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State of Texas Financial Portion of the
Statewide Single Audit Report
For the Year Ended
August 31, 2008

April 2009
Report No. 09-555

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Overall Conclusion

The basic financial statements included in the Comprehensive Annual Financial Report (CAFR) for the State of Texas accurately present the financial position and activities of the State for the fiscal year ended August 31, 2008. These 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.

The State successfully contends with significant complexities in preparing its basic financial statements. Compiling financial information and ensuring its accuracy for more than 200 state agencies and higher education institutions is a major undertaking. The financial statements convey the use of nearly \$97.2 billion.¹ Although auditors identified some weaknesses in the process, overall the State published materially accurate financial statements.

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 higher education institutions use to record their financial activities. Through that effort, auditors identified specific weaknesses that four agencies and three higher education institutions should correct to ensure the accuracy of their financial information.

The State Auditor's Office also audited the State's Schedule of Expenditures of Federal Awards (SEFA) for fiscal year 2008, which is prepared by the Office of the

Basic Financial Statements

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.

The State Auditor's Office audited material line items of major funds at 14 of the State's largest agencies and higher education institutions.

¹ The \$97.2 billion in annual expenditures exceeded the \$85.5 billion appropriated for fiscal year 2008 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.

Comptroller of Public Accounts (Comptroller's Office) using SEFA data from all state agencies and higher education institutions that made federal expenditures during the fiscal year. The State Auditor's Office and KMPG LLP audited the processes for preparing SEFA information at 15 agencies and 20 higher education institutions. Auditors identified errors caused by inadequate review of SEFA information at 22 agencies and higher education institutions. These errors are discussed in Chapter 1-H of this report.

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 by companies that review the State's fiscal integrity to rate state-issued bonds and by federal agencies that award grants.

Key Points

The financial systems and controls at the agencies and higher education institutions audited were adequate to enable the State to prepare materially accurate basic financial statements.

Although the financial systems and controls were adequate, audit work identified control weaknesses at 7 of the 14 state agencies and higher education institutions audited. (Appendix 2 of this report lists all agencies and higher education institutions audited.) Specifically:

- The Comptroller's Office should strengthen its CAFR consolidation process. In addition, the Comptroller's Office should continue to strengthen (1) access controls for the State Treasury Division's technology operations, (2) procedures for profile change requests, and (3) financial reconciliations. Auditors previously identified these same types of issues during the audit of fiscal year 2007.
- The Department of State Health Services (Department) should complete required financial reconciliations. The Department did not complete the reconciliation of its internal accounting system with the State's accounting system (the Uniform Statewide Accounting System or USAS).
- The Department of Transportation should regularly update user access rights for its automated systems and consistently amortize bond premiums in accordance with requirements.
- The Health and Human Services Commission (Commission) should implement all components of its payment monitoring system. Auditors previously identified this same issue during the audits of fiscal years 2006 and 2007. The Commission also should fully document policies and procedures for recording and approving Medicaid, CHIP, and Vendor Drug program expenditures. Auditors previously identified this issue during the audits of fiscal years 2005 through 2007. The Commission should review user access to USAS and ensure that related duties are

properly segregated. Auditors previously identified this issue during the audits of fiscal years 2006 and 2007. The Commission should disclose the potential financial liability associated with the open investigations of the Office of Inspector General. Auditors previously identified this issue during the audit of fiscal year 2007. In addition, the Commission should accrue necessary expenditures. The Commission also should strengthen password requirements for its Premium Payment System.

- The University of Texas at Austin should strengthen its inventory controls. Auditors previously identified this issue during the audit of fiscal year 2007.
- The University of Texas at San Antonio should strengthen its capital asset records and restrict access to USAS.
- The University of Texas Southwestern Medical Center at Dallas should strengthen its capital asset records and its patient billing process.
- Agencies and higher education institutions also should strengthen their reviews of their SEFAs. Auditors identified a lack of adequate review of SEFA information at 22 of the 35 agencies and higher education institutions at which SEFA information was reviewed.

Summary of Management's Responses

The agencies and higher education institutions to which auditors addressed recommendations generally agreed with the recommendations.

Summary of Information Technology Review

Auditors reviewed the internal controls over significant accounting and information systems at the agencies and higher education institutions 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 user access control weaknesses at the Comptroller's Office, the Department of Transportation, the Health and Human Services Commission, and the University of Texas at San Antonio. Correcting these weaknesses will help to ensure the reliability of those entities' financial information.

Auditors also reviewed internal controls over USAS. As previously discussed, the Comptroller's Office should continue to strengthen procedures regarding the central profile change request. The central profile change request process should be designed to ensure that all proposed system modifications are appropriately approved and tested before they are placed into production.

Auditors also reviewed access to the State Property Accounting system, the Human Resources Information System, the Standardized Payroll/Personnel Reporting System, and the Uniform Statewide Payroll/Personnel 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, 2008.

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 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. The opinion on the basic financial statements, *The State of Texas Comprehensive Annual Financial Report for the Fiscal Year Ended August 31, 2008*, was dated February 20, 2009.

The scope of the federal portion of the Statewide Single Audit included an audit of the State's Schedule of Expenditures of Federal Awards (SEFA), a review of compliance for each major program, and a review of significant controls over federal compliance. The State Auditor's Office contracted with KPMG LLP to provide an opinion on compliance for each major program and internal control over compliance. The State Auditor's Office provided an opinion on the State's Schedule of Expenditures of Federal Awards (SEFA). The report on the federal portion of the Statewide Single Audit is included in a separate report issued by KPMG LLP entitled *State of Texas Federal Portion of the Statewide Single Audit Report for the Fiscal Year Ended August 31, 2008*, dated February 20, 2009.

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.

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Schedule of Findings and Responses

*State of Texas Financial Portion of the
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Year Ended August 31, 2008*

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

Chapter 1-A

The Office of the Comptroller of Public Accounts Should Strengthen Certain Aspects of Its Financial and Information Technology Operations

Issue 1

The Office of the Comptroller of Public Accounts Should Strengthen Its Comprehensive Annual Financial Report Consolidation Process

Reference No. 09-555-01
(Prior Audit Issue 08-555-03)

Type of finding: Significant Deficiency

Definition of Significant Deficiency

A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

Source: Codification of Statements on Auditing Standards AU, Section 325.06, American Institute of Certified Public Accountants.

Although the Office of the Comptroller of Public Accounts (Comptroller's Office) relies on state agencies and public higher education institutions to provide accurate financial information, the Comptroller's Office is ultimately responsible for the accurate presentation of the State's Comprehensive Annual Financial Report (CAFR) and Schedule of Expenditures of Federal Awards (SEFA).

Control weaknesses exist in the Comptroller's Office's process for preparing the State's CAFR and SEFA that allowed errors to occur without being detected or corrected in a timely manner. Auditors identified errors in financial data, consolidation adjustments, CAFR note disclosures, and supporting documentation. Based on the audit, the Comptroller's Office corrected most known errors before finalizing the CAFR.

Control weaknesses in tax-related information. The Comptroller's Office did not record tax revenues according to generally accepted accounting principles for taxes, and it did not update the fiscal year 2008 CAFR to reflect all effects of tax transactions that occurred after the end of fiscal year 2008 but that were related to tax account balances for fiscal year 2008. Specifically, the Comptroller's Office:

- Incorrectly based tax revenues on the amount of taxes collected, rather than on the amount of taxes assessed. Generally accepted accounting principles require that revenues should be recognized when the underlying exchange transaction occurs.

- Did not adjust the CAFR to reflect \$606 million in tax overpayments for fiscal year 2008 as required by generally accepted accounting principles (see text box). Franchise taxpayers initially overpaid \$606 million in fiscal year 2008. The Comptroller's Office refunded the \$606 million to taxpayers after the end of fiscal year 2008. However, it did not initially reduce tax revenues or record the refunds due back to taxpayers on the fiscal year 2008 CAFR. This error caused franchise tax revenues to be overstated and accounts payable to be understated by \$606 million on the fiscal year 2008 CAFR. After auditors identified the issue, the Comptroller's Office adjusted tax revenues and accounts payable before finalizing the fiscal year 2008 CAFR.

Tax Revenue Recognition

Generally accepted accounting principles require that tax revenues be recognized, net of estimated refunds and estimated uncollectible amounts, when the transaction the tax is assessed upon occurs or when resources are received, whichever occurs first.

Source: Governmental Accounting Standards Board, Statement 33, paragraph 16.

- Reported negative deferred revenues related to natural gas production taxes. Natural gas producers can claim severance tax exemptions for low-producing gas wells to reduce their tax liability. In most cases, taxpayers remit their tax payments prior to qualifying for the exemptions and initially pay more than their final liability. The Comptroller's Office asserted that these overpayments represented resources collected but not yet earned. Because most of these credits would not be available to the taxpayer in time to reduce current year obligations, the Comptroller's Office did not reduce tax revenues, even though these overpayments represented cash collected that was not legally due to the Comptroller.

As part of the tax revenue reporting process, the Comptroller's Office used information from its Integrated Tax System (ITS) to adjust the amount of tax revenues collected. However, the staff preparing the CAFR did not have a thorough understanding of how ITS processed tax assessments, payments, credits, and refunds. Having a better understanding of ITS and all transactions related to tax revenue would help ensure that tax revenue is presented correctly in the CAFR. Auditors verified that the Comptroller's Office entered franchise tax payments into ITS correctly.

Control weaknesses in review of financial information. The Comptroller's Office did not always review financial information that agencies and higher education institutions submitted for reasonableness, accuracy, and completeness. For example, several agencies misclassified investment categories or reported investment balances that were not included in their annual financial reports when they reported investment balances through the Comptroller's Office's Web-based agency reporting system. Additionally, the Comptroller's Office did not verify the appropriateness of negative expenditures on one higher education institution's SEFA until auditors noted it during the audit.

Control weaknesses in following policies and procedures. The Comptroller's Office did not always follow established policies and procedures. For example,

explanations provided for one adjustment to the CAFR did not match the proposed adjusting entries. According to Comptroller's Office staff, the explanations had not been updated from the previous fiscal year.

The Comptroller's Office did not always conduct a thorough supervisory review process to detect errors and ensure that they were corrected in a timely manner. Conducting a thorough supervisory review could have enabled the Comptroller's Office to identify the errors noted above. While the individual errors that auditors identified did not materially affect the fair presentation of the CAFR, they demonstrated weaknesses in internal controls over the Comptroller's Office's process for reporting financial transactions.

The State's Uniform Statewide Accounting System (USAS) provides a systematic process for agencies and higher education institutions to record their financial data, but this data must be analyzed and adjusted by the Comptroller's Office Financial Reporting Section (FRS) before the State's CAFR can be completed. FRS also uses database applications to collect financial detail from agencies and higher education institutions to prepare notes to the CAFR and the SEFA.

Recommendations

The Comptroller's Office should strengthen its consolidation process for the CAFR and SEFA by:

- Ensuring that the CAFR consolidation policies and procedures are based on current financial system processes, available information, and reporting standards. The Comptroller's Office should determine whether revisions or new policies and procedures are needed to reflect changes in accounting standards or practices.
- Ensuring that staff understand and follow established policies and procedures for preparing the CAFR.
- Ensuring that the CAFR, the CAFR consolidation process, and supporting documentation are thoroughly reviewed by knowledgeable Comptroller's Office staff.
- Ensuring that it reviews the accuracy of the financial data provided by the state agencies and higher education institutions for reasonableness, accuracy, and completeness.

Management's Response

We agree that the Comptroller's Office is ultimately responsible for the accurate presentation of the State's Comprehensive Annual Financial Report (CAFR) and Schedule of Expenditures of Federal Awards (SEFA). Our staff

is committed to ensuring that these publications fairly present the financial position of the State and comply with generally accepted accounting principles.

The corrective actions discussed below will be monitored to ensure that they are effectively implemented as part of our system of quality control.

- *Financial Reporting Section (FRS) staff will make appropriate corrections to the procedures for calculating estimated tax revenues based upon taxes assessed and taking into account overpayments and refunds. FRS staff will also work with the Comptroller's Tax Policy and Information Technology Divisions to improve our understanding of processing related to tax assessments, payments, credits, and refunds.*
- *FRS staff will make appropriate corrections to the procedures governing the review of financial information submitted by agencies and higher education institutions. These changes will target strengthening the review process to improve our assessment of the reasonableness, accuracy, and completeness of agency financial information.*
- *FRS staff will amend the CAFR work plan to allot additional time to perform supervisory reviews to detect errors. Revising the work plan for this purpose will ensure that sufficient time is allowed for conducting reviews and that any errors identified can be corrected in a timely manner.*

We believe the above actions are responsive to the concerns documented in the finding.

Responsible Person: Manager of Fiscal Integrity

Implementation Date: September 1, 2009

Issue 2

The Office of the Comptroller of Public Accounts Should Continue to Strengthen Access Controls for the Treasury Division Technology Operations

Reference No. 09-555-02
(Prior Audit Issue 08-555-01)

Type of finding: Significant Deficiency

The Comptroller's Office continues to allow two developers to have access to production data for the State Treasury's automated systems. These systems were developed using a programming language that has limited security options. After auditors brought this issue to the Comptroller's Office's

attention during the fiscal year 2007 Statewide financial audit, the Comptroller's Office's Treasury Division reduced the access from 15 developers to 2 developers. The Comptroller's Office's Treasury Division is in the process of replacing the current systems with another application that can be designed with more advanced security features. It also has established compensating controls until the new application is completed.

**Title 1, Texas Administrative Code,
Section 202.20 (1)**

Information resources residing in the various state agencies of state government are strategic and vital assets belonging to the people of Texas. These assets must be available and protected commensurate with the value of the assets. Measures shall be taken to protect these assets against unauthorized access, disclosure, modification or destruction, whether accidental or deliberate, as well as to assure the availability, integrity, utility, authenticity, and confidentiality of information. Access to state information resources must be appropriately managed.

The Texas Administrative Code requires agencies to take measures to protect data from unauthorized access, disclosure, modification, or destruction, whether accidental or deliberate (see text box).

Granting excessive access and not providing for proper segregation of duties increases the risk of fraud, data corruption, potential service disruption, and loss of state revenue. Because the Treasury Division processes billions of dollars in revenue, the loss of even a single day's interest due to data manipulation or destruction would affect state revenue. However, nothing came to auditors' attention to indicate that automated systems had been compromised.

Recommendations

The Comptroller's Office should:

- Ensure that the security features of the planned new application enable the Treasury Division to manage end user and developer access for its automated systems.
- Continue to monitor end user and developer access to Treasury Division automated systems to ensure that the short-term compensating controls effectively address proper segregation of duties.

Management's Response

As noted, the Treasury Operations Division is in the process of replacing most of our current systems with new software. During this project we agree to ensure that the security features of the new system will allow for us to properly manage end user and developer access. The project is on target and is expected to be completed by the end of this calendar year.

Responsible Person: Director of Treasury Operations

Implementation Date: December 31, 2009

The Treasury Operations Division agrees to continue to monitor end user and developer access to our automated systems to ensure that the short-term compensating controls effectively address proper segregation of duties. After auditors brought this issue to our attention during the fiscal year 2007

statewide financial audit, we implemented a new security access process using the agency's Help Desk ticket system. The ticket system now requires multiple levels of approval before access is granted to files and automated systems. The user or developer requesting access must first obtain approval through their designated security coordinator, and then obtain approval through Treasury Operations' designated security coordinator before staff or developer access is granted. The process is monitored and approved at several check points throughout the process.

The current finding notes access to the Treasury Operations Division's automated systems is still granted to two developers. These individuals provide ongoing operations support to the automated system. We believe this access is a critical need given the large amount of dollars processed daily by the division. Any interruption in the daily processing could result in loss of interest earnings, directly affecting state revenue.

Responsible Person: Director of Treasury Operations

Implementation Date: Completed

Issue 3

The Office of the Comptroller of Public Accounts Should Continue to Strengthen Procedures Regarding Central Profile Change Requests

Reference No. 09-555-03
(Prior Audit Issue 08-555-02)

Type of finding: Significant Deficiency

The Comptroller's Office's Application Security Division should continue to improve the central profile change request process to ensure proper segregation of duties. All of the 25 change requests tested from fiscal year 2008 contained the initials of the Application Security Division employee entering the change. However, 2 (8 percent) of the 25 change requests had approvals that could not be verified as authorized using the Comptroller's Office Central Profile Action Request Authorized Approver Listing. One change request was not approved by an authorized approver and another change request was not signed by a reviewer. The Application Security Division had difficulty substantiating that authorized approvers had reviewed and approved change requests because the approver listing was incomplete or needed clarification.

The Texas Administrative Code requires agencies to take measures to protect data from unauthorized access, disclosure, modification, or destruction, whether accidental or deliberate. Granting excessive access and not providing for proper segregation of duties increases the risk of fraud, data corruption,

Title 1, Texas Administrative Code, Section 202.20

(5) The integrity of data, its source, its destination, and processes applied to it must be assured. Changes to data must be made only in an authorized manner.

(8) State agencies must ensure adequate controls and separation of duties for tasks that are susceptible to fraudulent or other unauthorized activity.

and potential service disruption (see text box).

The central profile change management process should be designed to ensure that all proposed system modifications are approved and that changes are tested and approved before they are placed into production. The risk of inaccurate financial data decreases when the required levels of approvals are obtained. Improper or unauthorized changes should not be made if the same individual both requests and approves a change.

Recommendations

The Comptroller's Office should:

- Update the Central Profile Action Request Authorized Approver Listing to ensure that employees who approve change requests are authorized to make the approvals and are clearly identified.
- Enforce its policies and procedures and ensure that staff obtain the proper authorization on change request forms prior to processing those requests.
- Ensure that the Applications Security Division carefully reviews central profile change requests for authorized approvals to ensure that all of the required signatures and initials are present before finalizing the change and filing the documentation.

Management's Response

The Comptroller's Office places great importance on the integrity of data and ensuring that adequate controls and separation of duties exist for processes that affect data.

The Central Profile Action Request Authorized Approver Listing was revised effective April 1, 2009, to address the issues noted above.

The Comptroller's Office will take additional steps to strengthen the review process to ensure that all Change Requests comply with the requirements of the Authorized Approver Listing. These steps include performing a supervisory review of each Change Request at the conclusion of the process to ensure that the policies and procedures that govern the change have been followed in their entirety.

We believe the above actions are responsive to the concerns documented in the finding.

Responsible Person: Manager of Fiscal Integrity

Implementation Date: May 1, 2009

Issue 4

The Comptroller's Office Should Continue to Strengthen Its Financial Reconciliations

Reference No. 09-555-04

Type of finding: Significant Deficiency

The Comptroller's Office should improve its Integrated Tax System reconciliation process. The Comptroller's Office should strengthen the timely preparation and review of its tax reconciliation process. The Comptroller's Office's Integrated Tax System (ITS) processed approximately \$37 billion in tax payments for fiscal year 2008. Auditors' test of 20 reconciliations of ITS collections to the cash balances in USAS determined that these reconciliations were not always prepared or reviewed in a timely manner. Specifically:

- 19 reconciliations (95 percent) were not prepared in a timely manner.
- 9 reconciliations (45 percent) were not reviewed in a timely manner.

The Comptroller's Office should improve its monthly fund-to-cash reconciliation process. The Comptroller's Office should strengthen its review of its fund-to-cash reconciliations. The Comptroller's Office performs the fund-to-cash reconciliations on a monthly basis to reconcile the Treasury Division's Fund Accounting System to USAS cash balances. It performs accurate and complete fund-to-cash reconciliations in a timely manner; however, there was no evidence of a formal review of these reconciliations for accuracy.

Performing cash reconciliations in a timely manner is a key management control for ensuring that errors are detected and corrected promptly. Review of these reconciliations by a knowledgeable, independent person ensures that the reconciliation control is in place and operating effectively.

Recommendations

The Comptroller's Office should improve financial reconciliations to ensure that it detects and corrects errors in a timely manner. Specifically:

- The Revenue Administration Division should retain evidence that reconciliations of ITS tax collections to USAS cash balances are performed and reviewed for completeness and accuracy in a timely manner. Reconciliations should be completed within one month of the end of the month being reconciled. The review of the reconciliations should be finalized within one month from the date the reconciliations are prepared.

- The Statewide Fiscal Services Division should retain evidence that fund-to-cash reconciliations are reviewed for completeness and accuracy in a timely manner. Reconciliations should be completed within one month of the end of the month being reconciled. The review of the reconciliation should be finalized within one month from the date the reconciliations are prepared.

Management's Response

Revenue Administration Division

The Revenue Accounting Division agrees the reconciliation of ITS tax collections to USAS cash balances should be performed within one month of the end of the month being reconciled, the reviews for completeness and accuracy of the reconciliations should be finalized within one month from the date the reconciliations are prepared and that evidence of the reconciliations and reviews should be retained.

1. The recommended timelines are consistent with Revenue Accounting Division's historic and current guidelines. Revenue Accounting Division was not within these timelines due to a tremendous loss of highly experienced personnel. The division is currently developing an aggressive training plan for its current staff in order to develop and maintain the expertise necessary to comply with its internal timelines and this recommendation.

Responsible Person: Manager of Revenue Accounting

Implementation Date: Completion of a comprehensive training plan – April 30, 2009.

2. Training for all staff members is projected to be completed by August 31, 2009. During this period, employees will continue to work on outstanding reconciliations.

Responsible Person: Manager of Revenue Accounting

Implementation Date: August 31, 2009

3. Between April 30 and August 31, some of the outstanding reconciliations will be completed as division staff attain additional levels of proficiency. By the end of the fiscal year, we will be able to project a completion date for all outstanding reconciliations based on previous reconciliation rates.

Responsible Person: Manager of Revenue Accounting

Implementation Date: August 31, 2010

Fiscal Management Division

The Comptroller's Office places great importance on the role of financial reconciliations in ensuring that errors are identified and corrected in a timely manner.

We will take additional steps to strengthen the Fund-to-Cash Reconciliation review process to include performing a monthly comprehensive peer review and management sign-off. We believe the above actions are responsive to the concerns documented in the finding.

Responsible Person: Manager of Statewide Fiscal Services

Implementation Date: May 1, 2009

Chapter 1-B

The Department of State Health Services Should Complete Required Reconciliations

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. 09-555-05

Type of finding: Significant Deficiency

The Department of State Health Services (Department) did not complete the reconciliation of its internal accounting system (the Health and Human Services Administrative System, HHSAS) with the State's accounting system (the Uniform Statewide Accounting System, USAS) as required by the Office of the Comptroller of Public Accounts (Comptroller's Office). The Department substantially completed its cash reconciliation for fiscal year 2008 (see prior year finding 08-555-11) but, as of December 22, 2008, it had not completed its general ledger reconciliation and it had not made the required adjusting entries for fiscal year 2008.

As a result, information in HHSAS did not agree with information in USAS. For example, there was a difference of \$230,318,445 for fiscal year 2008 between total assets recorded in HHSAS and total assets recorded in USAS. (Specifically, information in HHSAS showed that total assets totaled \$586,417,317, but information in USAS showed that total assets totaled \$816,735,762.) Without a complete reconciliation, it is not possible to determine whether either system accurately reflected the Department's financial position as of August 31, 2008.

Additionally, the Department did not comply with the Comptroller's Office requirement that each agency post and reconcile its annual financial data to USAS and the agency's accounting system on a generally accepted accounting principles basis by November 20. Despite its noncompliance with that requirement, the Department submitted the certification form required by the Comptroller's Office certifying that its financial data correctly reflected its financial position as of August 31 of the current fiscal year as recorded in USAS and in the agency's accounting system.

Recommendation

The Department should complete the reconciliation of HHSAS to USAS and make the necessary adjusting entries as required by the Comptroller's Office.

Management's Response

The Department of State Health Services (DSHS) appreciates the auditors noting that the department has substantially implemented the cash reconciliation between the statewide accounting system and our internal accounting system. Through implementation of better internal controls and our monitoring efforts DSHS has finally resolved the prior year findings. DSHS has completed the entry into their internal accounting system of the non-cash adjustments noted by the auditors and had no variances to the information submitted in the department's Annual Financial Report. However, DSHS concurs that the timely entry of these transactions is necessary to assure accurate reporting and will implement procedures to ensure the posting of these transactions to the department's internal accounting system prior to submittal of the Annual Financial Report.

Responsible Person: Accounting Director

Implementation Date: November 20, 2009

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

Issue 1

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

Reference No. 09-555-06

Type of finding: Significant Deficiency

In fiscal year 2008, the Department of Transportation (Department) did not regularly update access rights to its automated systems. Specifically:

**Title 1, Texas Administrative Code,
Section 202.20(1)**

Information resources residing in the various state agencies of state government are strategic and vital assets belonging to the people of Texas. These assets must be available and protected commensurate with the value of the assets. Measures shall be taken to protect these assets against unauthorized access, disclosure, modification or destruction, whether accidental or deliberate, as well as assure the availability, integrity, authenticity, and confidentiality of information. Access to state information resources must be appropriately managed.

**Title 1, Texas Administrative Code,
Section 202.25(3)(B)**

A user's access authorization shall be appropriately modified or removed when the user's employment or job responsibilities within the state agency change.

- Eight users whose employment with the Department had been terminated still had access rights to the Automated Purchasing System (APS) and the Material and Supply Management System (MSMS). APS is the Department's internal real-time purchasing system through which it requests and purchases all of its goods and services. MSMS is the Department's real-time inventory system.
 - Six users whose employment with the Department had been terminated still had access rights to APS.
 - Five 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.
 - Four users whose employment with the Department had been terminated still had access rights to APS, MSMS, and the Equipment Operating System (EOS). EOS is the Department's system of record for all information on major equipment.
-
- Two users whose employment with the Department had been terminated still had access rights to APS and EOS.
 - One user whose employment with the Department had been terminated still had access rights to APS and FIMS.
 - One user whose employment with the Department had been terminated still had access rights to APS and the Minor Equipment System (MES). MES is the Department's system of record for all information on minor equipment.

- One user whose employment with the Department had been terminated still had access rights to EOS and MSMS.
- One user whose employment with the Department had been terminated still had access rights to MES.

According to the Department's *Information Security Manual* dated November 2007, "when a user's employment status or job functions changes, a user's access authorization must be removed or modified appropriately and immediately."

None of the users discussed above had accessed the automated systems after their employment was terminated. The Department removed the inappropriate access rights for 26 of those users after auditors brought this matter to its attention.

Recommendation

The Department should regularly update user access rights for its automated systems, as outlined in its *Information Security Manual*.

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's account, leaving it intact, but with no login capabilities, while the user's responsibilities are transitioned or the account history is audited. Suspended accounts cannot be used to log in to any system. Although the account is suspended, the user id will appear on reports which include mainframe user ids.

In May 2007, TxDOT implemented the Compliance Monitoring system which provides several monitoring reports to the Security Administrators highlighting all account discrepancies. Since the implementation of this system, the 'Terminated User Report', which lists all terminated users for a district, division, or office, has been provided to the Security Administrators on a monthly basis. As a result of the monthly reports, TxDOT's Information Systems Security branch recorded a reduction in the number of active user accounts assigned to a terminated user. The improvement in suspending or deleting the user access after termination was improved; however, it was not sufficient to meet TxDOT policy.

In October 2008, the Information Systems Security branch implemented daily notification to Security Administrators of all terminated users in their district, division, or office. During this same time frame, the Information System Security branch also began daily monitoring of these reports. If a terminated

user remains on the report for more than 2 days, the Security Administrator is contacted via phone and advised to resolve the issue immediately. The daily notification also serves as a reinforcement of TxDOT's Information Security policy relating to suspending or deleting user accounts immediately upon termination. The results of the daily notification have been positive. The Security Administrators now have immediate access to users in their district, division, or office who have been terminated and they can pro-actively work with the supervisors to remove the access per TxDOT policy.

TxDOT believes the daily notification and daily monitoring of terminated users will provide the necessary controls to resolve the issues noted in this audit.

Responsible Person: Director, Technology Services Division

Implementation Date: October 2008

Issue 2

The Department of Transportation Did Not Consistently Amortize Bond Premiums in Accordance with Requirements

Reference No. 09-555-07

Type of finding: Significant Deficiency

In fiscal year 2008, the Department did not consistently amortize its bond premiums in accordance with the Office of the Comptroller of Public Accounts' (Comptroller's Office) *Reporting Requirements for Annual Financial Reports of State Agencies and Universities*. Specifically:

Amortizing Bond Discounts and Premiums

If bond discounts, premiums, issuance costs, and gain/(loss) on refunding are individually greater than five percent of the par value of the bond issue, the amount must be capitalized and amortized over the remaining life of the bonds using the straight-line or interest method. Amounts less than five percent of the par value may be capitalized or expensed at the time of bond issuance as determined by each individual agency. The five percent applies to each category, not the combined total of all.

Source: *Reporting Requirements for Annual Financial Reports of State Agencies and Universities*, Office of the Comptroller of Public Accounts, July 2008.

- The Department did not amortize bond premiums greater than 5 percent of the issuance cost for State Highway Fund 006. After this error was brought to the Department's attention, the Department amortized these premiums using the "bonds outstanding" method and submitted the amortization information to the Comptroller's Office. However, the "bonds outstanding" method is not one of the two methods outlined in the Comptroller's Office's *Reporting Requirements for Annual Financial Reports of State Agencies and Universities* (see text box for additional details).
- The Department used the "straight-line" method to amortize all bond premiums for the Central Texas Turnpike System. The straight-line method is one of the two methods outlined in *Reporting Requirements for Annual Financial Reports of State Agencies and Universities*. However, the Department used the "bonds outstanding" method to amortize all bond premiums for the Texas Mobility Fund. As discussed above, the "bonds outstanding" method is

not outlined in the *Reporting Requirements for Annual Financial Reports of State Agencies and Universities*. There was not a material difference between the amortization cost calculated using the “bonds outstanding” method and the amortization cost calculated using the methods outlined in *Reporting Requirements for Annual Financial Reports of State Agencies and Universities*.

Recommendation

The Department should establish and implement guidelines to ensure that it amortizes bond premiums and issuance costs consistently and in accordance with the Comptroller’s Office’s *Reporting Requirements for Annual Financial Reports of State Agencies and Universities*.

Management’s Response

The Department agrees with the recommendation. However, the Department is in the process of requesting the Comptroller's Office to add the bonds outstanding method of amortization of premium/discount on serial bonds to their reporting requirements. The bonds outstanding method of amortization provides a result which is closer to the interest method (the preferred method per generally accepted accounting principles) than the straight line method. Per Accounting Principles Board Opinion #21, any method of amortization may be used as long as it provides a result that is not materially different than that obtained under the interest method. In the future, the Department will only use a method for amortizing bond premiums/discounts permitted by the Comptroller's Office's Reporting Requirements for Annual Financial Reports of State Agencies and Universities.

Responsible Person: Director, Finance Division

Implementation Date: April 2009

Chapter 1-D

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

Public assistance program payments that the Health and Human Services Commission (Commission) reported in its fiscal year 2008 financial statements were materially accurate. 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. These internal controls exist at both the Commission and its

contractors. However, there are weaknesses in the design and operation of these internal controls that limit the assurances it can make regarding the

**Fiscal Year 2008 Federal Expenditures
from Public Assistance Programs**

Medicaid: 40 million claims paid, payments totaled \$9.5 billion.

Children's Health Insurance Program (CHIP): 4.7 million member months, payments totaled \$676 million.

Vendor Drug Program: More than 28 million prescriptions filled. Total payments are included within the Medicaid and CHIP payments.

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 for fiscal year 2008.

validity of payments made for public assistance programs in fiscal year 2008. The programs affected by these weaknesses spent \$10.2 billion in federal funds in fiscal year 2008 (see text box).

Several of the internal control weaknesses auditors identified during the audit of fiscal year 2008 had also been identified in prior audits and had not been fully corrected or mitigated. For example, the Commission's lack of documented policies and procedures for certain functions has been identified as a weakness in four consecutive years. Weaknesses in the Commission's payment monitoring system have been identified for three consecutive years. Weaknesses in user access have been identified for five consecutive years.

In addition, the Commission has only partially implemented prior year recommendations to correct identified internal control weaknesses in the Vendor Drug program and Medicaid. The Commission implemented prior year recommendations for Children's Medicaid, the Food Stamp program, and Temporary Assistance for Needy Families (TANF). The Commission also implemented a prior year recommendation to reconcile its internal accounting system with the Uniform Statewide Accounting System in a timely manner. The Commission took no action to implement prior year recommendations to track the open investigations of the Office of Inspector General and the Office of the Attorney General to account for contingent liabilities.

Auditors identified the following weaknesses during the audit of fiscal year 2008:

- The Commission did not fully implement all components of its payment monitoring process.
- The Commission did not sufficiently document policies and procedures for two key accounting functions.
- The Commission did not ensure that access to the Uniform Statewide Accounting System was properly segregated.
- The Commission did not disclose the potential financial liability associated with the open investigations of its Office of Inspector General.
- The Commission did not accrue \$430.3 million in expenditures associated with the Medicaid Upper Payment Limit program.
- The Commission did not have adequate password restrictions for its Premium Payment System.

Issue 1

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

Reference No. 09-555-08
(Prior Audit Issues 08-555-05 and 07-555-01)

Type of finding: Significant Deficiency

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 and managed care plans.

Vendor Drug Program

As the State Auditor's Office has reported in two previous audits, the Commission did not fully staff its regional pharmacists. As a result, the Commission continued to have vacancies in four highly populated regions: Fort Worth (two vacant positions), Houston (two vacant positions), Lubbock (one vacant position), and San Antonio (one vacant position).

During fiscal year 2008, only 4 of the Commission's 10 regional and sub-regional pharmacist positions were filled. The Commission uses regional and sub-regional pharmacists to review expenditure claims submitted by the approximately 4,150 pharmacies participating in the Vendor Drug program. However, it has not maintained a full complement of regional pharmacists to perform these reviews since prior to 2000.

The Commission hired a regional pharmacist manager during fiscal year 2008, and it has hired two regional pharmacists since August 31, 2008. The Vendor Drug program still needs to hire four more regional pharmacists in order to have all 10 regional and sub-regional pharmacist positions filled.

Additionally, the Commission did not maintain adequate monitoring records of the regional pharmacists' activities during fiscal year 2008. The monthly tracking reports the Commission provided to auditors for fiscal year 2008 were incomplete and included activities only through March 2008.

The Commission also did not ensure that the claims processing system at the Vendor Drug program service provider was operating as intended during fiscal year 2008. In fiscal year 2007, the Commission had a Statement on Auditing Standards No. 70 (SAS 70) review conducted on the service provider's claims processing system. As of September 2008, the Commission was finalizing a plan to address the issues identified in that review. The Commission made \$2.45 billion in Vendor Drug program expenditures during fiscal year 2008. On December 11, 2008, the Commission contracted with a

vendor to perform a SAS 70 review of the service provider's claims processing system for fiscal year 2008 and a portion of fiscal year 2009 (through December 2008).

Managed Care Plans

The Medicaid/Children's Health Insurance Program (CHIP) Division did not approve and sign off on all purchase vouchers related to managed care plan payments. Of 18 vouchers tested, 14 (77.8 percent) were not approved. As a result, the Medicaid/CHIP Division was not fully aware of the final amounts that were paid to the managed care organizations it oversees.

The Commission's Internal Audit Division also identified this issue in its *Audit of Medicaid/CHIP Division Managed Care Contract Monitoring Processes* (April 2008). Eight of the 18 vouchers tested that did not have program approval were paid after that internal audit report was published.

Recommendations

The Commission should:

- Continue to enhance its monitoring to ensure that payments for public assistance programs are allowable and paid to eligible clients. Monitoring could encompass activities within the Commission and should include, but not be limited to, the following programs: the Vendor Drug program, Medicaid, and CHIP.
- Ensure that contracted service providers report accurate financial information by either contracting for an independent review of service providers' automated systems or requiring Commission employees to perform sufficient testing of service providers' automated systems.
- Ensure that all payments made on behalf of Medicaid and CHIP programs are approved and signed by the appropriate Medicaid/CHIP Division staff.

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. (The Food Stamp Program is now referred to as the Supplemental Nutrition Assistance Program, SNAP). Management's control structure is augmented by oversight activities

performed by the HHSC Office of Inspector General (OIG), 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 2008, the following actions have subsequently been completed or are underway to provide additional controls over public assistance program expenditures.

Vendor Drug Program

Regional Pharmacists

According to the SAO Biennial Report on the State's Position Classification Plan (Report No. 09-701, October 2008), salaries of state pharmacists are approximately 27 percent lower than for equivalent positions in the marketplace. Despite the salary disparity, HHSC has had some success. In May 2008, HHSC hired a Vendor Drug Program Field Pharmacist Manager, whose primary focus has been to fill the vacant pharmacist positions. As a result, in December 2008 and January 2009, HHSC hired two pharmacists for the state's most populous region, Houston. On two separate occasions, pharmacists accepted offers for the San Antonio position, but then declined before the start date. HHSC's recruiting efforts continue to focus on filling four remaining vacancies. In addition, due to the competitive disadvantage experienced by HHSC in the marketplace, HHSC is exploring the possibility of hiring pharmacy technicians in lieu of pharmacists for these positions.

In addition to the Field Pharmacist Manager, HHSC hired a Regional Administrative Coordinator during fiscal year 2008. Both the manager and the coordinator are actively working with field staff to increase the level of standardization and compliance with procedures. In September 2008, HHSC began collecting monthly tracking statistics from all regional offices.

Responsible Person: Deputy Director for Medicaid/CHIP Vendor Drug Program

Implementation Date: December 2009 - Fill four regional pharmacist vacancies

Contracted Vendor Drug Service Provider

HHSC contracted with a vendor to perform a SAS 70 Level II review of the Pharmacy Claims and Rebate Administrator's (PCRA) system. The review period includes fiscal year 2008 and the first four months of fiscal year 2009. The vendor will review the PCRA system to determine the status of issues identified during the fiscal year 2007 SAS 70 and to report any new control weaknesses. To address reported issues, HHSC will take appropriate action, as allowed under the contract, including placing the Vendor Drug Service Provider under a corrective action plan.

To provide additional oversight and to determine whether the PCRA system is operating correctly, Vendor Drug Program staff is implementing a process to periodically review a random sample of claims.

Responsible Person: Deputy Director for Medicaid/CHIP Vendor Drug Program

Implementation Date: September 2009

Managed Care Operations

Managed Care Plan Payments

The Medicaid/CHIP Division is collaborating with Commission IT to fully automate the premium payment process across all managed care programs. The process will include review and authorization by Medicaid/CHIP Division staff prior to the processing of premium payments through HHSC's financial accounting system.

In the interim, the Medicaid/CHIP Division is employing an enhanced manual process to ensure Medicaid/CHIP Division staff review and approve all managed care organization payments prior to processing.

Responsible Person: Deputy Director for Managed Care Operations

Implementation Date: February 2010

Issue 2

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

Reference No. 09-555-09
(Prior Audit Issues 08-555-08, 07-555-04, and 06-555-09)

Type of finding: Significant Deficiency

The Commission has continued to operate two key accounting functions since fiscal year 2005 without documented policies and procedures. These key accounting functions are related to the recording of public assistance payments. Specifically, the Commission does not have documented policies and procedures for:

- Recording and approving Medicaid and CHIP expenditures.
- Recording and approving Vendor Drug program expenditures.

The Commission began developing draft policies and procedures for these two key functions during fiscal year 2008; however, the draft policies and

procedures are not sufficiently detailed to enable an individual to perform these key functions in the absence of individuals currently performing the functions. The Commission has documented many of its other key accounting functions and has trained backup personnel to perform those functions.

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 document its policies and procedures for recording and approving Medicaid, CHIP, and Vendor Drug program expenditures.

Management's Response

HHSC has documented processes and procedures for both Fiscal Agent and Vendor Drug vouchers to ensure expenditures are recorded, approved, and processed in a timely manner.

HHSC will review these processes and procedures to ensure they include sufficient detail to enable staff who are familiar with similar processes to perform the tasks. Once this review is completed, the processes and procedures will be finalized and approved. HHSC will periodically review the processes and procedures to ensure they are up-to-date and appropriately address changes in the operating environment.

Responsible Person: Director of Fiscal Management

Implementation Date: August 2009

Issue 3

The Health and Human Services Commission Should Review User Access to the Uniform Statewide Accounting System and Ensure That Related Duties Are Properly Segregated

Reference No. 09-555-10
(Prior Audit Issues 08-555-10 and 07-555-05)

Type of finding: Significant Deficiency

The Commission does not adequately manage user access to the Uniform Statewide Accounting System (USAS). Specifically:

- Seven users have access to sensitive financial data; can enter, edit, and delete accounting transactions; and can release any accounting transactions in USAS.
- Eight users have user USAS class codes that conflict with their job duties. All eight users have access to transaction codes for accounts receivable and accounts payable and can enter, edit, and delete accounting transactions. In addition, three of these eight users also can release revenue transactions. This represents a weakness in segregation of duties, which increases the risk that inappropriate financial transactions could be made without detection.
- Four users have higher access levels in USAS than is appropriate for their job titles.

In fiscal year 2008, 385 documents totaling \$9,873,973 were entered and/or modified and released by the same individual. Without mitigating controls, this increases the risk that intentional or unintentional errors could go undetected.

Recommendations

The Commission should:

- Continue to implement its process to identify individuals for whom access should be adjusted, including individuals whose employment has been terminated.
- Develop and implement procedures to monitor and mitigate the risk of employees performing incompatible duties and consider using USAS reports to monitor user access.

Management's Response

HHSC has documented policies and procedures to monitor employees whose USAS access rights should be terminated or adjusted. These procedures include monthly review of user accounts for terminated employees. HHSC will ensure that documented procedures include periodic confirmation from management that user access privileges are appropriate. For example, user access privileges would be modified when there are changes in responsibilities or transfers out of the business area.

HHSC has written policies and procedures to monitor and minimize the risks associated with the activities of individuals with entry, edit, delete, and release capabilities in USAS. These procedures include (1) monthly management review of a USAS report listing edited and released USAS transactions and (2) retention of documentation supporting the edits.

HHSC will review USAS security controls to determine whether current access levels can be further restricted. Once the review is completed, policies and procedures will be finalized and approved. HHSC will periodically review these policies and procedures to ensure they are up-to-date and appropriately address changes in the operating environment.

HHSC has performed job audits on the four positions with higher access levels in USAS than appropriate for their job title. These individuals' responsibilities and job titles are now aligned with their access privileges in USAS.

Responsible Person: Director of Fiscal Management

Implementation Date: August 2009

Issue 4

The Health and Human Services Commission Should Disclose the Potential Financial Liability Associated with the Open Investigations of Its Office of Inspector General

Reference No. 09-555-11
(Prior Audit Issue: 08-555-09)

Type of finding: Significant Deficiency

The Commission does not adequately track its Office of Inspector General's open investigations to determine related dollar amounts overpaid to providers for these cases.

As of August 31, 2008, the Commission's list of active open investigation cases included 3,646 cases. Due to their complexity, it takes more than one year to investigate the majority of those cases. The Commission did not analyze these cases to determine whether it should report them in its annual financial report as contingent liabilities. This resulted in the Commission not reporting a contingent liability in its annual financial report for fiscal year 2008. After this was brought to the Commission's attention, it provided a contingent liability note to the Office of the Comptroller of Public Accounts (Comptroller's Office) for inclusion in the State's Comprehensive Annual Financial Report for fiscal year 2008.

Contingent Liability

A loss contingency arising from a claim must be disclosed when it is reasonably possible that a loss will eventually be incurred and if it is either not probable or not subject to reasonable estimation. The disclosure should indicate the nature of the contingency and give an estimate of the possible loss or range of loss. However, if an estimate of the loss cannot be made, the disclosure must state this fact.

A loss contingency arising from a claim is accrued as of the balance sheet date when both of the following conditions are true:

- Information available before the financial statements are issued indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements. It must be probable that one or more future events will also occur confirming the fact of the loss.
- The amount of the loss can be reasonably estimated.

Source: *Reporting Requirements for Annual Financial Reports of State Agencies and Universities*, Office of the Comptroller of Public Accounts, July 2008.

The Comptroller's Office requires that notes to the financial statements communicate information that is necessary for a fair presentation of the financial position and the results of operations, but not readily apparent from, or not included in, the financial statements themselves (see text box for additional details).

Recommendation

The Commission should comply with the Comptroller's Office's requirement to prepare financial statements that are presented fairly and that include all required notes.

Management's Response

HHSC management drafted a contingent liability footnote addressing this issue and submitted it to the Comptroller's Office. The note was incorporated into the fiscal year 2008 annual financial report, and future reports will contain the same contingent liability disclosure.

Responsible Person: Inspector General, HHSC Office of Inspector General and Director of Fiscal Management

Implementation Date: Complete

Issue 5

The Health and Human Services Commission Should Accrue Necessary Expenditures

Reference No. 09-555-12

Type of finding: Significant Deficiency

Medicaid Upper Payment Limit

The Medicaid Upper Payment Limit requires that the Medicaid agency find that the estimated average proposed payment rate is reasonably expected to pay no more in the aggregate for inpatient hospital services or long-term care facility services than the amount that the agency reasonably estimates would be paid for the services under the Medicare principles of reimbursement.

Source: Title 42, Code of Federal Regulations, Section 447.253 (b) (2).

In fiscal year 2008, the Commission did not accrue \$430.3 million in expenditures with a fiscal year 2008 service date related to the Medicaid Upper Payment Limit (see text box) program, which it oversees. The Commission accrued the necessary expenditures in previous fiscal years.

After this issue was brought to the Commission's attention, the Commission prepared an adjustment to accrue the necessary expenditures. In future fiscal years, the Commission has asserted it will provide the adjustment to the Comptroller's

Office.

According to the Comptroller's Office's *Reporting Requirements for Annual Financial Reports of State Agencies and Universities*, expenditures should be recognized as soon as a liability is incurred, regardless of the timing of related cash flows.

Recommendation

The Commission should establish a process to ensure it reports any updated accrual information for unpaid expenditures to the Comptroller's Office as soon as practical.

Management's Response

HHSC has a process in place to ensure it reports UPL expenditures each year to the Comptroller's Office as a component of its annual Accounts Payable estimation.

Responsible Person: Director of Fiscal Management

Implementation Date: Complete

Issue 6

The Health and Human Services Commission Should Strengthen Password Requirements for its Premiums Payable System

Reference No. 09-555-13

Type of finding: Significant Deficiency

The Commission should strengthen the password requirements for its Premiums Payable System (PPS). Passwords for that system are not required to have a minimum length and do not have a system-enforced requirement to change the passwords at regular intervals. The PPS also does not maintain a history to prevent reuse of recent passwords. In addition, 7 (63.6 percent) of the 11 user accounts on the PPS online application are generic accounts. Use of generic user accounts prevents accountability for user actions and places the Commission's data at risk of unauthorized changes.

Title 1, Texas Administrative Code, Section 202.25(3)(A), requires that "each user of information resources shall be assigned a unique identifier except for situations where risk analysis demonstrates no need for individual accountability of users. User identification shall be authenticated before the information resources system may grant that user access." Title 1, Texas Administrative Code, Section 202.25(3)(D), requires that "Information

resources systems which use passwords shall be based on industry best practices on password usage and documented state agency security risk management decisions.”

The Commission informed auditors that it is replacing the PPS with a new system that has up-to-date security. The new system is expected to be in production after finalization of the State Data Center environment.

Recommendation

The Commission should ensure that the new system complies with Texas Administrative Code requirements.

Management's Response

In January 2009, Commission IT completed the migration of the Premiums Payable System (PPS) from the mainframe to a server-based platform. The risk identified in the audit has been mitigated by disabling access controls to the application. In the interim, access to system information is being fulfilled through ad hoc queries developed by authorized Commission IT programming staff. When PPS is enhanced and fully functional, system access will be controlled through a web-based solution that utilizes an identity management tool which fully complies with all Texas Administrative Code requirements, including strong eight character passwords, forced changing of passwords, role based security, and elimination of generic accounts.

To implement planned enhancements, Commission IT is dependent on IBM's Team for Texas, the state data center provider, to establish adequate development, test, and production environments. A formal request for these environments was made in July 2008. To date, no delivery date has been provided for these environments. Once these environments are available, the web-based solution can be implemented within 90 days.

Responsible Person: Director of Commission IT in coordination with the Deputy Director for Managed Care Operations

Implementation Date: 90 days after delivery of data center environments by IBM's Team for Texas

The University of Texas at Austin Should Strengthen Certain Aspects of Its Financial Operations

Issue 1

The University of Texas at Austin Should Strengthen its Inventory Controls

Reference No. 09-555-14
(Prior Audit Issue 08-555-15)

Type of finding: Significant Deficiency

The University of Texas at Austin (University) did not always follow state property accounting requirements established by the Office of the Comptroller of Public Accounts. Specifically:

- As of August 15, 2008, the University had not entered 799 capital assets valued at \$41.4 million into the inventory system as a permanent inventory record. This amount includes a single item for \$22.8 million. Of those capital assets, 644 with a value of \$38.4 million were purchased between September 5, 2007 and July 15, 2008. However, this activity was reflected in the August 31, 2008 financial statements. Inventory information should be entered on a timely basis into the permanent record of the item to ensure that inventory records are accurate and current.
- According to the University's Inventory Services unit, purchased items are required to be tagged within 30 days of receipt. Although the University's training documents include this expectation, the University had not updated its Handbook of Business Procedures (Handbook) to reflect this expectation as of September 2, 2008. Currently, the University Handbook has been updated and accurately reflects the tagging requirement.

Excerpts from the *SPA Process User's Guide*

Capital assets should be recorded at their historical costs, which include invoice, sales tax, initial installation costs, modifications, attachments, accessories or apparatus necessary to make the asset usable and render it into service. Historical costs also include ancillary charges, such as freight and transportation charges, site preparation costs, and professional fees.

Incidental charges, such as extended warranties or maintenance agreements, additional parts, or consumable items are no longer considered part of the capital asset cost.

Source: *SPA Process User's Guide*, Office of the Comptroller of Public Accounts, February 2008.

- The University did not correctly value 8 (21.6 percent) of 37 assets that auditors tested. Specifically:
 - ♦ The University did not account for \$3,742 in discounts when valuing 1 (2.7 percent) of the 37 assets that auditors tested.
 - ♦ The University incorrectly expensed 1 (2.7 percent) of the 37 assets that auditors tested. The asset, purchased for \$2,125, was necessary for the operation of equipment and should have been capitalized as required by the *SPA Process User's Guide* (see text box for additional details).
 - ♦ The University did not correctly value 4 (10.8 percent) of the 37 assets that auditors tested. These four assets had freight costs of \$671 that should have been capitalized as required by the *SPA Process User's Guide* (see text box for additional details).

- ♦ The University incorrectly capitalized \$1,758 in information technology support and maintenance costs associated with 2 (5.4 percent) of the 37 assets that auditors tested. These costs should have been expensed as required by the *SPA Process User's Guide* (see text box on the previous page for additional details).
- The University asserted that it reconciles its fixed asset system to the State Property Accounting (SPA) system on an annual basis, rather than on a quarterly basis. According to the *SPA Process User's Guide*, the University, as a reporting agency, should reconcile balances from its fixed assets system to the SPA system on a quarterly basis, and reconciling items identified should be cleared (that is, corrections should be made) as soon as possible. All reconciling items should be cleared before the preparation of the capital asset note in the financial statements.

Ensuring that accurate information is entered into the University's fixed asset system and the SPA system helps to ensure that capital asset balances, depreciation, and accumulated depreciation are reported accurately on the State's Comprehensive Annual Financial Report.

Recommendations

The University should:

- Conduct an independent verification of department inventory records throughout the fiscal year.
- Update permanent inventory records on a timely basis. As part of this effort, the Inventory Services unit should periodically monitor the assets that departments purchase to ensure that departments submit inventory information and that inventory tags are assigned to capitalized assets within 30 days of receipt.
- Develop written policies and procedures for accounting for freight, maintenance costs, and discounts. Specifically, it should:
 - ♦ Capitalize the shipping and handling costs associated with capital assets.
 - ♦ Capitalize all modifications, attachments, accessories or apparatus necessary to make assets usable and render them into service.
 - ♦ Expense service agreement costs (rather than capitalizing those costs) that are associated with capital assets if the warranty costs or service agreement costs are listed as separate line items on the purchase order or invoices.
 - ♦ Ensure it takes all discounts on assets.

- Strengthen guidance available to departments that are responsible for recording and tagging assets.
- Reconcile its fixed asset system to the SPA system on a quarterly basis.

Management's Response

The University concurs with the finding.

Spot audits of department inventory records will begin in April, 2009. This will allow Inventory Services to monitor, and provide additional guidance to departments, regarding tagging requirements and the need for timely submission of inventory information. The Handbook of Business Procedures has been updated accordingly.

There are many factors that contribute to the lateness of entering assets into the University's computerized inventory system. One issue is that the system design requires that it be closed at year-end to daily processing in order to perform fiscal year end procedures, and then reopened in late October. During that time departments and Inventory Services continue to tag items that are received by the University. The system close creates a delay in processing the permanent records by Inventory Services. In addition to the needed design changes to the University's electronic inventory system, other changes are needed to expedite the time it takes to enter each item into the inventory system including policy changes to allow the item serial number to function as the official University tag number, and better integration between the inventory system, the University's procurement systems, and departmental procedures. This is a long-term initiative and will involve communications with the State Comptroller, software modifications, and procedural modifications throughout the community. Resource availability is limited during the current hiring freeze and it is unlikely that all of this can be accomplished by the end of this fiscal year. The University will immediately begin spot testing purchases of capital and controlled items to address the procedural delays in the university community; however, full implementation of the inventory system design and integration will not be completed until the following fiscal year end, August 31, 2010.

The Handbook of Business Procedures has been updated to reflect the appropriate processing of shipping, handling, service agreements, maintenance costs, and warranty costs. The Handbook will be updated in May 2009 to include accounting policies for capitalizing modifications and attachments used for making an asset serviceable. Training has been provided to the Office of Accounting staff on how to correctly account for these costs including discounts. The University will continue to enhance written procedures and training for these costs.

Inventory data from the University's system is sent to SPA electronically via data uploads on a monthly basis. Data quality issues and limited staffing resources have prohibited more frequent reconciliations and made the current process manual and time consuming. The University is addressing the data quality issues utilizing the University's IQ (data warehousing) System and improving the automation processes in order to maximize limited resources. The University will develop and implement a plan by December 2009.

Responsible Person: Finance Manager, Inventory Services

Implementation Dates:

Handbook of Business Procedures updates May 2009

Quarterly reconciliation implementation December 2009

Inventory system design changes for year-end processing August 2010

Chapter 1-F

The University of Texas at San Antonio Should Strengthen Certain Aspects of Its Financial Operations and Information Technology

Issue 1

The University of Texas at San Antonio Should Strengthen Its Capital Asset Records

Reference No. 09-555-15

Type of Finding: Significant Deficiency

The University of Texas at San Antonio (University) did not always follow state property accounting requirements established by the Office of the Comptroller of Public Accounts (Comptroller's Office). Specifically:

- The University did not have documentation supporting the acquisition costs for 21 (43.8 percent) of 48 assets that auditors tested. The University's record retention policy requires the University to maintain this documentation for the fiscal year in which it purchased an asset plus three years. However, the Comptroller's Office's *SPA Process User's Guide* and the Library and Archive Commission's *Texas State Records Retention Schedule* require state entities to maintain property records for the life of the asset plus three years. The University acquired these 21 assets between June 1993 and August 2004, which was beyond the retention requirements of the University's record retention schedule but still within the retention requirements of the *SPA Process User's Guide* and the *Texas State Records Retention Schedule*. Six of the 21 assets were fully depreciated. Auditors performed additional procedures to substantiate the asset balances for the remaining 15 assets.

- The University made numerous clerical errors (including posting errors, incorrect classifications of furniture as building costs, and calculation errors) in the schedules within its annual financial report that related to buildings and depreciation. Auditor testing determined that the University overstated capital assets by \$164,249 or 0.02 percent, overstated depreciation expenses by \$296,194 or 1.1 percent, and understated accumulated depreciation by \$290,013 or 0.1 percent on its fiscal year 2008 annual financial report. The University’s financial statements reported \$849,566,355 in capital assets; \$26,317,313 in total depreciation and amortization expenses; and \$220,181,573 in total accumulated depreciation for fiscal year 2008.

Ensuring that accurate information is entered into the University’s fixed asset system and the State Property Accounting system helps to ensure that capital asset balances, depreciation, and accumulated depreciation are reported accurately on the State’s Comprehensive Annual Financial Report.

Recommendations

The University should:

- Follow the *SPA Process User’s Guide* and the *Texas State Records Retention Schedule* and retain invoices and documentation for capital assets for the life of the asset plus three years.
- Strengthen its process to review supporting documentation for capital asset purchases and the accumulation of construction costs for buildings.

Management’s Response

The University does not agree that the issues raised by the State Auditor rise to the level of a significant deficiency as defined by the American Institute of Certified Public Accountants. The SPA Process User’s Guide and the Library and Archive Commission’s Texas State Records Retention Schedule requires that a property record be maintained for the life of the asset plus three years. Neither of these documents defines the term “property record.” We interpret a property record to include: the carrying value of the asset, the useful life, a description of the asset, the acquisition date, and other pertinent information.

Further, there are specific sections in the Texas State Records Retention schedule related to invoicing, pricing, and other records of expenditures that require only Fiscal Year End plus three years retention including:

<i>4.1.002 Billing Detail</i>	<i>FE + 3 years</i>
<i>4.1005 Inventory and Other Cost Files (pricing)</i>	<i>FE + 3</i>

4.2.005 Purchase Vouchers (invoices or statements) FE + 3 years

We do not believe that the SPA Process User's Guide and the Library and Archive Commission's Texas State Records Retention Schedule requires the retention of invoices and other documents as supporting evidence for capital assets to be retained for the life of the asset plus three years. Within UTSA's financial accounting system, the Inventory module receives an electronic feed of data directly from the Accounting module whenever capital inventory object codes apply to an expenditure voucher. As such, certification of the invoice amount and review of the asset pricing is performed when the payment voucher is approved by a central module in detailed format, including cost, acquisition date and other pertinent information. Before an inventory tag is used by the University's central Capital Asset management staff, the existence of the asset is verified. We believe this data comprises the official UTSA property record which is maintained in our database for the life of the asset plus three years. We will continue to work with the State Comptroller's office to determine the type of evidence to meet the requirements outlined in the SPA Process User's Guide and the Library and Archive Commission's Texas State Records Retention Schedule.

The capital outlay analysis process is a manual process that will be reviewed to minimize the potential for clerical errors. The journal entry to record capital assets will be broken down by buildings as opposed to lump sum. The detailed entry will enable a more in-depth review and should ensure that assets are added to the correct classification and carried forward accurately between schedules. In addition, a closer review will be completed by appropriate Accounting management to minimize errors in depreciation and accumulated depreciation.

Responsible Person: Associate Vice President for Financial Affairs

Implementation Date: August 2009

Issue 2

The University of Texas at San Antonio Should Restrict Access to the Uniform Statewide Accounting System

Reference No. 09-555-16

Type of Finding: Significant Deficiency

Title 1, Texas Administrative Code, Section 202.20(1)

Information resources residing in the various state agencies of state government are strategic and vital assets belonging to the people of Texas. These assets must be available and protected commensurate with the value of the assets. Measures shall be taken to protect these assets against unauthorized access, disclosure, modification or destruction, whether accidental or deliberate, as well as assure the availability, integrity, authenticity, and confidentiality of information. Access to state information resources must be appropriately managed.

In fiscal year 2008, five users at the University had inappropriate access rights to the Uniform Statewide Accounting System (USAS, the State's accounting system). These users had the ability to enter, edit, and release transactions. The ability to perform all three of these actions in USAS enables users to alter data.

After auditors brought this issue to the University's attention, it removed the release access rights for these five users. University management asserted that these five users do not release transactions into USAS in accordance with their job descriptions.

Recommendation

The University should:

- Restrict access to USAS to the level necessary for each user's job functions.
- Restrict access granted to USAS to a level that provides for proper segregation of duties.

Management's Response

USAS access was corrected in February 2009 to restrict access to each authorized user's specific job responsibilities and to assure proper segregation of duties. Additionally, an internal access request form was developed, which will be approved by the employee's Director and the Assistant Vice President, Financial Affairs and Controller. The access request form will ensure access to USAS is necessary for the employee's job function and that there is proper segregation of duties. An annual review will also be conducted.

Responsible Person: Associate Vice President for Financial Affairs

Implementation Date: February 2009, with the access form to be implemented immediately and the annual review performed each August.

The University of Texas Southwestern Medical Center at Dallas Should Strengthen Certain Aspects of Its Financial Operations

Issue 1

The University of Texas Southwestern Medical Center at Dallas Should Strengthen Its Capital Asset Records

Reference No. 09-555-17

Type of finding: Significant Deficiency

The University of Texas Southwestern Medical Center at Dallas (Medical Center) did not always follow state property accounting requirements established by the Office of the Comptroller of Public Accounts and its own policies. Specifically:

- The Medical Center did not value 3 (5.6 percent) of 54 assets that auditors tested using a reasonable method. The three assets were works of art that the Medical Center valued at \$301,376 (one of the assets was valued at \$300,000). The Medical Center based the value of these donated assets on the donor's assertion of their value. According to the Office of the Comptroller of Public Accounts' *SPA Process User's Guide* (February 2008), donated property must be recorded at its estimated fair market value on the date of acquisition using a reasonable method. The method must be fully documented, maintained on file, and reported to the State Property Accounting (SPA) system. Examples of reasonable methods include the use of appraisals, tax assessment records, manufacturer price lists, and industry publications.
- The Medical Center capitalized and depreciated 1 (1.9 percent) of 54 assets that auditors tested, rather than expensing it in accordance with its unofficial policy. As a result, the Medical Center overstated capital assets by \$62,700 and overstated accumulated depreciation by \$18,661 on its fiscal year 2008 financial statements. The Medical Center did not consistently follow its unofficial policy of expensing research and laboratory animals after they are purchased.
- Auditors were unable to locate 2 (3.7 percent) of 54 assets that auditors tested. One asset was the laboratory animal discussed in the preceding bullet, and the other asset was a piece of equipment that the Medical Center had salvaged but had not removed from its fixed asset system. According to the *SPA Process User's Guide*, state entities should maintain a detailed description of the exact location of assets and update the location as necessary.
- The Medical Center did not have documentation supporting the acquisition costs for 4 (7.4 percent) of 54 assets that auditors tested. The Medical Center acquired these 4 assets at least 10 years ago. According to the *SPA Process User's Guide* and the Library and Archive Commission's

Texas State Records Retention Schedule, state entities are required to maintain property records for the life of the asset plus three years.

- The Medical Center did not have documentation supporting the disposal of 15 (50 percent) of 30 fiscal year 2008 asset disposals that auditors tested. As discussed above, the *SPA Process User's Guide* requires that property records be maintained for the life of the asset plus three years. Specifically:
 - ♦ The Medical Center disposed of 7 (46.7 percent) of the 15 assets by having an auctioneer sell the assets. However, the assets were not individually identified in the receipts the Medical Center received from the auctioneer. Starting in fiscal year 2009, the Medical Center asked the auctioneer to individually identify the assets in each lot on receipts.
 - ♦ Other than screen prints from its fixed asset system, the Medical Center did not have supporting documentation for 8 (53.3 percent) of the 15 assets.
- Of the 30 fiscal year 2008 asset disposals that auditors tested, auditors determined that one asset had been disposed of in the prior fiscal year. The Medical Center had disposed of this asset in April 2007, but it did not remove the asset from its fixed assets system until April 2008. According to the *SPA Process User's Guide*, once property is disposed of it should be removed from the fixed asset system.
- The Medical Center did not expense warranty costs for two assets. The warranty costs associated with these two assets totaled \$83,060. As a result of this issue, the Medical Center overstated accumulated depreciation by \$6,222 on its fiscal year 2008 financial statements. According to the *SPA Process User's Guide*, warranty costs should be expensed if they are itemized on the invoice or purchase order. In addition, the Medical Center did not deduct a credit of \$1,087 from the acquisition cost of one of these assets.

Ensuring that accurate information is entered into the Medical Center's fixed asset system and the SPA system helps to ensure that capital asset balances, depreciation, and accumulated depreciation are reported accurately on the State's Comprehensive Annual Financial Report.

Recommendations

The Medical Center should:

- Use a reasonable assessment when determining the value of donated capital assets.

- Apply all credits to the acquisition cost of assets.
- Follow the *SPA Process User's Guide* and the *Texas State Records Retention Schedule* and retain invoices and documentation for capital assets for the life of the asset plus three years.
- Maintain documentation supporting the removal of assets from its fixed asset system.
- Remove assets from its fixed asset system in the fiscal year in which it disposes of the assets.
- Expense warranty costs (rather than capitalizing those costs) associated with capital assets when the warranty costs are listed as separate line items on purchase orders or invoices.

Management's Response

We agree with the recommendation. We will implement the recommendations outlined in the report to ensure capital assets are accurately recorded, documentation is adequately maintained, and assets are properly disposed.

Responsible Person: Assistant Vice President for Materials Management

Implementation Date: April 1, 2009

Issue 2

The University of Texas Southwestern Medical Center at Dallas Should Strengthen Its Patient Billing Process

Reference No. 09-555-18

Type of finding: Significant Deficiency

The Medical Center did not review and address in a timely manner uncharged outpatient transactions for the two hospitals that it manages. Unbilled outpatient transactions are identified on the Medical Center's *Discharged Not Final Billed Report*.

As of August 31, 2008, the Medical Center had not billed for 6,126 patient accounts with charges totaling \$7,151,027 (see Table 1 on the next page).

Table 1

Summary of Accounts for which the Medical Center Had Not Billed As of August 31, 2008		
Number of Days Account Had Not Been Billed	Number of Accounts	Balance
0-30 days	3,341	\$4,657,184
31-60 days	1,548	1,232,488
61-90 days	212	318,147
More than 90 days	1,025	943,208
Totals	6,126	\$7,151,027

Of the 1,025 accounts for which the Medical Center had not billed for more than 90 days, 194 (18.9 percent) were from fiscal years 2005, 2006, and 2007. These 194 accounts represented 23.1 percent or \$217,530 of the total balance of accounts not billed for more than 90 days. According to Medical Center personnel, 13 of the accounts were previously billed.

In addition, numerous patient accounts did not have associated billing amounts. As a result, it was not possible to determine from the *Discharged Not Final Billed Report* how much these patients owed the Medical Center. Some of these accounts had registration dates from October 2004.

There are several reasons that the Medical Center may not have billed an account. For example:

- In some cases, doctors have not provided a final diagnosis.
- The Medical Center sometimes places holds on accounts because the accounts are awaiting insurance verification, lack an emergency room level charge, or are awaiting the entry of a national drug code for Medicaid.

Recommendation

The Medical Center should review and address in a timely manner its uncharged outpatient transactions.

Management's Response

We agree with the recommendation. We will review and address unbilled transactions in a timely manner.

Responsible Person: Director Patient Financial Services Hospital Administration

Implementation Date: April 1, 2009

Chapter 1-H

Agencies and Higher Education Institutions Should Strengthen Their Reviews of Their Schedules of Expenditures of Federal Awards

Reference No. 09-555-19

Type of finding: Significant Deficiency

Schedule of Expenditures of Federal Awards (SEFA)

Each agency, college, and university that expends federal awards is required to prepare a Schedule of Expenditures of Federal Awards (SEFA). Federal awards include federal financial assistance and federal cost-reimbursement contracts that non-federal entities receive directly from federal awarding agencies or indirectly from pass-through entities [Office of Management and Budget (OMB) Circular A-133, Section .105].

Federal financial assistance includes any assistance that non-federal entities receive or administer in the form of grants, loans, loan guarantees, property (including donated surplus property), cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, and other assistance (OMB Circular A-133, Section .105).

Source: *Reporting Requirements for Annual Financial Reports of State Agencies and Universities*, Office of the Comptroller of Public Accounts, July 2008.

The agencies and higher education institutions listed in Table 2 did not perform an adequate review of their fiscal year 2008 Schedules of Expenditures of Federal Awards (SEFAs) (see textbox for additional information).

Because they did not perform an adequate review, the SEFAs these agencies and higher education institutions submitted to the Office of the Comptroller of Public Accounts (Comptroller’s Office) contained errors. Table 2 summarizes the errors auditors identified in these agencies’ and higher education institutions’ fiscal year 2008 SEFA.

The 22 agencies and higher education institutions listed below reported \$7.7 billion in federal expenditures, or 21.9 percent of the total federal expenditures reported by the State of Texas for fiscal year 2008. The errors listed

below were not material to the fiscal year 2008 SEFA for the State of Texas or to the fiscal year 2008 Comprehensive Annual Financial Report for the State of Texas.

Table 2

Summary of Errors Identified in Agency and Higher Education Institution Fiscal Year 2008 SEFAs								
Agency or Higher Education Institution	Incorrect Program Clustering ^a	Incorrect Pass-through Reporting ^b	Incorrect Preparation of SEFA Using Revenues ^c	Incorrect Classification of Expenditures ^d	Incorrect Exclusion of Expenditures ^e	Errors in Notes to the SEFA ^f	Inadequate Support ^g	Incorrect Exclusion of Indirect Cost Recovery ^h
Angelo State University	X							
Department of Agriculture		X		X	X			X
Department of Public Safety	X			X	X			

Summary of Errors Identified in Agency and Higher Education Institution Fiscal Year 2008 SEFAs

Agency or Higher Education Institution	Incorrect Program Clustering ^a	Incorrect Pass-through Reporting ^b	Incorrect Preparation of SEFA Using Revenues ^c	Incorrect Classification of Expenditures ^d	Incorrect Exclusion of Expenditures ^e	Errors in Notes to the SEFA ^f	Inadequate Support ^g	Incorrect Exclusion of Indirect Cost Recovery ^h
Department of State Health Services			X	X				X
Department of Transportation		X						
Parks and Wildlife Department			X					
Texas A&M University	X							
Texas A&M University - Corpus Christi	X		X					
Texas AgriLife Research	X			X				
Texas Southern University	X				X			
Texas State University - San Marcos	X			X				
Texas Tech University				X				
University of North Texas Health Science Center at Fort Worth	X			X				
The University of Texas at Austin	X			X				
The University of Texas at Dallas	X							
The University of Texas at El Paso						X		
The University of Texas of the Permian Basin	X			X				
The University of Texas Southwestern Medical Center at Dallas				X		X		

Summary of Errors Identified in Agency and Higher Education Institution Fiscal Year 2008 SEFAs

Agency or Higher Education Institution	Incorrect Program Clustering ^a	Incorrect Pass-through Reporting ^b	Incorrect Preparation of SEFA Using Revenues ^c	Incorrect Classification of Expenditures ^d	Incorrect Exclusion of Expenditures ^e	Errors in Notes to the SEFA ^f	Inadequate Support ^g	Incorrect Exclusion of Indirect Cost Recovery ^h
The University of Texas Health Science Center at Houston				X				
The University of Texas Health Science Center at San Antonio	X							
The University of Texas Medical Branch at Galveston	X			X			X	
West Texas A&M University	X							

^a Reported federal programs in an incorrect cluster. Texas Southern University incorrectly included one federal program on its SEFA. That program should have been reported by the Higher Education Coordinating Board on its SEFA.

^b Incorrectly classified expenditures as direct expenditures. The expenditures should have been classified as "Pass-Through to Non-State Entities" and "Pass-Through to Agencies or Universities."

^c Incorrectly prepared SEFA using federal revenues rather than expenditures.

^d Incorrectly classified expenditures between federal programs.

^e Texas Southern University did not include all federal expenditures from its general ledger. The Department of Agriculture and the Department of Public Safety did not include accrued expenditures on their SEFAs.

^f The University of Texas Southwestern Medical Center at Dallas incorrectly excluded the ending balance of previous year's loan for one program in the notes to their SEFA. Summaries of the prior year ending loan balances and new loans are required to be presented in the SEFA. The University of Texas at El Paso incorrectly classified an expenditure between federal programs in the reconciliation note to its SEFA.

^g On September 13, 2008, Hurricane Ike led to an extended closure of the University of Texas Medical Branch at Galveston (Medical Branch). During the transportation of files, the Medical Branch misplaced or misfiled some documents that supported the amounts on its SEFA.

^h Did not include indirect cost recovery.

Performing an adequate review of their SEFAs and supporting documentation would help the agencies and higher education institutions ensure that the SEFA information they submit to the Comptroller's Office is accurate.

Recommendation

Agencies and higher education institutions should implement an adequate review process to ensure that the SEFA information they submit to the Comptroller's Office is accurate.

Summary of Management's Responses

The agencies and higher education institutions to which auditors addressed the recommendation agreed with the recommendation. Responses from each agency and higher education institution are presented in Appendix 3.

Federal Award Findings and Questioned Costs

A finding regarding the Schedule of Expenditures of Federal Awards for fiscal year 2008 was included in Chapter 1-H of this report. All other fiscal year 2008 federal award information was issued in a separate report. See *State of Texas Federal Portion of the Statewide Single Audit Report for the Fiscal Year Ended August 31, 2008*, by KPMG LLP, dated February 20, 2009.

Summary Schedule of Prior Audit Findings

*State of Texas Financial Portion of the
Statewide Single Audit Report for the
Year Ended August 31, 2008*

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:

- *An Audit Report on Financial Management at the Department of Health* (State Auditor’s Office Report No. 01-021, March 2001).
- *State of Texas Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2001* (State Auditor’s Office Report No. 02-555, May 2002).
- *State of Texas Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2002* (State Auditor’s Office Report No. 03-555, April 2003).
- *State of Texas Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2003* (State Auditor’s Office Report No. 04-555, March 2004).
- *State of Texas Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2004* (State Auditor’s Office Report No. 05-555, March 2005).
- *State of Texas Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2005* (State Auditor’s Office Report No. 06-555, March 2006).
- *State of Texas Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2006* (State Auditor’s Office Report No. 07-555, April 2007).
- *State of Texas Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2007* (State Auditor’s Office Report No. 08-555, April 2008).

The Summary Schedule of Prior Audit Findings (for the year ended August 31, 2008) has been prepared to address these responsibilities.

The Office of the Comptroller of Public Accounts Should Strengthen Certain Aspects of Its Financial and Information Technology Operations

Issue 1

The Treasury Division within the Office of the Comptroller of Public Accounts Should Strengthen Access Controls and Financial Reconciliations

Reference No. 08-555-01

Auditors identified weaknesses in access to automated systems and in financial reconciliations within the Treasury Division (Division) at the Office of the Comptroller of Public Accounts (Comptroller's Office).

The Division should improve how it grants access to automated systems.

The Division grants inappropriate access to its automated systems. Auditors reviewed access rights for automated systems that processed and reconciled \$47.2 billion in fiscal year 2007 and identified the following:

- Twenty-three developers had access rights that allowed them to modify and delete data in all eight automated systems.
- Thirteen staff, including executive assistants, could modify and delete data in all eight automated systems.
- For all eight automated systems, the Division assigned access rights to staff regardless of whether staff's job duties required this level of access. For three of the automated systems reviewed, more than 40 users could modify and delete data.
- Fifteen developers who were contracting with the Comptroller's Office were erroneously granted access to the Division's systems.

After auditors brought these matters to the Division's attention, the Division began to review the access levels for individuals and accounts and remove inappropriate access levels.

Title 1, Texas Administrative Code, Section 202.20 (1)

Information resources residing in the various state agencies of state government are strategic and vital assets belonging to the people of Texas. These assets must be available and protected commensurate with the value of the assets. Measures shall be taken to protect these assets against unauthorized access, disclosure, modification or destruction, whether accidental or deliberate, as well as to assure the availability, integrity, utility, authenticity, and confidentiality of information. Access to state information resources must be appropriately managed.

The Texas Administrative Code requires agencies to take measures to protect data from unauthorized access, disclosure, modification, or destruction, whether accidental or deliberate (see text box). Granting excessive access and not providing for proper segregation of duties increases the risk of fraud and potential service disruption.

Because the Division is responsible for processing billions of dollars in revenue, loss of interest on even a single day's interest due to data manipulation or destruction would affect state revenues. It is important to note, however, that nothing came to auditors' attention to indicate that automated systems

had been compromised. Although compensating manual controls could reduce the risk of undetected errors or fraud in the Division's financial system, auditors identified weaknesses in those controls, which are discussed below.

Treasury Accounting should consistently review reconciliations.

Performing financial reconciliations could mitigate the risks associated with the access weaknesses described above. However, Treasury Accounting, a unit within the Division, consistently reviews financial reconciliations that are completed on the same day every week. Therefore, it did not review 142 of 176 (80.7 percent) financial reconciliations tested.

Treasury Accounting staff perform more than 600 financial reconciliations per month. Reviewing these reconciliations helps to ensure that all cash paid to the State is accounted for and helps to maintain the integrity of accounting data. Auditors identified no errors in the reconciliations reviewed.

Corrective Action and Management's Response

See current year finding 09-555-02.

Issue 2

The Office of the Comptroller of Public Accounts Should Strengthen Procedures Regarding Central Profile Change Requests

Reference No. 08-555-02

The Application Security Section at the Comptroller's Office does not ensure that the proper segregation of duties exists for the central profile change request process. Of the 27 central profile change request forms auditors tested, 7 (26 percent) were initiated and approved by the same individual. The central profile change management process should be designed to ensure that all proposed system modifications are appropriately approved and that changes are tested and approved before they are placed into production.

In addition, not all of the 27 change request forms auditors tested contained all of the approvals required by the Comptroller's Office's policies and procedures. Specifically, 23 change request forms tested (85 percent) lacked the approvals that are required to facilitate the change request. The Uniform Statewide Accounting System security administrator review approval also was not obtained or documented on four (15 percent) of the change request forms tested.

Changes to state data should be managed appropriately. Improper or unauthorized changes could be made if the same individual requests and approves a change. In addition, the risk of inaccurate financial data decreases

when the required levels of approvals are obtained. Title 1, Texas Administrative Code, Section 202.20 (5), states “The integrity of data, its source, its destination, and processes applied to it must be assured. Changes to data must be made only in an authorized manner.” Additionally, Title 1, Texas Administrative Code, Section 202.20 (8), states “State agencies must ensure adequate controls and separation of duties for tasks that are susceptible to fraudulent or other unauthorized activity.”

Corrective Action and Management’s Response

See current year finding 09-555-03.

Issue 3

The Office of the Comptroller of Public Accounts Should Strengthen Its Review of the Consolidation Process for the Comprehensive Annual Financial Report

Reference No. 08-555-03

The Comptroller’s Office’s Financial Reporting Section does not consistently perform a thorough review of documentation that supports the process for consolidating financial data for the Comprehensive Annual Financial Report (CAFR). Auditors identified errors in consolidation adjustments, CAFR note disclosures, and calculations, as well as instances in which the CAFR did not agree with supporting documentation. Based on the audit, the Comptroller’s Office corrected these errors before finalizing the CAFR.

Performing a thorough review of the documentation that supports the process for consolidating financial data helps to ensure that all financial data is correct and helps to maintain internal consistency within the CAFR.

Corrective Action and Management’s Response

See current year finding 09-555-01.

Chapter 3-B

The Department of Transportation Should Strengthen Certain Aspects of Its Information Technology

Reference No. 08-555-04

To protect the integrity of its information resources, the Department of Transportation (Department) should ensure that it properly restricts access to certain automated systems and that user passwords are sufficiently complex.

**Title 1, Texas Administrative Code,
Section 202.20(1)**

Information resources residing in the various state agencies of state government are strategic and vital assets belonging to the people of Texas. These assets must be available and protected commensurate with the value of the assets. Measures shall be taken to protect these assets against unauthorized access, disclosure, modification or destruction, whether accidental or deliberate, as well as assure the availability, integrity, authenticity, and confidentiality of information. Access to state information resources must be appropriately managed.

**Title 1, Texas Administrative Code,
Section 202.25(3)(B)**

A user's access authorization shall be appropriately modified or removed when the user's employment or job responsibilities within the state agency change.

The Department should restrict access to the Uniform Statewide Accounting System.

In fiscal year 2007, nine users at the Department had inappropriate access rights to the Uniform Statewide Accounting System (USAS). These users could access one to four agencies outside of the Department, and this access was not necessary for their job duties. The agency has since taken action to remove users' improper access. The Comptroller's Office uses the information in USAS to create the State's Comprehensive Annual Financial Report. Restricting the level of access to USAS to only what is necessary for a user's job functions helps to ensure that information resources, including the State's accounting system, are protected against unauthorized access, disclosure, modification, or destruction. It also helps to ensure the availability, integrity, authenticity, and confidentiality of information.

The Department should restrict access to SiteManager.

The Department uses the automated SiteManager system to monitor construction projects, generate daily work reports, and process contractor payment estimates for projects funded through the federal Highway Planning and Construction cluster of programs. Access to SiteManager is controlled by security administrators at each district and division within the Department. However, the Department does not ensure that its districts and divisions restrict SiteManager access to current, active employees. Furthermore, the Department does not ensure that access to SiteManager is removed immediately upon termination of employment or a change in employee job functions. As a result, 2 of 61 (3 percent) employees tested had access to SiteManager after their employment had been terminated. Auditors also identified 30 additional employees who had access to SiteManager after their employment had been terminated or after their job functions changed and they no longer required the use of SiteManager. After auditors brought this matter to the Department's attention, the Department inactivated access for all of the employees involved in the circumstances described above.

Removing access to SiteManager immediately upon termination of an employee or a change in job functions helps to ensure that information resources, including SiteManager, are protected against unauthorized access, disclosure, modification, or destruction. It also helps to ensure the availability, integrity, authenticity, and confidentiality of information.

Auditors did not identify any issues that resulted from the deficiencies discussed above.

The Department should strengthen network and Financial Information Management System password settings.

Employees and users of the Department's automated systems must have access to the Department's network to access those systems. The Financial Information Management System (FIMS) is the Department's internal accounting system used to create and process vouchers for payment. To access the network and FIMS, users must enter a password. According to the Department of Information Resources, state agencies should use unique passwords that contain both alphanumeric characters and special characters. However, the Department does not require this for users of its network and FIMS. Instead, the Department requires only that passwords be eight characters in length. The Department's network and FIMS password settings give users the option to use alphanumeric or special characters in their passwords; however, they do not require this.

Requiring the use of passwords that include both alphanumeric and special characters helps to ensure that information resources, including financial systems, are protected against unauthorized access, disclosure, modification, or destruction. It also helps to ensure the availability, integrity, authenticity, and confidentiality of information.

Corrective Action and Management's Response

Corrective action was taken.

Fiscal Year 2007 Federal Expenditures from Public Assistance Programs

Medicaid: 43 million claims paid, payments totaled \$8.9 billion.

Children's Health Insurance Program (CHIP): 3.7 million member months, payments totaled \$0.4 billion.

Food Stamp Program: Average of 1 million households served per month, payments totaled \$2.9 billion.

Temporary Assistance to Needy Families: Average of 59,500 households served per month, payments totaled \$0.1 billion.

Vendor Drug Program: More than 28 million prescriptions filled. Total payments are included within the Medicaid and CHIP payments.

Sources: *Summary of Federal Expenditures by State Agencies* prepared by the Comptroller of Public Accounts and Health and Human Services Commission self-reported service levels for fiscal year 2007.

Chapter 3-C

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

Public assistance program payments that the Health and Human Services Commission (Commission) reported in its fiscal year 2007 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. These internal controls exist at both the Commission and its contractors. However, there are weaknesses in the design and operation of these internal controls that limit the assurances it can make regarding the validity of payments made for public assistance programs in fiscal year 2007. The programs affected by these weaknesses spent \$12.1 billion in federal funds in fiscal year 2007.

Several of the internal control weaknesses auditors identified during the audit of fiscal year 2007 had also been identified in prior audits and not been fully corrected or mitigated. For example, the Commission's lack of documented policies and procedures for certain functions has been identified as a weakness in three consecutive years. Weaknesses in the Commission's payment monitoring system have been identified for two consecutive years. Weaknesses in user access have been identified for four consecutive years.

In addition, the Commission does not adequately monitor the specific areas in which auditors identified internal control weaknesses in the Vendor Drug program, Medicaid, Children's Medicaid, Food Stamps program, and Temporary Assistance for Needy Families (TANF). The Commission also does not adequately monitor its Office of Inspector General's post-payment audit, review, and investigative activities, which significantly increases the risk of intentional or unintentional overpayment for public assistance services.

The Commission cannot provide full assurance that all of these expenditures were allowable and paid to eligible clients because:

- The Commission has not fully implemented all components of its payment monitoring process.
- The Commission's Office of Inspector General has not conducted a significant portion of the audits and reviews it planned to conduct.
- The Commission has not regularly reconciled its internal accounting system to the cash in the State's accounting system.
- The Commission has not fully documented policies and procedures for two key accounting functions.
- The Commission does not adequately track and monitor the open investigations of its Office of Inspector General and the Office of the Attorney General to determine the related dollar amounts paid to providers for these cases.
- The Commission does not regularly update user access to the Uniform Statewide Accounting System.

Issue 1

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

Reference No. 08-555-05
(Prior Audit Issue 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 Food Stamp program, and the Temporary Assistance to Needy Families (TANF) program.

Vendor Drug Program

During fiscal year 2007, the Commission did not fully staff its regional pharmacists in nine highly populated regions: Houston, Dallas, Beaumont, Austin, San Antonio, Midland, El Paso, Longview, and Abilene. The Commission uses 14 regional and sub-regional pharmacist positions to review expenditure claims submitted by the approximately 4,125 pharmacies participating in the Vendor Drug program. However, it has not maintained a full complement of regional pharmacists to perform these reviews since prior to 2000. In September 2007, the Commission approved an optimization plan to address the regional pharmacist vacancies. However, as of December 2007, the Commission had not posted any of these positions.

Additionally, the Commission did not maintain adequate monitoring records of the regional pharmacists' activities during fiscal year 2007. The monthly tracking reports the Commission provided to the auditors for fiscal year 2007 were incomplete.

The Commission's Office of Inspector General completed only one Vendor Drug program review in fiscal year 2007. The Office of Inspector General asserted that it used available audit and review resources to address the backlog of desk reviews and field audits of the cost reports that providers submit.

Medicaid and Children's Medicaid

During fiscal years 2006 and 2007, the Commission's Office of Inspector General initiated reviews at six hospitals and started reviewing outpatient costs for Medicaid from fiscal year 2001 through fiscal year 2005. As of October 2007, however, it had not completed those reviews.

During fiscal year 2007, the Commission's Office of Inspector General did not pursue fraud investigations or recovery of overpayments to Medicaid clients whose eligibility was determined through the Texas Integrated Eligibility Redesign System (TIERS). In August 2007, the Office of Inspector General reviewed the standards it used to determine support for fraud (criminal) cases and determined that it could rely on TIERS data as evidence for these cases.

The Office of Inspector General began investigating TIERS administrative cases in September 2007. Administrative cases are non-fraud cases related to overpayments resulting from Commission errors, client errors, or intentional program violations of less than \$1,500 per client.

Food Stamp Program and TANF

During fiscal year 2007, the Office of Inspector General did not pursue fraud investigations or recoupment of overpayments to Food Stamp and TANF clients whose eligibility was determined through TIERS. As discussed above, the Office of Inspector General began investigating TIERS administrative cases in September 2007.

Corrective Action and Management's Response

See current year finding 09-555-08.

Issue 2

The Commission's Office of Inspector General Did Not Fully Implement Its Audit Plan for Fiscal Year 2007

Reference No. 08-555-06

The Commission's Office of Inspector General did not fully implement its plan for fiscal year 2007 to audit the state's Medicaid, Vendor Drug, Food Stamps, and TANF programs. The Commission has assigned certain audit responsibility for the State's public assistance programs to the Office of Inspector General.

The Office of Inspector General did not complete significant portions of its fiscal year 2007 audit plan. Specifically, it did not complete the following planned audits or reviews:

- 14 of 14 planned audits of Commission contracts. The purpose of those audits was to ensure that contractors (1) complied with contractual requirements; (2) used funds properly to provide contracted services to eligible recipients; (3) adequately managed funds; and (4) prevented and detected fraud, waste, and abuse. The types of contracts that could have been selected for audit included contracts for nursing care, community care services, nutrition assistance, child care, foster care, outpatient pharmaceutical services, and various consulting and professional services.
- 34 of 35 planned audits of Vendor Drug program providers.
- 5,045 of 5,046 planned audits of provider cost reports for fiscal years 2006 and 2007 (the initial audit plan called for conducting 6,523 of these reviews or audits for fiscal years 2006 and 2007).
- A planned audit of the National Heritage Insurance Company's risk stabilization reserve. The purpose of that audit was to review the settlement of the risk stabilization reserve outstanding balance from the Commission's contract with the National Heritage Insurance Company.

(The National Heritage Insurance Company was the Commission's former Medicaid claims administrator, and its contract with the Commission ended on December 31, 2003.)

- A planned audit of Medicaid hospice drug costs for long-term care facilities.
- A planned audit of the information system of First Health (a Vendor Drug program service organization).
- A planned audit of the information system of a Texas Medicaid Administrative Services (TMAS) contractor, McKesson Health Systems (a disease management contractor).
- A planned attestation review of the implementation of amendment 15 to the Texas Medicaid and Healthcare Partnership (TMHP) contract. That amendment authorized TMHP to perform additional months of service and authorized payment for those additional months of service, primarily to support the Commission's Vendor Drug Program help desk function.
- 6 planned audits of Medicaid outpatient hospital cost reports for fiscal years 2006 and 2007.

The Office of Inspector General also did not complete any of an unspecified number of planned reviews of audits of Medicaid contractors. Additionally, neither the Office of Inspector General's fiscal year 2007 activities nor its audit plan included audits of subrecipients of federal funds.

The Office of Inspector General did complete or initiate portions of its fiscal year 2007 audit plan. Specifically, it completed or initiated the following planned audits or reviews:

- 66 agreed-upon procedure attestation engagements of intermediate care facilities covering fiscal years 2004 through 2007.
- 4,685 reviews or audits of cost reports submitted by providers covering fiscal years 2002, 2004, 2005, and 2006.
- 2,412 reviews or audits of attendant compensation reports submitted by providers covering fiscal years 2005 and 2006.

The Commission relies on the activities of the Office of Inspector General to serve as a portion of its internal control structure over public assistance programs. Therefore, the lack of audit coverage by the Office of Inspector General is a weakness in the Commission's internal control structure and increases the risk that intentional or unintentional errors go undetected.

Corrective Action and Management's Response

Corrective action was taken.

Issue 3

The Health and Human Services Commission Does Not Reconcile Its Internal Accounting System with the Uniform Statewide Accounting System in a Timely Manner

Reference No. 08-555-07

Reconciliation Requirements

Texas Government Code, Section 2101.012, specifies that the Comptroller of Public Accounts shall prescribe uniform accounting and financial reporting procedures that each state agency shall use in the preparation of its annual financial reports.

The Comptroller of Public Accounts' *Reporting Requirements for Annual Financial Reports of State Agencies and Universities* (July 2007) and its *USAS User Manual* (Volume 1, December 1995) require state agencies to reconcile their USAS cash in the State Treasury to their internal accounting systems on a monthly basis.

The Commission does not reconcile cash recorded in the Health and Human Services Administrative System (HHSAS, the Commission's internal accounting system) with the Uniform Statewide Accounting System (USAS, the State's accounting system) in a timely manner as required by the Comptroller of Public Accounts and statute (see text box for additional details). From September 2006 to December 2006, the Commission identified cash variances between these two systems, but it did not begin investigating or researching these differences until January 2007. Auditors identified 74 cash variances with an absolute value of \$76,602,238.54 (or 22.9 percent of the USAS year-end cash balance) that the Commission did not correct in a timely manner.

Corrective Action and Management's Response

Corrective action was taken.

Issue 4

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

Reference No. 08-555-08
(Prior Audit Issues 07-555-04 and 06-555-09)

The Commission has continued to operate two key accounting functions since fiscal year 2005 without documented policies and procedures. These key accounting functions are related to the recording of public assistance payments. Specifically, the Commission does not have documented policies and procedures for:

- Recording and approving Medicaid and CHIP expenditures.
- Recording and approving Vendor Drug program expenditures.

The Commission began developing draft policies and procedures for these two functions during fiscal year 2008. It also has documented many of its other key accounting functions and has trained backup personnel to perform these functions.

It is important to note that the accounts payable department responsible for these two key accounting functions experienced turnover rates of 48.5 percent and 5.9 percent in fiscal years 2006 and 2007, respectively. The Commission attributes the high turnover rate for fiscal year 2006 to the effects of the consolidation of the state's health and human service agencies required by House Bill 2292 (78th Legislature, Regular Session), which became effective on September 1, 2003.

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.

Corrective Action and Management's Response

See current year finding 09-555-09.

Issue 5

The Health and Human Services Commission Does Not Adequately Track and Monitor the Open Investigations of the Office of Inspector General and the Office of the Attorney General

Reference No. 08-555-09

The Commission does not adequately track and monitor its Office of Inspector General's open investigations to determine related dollar amounts paid to providers for these cases. The Commission's open investigation list includes both Office of Inspector General investigation cases and Office of the Attorney General Medicaid investigation cases. These cases represent potential overpayments of federal and state funds for public assistance programs. Without adequate tracking and monitoring of these cases, the Commission cannot reasonably determine whether the related dollar amounts paid to providers for these cases are material to its financial statements.

The Office of Inspector General tracks the questioned costs associated with these cases after the cases are closed and settled. However, this information is limited, and each case must be reviewed individually to identify the questioned costs related to a specific fiscal year. Additionally, this

information does not take into account the possible questioned payments made to the providers during the investigation period.

Contingent Liability

A loss contingency arising from a claim must be disclosed when it is reasonably possible that a loss will eventually be incurred and if it is either not probable or not subject to reasonable estimation. The disclosure should indicate the nature of the contingency and give an estimate of the possible loss or range of loss. However, if an estimate of the loss cannot be made, the disclosure must state this fact.

A loss contingency arising from a claim is accrued as of the balance sheet date when both of the following conditions are true:

- Information available before the financial statements are issued indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements. It must be probable that one or more future events will also occur confirming the fact of the loss.
- The amount of the loss can be reasonably estimated.

Source: *Reporting Requirements for Annual Financial Reports of State Agencies and Universities*, Comptroller of Public Accounts, July 2007.

The Commission's list of active open investigation cases during fiscal year 2007 included more than 7,000 cases. Due to their complexity, it takes more than one year to investigate the majority of those cases. As a result, with some exceptions, the providers under investigation continue to submit claims for public assistance services provided to the clients. These claims may be related to the cases under investigation. Therefore, a portion of the \$12.1 billion in federally-funded public assistance payments reported in the Commission's fiscal year 2007 annual financial report could be identified as questioned costs that will later be recovered through various processes the Commission has established. However, the Commission has not analyzed these possible questioned costs to determine if they should be reported in the Commission's annual financial report as contingent liabilities. The Comptroller of Public Accounts requires that notes to the financial statements communicate information that is necessary for a fair presentation of the financial position and the results of operations, but not readily apparent from, or not included in, the financial statements themselves (see text box for additional details).

Corrective Action and Management's Response

See current year finding 09-555-11.

Issue 6

The Health and Human Services Commission Does Not Regularly Update User Access to the Uniform Statewide Accounting System

Reference No. 08-555-10
(Prior Audit Issue 07-555-05)

In fiscal year 2007, the Commission did not regularly update user access to the Uniform Statewide Accounting System (USAS, the State's accounting system). Specifically:

- 4 users whose employment with the Commission had been terminated still had access rights to USAS.
- 11 users had inappropriate access rights to USAS because their access rights included access to agencies that no longer exist (the Department of Human Services, the Texas Low-Level Radioactive Waste Disposal Authority, and the Department of Mental Health and Mental Retardation).

After auditors brought these issues to the Commission's attention, it deleted the access rights for each of the instances noted above.

Additionally, two Commission employees had voucher payment edit and release capabilities and duties in USAS, but the Commission has not documented the policies and procedures addressing these duties. In fiscal year 2007, there were 232 instances totaling \$5,562,304.28 in which these two employees edited and released USAS transactions after addressing USAS transaction errors. Without documented procedures or mitigating controls, these activities increase the risk that intentional or unintentional errors could go undetected.

Corrective Action and Management's Response

See current year finding 09-555-10.

Chapter 3-D

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 Reconcile Its Internal Accounting System with the State's Accounting System in a Timely Manner

Reference No. 08-555-11

(Prior Audit Issue 07-555-06, 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) has established formal policies and procedures for the reconciliation of its internal accounting system (the Health and Human Services Administrative System) and the State's accounting system (the Uniform Statewide Accounting System). However, it did not clear, adjust, or correct certain reconciling differences in a timely manner as required by the Comptroller of Public Accounts and statute (see text box for additional details). This issue has existed at the Department or its predecessor agency (the Department of Health) for the past seven years. However, during the audit of fiscal year 2007, auditors noted improvement in the Department's efforts to reconcile the two systems on a timely basis.

Reconciliation Requirements

Texas Government Code, Section 2101.012, specifies that the Comptroller of Public Accounts shall prescribe uniform accounting and financial reporting procedures that each state agency shall use in the preparation of its annual financial reports.

The Comptroller of Public Accounts' *Reporting Requirements for Annual Financial Reports of State Agencies and Universities* (July 2007) and its *USAS User Manual* (Volume 1, December 1995) require state agencies to reconcile their USAS cash in the State Treasury to their internal accounting systems on a monthly basis.

Although the Department reconciles by appropriation year, fund, and appropriation to ensure the accuracy and completeness of recorded transactions, it continues to carry forward a significant number and dollar amount of reconciling items between periods without resolution and after the Department's internal accounting system has

been closed for the respective accounting period. For the month ending October 31, 2007, auditors identified the following:

- The Department cleared 2,666 reconciling items from prior appropriation years 2003 through 2007 between September 30, 2007, and October 31, 2007. (Auditors reviewed the September 30, 2007, and October 31, 2007, reconciliations because the Department had reported that it had taken corrective action on the prior audit issue as of October 2007.) However, 1,951 reconciling items still needed to be cleared. The individual amounts of the 1,951 outstanding reconciling items ranged from \$0.01 to \$8.9 million and had a combined absolute value of \$94,363,761.12.
- Of the 1,951 outstanding reconciling items, 730 were reconciling items arising from transactions posted during October 2007 that affected appropriation years 2004 through 2007.

In prior years, the Department indicated that many of the 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 reconciling items from prior appropriations must be adjusted or written off before the appropriations expire. However, of the items remaining to be reconciled, auditors identified one item from appropriation year 2003 (\$31,659.56) and six items from appropriation year 2004 (with a combined absolute value of \$631,789.63). (At the time of audit fieldwork, the Department's internal accounting system had been closed for appropriation years 2003 and 2004.)

Corrective Action and Management's Response

Corrective action was taken.

Issue 2

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

Reference No. 08-555-12
(Prior Audit Issues 07-555-07, 06-555-05, and 05-555-03)

Title 1, Texas Administrative Code, Section 202.25(3)(B)

A user's access authorization shall be appropriately modified or removed when the user's employment or job responsibilities within the state agency change.

Title 1, Texas Administrative Code, Section 202.25(5)(A)

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.

In fiscal year 2007, 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, 11 individuals whose employment had been terminated still had access to Texas WIN. This is a violation of Title 1, Texas Administrative Code, Section 202.25(3)(B) (see text box for additional details).

Auditors also identified one active test user account that could be used to access live production data. This is a violation of Title 1, Texas Administrative Code, Section 202.25(5)(A) (see text box for additional details).

After auditors brought these issues to the Department's attention, the Department deleted the access rights associated with each of the instances noted above.

Corrective Action and Management's Response

Corrective action was taken.

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 Information System Security Monitoring

Reference No. 08-555-13
(Prior Audit Issues 07-555-11, 06-555-11, and 05-555-05)

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.

The Texas Workforce Commission (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 (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 provides 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, staffing limitations have prevented the agency from being able to fully utilize the 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

Corrective action was taken.

Issue 2

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

Reference No. 08-555-14
(Prior Audit Issues 07-555-12, 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.

Fire suppression systems can help reduce the damage to data and systems in the event of a fire and can reduce the time needed to resume operations. 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

Corrective action was taken.

The University of Texas at Austin Should Strengthen Its Capital Asset Records

Reference No. 08-555-15

The University should update its capital asset records in a timely manner.

The University of Texas at Austin (University) does not always process its capital assets in a timely manner. Specifically:

Property Tagging Requirements

Texas Government Code, Section 2101.012, specifies that the Comptroller of Public Accounts shall prescribe uniform accounting and financial reporting procedures that each state agency shall use in the preparation of its annual financial report.

The Comptroller of Public Accounts' *State Property Accounting (SPA) Process User's Guide*, Chapter 2, February 2008, requires that "all property capitalized or designated as a 'controlled' asset must be marked or tagged as property owned by the agency with the exception of real property."

- In October 2007, auditors obtained a list of untagged capital assets from University management. Excluding purchased software and internally developed software, the value of the assets on that list totaled nearly \$8 million. The University purchased those assets between July 25, 2007, and August 31, 2007.
- The University had not tagged or had incorrectly tagged 7 of 51 (13.7 percent) capital assets that auditors tested.
- The University's Inventory Services unit processed \$43 million in new assets in the last 38 days of fiscal year 2007. Those assets represented 66.1 percent of the University's new assets for fiscal year 2007.

According to University policy, Inventory Services is required to assign an inventory number or affix a numbered property control plate to each asset. In addition, it is the University's practice to tag assets within 30 days of receipt. Management indicated the high number of assets processed at the end of the fiscal year occurred because of (1) a shortage in resources that resulted from the implementation of additional inventory controls (for example, the University began using new scanners to interact with its internal accounting system) and (2) employee turnover.

Tagging is important in providing an accurate method of identifying assets; controlling the location of assets; aiding in the identification of assets if they are lost or stolen; discouraging theft; and reducing the magnitude of the State's property losses. If assets are not tagged, there is an increased risk of misappropriation.

The University should properly account for incidental charges associated with capital assets.

The University does not always expense warranty costs and service agreement costs that are associated with its capital assets. It also does not always capitalize shipping and handling costs associated with its capital assets. Specifically:

Requirements for Recording of Incidental Charges

Texas Government Code, Section 2101.012, specifies that the Comptroller of Public Accounts shall prescribe uniform accounting and financial reporting procedures that each state agency shall use in the preparation of its annual financial report.

The Comptroller of Public Accounts' *State Property Accounting (SPA) Process User's Guide*, Chapter 1, June 2006 and February 2008, states that incidental charges, such as extended warranties or maintenance agreements, are no longer considered part of the capital asset cost. These charges should now be expensed. However, if the incidental items are not broken out separately on the purchase order or on the invoice, the incidental charges are considered a part of the capital asset and should be capitalized.

The guide also states that freight and transportation charges should be included as part of the historical cost of the asset.

- The University had not expensed the warranty costs or service agreement costs associated with 5 of 55 (9.1 percent) assets that auditors tested. For these five assets, the University instead capitalized the \$7,742.64 in associated warranty costs or service agreement costs. According to the Comptroller of Public Account's *SPA Process User's Guide*, warranty costs or service agreement costs should be expensed if they are itemized on the invoice or purchase order.

- The University had not capitalized the shipping and handling costs associated with 2 of 55 (3.6 percent) assets that auditors tested. According to the Comptroller of Public Account's *SPA Process User's Guide*, the

University should have capitalized the \$4,250 in shipping and handling costs associated with the assets.

Corrective Action and Management's Response

See current year finding 09-555-14.

Chapter 3-G

The Water Development Board Should Strengthen Certain Aspects of Its Information Technology

Reference No. 08-555-16

To protect the integrity of its information resources, the Water Development Board (Board) should ensure that it properly restricts access to certain automated systems.

The Board should restrict access to its network.

The Board does not always remove access to its network after an individual is no longer employed by the Board. Auditors determined that four individuals whose employment with the Board had been terminated still had access to the Board's network. After auditors brought this issue to the Board's attention, the Board removed the access for these individuals.

The Board should restrict access to the Financial Information System.

Six users whose employment with the Board had been terminated still had access rights to the Financial Information System (FIS), a database developed by the Board and used to track all information associated with the Board's debt and financial assistance (including bonds, loan contracts, and loan forgiveness contracts). After auditors brought this issue to the Board's attention, it removed the access for these six individuals. The employees had not accessed FIS after their employment ended.

**Title 1, Texas Administrative Code,
Section 202.20(1)**

Information resources residing in the various state agencies of state government are strategic and vital assets belonging to the people of Texas. These assets must be available and protected commensurate with the value of the assets. Measures shall be taken to protect these assets against unauthorized access, disclosure, modification or destruction, whether accidental or deliberate, as well as assure the availability, integrity, authenticity, and confidentiality of information. Access to state information resources must be appropriately managed.

**Title 1, Texas Administrative Code,
Section 202.25(3)(B)**

A user's access authorization shall be appropriately modified or removed when the user's employment or job responsibilities within the state agency change.

The Board should ensure employees have a current authorized access form on file.

In July 2007, the Board's internal auditor recommended that each employee have a current form on file that identifies all authorized access to the Micro Information Products (MIP, the Board's internal accounting system) and a group of systems managed by the Office of the Comptroller of Public Accounts. The group of systems included the Uniform Statewide Accounting System, the Uniform Statewide Payroll/Personnel System, the Texas Identification Number System, and Web Warrant Inquiry/Cancellation Access. In addition, the internal auditor recommended that the Board review the forms when staff duties are altered significantly. Auditors reviewed access levels for MIP during financial compliance testing and determined that the access levels were appropriate.

Corrective Action and Management's Response

Corrective action was taken.

Independent Auditor's Report

*State of Texas Financial Portion of the
Statewide Single Audit Report for the
Year Ended August 31, 2008*

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. Significant deficiencies identified not considered to be material weaknesses? | Yes |
| c. Noncompliance material to financial statements noted? | No |

Federal Awards

A finding regarding the Schedule of Expenditures of Federal Awards for fiscal year 2008 was included in Chapter 1-H of this report. All other fiscal year 2008 federal award information was issued in a separate report (see *State of Texas Federal Portion of the Statewide Single Audit Report for the Fiscal Year Ended August 31, 2008*, by KPMG LLP, dated February 20, 2009).



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 Joe Straus III, 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 units and remaining fund information of the State of Texas as of and for the year ended August 31, 2008, which collectively comprise the State's basic financial statements and have issued our report thereon dated February 20, 2009. 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 consideration of 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 M.D. Anderson Cancer Center, the University of Texas Investment Management Company, 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 as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity’s ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity’s financial statements that is more than inconsequential will not be prevented or detected by the entity’s internal control. We consider the deficiencies described in the accompanying schedule of findings and responses to be significant deficiencies in internal control over financial reporting.

Summary of Findings	
Agency	Finding Numbers
Comptroller of Public Accounts	09-555-01 09-555-02 09-555-03 09-555-04
Department of State Health Services	09-555-05
Department of Transportation	09-555-06 09-555-07
Health and Human Services Commission	09-555-08 09-555-09 09-555-10 09-555-11 09-555-12 09-555-13
The University of Texas at Austin	09-555-14
The University of Texas at San Antonio	09-555-15 09-555-16
The University of Texas Southwestern Medical Center at Dallas	09-555-17 09-555-18
Multiple agencies and higher education institutions	09-555-19

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity’s internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not

necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that none of the significant deficiencies 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
Permanent School Fund	An audit of the statements of fiduciary net assets, changes in fiduciary net assets, and supplemental schedules of the Permanent School Fund was conducted as of and for the years ended August 31, 2008.
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, 2008 and 2007, and the related statements of changes in pool net assets for the years then ended.
Permanent University Fund	An audit of the statements of fiduciary net assets and changes in fiduciary net assets of the Permanent University Fund was conducted as of and for the years ended August 31, 2008 and 2007.
The University of Texas System General Endowment Fund	An audit of the statements of fiduciary net assets and changes in fiduciary net assets of the University of Texas System General Endowment Fund was conducted as of and for the years ended August 31, 2008 and 2007.
The University of Texas System Intermediate Term Fund	An audit of the statements of fiduciary net assets and changes in fiduciary net assets of the University of Texas System Intermediate Term Fund was conducted as of and for the years ended August 31, 2008 and 2007.
The University of Texas System Long Term Fund	An audit of the statements of fiduciary net assets and changes in fiduciary net assets of the University of Texas System Long Term Fund was conducted as of and for the years ended August 31, 2008 and 2007.
The University of Texas System Permanent Health Fund	An audit of the statements of fiduciary net assets and changes in fiduciary net assets of the Permanent Health Fund was conducted as of and for the years ended August 31, 2008 and 2007.
The University of Texas M.D. Anderson Cancer Center	An audit of the consolidated balance sheets of the University of Texas M.D. Anderson Cancer Center and subsidiaries as of August 31, 2008 and 2007, and the related consolidated 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 2008 Financial Statements* (State Auditor's Office Report No. 09-015, December 2008)
- *A Report on the Audit of the Department of Transportation's Central Texas Turnpike System Financial Statements for the Fiscal Year Ended August 31, 2008* (State Auditor's Office Report No. 09-016, January 2009)
- *A Report on the Audit of the Employees Retirement System's Fiscal Year 2008 Financial Statements* (State Auditor's Office Report No. 09-017, January 2009)
- *A Report on the Audit of the Office of the Fire Fighters' Pension Commissioner's Fiscal Year 2008 Financial Statements* (State Auditor's Office Report No. 09-018, January 2009)

The State's response to the findings identified in our audit are described in the accompanying schedule of findings and responses. We did not audit the State's response, and accordingly, we express no opinion on it.

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, 2009

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, 2008.

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.

Scope

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. The opinion on the basic financial statements, *The State of Texas Comprehensive Annual Financial Report for the Fiscal Year Ended August 31, 2008*, was dated February 20, 2009.

The scope of the federal portion of the Statewide Single Audit included an audit of the State's Schedule of Expenditures of Federal Awards (SEFA), a review of compliance for each major program, and a review of significant controls over federal compliance. The State Auditor's Office contracted with KPMG LLP to provide an opinion on compliance for each major program and internal control over compliance. The State Auditor's Office provided an opinion on the State's Schedule of Expenditures of Federal Awards (SEFA). The report on the federal portion of the Statewide Single Audit is included in a separate report issued by KPMG LLP entitled *State of Texas Federal Portion of the Statewide Single Audit Report for the Fiscal Year Ended August 31, 2008*, dated February 20, 2009.

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 higher education institution policies and procedures.
- Agency and higher education institution systems documentation.

- Agency and higher education institution accounting data.
- Agency and higher education institution year-end accounting adjustments.
- Agency and higher education institution fiscal year 2008 annual financial reports.
- Agency and higher education institution fiscal year 2008 Schedule of Expenditures of Federal Award submissions to the Office of the Comptroller of Public Accounts.

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 higher education institution accounting practices with Office of the Comptroller of Public Accounts reporting requirements.

Information systems reviewed included the following:

- Agency and higher education institution internal accounting systems.
- Uniform Statewide Accounting System (USAS).
- State Property Accounting system (SPA).
- Human Resource Information System (HRIS).
- Standardized Payroll/Personnel Reporting System (SPRS).
- Uniform Statewide Payroll/Personnel System (USPS).

Criteria used included the following:

- Texas statutes.
- Texas Administrative Code.
- General Appropriations Act (80th Legislature).
- The Office of the Comptroller of Public Accounts' policies and procedures.
- The Office of the Comptroller of Public Accounts' *Reporting Requirements for Annual Financial Reports of State Agencies and Universities*.

- The Office of the Comptroller of Public Accounts' *SPA Process User's Guide*.
- Generally accepted accounting principles.
- Agency and higher education institution policies.
- Office of Management and Budget Circular A-133.

Other Information

Fieldwork was conducted from July 2008 through February 2009. 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 Ann Feller, CIA (Project Manager)
Jules Hunter, CPA, CIA (Project Manager)
Scott Ela, CPA (Assistant Project Manager)
William J. Morris, CPA (Assistant Project Manager)
Jenay Oliphant (Assistant Project Manager)
Snehi Basnet, MAcy
Michael Boehme, CIA, PHR
Robert H. (Rob) Bollinger, CPA, CFE
Mark A. Cavazos
Bruce W. Dempsey, CIA
Melissa Dozier
W. Chris Ferguson, MBA
Michael Gieringer, CFE
Lauren Godfrey, CGAP
Joe K. Fralin, MBA
Nick Frey
Cindy Haley, CPA
Kathryn K. Hawkins
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Joyce Inman, CGFM
Tracy Jarratt, CPA, MAcy
Ashlee C. Jones, MAcy, CGAP, CFE
Robert G. Kiker, CGAP
Joe Kozak, CPA, CISA
Marlen Randy Kraemer, MBA, CISA, CGAP
Brianna Lehman
Jennifer Lehman, MBA, CGAP
Jennifer Logston, MBA
Thomas Andrew Mahoney
Kenneth Manke
Shahpar McIntyre, MS, JD, CPA, State Bar
Joseph Mungai, CIA, CISA
Robert Pagenkopf
Jeannette Quiñonez
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Michael A. Simon, MBA, CGAP
Serra Tamur, MPAff, CISA, CIA
Tony White, CFE
Rachelle Wood, MBA
Leslie Ashton, CPA (Quality Control Reviewer)
Dennis Ray Bushnell, CPA (Quality Control Reviewer)
Charles P. Dunlap, Jr., CPA (Quality Control Reviewer)
Worth S. Ferguson, CPA (Quality Control Reviewer)
Kelly Furgeson Linder, CIA, CGAP (Federal Funds Audit Manager)
Angelica C. Martinez, CPA (Audit Manager)
Michael C. Apperley, CPA (Assistant State Auditor)

Agencies and Higher Education Institutions Audited

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

- Department of Aging and Disability Services.
- Department of State Health Services.
- Department of Transportation.
- Health and Human Services Commission.
- Office of the Comptroller of Public Accounts.
- Texas A&M University System.
- Texas Education Agency.
- Texas Workforce Commission.
- The University of Texas at Austin.
- The University of Texas at San Antonio.
- The University of Texas Health Science Center at San Antonio.
- The University of Texas Southwestern Medical Center at Dallas.
- The University of Texas System.
- Water Development Board.

Schedule of Expenditures of Federal Awards at the following agencies and higher education institutions were audited by either the State Auditor's Office or KPMG LLP:

- Angelo State University.
- Department of Aging and Disability Services.
- Department of Agriculture.
- Department of Assistive and Rehabilitative Services.
- Department of Family and Protective Services.
- Department of Housing and Community Affairs.
- Department of Public Safety.
- Department of State Health Services.
- Department of Transportation.
- Health and Human Services Commission.
- Higher Education Coordinating Board.
- Office of the Attorney General.
- Parks and Wildlife Department.
- Sul Ross State University.
- Texas A&M University.
- Texas A&M University – Corpus Christi.
- Texas AgriLife Research.

- Texas Education Agency.
- Texas Southern University.
- Texas State University – San Marcos.
- Texas Tech University.
- Texas Workforce Commission.
- University of Houston.
- University of North Texas Health Science Center at Fort Worth.
- The University of Texas at Austin.
- The University of Texas at Dallas.
- The University of Texas at El Paso.
- The University of Texas of the Permian Basin.
- The University of Texas at San Antonio.
- The University of Texas Health Science Center at Houston.
- The University of Texas Health Science Center at San Antonio.
- The University of Texas Medical Branch at Galveston.
- The University of Texas Southwestern Medical Center at Dallas.
- Water Development Board.
- West Texas A&M University.

Agency and Higher Education Institution Responses to Schedule of Expenditures of Federal Awards Finding

Below are the individual responses from management at agencies and higher education institutions included in the Schedule of Expenditures of Federal Awards (SEFA) finding in Chapter 1-H of this report.

Angelo State University

Each grant will be screened for inclusion in the Research & Development cluster. This will be accomplished by using the CFDA website and reviewing grant objectives and uses. The principal investigator for each grant may also be contacted during this process.

Responsible Person: Director of Accounting

Implementation Date: June 30, 2009

Department of Agriculture

The Texas Department of Agriculture's (TDA) Financial Services Division (Division) staff will ensure information submitted to the Comptroller's Office in the SEFA is accurate. Division staff will work with KPMG and Comptroller Office staff to resolve inconsistencies in prior year guidance and reporting instructions provided to agencies and universities, participate in current Comptroller Office SEFA trainings where these issues are being discussed and addressed, and ensure TDA's SEFA review process is adequate to prevent future errors.

Responsible Person: Assistant Commissioner for Financial Services

Implementation Date: November 2009

Department of Public Safety

The Department agrees with the finding a) Incorrect Program Clustering

A thorough review will be conducted of the A-133 Compliance Supplemental for 2009 to ensure proper identification of cluster. In instances where there is confusion if a program should be included in a cluster, the department will seek clarification from the Comptroller of Public Accounts prior to submission of the SEFA. This process should eliminate any potential inconsistencies in interpreting cluster type programs.

Responsible Person: Grant Accounting Supervisor

Implementation Date: July 2009

The Department agrees with the finding d) Incorrect Classification of Expenditures

All correcting entries and cost allocations will be completed before year-end to ensure that expenditures are distributed correctly between federal programs. Review and approval will be carried out by in line management on a monthly basis on all reconciliations which will identify all adjusting entries for cost allocations.

Responsible Person: Grant Accounting Supervisor

Implementation Date: May 2009

The Department agrees with the finding e) Incorrect Exclusion of Expenditures

An additional report will be created and run at year end identifying unexpended award balances for all sub-awards to local agencies. A formula based on average expenditures for the previous year will be used to calculate an estimate of anticipated accruals for non-state agencies. The methodology will be documented and available for review by the Auditors.

Responsible Person: Grant Accounting Supervisor

Implementation Date: May 2009

Department of State Health Services

The adjustment to the Schedules of Expenditures for Federal Awards (SEFA) for the Department of State Health Services (DSHS), as noted by the auditors, were not material to the (SEFA) or Comprehensive Annual Financial Report. DSHS has implemented procedures for validating the information and will continue to enhance these controls to reduce the number of adjustments required.

Responsible Person: Accounting Director

Implementation Date: November 20, 2009

Department of Transportation

The Department agrees with the recommendation. New processes will be developed and implemented prior to August 1, 2009, to help ensure that the SEFA information submitted to the Comptroller's Office is accurate.

Responsible Person: Director, Finance Division

Parks and Wildlife Department

Texas Parks and Wildlife Department agrees with the recommendation that SEFA information should be prepared using federal expenditures rather than revenues. Our current financial system extracts expenditures for federal billing accurately but does not store the history of which qualifying expenses were actually billed.

However, this data is only available in detailed individual grant files making the preparation of SEFA in the correct manner a massive task. Our agency is in the process of implementing a new system which will clearly identify expenses billed to our federal partners in the system.

Responsible Person: Finance Director

Implementation Date: September 1, 2010

Texas A&M University

Texas A&M University has established SEFA preparation and review procedures. The University will continue to evaluate procedures for enhancement opportunities that are reasonable and cost effective to further minimize errors. A review of current procedures will be performed prior to the next SEFA preparation.

Responsible Person: Director of Project Administration, TAMU-RS

Implementation Date: November 1, 2009

Texas A&M University - Corpus Christi

While Texas A&M University-Corpus Christi had correctly identified the programs within the Research & Development Cluster on the university's Schedule of Expenditures of Federal Awards (SEFA) work papers, due to a clerical data entry error, the information was not transferred to the SEFA. Of \$55,458,544.35 in federal expenditures, \$235,081.88 was incorrectly reported, which understated expenditures. The SEFA preparation process has been reviewed with all staff involved in preparing and reviewing the SEFA. The SEFA procedures have been updated to ensure the proper reporting of federal expenditures on all future SEFA submissions.

Responsible Person: University Comptroller

Implementation Date: September 1, 2009

Texas AgriLife Research

We agree with the findings and will incorporate review processes in to our procedures to address these findings. We will include a complete review of all final CFDA and cluster data entered in to the web system. We will look for potential items which should not be included in research and development and seek guidance as needed for clarification.

Responsible Person: Financial Management Supervisor, Contracts and Grants office

Implementation Date: Fall 2009

Texas Southern University

Management concurs. The action steps for corrective measures are as follows:

- 1. The Director of Grants and Contracts will perform a detail review of proposed clustering, prior to inclusion on the SEFA.*
- 2. The Staff Accountant will perform reconciliation between expenditures on the SEFA and the general ledger*
- 3. The Director of Grants and Contracts will review the reconciliation between the expenditures on the SEFA and the general ledger and resolve any discrepancies.*

Responsible Persons: Director of Grants and Contracts and Senior Grant Accountant

Implementation Date: November 2009

Texas State University - San Marcos

Texas State University-San Marcos Management concurs that the TRIO Cluster including Student Support Service, Talent Search, and Upward Bound was misclassified and reported in the incorrect Cluster. Further Texas State agrees with the SAO's recommendation. Management will review current business practices, procedures, and systems for establishment of grant master data and completion and quality control review of the SEFA. Following analysis and review, enhanced business practices, procedures, and quality control measures will be implemented to ensure the accuracy of the information presented on the Schedule of Expenditures of Federal Awards.

Texas State will also consider, year to year changes in the A-133 Compliance Supplement, review of cluster program definitions and requirements, and published Chapter 8 — Requirements for Schedules to the Financial

Statements in its review. The General Accounting Office is identified as the project lead and in collaboration with the Office of Sponsored Programs and the Office of Financial Aid and Scholarships jointly accepts responsibility to represent Texas State in order to remedy the referenced Significant Deficiency Finding.

Responsible Persons: Interim Director, Accounting (Project Lead); Director, Office of Sponsored Programs; and Director, Financial Aid and Scholarships

Implementation Date: The corrective action plan for this finding will be completed by August 31, 2009. Business processes and procedures will be updated by August 31 to ensure timely completion and submission of an accurate SEFA report for the year ending August 31, 2009. Potential Financial System Modifications which might be identified during the Business Process Review will be completed by December 31, 2009.

Texas Tech University

Management agrees that there should be an adequate review process to ensure the SEFA information we submit to the Comptroller's Office is accurate. Supporting documentation and the accounting system was accurate with regards to the classification of expenditures. However, when the data was entered into the Comptroller's website, expenditures for a grant were listed with the incorrect CFDA due to a data entry error. An additional step will be added to perform a thorough and complete review of all supporting documentation prior to final submission of the SEFA to ensure data entry accuracy.

Responsible Person: Managing Director, Sponsored Programs Accounting & Reporting

Implementation Date: September 2009

University of North Texas Health Science Center at Fort Worth

The management of the University of North Texas Health Science Center (UNTHSC) agrees with your recommendation. UNTHSC will implement an adequate review process to ensure that the SEFA information submitted to the Comptroller's Office is accurate.

Responsible Person: Director of Accounting

Implementation Date: November 1, 2009

The University of Texas at Austin

Management agrees that a more adequate review needs to occur prior to submission of the SEFA information. The University has enhanced its post initial certification procedures related to classification of expenditures and will track changes more diligently.

Management also agrees that procedures need to be enhanced to correctly identify clusters. The University has taken action to improve the process resulting in SEFA cluster presentation. Those actions include additional staff training, periodic review for programs with a normal cluster default, and improvements to year end processes related to the SEFA presentation.

Responsible Person: Associate Director, Office of Sponsored Projects

Implementation Date: January 2009

The University of Texas at Dallas

The University agrees with the recommendation and has already taken the necessary corrective actions. In January 2009 management reassigned the responsibility for entering contract and grant award documents into the accounting system to the Office of Finance from the Office of Sponsored Projects. This change of responsibilities will provide the necessary quality assurance of financial data before it is entered into the financial reporting system.

Responsible Person: Associate Vice President for Finance and Controller

Implementation Date: January 2009

The University of Texas at El Paso

The University of Texas at El Paso concurs with the finding. An incorrect CFDA number was used in the notes section of the Schedule of Expenditure of Federal Awards due to an oversight during preparation. The misidentification is easily correctable and greater care will be taken when preparing the Schedule in the future to avoid similar errors.

Responsible Person: Director, Contracts and Grants Accounting

Implementation Date: April 30, 2009

The University of Texas of the Permian Basin

Management concurs. We will implement a review process to ensure the accuracy of SEFA reports submitted to the Comptroller.

Responsible Person: Director of Accounting

Implementation Date: April 14, 2009

The University of Texas Southwestern Medical Center at Dallas

We agree with the recommendation. We will implement a review process that ensures accurate information is submitted to the Comptroller's Office.

Responsible Person: Assistant Vice President, Office of Accounting

Implementation Date: April 1, 2009

The University of Texas Health Science Center at Houston

While the error rate experienced by UTHSC-H was less than .1%, in the future we will implement a secondary check specifically for all special exclusion items to re-verify and tie CFDA totals on the 1A schedule prior to submission. This additional review step will be included in our procedure documentation.

Responsible Person: Vice President, Finance and Business Services

Implementation Date: June 30, 2009

The University of Texas Health Science Center at San Antonio

The Health Science Center will strengthen its procedures related to the review of information contained in the SEFA submitted to the Comptroller's Office. The Office of Accounting will review the SEFA before and after submission to ensure that all programs are assigned the appropriate CFDA number and are properly classified in the appropriate cluster.

Responsible Person: Director of Accounting

Implementation Date: Fall 2009

The University of Texas Medical Branch at Galveston

Management concurs with the finding and will establish an appropriate review process to ensure accuracy of future year SEFA reports submitted to the Comptroller.

Responsible Person: Director, Post-Award, Office of Sponsored Programs

Implementation Date: September 2009

West Texas A&M University

Total federal funding was \$35,871,709 and the amount misclassified was \$198,079. This grant was a pass-through from another state agency to West Texas A&M University and was simply misclassified with regards to the type of expenditures related to the grant. The university has put in place a process to review identification and designation of federal grant funding.

Responsible Person: Vice President for Business and Finance

Implementation Date: April 10, 2009

Copies of this report have been distributed to the following:

Legislative Audit Committee

The Honorable David Dewhurst, Lieutenant Governor, Joint Chair
The Honorable Joe Straus III, Speaker of the House, Joint Chair
The Honorable Steve Ogden, Senate Finance Committee
The Honorable Thomas “Tommy” Williams, Member, Texas Senate
The Honorable Jim Pitts, House Appropriations Committee
The Honorable Rene Oliveira, House Ways and Means Committee

Office of the Governor

The Honorable Rick Perry, Governor

Boards, Commissions, Chancellors, Executive Directors, and Presidents of the Following Agencies and Higher Education Institutions

Angelo State University
Department of Aging and Disability Services
Department of Agriculture
Department of Assistive and Rehabilitative Services
Department of Family and Protective Services
Department of Housing and Community Affairs
Department of Public Safety
Department of State Health Services
Department of Transportation
Health and Human Services Commission
Higher Education Coordinating Board
Office of the Attorney General
Office of the Comptroller of Public Accounts
Parks and Wildlife Department
Sul Ross State University
Texas A&M University
Texas A&M University - Corpus Christi
Texas A&M University System
Texas AgriLife Research
Texas Education Agency
Texas Southern University
Texas State University - San Marcos
Texas State University System
Texas Tech University
Texas Tech University System
Texas Workforce Commission
The University of Texas at Austin
The University of Texas at Dallas
The University of Texas at El Paso
The University of Texas at San Antonio
The University of Texas Health Science Center at Houston
The University of Texas Health Science Center at San Antonio
The University of Texas Medical Branch at Galveston

The University of Texas of the Permian Basin
The University of Texas Southwestern Medical Center at Dallas
The University of Texas System
University of Houston
University of Houston System
University of North Texas Health Science Center at Fort Worth
University of North Texas System
Water Development Board
West Texas A&M University



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