monitoring activities. The SBA has demonstrated its commitment to monitoring its business activities through the establishment of an internal audit department charged with performing evaluations of the effectiveness of the internal control environment.

These interrelated internal control components form an integrated system that reacts dynamically to changing conditions. It should be intertwined with the organization’s operating activities and exist for fundamental business reasons.



Attachment A to Chief Operating Office Obs. #25

The SBA currently has developed a strategic objective addressing records managements that deals with the same concerns that are noted in your draft recommendation. The strategic objective will include a review and evaluation of all records associated with the SBA's records management program including paper, electronic, E-mail, and Web information. The objective will be accomplished in two phases. The first phase will consist of a review, evaluation and recommendations in the following areas:

- Overall records management strategy, policy, and procedures and what SBA peers are doing in the records management area
- Records retention schedules with emphasis on compliance with governing legislation and other pertinent rules and laws that might govern SBA records. (i.e. Florida Statues Federal Law, SEC Regulations)
- Proper identification and inventory of records subject to retention
- Records workflow
- Filing and information retrieval systems. Storage – both on and offsite, adequate protection of records, physical protection of records, management of records in records centers, managing archives, records security review, preservation and controlling measures



Attachment A (continued)

Economical and space-effective storage of active and inactive records

- The SBA's capabilities of providing access to public information records in a manner to facilitate access by the public as required by Florida Statutes
- Sufficient resource requirements, such as facilities and staffing

The second phase will consist of developing and implementing an action plan for an SBA records management solution. This action plan will include the following:

- Identification, acquisition and implementation of the most cost effective records management system application suitable to the SBA's needs for providing automated information management controls, storage and imaging services for electronic records that conforms to regulatory, legal governing statutes and guidelines and allows for efficient and controlled access to records.
- Education program for employees as to how to manage their electronic data.
- Ongoing audits of records management program to ensure compliance.