



John Keel, CPA
State Auditor

State of Texas Financial Portion of the
**Statewide Single Audit Report for
the Year Ended August 31, 2006**

April 2007
Report No. 07-555



John Keel, CPA
State Auditor

State of Texas Financial Portion of the
Statewide Single Audit Report for the
Year Ended August 31, 2006

SAO Report No. 07-555
April 2007

Overall Conclusion

The Comprehensive Annual Financial Report (CAFR) for the State of Texas accurately presents the financial position and activities of the State for the year ended August 31, 2006.

The ability to prepare materially correct financial statements represents a significant accomplishment for the State. With the third-largest budget among all 50 states, nearly \$83.6 billion¹ in annual expenses, and more than 200 state agencies and institutions of higher education, the State must contend with significant complexities in preparing its basic financial statements. The financial statements provide a comprehensive picture of how the State used its resources during the year, as well as the State's remaining assets and obligations at the end of the year.

Auditing financial statements is not limited to reviewing the accuracy of the numbers in those statements. Conducting this audit also requires the State Auditor's Office to audit the underlying systems and processes that agencies and institutions of higher education use to record their financial activities. Through that effort, we identified specific weaknesses that certain agencies should correct to ensure the accuracy of their financial information.

The State Auditor's Office conducts this audit so that the State can comply with legislation and federal grant requirements to obtain an opinion regarding the material accuracy of its basic financial statements and a report on internal controls related to those statements. The results of this audit are used primarily

Background Information

The State's basic financial statements include both government-wide and fund financial statements:

- Government-wide financial statements are designed to present an overall picture of the financial position of the State. These statements do not include retirement system assets, trust funds, or agency funds.
- Fund financial statements present financial information, focus on the most significant funds, and are presented in a form that is more familiar to experienced users of governmental financial statements.

We audited material line items of major funds at 10 of the State's largest agencies and institutions of higher education.

¹ The \$83.6 billion in annual expenditures exceeded the \$71.8 billion appropriated for fiscal year 2006 primarily because:

- Certain expenditures (such as higher education institutions' expenditures of funds held outside the State Treasury and expenditures for the Food Stamp program) are included in the Comprehensive Annual Financial Report but are not included in the General Appropriations Act.
- The Comprehensive Annual Financial Report presents actual expenditures of federal funds, while the General Appropriations Act presents estimated receipts of federal funds.
- The Comprehensive Annual Financial Report is presented on an accrual basis, while the General Appropriations Act is presented on a cash basis.

by bond rating agencies that rate newly issued bonds and by federal agencies that award grants.

Key Points

The financial systems and controls at the agencies audited were adequate to enable the State to prepare materially correct basic financial statements.

Audit work identified control weaknesses at 4 of the 10 state agencies and institutions of higher education audited. (Appendix 2 of this report lists all agencies and institutions of higher education audited.)

One agency has weaknesses in the design and operation of its internal controls that limit the assurances it can make regarding the validity of payments made for public assistance programs in fiscal year 2006. Three other agencies had weaknesses in access controls for their automated systems or did not complete financial reconciliations. Specifically:

- The Health and Human Services Commission (Commission) should strengthen the design and operation of its internal controls over validating payments for public assistance programs. The Commission should make improvements in its payment monitoring system for the Vendor Drug program, Medicaid, Children's Medicaid, the Children's Health Insurance Program (CHIP), the Food Stamp program, and the Temporary Assistance to Needy Families (TANF) program. The Commission outsourced the processing of Vendor Drug program claims in January 2006. The Commission performed some testing to ensure that the service organization's claims processing system was operating as intended; however, it did not maintain sufficient documentation to ensure that a comprehensive review of the system was performed.

In addition, neither the Commission nor its contracted service organization that processes Medicaid and Children's Medicaid expenditure claims maintained weekly billing files beyond one year after the billing submission date. The Commission also does not have documented policies and procedures for three key accounting functions, and it does not regularly update user access to two information systems.

- The Department of State Health Services (Department) should strengthen certain aspects of its financial and information technology operations. The Department continues its practice of not clearing, adjusting, or correcting certain reconciling differences between its internal accounting system and the Uniform Statewide Accounting System (USAS). The Department also should regularly update user access rights for the Texas WIC Information Network, which is the system that maintains program and expenditure information for the Women, Infants, and Children nutrition program.
- The Department of Transportation (Department) should strengthen certain aspects of its financial and information technology operations. The Department

did not regularly update access rights for its financial system and four information technology systems. In addition, the Department did not regularly match users' access to one of the automated systems with employee's job functions.

- The Texas Workforce Commission (Commission) should strengthen certain aspects of its information system security and fire protection and backup power capabilities. The Commission has not performed regular audits of authorized users and configuration settings and has not adequately reviewed security reports. It also should correct issues regarding the absence of (1) a fire suppression system and a secondary method of power supply in its data center and (2) an uninterruptible power supply system for its mainframe systems.

Summary of Managements' Responses

The agencies to which we addressed recommendations agreed with our recommendations.

Summary of Information Technology Review

Auditors reviewed the internal controls over significant accounting and information systems at the agencies and institutions of higher education audited. To do that, auditors identified systems that compiled and contained data used to prepare financial statements and then reviewed basic data protection controls such as user access rights, location of data, and backup processes. As discussed previously, auditors identified certain information technology control weaknesses that the Health and Human Services Commission, the Department of State Health Services, the Department of Transportation, and the Texas Workforce Commission should correct to help ensure the reliability of their financial information.

Auditors also reviewed internal controls within USAS and the State Property Accounting (SPA) system and did not identify any significant control weaknesses in those systems.

Summary of Objective, Scope, and Methodology

The audit objective was to determine whether the State's basic financial statements accurately reflect the balances and activities for the State of Texas for the fiscal year ended August 31, 2006.

The Statewide Single Audit is an annual audit for the State of Texas. It is conducted so that the State complies with the Single Audit Act Amendments of 1996 and Office of Management and Budget (OMB) Circular A-133. The State Auditor's Office performed the financial portion of the Statewide Single Audit and audited the fiscal year 2006 Schedule of Expenditures of Federal Awards. The State Auditor's Office contracted with KPMG LLP to perform part of the federal

portion of the Statewide Single Audit. The federal portion included a review of compliance and controls over the State's federal awards.

The scope of the financial portion of the Statewide Single Audit included an audit of the State's basic financial statements and a review of significant controls over financial reporting and compliance with applicable requirements. As required by the Single Audit Act, this report also includes our *Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards*.

The audit methodology consisted of collecting information, conducting data analyses, performing selected audit tests and other procedures, and analyzing and evaluating the results against established criteria.

Contents

Schedule of Findings and Responses

Chapter 1	
Financial Statement Findings.....	2
Chapter 1-A	
The Health and Human Services Commission Should Strengthen the Design and Operation of Its Internal Control Structure over Validating Payments for Public Assistance Programs	2
Chapter 1-B	
The Department of State Health Services Should Strengthen Certain Aspects of Its Financial and Information Technology Operations	11
Chapter 1-C	
The Department of Transportation Should Strengthen Certain Aspects of Its Financial and Information Technology Operations	14
Chapter 1-D	
The Texas Workforce Commission Should Strengthen Certain Aspects of Its Information System Security and Fire Protection and Backup Power Capabilities	17
Chapter 2	
Federal Award Findings and Questioned Costs.....	22

Summary Schedule of Prior Audit Findings

Chapter 3	
Summary Schedule of Prior Audit Findings	24
Chapter 3-A	
The Health and Human Services Commission Should Strengthen Certain Aspects of Its Information Technology and Financial Operations.....	24
Chapter 3-B	
The Department of State Health Services Should Strengthen Certain Aspects of Its Financial and Information Technology Operations	26

Chapter 3-C
The Department of Aging and Disability Services Should
Strengthen Certain Aspects of Its Financial Operations.. 28

Chapter 3-D
The Texas Workforce Commission Should Strengthen
Certain Aspects of Its Information System Security and Its
Fire Protection and Backup Power Capabilities 30

Independent Auditor’s Report

Chapter 4
Summary of Auditor’s Results 34

Report on Internal Control over Financial Reporting and
on Compliance and Other Matters Based on an Audit of
Financial Statements Performed in Accordance with
Government Auditing Standards..... 35

Appendices

Appendix 1
Objective, Scope, and Methodology..... 39

Appendix 2
Agencies and Institutions of Higher Education Audited 42

Schedule of Findings and Responses

*State of Texas Financial Portion of the
Statewide Single Audit Report for the
Year Ended August 31, 2006*

Financial Statement Findings

This chapter identifies the reportable conditions related to the financial statements that are required to be reported in accordance with *Government Auditing Standards*.

Chapter 1-A

The Health and Human Services Commission Should Strengthen the Design and Operation of Its Internal Control Structure over Validating Payments for Public Assistance Programs

Internal Controls

Internal controls are the policies and procedures, as well as the overall control environment, established by management to protect the government's assets and ensure the integrity and comprehensiveness of the accounting data used in external and internal reporting.

Source: *An Elected Official's Guide to Auditing*, Stephen Gauthier, Government Finance Officers Association, 1992.

Public assistance program payments that the Health and Human Services Commission (Commission) reported in its fiscal year 2006 financial statements were materially accurate and fairly stated. The Commission relies on an internal control structure, including pre- and post-payment controls, to help ensure that public assistance program payments for eligible clients are allowable and accurate. However, the Commission has weaknesses in the design and operation of its internal controls that limit the assurances it can make regarding the validity of payments made for public assistance programs in fiscal year 2006.

Fiscal Year 2006 Federal Expenditures from Public Assistance Programs

Medicaid (Medicaid Cluster) (44 million claims paid)	\$ 8.0 billion
Children's Health Insurance Program (CHIP) (Catalog of Federal Domestic Assistance program 93.767) (5.2 million member months)	0.2 billion
Food Stamps (Food Stamps Cluster) (average of 1 million households served per month)	3.1 billion
Temporary Assistance to Needy Families (TANF) (Catalog of Federal Domestic Assistance program 93.558) (average of 70,000 households served per month)	<u>0.1 billion</u>
Total	\$11.4 billion

Note: Vendor Drug program expenditures (\$1.9 billion) are included within the Medicaid and CHIP expenditures. The Vendor Drug program expenditures were associated with more than 31 million prescriptions.

Sources: *Summary of Federal Expenditures by State Agencies* prepared by the Office of the Comptroller of Public Accounts and Health and Human Services Commission self-reported service levels provided in fiscal year 2006.

The Commission accurately recorded expenditure transactions related to public assistance programs in fiscal year 2006. However, it cannot provide full assurances that all of these expenditures were allowable and paid to eligible clients. This is because:

- The Commission has not fully implemented all components of its payment monitoring process.
- The Commission does not ensure that its contracted Vendor Drug program service organization reports accurate financial information.
- The Commission does not retain complete documentation supporting its payments to certain service providers. The documentation that is maintained is not retained in its original format and is not maintained for the required retention period.
- The Commission has not fully documented policies and procedures for three key accounting functions.
- The Commission does not regularly update user access to

two information systems.

The programs affected by these issues spent \$11.4 billion in federal funds in fiscal year 2006.

Issue 1

The Health and Human Services Commission Should Implement All Components of Its Payment Monitoring System

Reference No. 07-555-01

The Commission relies on an internal control structure, including pre- and post-payment controls, to help ensure that public assistance program payments for eligible clients are allowable and accurate. However, it should make improvements in its payment monitoring system for the Vendor Drug program, Medicaid, Children's Medicaid, the Children's Health Insurance Program (CHIP), the Food Stamp program, and the Temporary Assistance to Needy Families (TANF) program.

Vendor Drug Program

- During fiscal year 2006, the Commission did not have regional pharmacists in six highly populated regions: Houston, Beaumont, Austin, San Antonio, Midland, and Abilene. The Commission uses 14 regional and sub-regional pharmacist positions to review expenditure claims submitted by the participating pharmacies for the Vendor Drug program. However, it has not maintained a full complement of regional pharmacists to perform these reviews since prior to 2000. According to Commission records, its six regional pharmacists visited only 1,479 (36 percent) of the 4,112 participating pharmacies in fiscal year 2006.
- The Office of Inspector General did not conduct any Vendor Drug program reviews in fiscal year 2006 because it asserted that it had not been able to obtain data necessary to perform these reviews. The Office of Inspector General received the information necessary to perform these reviews in December 2006.

Medicaid and Children's Medicaid

- In June 2006, the Office of Inspector General initiated reviews at two Austin-area hospitals and started reviewing outpatient costs for Medicaid from fiscal year 2001 through fiscal year 2004. As of December 2006, the two Austin-area reviews were being completed and four more reviews were beginning.
- The Office of Inspector General also has conducted investigations as a result of data analysis using the Medicaid Fraud and Abuse System (MFADS). However, some of the data used for this analysis is not complete. In fiscal year 2006, the Office of Inspector General did not

receive data on claim adjustments for the long-term care programs from the State's Medicaid claims processor.

- The Office of Inspector General did not pursue fraud investigations or recoupment of overpayments to providers serving Medicaid clients in Hays and Travis counties, where eligibility was determined through the Texas Integrated Eligibility Redesign System (TIERS) during fiscal year 2006. It did not pursue investigations or recoupment because some required audit trails and transaction history were not readily available.
- The Commission began performing a monthly quality analysis for August 2006 of paid or finalized claims for Medicaid and Children's Medicaid. Claims information is provided by the Medicaid service organization provider (the Texas Medicaid Health Partnership or TMHP). The Commission received a sample of claims that TMHP selected (900 to 1,110 claims) and pulled a random sample of 41 claims to ensure that (1) the claims went through the edit checks and (2) no edits were inappropriately overwritten.

Food Stamp Program and TANF

- The Office of Inspector General did not pursue fraud investigations or recoupment of Food Stamp and TANF program overpayments processed through TIERS for clients living in Hays and Travis counties during fiscal year 2006. It did not pursue investigations or recoupment because some required audit trails and transaction history were not readily available.

Recommendation

The Commission should develop strategies to enhance monitoring processes designed to result in timely and adequate assurances that expenditures from public assistance programs are allowable and paid to eligible clients. The strategies could encompass activities within the Commission, as well as independent reviews provided by external and internal auditors and the Office of Inspector General. The strategies should include, but not be limited to, the following programs: the Vendor Drug program, Medicaid, Children's Medicaid, CHIP, the Food Stamp program, and TANF.

Management's Response

Responsibility for monitoring public assistance program payments rests with management within various HHSC departments who perform complementary functions which, when combined, result in a comprehensive monitoring function. Control structures are maintained in Eligibility Determination, Medicaid Claims Processing, Medicaid/CHIP Managed Care, Medicaid/CHIP Vendor Drug Program, and Temporary Assistance to Needy

Families (TANF) and Food Stamp programs. Management's control structure is augmented by oversight activities performed by the HHSC Office of Inspector General, HHSC Internal Audit, other state and federal audit entities, and external audit firms.

While most components of HHSC's monitoring function were in place and working as intended during fiscal year 2006, the following actions have subsequently been completed or are underway to provide additional controls over public assistance program expenditures.

Vendor Drug Program

Regional Pharmacists

HHSC is currently re-assessing the functions of the Vendor Drug field staff and will determine whether the current, or an alternative, structure and staffing levels would best support the monitoring of program expenditures and compliance with program requirements. As part of this assessment, HHSC will evaluate risk-based methods for selecting pharmacies for on-site visits in order to maximize the effectiveness of current staffing levels.

Title of Responsible Person: Deputy Director, Medicaid/CHIP Vendor Drug Program

Estimated Completion Date: August 2007

Vendor Drug Audits

Fully Implemented - OIG began performing Vendor Drug contract audits in early fiscal year 2007.

Medicaid and Children's Medicaid

Hospital Audits

Fully Implemented - In July 2005, HHSC OIG formed a unit to audit out-patient hospital cost data reported in the Medicare cost report to mitigate the risks that are not addressed in out-patient hospital cost audits that have been performed by Medicare since fiscal year 2001. The Texas Medicaid program's cost reimbursement methodology for out-patient hospitals is based on the cost data reported in the Medicare cost report. The unit currently has in progress, at varying stages, audits of out-patient hospital cost data for fiscal years 2001-2004 at eight hospitals. OIG anticipates continuing and expanding this audit effort as circumstances warrant.

MFADS

Fully Implemented - OIG received long-term care adjustment data in March 2007 and has loaded the corrected data into MFADS for analysis.

Monthly Quality Analysis

Fully Implemented - HHSC will continue to conduct monthly post-payment quality assurance reviews of paid Medicaid and Children's Medicaid claims and take proactive steps based upon this process to ensure claims continue to be paid appropriately.

The current TMHP requirement for a SAS 70, Type I audit to be performed every other year is in the process of being updated. The new requirement, put in place during April 2007 provides for a SAS 70, Type II audit to be conducted every year.

Food Stamp Program, TANF, and Medicaid

HHSC has developed a TIERS historical report that captures the case data needed by the OIG to support investigations and pursue fraud and recoupment cases. The report was developed in collaboration with the OIG over the past year. One modification was requested by OIG, and this change will be completed no later than June 2007.

In addition, HHSC is currently in process of developing income and eligibility verification system interfaces which are used by the OIG to identify potential fraud cases. Development will occur in three phases, the first of which is scheduled for completion in June 2007.

When both the TIERS historical report and these interfaces are available, the OIG will have access to the information required to resume the pursuit of fraud and recoupment cases.

Title of Responsible Person:

- *Inspector General, HHSC Office of Inspector General*
- *HHS Chief Information Officer*
- *Director, HHSC Commission IT*

Estimated Completion Date:

- *The TIERS historical report needed to support OIG investigations and pursue fraud and recoupment cases was available on March 31, 2007. By*

June 30, 2007, the historical report will be enhanced to include the time of day to an existing date stamp, as requested by OIG.

- *Full implementation of the income and eligibility verification system interfaces is scheduled for August 31, 2007.*

Issue 2

The Health and Human Services Commission Did Not Fully Ensure That Its Contracted Vendor Drug Program Service Organization Reports Accurate Financial Information

Reference No. 07-555-02

The Commission outsourced the processing of Vendor Drug program claims in January 2006. The Commission performed some testing to ensure that the service organization's claims processing system was operating as intended. However, auditors were unable to determine the extent and effectiveness of this testing because the Commission did not maintain sufficient documentation to ensure that a comprehensive review of the system was performed.

Auditors performed tests to verify the accuracy of the service organization's claims for vendor drug payments and determined that the claims were properly adjudicated and submitted for payment. Auditors also determined that the Commission accurately paid the claims.

Recommendation

The Commission should ensure that contracted service organizations report accurate financial information by either contracting for an independent review of the service organizations or requiring Commission employees to perform sufficient testing of services organizations' systems.

Management's Response

HHSC has solicited a bid from its independent auditing firm for a contract amendment to perform a Statement on Auditing Standards No. 70 (SAS 70), Type II audit of the pharmacy claims administrator. This audit will provide assurance that the service organization's controls are operating with sufficient effectiveness to provide reasonable assurance that financial information is accurately reported. The audit will cover claims processed and financial information reported in fiscal year 2007.

HHSC will fully implement procedures to ensure appropriate coordination between Information Technology staff and applicable Program staff in the development, validation of test plans, testing, and implementation of

outsourced contractor solutions involving key business processes. Procedures will also include a requirement for independent review and testing of contractor modifications before implementation. This may be accomplished through an independent verification and validation contractor for large systems or through an assessment by an independent internal group for smaller systems.

Title of Responsible Person:

- *Deputy Director Medicaid/CHIP Vendor Drug Program*
- *HHS Chief Information Officer*
- *Director, HHSC Commission IT*

Estimated Completion Date:

- *The SAS 70, Type II audit will be completed and a report prepared by December 31, 2007.*
- *Procedures will be in place by December 31, 2007 to ensure Information Technology involvement in the independent assessment of automated systems initially when transitioned to outside vendors, and later, as system modifications are made.*

Issue 3

The Health and Human Services Commission Does Not Maintain Complete Documentation Supporting Its Payments to Certain Service Providers

Reference No. 07-555-03

Neither the Commission nor its contracted service organization that processes Medicaid and Children's Medicaid expenditure claims maintains weekly billing files beyond one year after the billing submission date. Although the contracted service organization maintains detailed claim information in its COMPASS21 system, this data is not in a readily usable format. Without the detailed billing data, the Commission's ability to provide timely support for the payments it makes in response to service providers' bills could be limited.

The Texas State Library and Archives Commission's record retention schedule outlined in Texas Government Code, Section 441.185, requires claim files be retained until they are closed, plus three years.

Recommendation

The Commission should develop and follow procedures to maintain weekly claim file billing detail data submitted by its contracted Medicaid service organization for the period required by statutory retention schedules.

Management's Response

Fully Implemented - HHSC archives the Medicaid service organization's original file each week (beginning on August 7, 2006). Each file is backed up and will be retained for a record retention period that meets or exceeds the statutory requirement.

Issue 4

The Health and Human Services Commission Has Not Fully Documented Policies and Procedures for Three Key Accounting Functions

Reference No. 07-555-04
(Prior Audit Issue 06-555-09)

The Commission does not have documented policies and procedures for three key accounting functions related to the recording of public assistance payments and federal revenue. Specifically, it does not have documented policies and procedures for:

- Recording and approving Medicaid and CHIP expenditures.
- Recording and approving Vendor Drug program expenditures.
- Requesting quarterly federal budget approval for Medicaid, CHIP, and the Vendor Drug program.

While it lacks documented policies and procedures for these accounting functions, the Commission has documented many of its other key accounting functions and has trained backup personnel to perform these functions in the event of unplanned absences.

Having documented policies and procedures is a key control over the Commission's financial reporting. It is important for management to communicate and monitor, through policies and procedures, staff members' responsibilities and expectations related to their job functions. In addition, policies and procedures are beneficial for new employees and backup personnel.

Recommendation

The Commission should continue to document policies and procedures for the key accounting functions that are undocumented.

Management's Response

The Commission will document these three accounting functions.

Title of Responsible Person:

- *HHSC Deputy Chief Financial Officer*
- *HHSC Team Lead, Infrastructure Maintenance*

Estimated Completion Date: May 31, 2007

Issue 5

The Health and Human Services Commission Does Not Regularly Update User Access to Two Information Systems

Reference No. 07-555-05
(Prior Audit Issues 06-555-08, 05-555-03 and 05-555-07)

In fiscal year 2006, the Commission did not regularly update user access to the Health and Human Services Administrative System (HHSAS, the internal accounting system) and Uniform Statewide Accounting System (USAS, the State's accounting system). Specifically:

- Twenty-five users had inappropriate access rights to USAS because their access rights were not necessary for their job duties.
- Three users whose employment with the Commission had been terminated still had access rights to HHSAS.
- Four users had inappropriate access rights to HHSAS because their access rights were not necessary for their job duties.
- One user had duplicate access to HHSAS.
- One user had a user account in HHSAS with an incorrect user name.

These issues constituted a violation of Title 1, Texas Administrative Code, Section 202.25(3)(B), which specifies that "a user's access authorization shall be appropriately modified or removed when the user's employment or job responsibilities within the state agency change." After auditors brought these issues to the Commission's attention, it deleted or corrected access rights for each of the instances noted above.

Additionally, the Commission has developed a report to identify HHSAS transactions entered and released (approved) by the same user; however, this report was not produced and reviewed by supervisors for appropriateness of the transactions until September 6, 2006. This report identified five vouchers totaling \$141,489 that were entered and approved by the same user during fiscal year 2006.

Recommendations

The Commission should:

- Continue implementing its process to identify individuals for whom system access should be terminated or adjusted.
- Conduct a search for the user accounts of terminated employees.

Management's Response

USAS Access

Fully Implemented – HHSC implemented a daily process in September 2006 that compares current USAS users to the HRMS Termination Report to ensure all terminated employees have their USAS system access removed. Detailed security access reports will be reviewed at least semi-annually by the HHSC security coordinator to ensure USAS access rights are consistent with the users existing job responsibilities.

HHSAS Financials Access

Fully Implemented – Several reporting and procedural improvements were in process during this audit and were fully implemented in December 2006. One improvement compares current users to a termination report on a twice-weekly basis to ensure all terminated employees have been removed. In addition, a process is in place to ensure that security staff will scan the user file for duplicates/misspelled users while reviewing users for termination. HHSC managers will also run a report detailing specified user access to facilitate the review and validation of current user access at least semi-annually.

Chapter 1-B

The Department of State Health Services Should Strengthen Certain Aspects of Its Financial and Information Technology Operations

Issue 1

The Department of State Health Services Continues to Leave the Reconciliation of Its Internal Accounting System with the State's Accounting System Unfinished

Reference No. 07-555-06

(Prior Audit Issue 06-555-04, 05-555-02, 04-555-02, 03-555-01, 02-555-01 and 01-021)

The Department of State Health Services (Department) continues its practice of not clearing, adjusting, or correcting certain reconciling differences

between its internal accounting system (the Health and Human Services Administrative System) and the state's accounting system (the Uniform Statewide Accounting System). This issue has been communicated to Department management for the past five years.

Although the Department reconciles by fiscal year, fund, and appropriation to ensure the accuracy and completeness of recorded transactions, a significant number and dollar amount of reconciling items are carried over between periods without resolution and potentially until the appropriations expire. For the month ending August 31, 2006, auditors reviewed 6 of 1,056 reconciliations by fiscal year, fund, and appropriation and identified the following:

- The Department cleared only 40 of 240 reconciling items from July 2006, allowing the remaining 200 items to carry over across multiple periods.
- The total amount of uncleared reconciling items for each reconciliation ranged from \$984,676 to \$27.3 million.

The Department has indicated that many of these reconciling items were created during fiscal year 2005, when the Department of State Health Services took over the operations of the former Department of Health. The Department also indicated that these items must be adjusted or written off during fiscal year 2007, when the appropriations expire.

Recommendation

The Department should implement a policy to clear reconciling items in a timely manner, such as requiring that reconciling items that are 90 days or older be cleared prior to the end of the fiscal year. This policy would result in having only reconciling items that are relatively current and would help to ensure the completeness and accuracy of recorded transactions.

Management's Response

DSHS Accounting Section's objective has been and continues to be for all reconciliation items to be cleared within 90 days of the month in which they occurred. However, as mentioned above, when DSHS was created in 2005, numerous reconciling items resulted from the conversion of three legacy agency's budget structures, business processes, and accounting records into one. Many of these transactions have taken considerable time to research and resolve at the detail level. We continue to make steady progress towards clearing these items. The conversion did not provide a structure that would allow Comptroller entries made at the fund-level only in Uniform Statewide Accounting System to be entered in the new agency's accounting system. We have now made the system changes that would allow us to make these entries,

and this change should resolve a significant number of the remaining reconciling items. Of the 240 reconciling items identified in the auditor's sample, 71 have been cleared as of February 6, 2007. The amount for each of the un-cleared reconciling balance now ranges from \$63 to \$2.6 million. Our target is to have the appropriation year 2005 reconciliation items cleared by May 31, 2007, and any remaining 2006 items cleared by July 31, 2007.

Title of Responsible Person: Accounting Director

Estimated Completion Date: July 31, 2007

Issue 2

The Department of State Health Services Did Not Regularly Update User Access for the Texas WIC Information Network

Reference No. 07-555-07
(Prior Audit Issues 06-555-05 and 05-555-03)

In fiscal year 2006, the Department did not regularly update user access to the Texas WIC Information Network (Texas WIN), which is the system that maintains program and expenditure information for the Women, Infants, and Children nutrition program. Specifically, four individuals whose employment had been terminated or who transferred to another health and human services agency still had access to Texas WIN. The Department has implemented a notification process to identify individuals for whom access to systems should be terminated.

Additionally, auditors identified 12 user accounts that were not assigned to individual users. This is a violation of Title 1, Texas Administrative Code, Section 202.25(5)(A), which specifies that, "Information resources systems must provide the means whereby authorized personnel have the ability to audit and establish individual accountability for any action that can potentially cause access to, generation of, modification of, or effect the release of confidential information." These 12 accounts were test accounts that could be used to access live production data.

After auditors brought these matters to the Department's attention, it deleted access rights for the 16 user accounts discussed above.

Recommendations

The Department should:

- Continue implementing its process to identify individuals for whom system access should be terminated and include a search for the user accounts of terminated employees who may have been overlooked.

- Control test user accounts; conduct an information technology policy review to ensure compliance with Title 1, Texas Administrative Code, Section 202.25(5)(A); and determine an acceptable process for the use of system maintenance and test accounts that provides accountability and protects confidential data.

Management's Response

DSHS concurs with the SAO's findings from the audit of the State of Texas Comprehensive Annual Financial Report. DSHS continues to implement and improve the process for identifying individuals for whom system access should be terminated. We have added processes to receive termination notices from a number of different sources including from the WIC program, DSHS Security Office, and Health and Human Services. Using a number of sources for this information will help ensure that we are notified of all terminated staff.

To ensure compliance with TAC §202.25(5)(A), individual users have been assigned to each system maintenance and test account as the responsible person for that account. This will ensure that an individual is associated with each account in the system to provide accountability and protection of confidential data.

Title of Responsible Person: Director of Application Development

Estimated Completion Date: March 1, 2007

Chapter 1-C

The Department of Transportation Should Strengthen Certain Aspects of Its Financial and Information Technology Operations

Issue 1

The Department of Transportation Did Not Regularly Update User Access Rights for its Automated Systems

Reference No. 07-555-08

In fiscal year 2006, the Department of Transportation (Department) did not regularly update access rights to its automated systems. Specifically:

- Nine users whose employment with the Department had been terminated still had access rights to the Financial Information Management System (FIMS). FIMS is the Department's internal accounting system.

- Forty-six users whose employment with the Department had been terminated still had access rights to the Automated Purchasing System (APS). APS is the Department's internal real-time purchasing system.
- Twenty-six users whose employment with the Department had been terminated still had access rights to the Equipment Operating System (EOS). EOS is the Department's system of record for all information on major equipment.
- Four users whose employment with the Department had been terminated still had access rights to the Minor Equipment System (MES). MES is the Department's system of record for all information on minor equipment.
- Forty-three users whose employment with the Department had been terminated still had access rights to the Materials and Supply Management System (MSMS). In addition, two group login IDs to the system had not been used since August 2005 and November 2005, respectively. MSMS is the Department's real-time inventory system.

According to the Department's policy, "when a user's employment status or job functions change, a user's access authorization must be removed or modified appropriately and immediately."

None of these users had accessed the automated systems after their employment was terminated. The Department has removed the inappropriate access rights that auditors identified.

Recommendation

The Department should regularly update user access rights for its automated systems, as outlined in its policy.

Management's Response

TxDOT understands the importance of removing access rights for users who no longer require access (either through terminations or job reassignments). In some cases, the security administrator (SA) in a district, division or office may elect to suspend the user accounts, leaving it intact, but with no login capabilities, while the user's responsibilities are transitioned or account history is audited. In these cases, the user id will appear on any reports listing mainframe user ids.

SAs have the ability to view an expired accounts report (these are accounts that have gone beyond the 90 day password expiration period without a change). This capability is used to discover older or terminated accounts that no longer require access. There are several accounts that are only used periodically and will appear on the 90 day report that are valid accounts. To

help ensure the SAs are validating these expired accounts, TxDOT has implemented a comprehensive compliance monitoring system for automated systems. One of the reports produced through the compliance monitoring system is “No Employee Status Code Report”. This report will list any user who is no longer marked as an active employee in the TxDOT Human Resource system that has a corresponding active user account. Another report, “Inactive User Id’s”, reports all user accounts that have not had any activity in the past 365 days.

The compliance monitoring reports are provided to each district, division, and office SA on a monthly basis and are monitored by the Information Systems Security Branch of the Information Systems Division to ensure all identified accounts are corrected in a timely manner.

Issue 2

The Department of Transportation Should Monitor Access to Its Automated Purchasing System to Ensure That This Access Matches Users’ Job Functions

Reference No. 07-555-09

In fiscal year 2006, the Department did not regularly match users’ access to APS with their job functions. Of the Department’s 4,102 employees who have access to APS, 129 (3.1 percent) have both purchaser and receiver access rights. This means that, as purchasers, these users can add, create, and change purchase orders. As receivers, these users also can receive the purchased items and authorize payment.

According to the Department’s policy, the Office of Primary Responsibility must approve assigning a user both purchaser and receiver access rights. The Department was unable to provide documentation indicating that the 129 users discussed above had received this approval.

Recommendations

The Department should:

- Implement procedures to monitor and enforce adherence to its policy regarding assignment of user access rights to the Automated Purchasing System.
- Ensure that users’ access rights to the Automated Purchasing System match their job functions.

Management's Response

TxDOT documents the appropriate user access roles for each automated system in the access criteria document. Each automated system, including the Automated Purchasing System (APS), has an access criterion which defines all approved levels of access. The access criteria for the APS states that no user should have both a purchaser and receiver access without approval from the Office of Primary Responsibility (OPR). Access criteria are used by the security administrators and supervisors to determine if the access requested is appropriate. As this audit found, there were 129 users identified with both roles assigned.

TxDOT has either removed or received the necessary OPR approval for all APS accounts that had both purchaser and receiver roles identified during this audit.

To ensure that the documented access roles are properly assigned, TxDOT has also enhanced the compliance monitoring program to now include a new report, "APS Function Code(s) requiring OPR Approval", which shows all APS user ids with roles that require OPR approval. These reports are provided to each district, division, and office Security Administrator on a monthly basis and are monitored by the Information Systems Security Branch of the Information Systems Division to ensure all identified accounts are corrected in a timely manner.

Chapter 1-D

The Texas Workforce Commission Should Strengthen Certain Aspects of Its Information System Security and Fire Protection and Backup Power Capabilities

Issue 1

The Texas Workforce Commission Should Strengthen Security and Password Settings

Reference No. 07-555-10
(Prior Audit Issues 06-555-10 and 05-555-04)

Security Settings

Security settings are critical to the security of automated systems and data because they control functions such as:

- Granting and restricting access to business systems, data, and other resources.
- Password and user account rules.
- Auditing access to resources.

The Texas Workforce Commission (Commission) has improved computer security since the State Auditor's Office's audits of fiscal years 2005 and 2004. The Commission has corrected weaknesses in password settings and security settings to decrease the risk that unauthorized users could access its automated systems and data. However, it has not performed regular audits of authorized users and configuration settings.

The Commission has created an annual security audit checklist to guide the review of security settings. However, it has not used that

checklist to review the adequacy of baseline mainframe security settings. Although the Commission reviews these settings informally during system upgrades, these reviews may not be sufficiently thorough.

Recommendation

The Commission should periodically (for example, annually) perform a complete review of mainframe security settings.

Management's Response

Management concurs with the recommendation.

In January 2007 TWC conducted a comprehensive review of mainframe security settings using the existing annual security audit checklist. The results were provided to the State Auditor's Office. TWC's Information Resources Integrity and Security Unit will, at least annually, conduct a review. TWC will work with DIR and the data center outsourcing service provider to determine how the applicable parts of the review can be conducted after the transition, which is scheduled for April 2007.

Title of Responsible Person: Chief Information Security Officer

Estimated Completion Date: August 2007

Issue 2

The Texas Workforce Commission Should Strengthen Information System Security Monitoring

Reference No. 07-555-11
(Prior Audit Issues 06-555-11 and 05-555-05)

The Commission should revise its security reporting to make this task more manageable and ensure that it is performed consistently. The Commission

Security Management Products

Mainframe security management products are used to restrict access to a computer system to only users who have been authorized to access the system.

These security products identify and authenticate users, determine the information assets to which each user is authorized, and log and report unauthorized users' attempts to access protected assets.

does not adequately review security reports that provide information on security events identified by its mainframe computer's security management product (see text box). This prevents it from promptly investigating potential instances of unauthorized access.

Reviewing security reports is important because this can enable the Commission to detect security events such as unauthorized attempts to access its mainframe and, therefore, its automated systems and data. Although the security reports are

comprehensive, they are lengthy and can be difficult to manage and review. While the Commission distributes the full reports to its central computer

security function and portions of the reports to departmental security managers, improvements are needed to ensure an effective review process.

Certain information technology resources at the Commission, including the mainframe equipment in the Commission's data center, are subject to transfer to the Department of Information Resources in accordance with the requirements of House Bill 1516 (79th Legislature, Regular Session). As a result, the Department of Information Resources has delayed all software purchases related to the Commission's mainframe pending the determination of the new consolidated data center environment.

The Commission has previously taken steps to correct this issue by:

- Installing software that monitors security and generates monitoring reports. However, additional software to analyze the data generated has not been received due to the pending data center consolidation.
- Generating daily monitoring reports that list any (1) changes made to operating system libraries or (2) use of a specific, powerful administrative account.
- Generating daily reports of departmental incidents that have occurred on the Commission's internal network.

Recommendations

The Commission should:

- Work with the Department of Information Resources to determine which monitoring responsibilities will remain with the Commission and which will move to the Department of Information Resources.
- After the new information technology environment is established, review the design of the new environment, generate security reports, and investigate significant security events. The Commission also should ensure that its staff reports the outcomes of these investigations to management.
- Provide training or additional instruction to departmental security managers regarding how to use the security reports and tools.

Management's Response

Management concurs with the recommendation.

TWC's Information Resources Integrity and Security unit will work with DIR to identify and implement appropriate monitoring and investigative processes.

TWC will ensure training of departmental security managers regarding security reports and tools takes place, as the reports and tools are implemented.

Title of Responsible Person: Chief Information Security Officer

Estimated Completion Date: August 2007

Issue 3

The Texas Workforce Commission Should Strengthen Its Fire Protection and Backup Power Capabilities

Reference No. 07-555-12
(Prior Audit Issues 06-555-12 and 05-555-06)

The Commission's data center does not have a fire suppression system (other than hand-held extinguishers), a secondary method of power supply (such as a generator), or an uninterruptible power supply system for its mainframe systems. However, certain information technology resources at the Commission, including the mainframe equipment in the Commission's data center, are subject to transfer to the Department of Information Resources in accordance with the requirements of House Bill 1516 (79th Legislature, Regular Session). As a result, the Commission has not dedicated funds to correct the fire suppression issues in its data center and is waiting until a decision is made regarding which information technology resources will be transferred to the Department of Information Resources.

Although the Commission has a processing agreement for an alternative site for system backup and recovery, the lack of a fire suppression system in the data center increases the reliance on this backup site and could result in significant costs to the Commission if it needed to rely on the backup center for an extended period of time.

Having an uninterruptible power supply system or generator could help the Commission avoid having to (1) revert to its off-site backup and recovery processing facility to continue operations, (2) delay processing until power could be restored to the data center, or (3) lose and re-enter data.

Recommendations

The Commission should:

- Work with the Department of Information Resources to determine which information technology resources will be transferred to the Department of Information Resources.
- After the information technology resources that will be transferred to the Department of Information Resources have been identified, perform a

formal cost-benefit analysis and decide whether any of the following is cost-beneficial:

- ♦ Installing a central fire suppression system in its data center.
- ♦ Installing both an uninterruptible power supply system and backup generator for its data center.
- ♦ Installing a backup generator without an uninterruptible power supply system in its data center.

Management's Response

Management concurs with these recommendations.

TWC will work with DIR as decisions are finalized regarding the timing of resources that will be transferred to the consolidated data centers. TWC will then conduct a cost-benefits analysis regarding the protection of the remaining resources in the TWC data center.

Title of Responsible Person: Information Technology Director

Estimated Completion Date: August 2007

Federal Award Findings and Questioned Costs

For fiscal year 2006, federal award information has been issued in a separate report. See *State of Texas Federal Portion of the Statewide Single Audit Report for the Fiscal Year Ended August 31, 2006*, by KPMG LLP, dated February 20, 2007.

Summary Schedule of Prior Audit Findings

*State of Texas Financial Portion of the
Statewide Single Audit Report for the
Year Ended August 31, 2006*

Summary Schedule of Prior Audit Findings

Federal regulations (Office of Management and Budget Circular A-133) state that “the auditee is responsible for follow-up and corrective action on all audit findings.” As part of this responsibility, the auditees report the corrective actions they have taken for the findings reported in:

- *State of Texas Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2001* (SAO Report No. 02-555, May 2002).
- *State of Texas Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2002* (SAO Report No. 03-555, April 2003).
- *State of Texas Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2003* (SAO Report No. 04-555, March 2004).
- *State of Texas Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2004* (SAO Report No. 05-555, March 2005).
- *State of Texas Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2005* (SAO Report No. 06-555, March 2006).

The Summary Schedule of Prior Audit Findings (for the year ended August 31, 2006) has been prepared to address these responsibilities.

Chapter 3-A

The Health and Human Services Commission Should Strengthen Certain Aspects of Its Information Technology and Financial Operations

Issue 1

The Health and Human Services Commission Should Monitor System Access and Restrict User Access to Match Users' Job Functions

Reference No. 06-555-08
(Prior Audit Issues 05-555-03 and 05-555-07)

As a result of House Bill 2292 (78th Legislature, Regular Session), in fiscal year 2005 the Health and Human Services Commission (Commission) consolidated several administrative functions. The Commission became responsible for maintaining access rights to the Health and Human Services Administrative System (HHSAS, the internal accounting system) and the Human Resources Management System (HRMS) for all health and human services agencies.

The following issues regarding access rights increase the risk that individuals could make unauthorized additions, changes, or deletions to financial data without detection (however, auditors noted no such instances):

- At the Commission, 19 users had access to both enter and approve financial transactions in HHSAS. The Commission's policy states that users should not approve the transactions they enter; however, 3 of the 19 users entered and approved a total of 162 of their own financial transactions. The Commission deleted 9 of these users' transaction approval rights when auditors inquired about this issue. In addition, auditors identified 23 users who had access to HHSAS when they should not have had this access. The Commission deleted this access for 22 of these users when auditors inquired about this issue.
- At the Department of Aging and Disability Services, 17 users who had access to HHSAS were not employed by the agency. After auditors inquired about this issue, the Commission deleted these 17 user accounts.
- At the Department of State Health Services, four users who had access to HHSAS or HRMS were not employed by the agency. After auditors inquired about this issue, the Commission deleted these four user accounts.

Corrective Action and Management's Response

See current year finding 07-555-05.

Issue 2

The Health and Human Services Commission Should Document Policies and Procedures for Key Accounting Functions

Reference No. 06-555-09

The Commission does not have documented policies and procedures for the majority of key accounting functions related to the recording of public assistance payments and federal revenue. In addition, the Commission does not have documented policies and procedures for reconciling information in HHSAS with the information in the State's accounting system (the Uniform Statewide Accounting System, or USAS).

Having documented policies and procedures is a key control over the Commission's financial reporting. It is important for management to communicate and monitor, through policies and procedures, staff members' responsibilities and expectations related to their job functions. In addition, policies and procedures are beneficial for new employees and backup personnel. The accounting staff's duties are critical to accurate financial reporting.

Corrective Action and Management's Response

See current year finding 07-555-04.

Chapter 3-B

The Department of State Health Services Should Strengthen Certain Aspects of Its Financial and Information Technology Operations

Issue 1

The Department of State Health Services Did Not Complete the Reconciliation of Its Internal Accounting System with the State's Accounting System

Reference No. 06-555-04

(Prior Audit Issues 05-555-02, 04-555-02, 03-555-01, 02-555-01, and 01-021)

In fiscal year 2005, the Department of State Health Services (Department) attempted to complete the reconciliation of its internal accounting system (the Health and Human Services Administrative System, or HHSAS) with the State's accounting system (the Uniform Statewide Accounting System, or USAS). However, as of the fiscal year end, there were at least 332 outstanding reconciling items. The absolute value of those items was approximately \$83 million, which averages approximately \$250,000 per reconciling item.

The Department did not generate a trial balance to prepare its fiscal year 2005 annual financial report; therefore, it used USAS to prepare its annual financial report. Because the Department did not generate a trial balance, auditors could not test the trial balance to determine whether a coding error that was identified by the State Auditor's Office in fiscal year 2004 at the Department of Health (the Department's predecessor agency) was corrected.

Although the Department's annual financial report was materially accurate, the Department should complete the reconciliation to ensure that information in HHSAS and USAS is accurate.

Corrective Action and Management's Response

See current finding 07-555-06.

Issue 2

The Department of State Health Services Did Not Regularly Update User Access Rights for the Texas WIC Information Network

Reference No. 06-555-05
(Prior Audit Issue 05-555-03)

In fiscal year 2005, the Department did not regularly update user access rights to the Texas WIC Information Network (Texas WIN), which is the system that maintains program and expenditure information for the Women, Infants, and Children nutrition programs. Specifically, 10 individuals whose employment had been terminated or who transferred to another health and human services agency still had access to Texas WIN. After auditors brought this matter to the Department's attention, it deleted access rights for these 10 users. Auditors did not identify any financial discrepancies that resulted from these weaknesses.

Corrective Action and Management's Response

See current finding 07-555-07.

Issue 3

The Department of State Health Services Did Not Ensure That Employee Time Records in the Human Resource Management System Were Accurate

Reference No. 06-555-06

In fiscal year 2005, the Department did not ensure that employee time records in its Human Resources Management System (HRMS) were accurate. In a sample of 63 time sheets, auditors identified 21 instances in which data in HRMS did not reflect the data on employee time sheets. Thirteen of the data entry errors resulted in the Department's overstating its obligations by a net amount of approximately \$1,500 (or 85 hours). In fiscal year 2006, the Department corrected these errors after auditors brought them to its attention.

The Department's timekeeping system was manual in fiscal year 2005, and the Department states that an automated timekeeping system was implemented in fiscal year 2006.

Corrective Action and Management's Response

Corrective action was taken.

Issue 4

The Department of State Health Services Did Not Have Finalized Policies and Procedures at the Program Level for Its Accounting Functions for Fiscal Year 2005

Reference No. 06-555-07

In fiscal year 2005, the Department did not have finalized policies and procedures for accounting functions for the following programs:

- Substance Abuse Program.
- Women, Infants, and Children (WIC) Program (lacked finalized policies and procedures for reconciliation of payments between systems).
- NorthSTAR Program (which provides mental health and chemical dependency services).
- Mental Health Services for Adults and Children Program.

Additionally, the Department did not have finalized policies and procedures for generating its monthly payroll.

It is important for management to communicate and monitor, through policies and procedures, staff members' responsibilities and expectations related to their job functions. In addition, policies and procedures are beneficial for new employees and backup personnel. The duties of staff performing accounting functions are critical to accurate financial reporting.

Corrective Action and Management's Response

Corrective action was taken.

Chapter 3-C

The Department of Aging and Disability Services Should Strengthen Certain Aspects of Its Financial Operations

Issue 1

The Department of Aging and Disability Services Did Not Resolve All Reconciling Items It Identified in Fiscal Year 2005

Reference No. 06-555-01
(Prior Audit Issue 05-555-01)

During fiscal year 2005, the Department of Aging and Disability Services (Department) began reconciling monthly balances in its internal accounting system (the Health and Human Services Administration System, or HHSAS) with the State's accounting system (the Uniform Statewide Accounting

System, or USAS). However, it did not complete the reconciliation process and resolve all reconciling items by the time it compiled its annual financial report for fiscal year 2005.

In order for its annual financial report to agree with USAS, the Department made a summary adjustment of approximately \$17 million to HHSAS. In fiscal year 2006, the Department intends to reverse the adjustment it made to HHSAS and to continue resolving the reconciling items.

Corrective Action and Management's Response

Corrective action was taken.

Issue 2

The Department of Aging and Disability Services Did Not Ensure That Employee Time Records in the Human Resource Management System Were Accurate

Reference No. 06-555-02

In fiscal year 2005, the Department did not ensure that employee time records in its Human Resources Management System (HRMS) were accurate. In a sample of 54 time sheets, auditors identified 12 instances in which data in HRMS did not reflect the data on employee time sheets. This resulted in an \$850 overstatement of the Department's liabilities. The Department corrected these errors in HRMS after auditors brought them to its attention.

The Department's timekeeping system was manual in fiscal year 2005, and the Department states that an automated timekeeping system was implemented in fiscal year 2006.

Corrective Action and Management's Response

Corrective action was taken.

Issue 3

The Department of Aging and Disability Services Did Not Have Well-Documented Policies and Procedures for the Majority of Its Accounting Functions

Reference No. 06-555-03
(Prior Audit Issue 05-555-01)

The Department did not have well-documented policies and procedures for the majority of its accounting functions during most of fiscal year 2005.

It is important for management to communicate and monitor, through policies and procedures, staff members' responsibilities and expectations related to

their job functions. In addition, policies and procedures are beneficial for new employees and backup personnel. Accurately carrying out accounting duties is critical to accurate financial reporting.

Corrective Action and Management's Response

Corrective action was taken.

Chapter 3-D

The Texas Workforce Commission Should Strengthen Certain Aspects of Its Information System Security and Its Fire Protection and Backup Power Capabilities

Issue 1

The Texas Workforce Commission Should Strengthen Security and Password Settings

Reference No. 06-555-10
(Prior Audit Issue 05-555-04)

The Texas Workforce Commission (Commission) has improved computer security since the State Auditor's Office's 2004 audit by deactivating certain default security settings and reducing the number of accounts with powerful security settings. However, the Commission still needs to correct weaknesses in password and security settings to decrease the risk that unauthorized users could access its automated systems and data.

The Commission should improve mainframe password settings. The mainframe password settings that the Commission uses are not sufficient to ensure adequate security. However, this is partially mitigated by the fact that the Commission limits the number of invalid access attempts that are allowed. It also requires users to change their passwords with sufficient frequency. Requirements for password settings are outlined in Title 1, Texas Administrative Code, Chapter 202. The Department of Information Resources' *Practices for Protecting Information Resources Assets* also provides recommendations in this area.

The Commission should review baseline mainframe security settings. The Commission has created an annual security audit checklist to guide the review of security settings. However, the Commission has not implemented this checklist by using it to review the adequacy of baseline mainframe security settings. Although these settings are reviewed informally during system upgrades, these reviews may not be sufficiently thorough.

Corrective Action and Management's Response

See current year finding 07-555-10.

Issue 2

The Texas Workforce Commission Should Strengthen Information System Security Monitoring

Reference No. 06-555-11
(Prior Audit Issue 05-555-05)

The Commission should revise its security reporting to make this task more manageable and ensure that it is performed consistently. The Commission does not adequately review security reports that provide information on security events identified by its mainframe computer's security management product. This prevents it from promptly investigating potential instances of unauthorized access.

Reviewing security reports is important because this can enable the Commission to detect security events such as unauthorized attempts to access its mainframe and, therefore, its automated systems and data. Although the security reports are comprehensive, they are lengthy and can be difficult to manage and review. While the Commission distributes the full reports to its central computer security function and portions of the reports to departmental security managers, improvements are needed to ensure an effective review process.

The Commission has taken preliminary steps to correct this issue by:

- Purchasing software that monitors security and generates monitoring reports. However, the Commission has not yet begun using this software.
- Generating daily monitoring reports that list any (1) changes made to operating system libraries or (2) use of a specific, powerful administrative account.
- Generating daily reports of departmental incidents that have occurred on the Commission's internal network.

Corrective Action and Management's Response

See current year finding 07-555-11.

Issue 3

The Texas Workforce Commission Should Strengthen Its Fire Protection and Backup Power Capabilities

Reference No. 06-555-12
(Prior Audit Issue 05-555-06)

The Commission's data center does not have a fire suppression system (other than hand-held extinguishers), a secondary method of power supply (such as a generator), or an uninterruptible power supply system for its mainframe systems. However, certain information technology resources at the Commission, including the mainframe equipment in the Commission's data center, are subject to transfer to the Department of Information Resources in accordance with the requirements of House Bill 1516 (79th Legislature, Regular Session). As a result, the Commission has not dedicated funds to correct the issues in its data center and is waiting until a decision is made regarding which information technology resources will be transferred to the Department of Information Resources.

Although the Commission has a processing agreement for an alternative site for system backup and recovery, the lack of a fire suppression system in the data center increases the reliance on this backup site and could result in significant costs to the Commission if it needed to rely on the backup center for an extended period of time.

Having an uninterruptible power supply system or generator could help the Commission avoid having to (1) revert to its off-site backup and recovery processing facility to continue operations, (2) delay processing until power could be restored to the data center, or (3) lose and re-enter data.

Corrective Action and Management's Response

See current year findings 07-555-12.

Independent Auditor's Report

*State of Texas Financial Portion of the
Statewide Single Audit Report for the
Year Ended August 31, 2006*

Summary of Auditor's Results

Financial Statements

- | | |
|---|-------------|
| 1. Type of auditor's report issued: | Unqualified |
| 2. Internal control over financial reporting: | |
| a. Material weakness identified? | No |
| b. Reportable conditions identified not considered to be material weaknesses? | Yes |
| c. Noncompliance material to financial statements noted? | No |

Federal Awards

For fiscal year 2006, federal award information has been issued in a separate report. See *State of Texas Federal Portion of the Statewide Single Audit Report for the Fiscal Year Ended August 31, 2006*, by KPMG LLP, dated February 20, 2007.



Report on Internal Control over Financial Reporting and on Compliance and Other
Matters Based on an Audit of Financial Statements Performed
in Accordance with *Government Auditing Standards*

The Honorable Rick Perry, Governor
The Honorable Susan Combs, Comptroller of Public Accounts
The Honorable David Dewhurst, Lieutenant Governor
The Honorable Tom Craddick, Speaker of the House of Representatives
and
Members of the Texas Legislature
State of Texas

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate discretely presented component unit and remaining fund information of the State of Texas as of and for the year ended August 31, 2006, which collectively comprise the State's basic financial statements and have issued our report thereon dated February 20, 2007. Our report was modified to include a reference to other auditors. Except as discussed in the following paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Other auditors audited the financial statements of the entities listed below. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors. The financial statements of the University of Texas System, the Department of Texas Turnpike Authority, and the Texas Local Government Investment Pool (TexPool) were not audited in accordance with *Government Auditing Standards*.

We have chosen not to comply with a reporting standard that specifies the wording to be used in discussing restrictions on the use of the report. We believe this wording is not in alignment with our role as a legislative audit function.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the State's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or

operation of the internal control over financial reporting that, in our judgment, could adversely affect the State’s ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. The accompanying schedule of findings and responses describes reportable conditions:

Summary of Findings	
Agency	Finding Numbers
Health and Human Services Commission	07-555-01
	07-555-02
	07-555-03
	07-555-04
	07-555-05
Department of State Health Services	07-555-06
	07-555-07
Department of Transportation	07-555-08
	07-555-09
Texas Workforce Commission	07-555-10
	07-555-11
	07-555-12

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State’s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Work Performed by Other Auditors

The State Auditor's Office did not audit the entities and funds listed in the table below. These entities were audited by other auditors.

Entities Audited by Other Auditors	Scope of Work Performed
Texas Guaranteed Student Loan Corporation	An audit of the financial statements of the Texas Guaranteed Student Loan Corporation, a component unit of the State of Texas, was conducted as of and for the years ended September 30, 2006 and 2005.
Texas Local Government Investment Pool	An audit of the statements of pool net assets of the Texas Local Government Investment Pool, an investment trust fund of the State of Texas, was conducted as of August 31, 2006 and 2005, and the related statements of change in pool net assets for the years then ended.
Texas Treasury Safekeeping Trust Company	An audit of the financial statements of the business-type activities, each major fund, and the aggregate remaining fund information of the Texas Treasury Safekeeping Trust Company, a component unit of the State of Texas, was conducted as of and for the year ended August 31, 2006.
Texas Prepaid Higher Education Tuition Board	An audit of the financial statements of the governmental activities, business-type activities, the aggregate discretely presented component unit, each major fund, and the fiduciary fund information of the Texas Prepaid Higher Education Tuition Board, a Board of the State of Texas, was conducted as of and for the year ended August 31, 2006.
Employees Retirement System	An audit of the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Employees Retirement System of Texas was conducted as of and for the year ended August 31, 2006. An audit was also conducted for the combining statements of fiduciary net assets and changes in fiduciary net assets of the pension plans administered by the Employees Retirement System as of August 31, 2006.
Department of Housing and Community Affairs	An audit of the financial statements of the governmental activities, business-type activities, major funds, remaining fund information, and supplementary schedules 1A through 1F of the Department of Housing and Community Affairs was conducted as of and for the year ended August 31, 2006.
Permanent University Fund	An audit of the statements of fiduciary net assets, changes in fiduciary net assets, and supplemental schedules of the Permanent University Fund was conducted as of and for the years ended August 31, 2006, and August 31, 2005.
The University of Texas System Long Term Fund	An audit of the statements of fiduciary net assets, changes in fiduciary net assets, and supplemental schedules of the University of Texas System Long Term Fund was conducted as of and for the years ended August 31, 2006, and August 31, 2005.
The University of Texas System Intermediate Term Fund	An audit of the statements of fiduciary net assets, changes in fiduciary net assets, and supplemental schedules of the University of Texas System Intermediate Term Fund was conducted as of August 31, 2006, and for the period from February 1, 2006 (inception) to August 31, 2006.
The University of Texas System Permanent Health Fund	An audit of the statements of fiduciary net assets, changes in fiduciary net assets, and supplemental schedules of the Permanent Health Fund was conducted as of and for the years ended August 31, 2006, and August 31, 2005.
The University of Texas System General Endowment Fund	An audit of the statements of fiduciary net assets, changes in fiduciary net assets, and supplemental schedules of the University of Texas General Endowment Fund was conducted as of and for the years ended August 31, 2006, and August 31, 2005.
Department of Transportation Turnpike Authority	An audit of the basic financial statements of the Central Turnpike System of the Texas Transportation Authority was conducted as of August 31, 2006 and 2005.
The University of Texas System	An audit of the consolidated balance sheets of the University of Texas System was conducted as of and for the years ended August 31, 2006 and 2005, and the related statements of revenues, expenses, and changes in net assets and of cash flows for the years then ended.

This report, insofar as it relates to the entities listed in the table above, is based solely on the reports of the other auditors.

Other Work Performed by the State Auditor's Office

We issued opinions in the reports on the following financial statements, which are consolidated into the basic financial statements of the State of Texas:

- *A Report on the Audit of the Teacher Retirement System's Fiscal Year 2006 Financial Statements* (SAO Report No. 07-006, December 2006)
- *A Report on the Audit of the Department of Transportation's Texas Mobility Fund Financial Statements for the Fiscal Year Ended August 31, 2006* (SAO Report No. 07-007, December 2006)
- *A Report on an Audit of the Texas Lottery Commission's Annual Financial Report for the Fiscal Year Ended August 31, 2006* (SAO Report No. 07-008, December 2006)
- *A Report on the Audit of the Fire Fighters' Pension Commissioner's Fiscal Year 2006 Financial Statements* (SAO Report No. 07-010, January 2007)
- *A Report on the Audit of the Permanent School Fund's Fiscal Year 2006 Financial Statements* (SAO Report No. 07-029, April 2007)

This report is intended for the information and use of the Governor, the Legislature, audit committees, boards and commissions, and management. However, this report is a matter of public record and its distribution is not limited.

Sincerely,

John Keel, CPA
State Auditor

February 20, 2007

Appendices

Appendix 1

Objective, Scope, and Methodology

Objective

The audit objective was to determine whether the State's basic financial statements accurately reflect the balances and activities for the State of Texas for the fiscal year ended August 31, 2006.

The Statewide Single Audit is an annual audit for the State of Texas. It is conducted so that the State complies with the Single Audit Act Amendments of 1996 and the Office of Management and Budget (OMB) Circular A-133. The State Auditor's Office performed the financial portion of the Statewide Single Audit and audited the fiscal year 2006 Schedule of Expenditures of Federal Awards. The State Auditor's Office contracted with KPMG LLP to perform part of the federal portion of the Statewide Single Audit. The federal portion included a review of compliance and controls over the State's federal awards and an audit of the Schedule of Expenditures of Federal Awards.

Scope

The scope of the financial portion of the Statewide Single Audit included an audit of the State's basic financial statements for fiscal year 2006 and a review of significant controls over financial reporting and compliance with applicable requirements.

Methodology

The audit methodology consisted of collecting information, conducting data analyses, performing selected audit tests and other procedures, and analyzing and evaluating the results against established criteria.

Information collected included the following:

- Agency and institution of higher education policies and procedures.
- Agency and institution of higher education systems documentation.
- Agency and institution of higher education accounting data.
- Agency and institution of higher education year-end accounting adjustments.
- Agency and institution of higher education fiscal year 2006 annual financial reports.

Procedures and tests conducted included the following:

- Evaluating automated systems controls.
- Performing analytical tests of account balances.
- Performing detail tests of vouchers.
- Comparing agency and institution of higher education accounting practices with Comptroller of Public Accounts reporting requirements.

Information systems reviewed included the following:

- Agency and institution of higher education internal accounting systems.
- Uniform Statewide Accounting System (USAS).
- State Property Accounting system (SPA).

Criteria used included the following:

- Texas statutes.
- Texas Administrative Code.
- General Appropriations Act (79th Legislature).
- The Comptroller of Public Accounts' policies and procedures.
- The Comptroller of Public Accounts' *Reporting Requirements for Annual Financial Reports of State Agencies and Universities*.
- Generally accepted accounting principles.
- Agency and institution of higher education policies.

Other Information

Fieldwork was conducted from June 2006 through March 2007. Except as discussed in the following paragraph, we conducted this audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

We have chosen not to comply with a reporting standard that specifies the wording to be used in discussing restrictions on the use of the report. We believe this wording is not in alignment with our role as a legislative audit function.

The following members of the State Auditor's staff performed the audit work:

- Michelle A. Feller (Project Manager)
- William J. Morris, CPA (Assistant Project Manager)
- Nick Ballard
- Kelly Bellah
- Robert Henry (Rob) Bollinger, CPA, CFE
- Joe Curtis, CPA, CIA
- Olin Davis, MBA
- David Dowden
- Scott Ela
- Nicole Elizondo
- Mary Goldwater
- Wesley Vaughn Hodgin, CPA
- Jules Hunter, CPA, CIA
- Tracy Jarratt, Macy.
- Robert G. Kiker, CGAP
- Joe Kozak, CPA, CISA
- Jennifer Logston, MBA
- Veda Bragg Mendoza, CIA, CGAP
- Joseph K. Mungai, CIA, CISA
- Jenay Oliphant
- Paige Paul, MBA
- Claudia Pena
- Cherisse Robison, MPAff
- Tamara Shepherd
- Barrett Sundberg
- Brendi Tubbs
- Bill Vanecek, CGAP
- Kenneth F. Wade
- Mary Ann Wise, CPA
- Anita D'Souza, JD (General Counsel)
- Dennis Ray Bushnell, CPA (Quality Control Reviewer)
- Charles P. Dunlap, Jr., CPA (Quality Control Reviewer)
- Worth S. Ferguson, CPA (Quality Control Reviewer)
- Kelly Linder, MSCRP, CGAP (Federal Funds Audit Manager)
- Michael C. Apperley, CPA (Assistant State Auditor)

Agencies and Institutions of Higher Education Audited

Financial accounts at the following state agencies and institutions of higher education were audited:

- Comptroller of Public Accounts
- Department of Aging and Disability Services
- Department of State Health Services
- Department of Transportation
- Health and Human Services Commission
- Texas A&M University
- Texas A&M University System Administrative and General Offices
- Texas Education Agency
- Texas Workforce Commission
- Water Development Board

Copies of this report have been distributed to the following:

Legislative Audit Committee

The Honorable David Dewhurst, Lieutenant Governor, Joint Chair
The Honorable Tom Craddick, Speaker of the House, Joint Chair
The Honorable Steve Ogden, Senate Finance Committee
The Honorable Thomas “Tommy” Williams, Member, Texas Senate
The Honorable Warren Chisum, House Appropriations Committee
The Honorable Jim Keffer, House Ways and Means Committee

Office of the Governor

The Honorable Rick Perry, Governor

Comptroller of Public Accounts

The Honorable Susan Combs, Comptroller of Public Accounts

Department of Aging and Disability Services

Ms. Adelaide Horn, Commissioner

Department of State Health Services

Dr. David L. Lakey, Commissioner

Department of Transportation

Members of the Texas Transportation Commission
Mr. Michael W. Behrens, P.E., Executive Director

Health and Human Services Commission

Mr. Albert Hawkins, Executive Commissioner

Texas A&M University

Members of the Texas A&M University System Board of Regents
Dr. Mike McKinney, Chancellor
Mr. Eddie J. Davis, Interim President

Texas Education Agency

Members of the State Board of Education
Dr. Shirley J. Neeley, Commissioner of Education

Texas Workforce Commission

Members of the Texas Workforce Commission
Mr. Larry Temple, Executive Director

Water Development Board

Members of the Water Development Board
Mr. J. Kevin Ward, Executive Administrator



This document is not copyrighted. Readers may make additional copies of this report as needed. In addition, most State Auditor's Office reports may be downloaded from our Web site: www.sao.state.tx.us.

In compliance with the Americans with Disabilities Act, this document may also be requested in alternative formats. To do so, contact our report request line at (512) 936-9880 (Voice), (512) 936-9400 (FAX), 1-800-RELAY-TX (TDD), or visit the Robert E. Johnson Building, 1501 North Congress Avenue, Suite 4.224, Austin, Texas 78701.

The State Auditor's Office is an equal opportunity employer and does not discriminate on the basis of race, color, religion, sex, national origin, age, or disability in employment or in the provision of services, programs, or activities.

To report waste, fraud, or abuse in state government call the SAO Hotline: 1-800-TX-AUDIT.