

A Review of
**Fiscal Year 2002
Encumbrances and Payables at
Selected Agencies**

June 18, 2003

Members of the Legislative Audit Committee:

We reviewed encumbrances and accounts payable at seven agencies to determine whether they accurately reported their obligations as of August 31, 2002, in accordance with Accounting Policy Statement (APS) 018: Encumbrance Report and Lapsing of Appropriations. Four of the agencies overstated encumbrances by a total of \$25.5 million (see Table 1). While the agencies' encumbrance practices could allow them to keep cash balances that might otherwise be available for appropriation, we found no significant evidence that any of these seven agencies obligated funds with the intent to inappropriately circumvent the lapse of funds. We based this assessment on a limited review of the accounts payable and encumbrances that the agencies reported in the Uniform Statewide Accounting System (USAS) and their 2002 Annual Financial Reports (AFR). According to APS 018, the purpose of the binding encumbrance and payables report is to certify the correctness of USAS data, which is then used to identify funds that are available to lapse.

Table 1

Agency	Overstatement	Total Obligations
Commission on Environmental Quality	\$ 8.8 million	\$ 11.8 million
Parks and Wildlife Department	0.9 million	97.6 million
Department of Public Safety	0.8 million	64.0 million
Department of Economic Development	15.0 million	19.8 million
Total	\$ 25.5 million	\$ 193.2 million

The 2002 State of Texas Comprehensive Annual Financial Report reported \$6.0 billion in obligations (encumbrances and accounts payable) as of August 31, 2002. The seven agencies we reviewed reported \$1.6 billion in obligations:

- Commission on Environmental Quality
- Parks and Wildlife Department
- Department of Public Safety
- Department of Economic Development
- Department of Protective and Regulatory Services
- Department of Human Services
- Department of Transportation

Encumbrances vs. Payables

Encumbrances are funds that agencies set aside based on commitments they make before the end of the reporting period for services or goods they will receive after the beginning of the next reporting period. The encumbrance is for actual contracts awarded. Anticipated contracts or contracts under negotiation are not legal commitments and should not be reported as encumbrances.

Payables are amounts obligated for goods or services that the agency has received but not yet paid for.

Source: APS 018

Of the four agencies that overstated their reported encumbrances as of August 31, 2002, some encumbered funds without having a contractual obligation as required by APS 018. Others did not cancel or adjust encumbrances that they no longer needed in a timely manner. The attachment to this letter provides additional information about these encumbrances, which we previously communicated to the Legislative Audit Committee and the Legislative Budget Board in individual letters dated April 22, 2003.

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Three of the seven agencies we reviewed did not use the standard encumbrance process in their operations and utilized projections to calculate obligations. The Department of Protective and Regulatory Services and the Department of Human Services classify their obligations as accounts payable rather than encumbrances, but the effect of setting aside funds to meet obligations is essentially the same. Both agencies projected total required expenditures for client services that were provided in fiscal year 2002 to calculate accounts payable amounts. The Department of Transportation used an estimation/projection approach for recording year-end obligations due to the nature of contracting and the contractors' billing process for highway construction completed during fiscal year 2002.

It is critical for state entities to report encumbrances accurately. Encumbrances are used to ensure that money is available to meet obligations. In addition, the encumbered amounts help determine whether there are excess funds available to be lapsed into the State's General Revenue Fund. Once the funds are returned to the General Revenue Fund, they can be used as future appropriations or transferred to the Economic Stabilization Fund (or Rainy Day Fund) at the end of the biennium.

The objective of this review was to answer the following questions:

1. Did the agency accurately report its obligations as of August 31, 2002, in USAS?
2. Do the agency's encumbrance practices (obligation of funds) allow it to keep cash balances that might otherwise be available for appropriation?

Our limited testing of the encumbrances and payables at the seven agencies would not necessarily disclose all instances of noncompliance with APS 018. The material in this document has not been subjected to all of the tests and confirmations performed in an audit. If you have any questions about our review of encumbrances and accounts payable, please contact Joanna B. Peavy, CPA, Audit Manager, at (512) 936-9500.

Sincerely,

Lawrence F. Alwin, CPA
State Auditor

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Attachment

cc: Legislative Budget Board
Mr. John M. Keel, CPA, Executive Director
Ms. Marva Scallion, Manager
Office of the Governor
The Honorable Rick Perry, Governor
Executive Directors and Board Members of agencies reviewed

Detailed Results

Four of Seven Agencies Reviewed Overstated Fiscal Year 2002 Encumbrances

Commission on Environmental Quality

The Commission on Environmental Quality (TCEQ) overstated its encumbrances by \$8.8 million (out of total obligations of \$11.8 million) as of August 31, 2002. Most of these encumbrances were in General Revenue Fund 1 – Dedicated, General State Operating and Disbursing Funds. Our testing identified the following instances in which the reported encumbrances were overstated:

- TCEQ encumbered \$7.6 million without having contractual obligations, which is a requirement of Accounting Policy Statement (APS) 018. The funds were encumbered based on requests for bids. TCEQ did not award any contracts and unencumbered these funds after August 31, 2002. However, TCEQ had unexpended balance carry-forward authority for \$7.5 million in the Solid Waste Disposal Fees Fund Account.
- For one contract that TCEQ awarded before August 31, 2002, the actual contract amount was for approximately \$1.2 million less than the amount TCEQ had encumbered. TCEQ did not unencumber the difference until February 2003.

Parks and Wildlife Department

Encumbrance Overstatements

The Parks and Wildlife Department (TPWD) overstated its encumbrances by \$916,037 (out of total obligations of \$97.6 million) as of August 31, 2002. Most of the funds associated with the obligations we identified are consolidated General Revenue funds that the Legislature has dedicated for specific purposes. The encumbrances were overstated for the following reasons:

- TPWD reported outstanding encumbrances for grants in the amount of \$677,100 from appropriation year 1998. The majority of these funds represented five grants for the construction of local parks, which are treated as construction projects. TPWD's appropriation authority for these 1998 funds expired at the end of fiscal year 2002; therefore, TPWD should not have included them in the Binding Encumbrance and Payables Report for Prior Year Appropriations as of August 31, 2002. TPWD unencumbered these funds in November 2002.
- Encumbrances totaling \$148,057 were not canceled or adjusted in a timely manner.
- TPWD reported encumbrances of \$90,880 for consumable items and licenses that were for use in the 2003 appropriation year.

Encumbrance Practices

TPWD encumbers funds associated with grants after the Texas Parks and Wildlife Commission (Commission) approves a decision to award a grant to a qualified recipient such as a city or a county. The grant recipient obtains permits and licenses, and the contract may be established after TPWD encumbers the funds. For example, the Commission approved a grant for \$750,000 in June 2000, and TPWD set up the encumbrance obligating appropriation year 2000 funds. As of April 11, 2003, however, TPWD still did not have a contract for grants associated with these funds.

Although TPWD does not have valid contracts associated with these funds, the Comptroller of Public Accounts (Comptroller) considers the Commission's approval to be an "other action" described in APS 018 and to be sufficient action to report encumbrances.

Department of Public Safety

The Department of Public Safety (DPS) overstated its encumbrances by \$817,572 (out of total obligations of \$64 million) as of August 31, 2002. However, the majority of the encumbrances and payables are in State Highway Fund 6, which is constitutionally dedicated for use by DPS.

The encumbrances were overstated for the following reasons:

- DPS did not cancel or adjust its encumbrances in a timely manner. The funds that DPS encumbered exceeded actual payments or contract terms by \$636,299.
- DPS incorrectly reported pre-encumbrances of \$181,273 as if they were encumbrances. Pre-encumbrances are not contractual obligations, which is a requirement of APS 018. DPS's computer program for uploading encumbrances from its internal accounting system into the Uniform Statewide Accounting System (USAS) erroneously uploads pre-encumbrance amounts in addition to encumbrances.

Department of Economic Development

The Department of Economic Development (TDED) overstated its encumbrances by \$15 million (out of total obligations of \$19.8 million) as of August 31, 2002. Funds were encumbered without having contractual obligations, which is a requirement of APS 018. The \$15 million was originally appropriated for the Smart Jobs program. TDED encumbered the money because it expected legislation to be passed that would authorize TDED to spend the funds for business location incentives in fiscal year 2003. Rather than encumbering the funds, TDED should have classified them as reserved fund balance. As of April 1, 2003, the \$15 million was reserved for use under Senate Bill 15, 78th Legislature, for business location incentives.

Three of Seven Agencies Reviewed Utilized Projections to Report Obligations

Department of Protective and Regulatory Services and Department of Human Services

The Department of Protective and Regulatory Services (PRS) reported estimated accounts payable of \$84 million as of August 31, 2002. The Department of Human Services (DHS) reported estimated accounts payable of \$490 million as of August 31, 2002. Based on a limited review of the accounts payable reported in USAS, these obligations of state funds appear to be reasonable and in accordance with APS 018.

PRS and DHS classify their obligations as accounts payable rather than encumbrances, but the effect of setting aside funds to meet obligations is essentially the same. The agencies believe that the encumbrance process would lock up funds for specific clients and programs and in turn prevent other clients and programs from receiving benefits. PRS's and DHS's accounts payable amounts in USAS are based on projections of total expenditures for client services provided in 2002 less actual cash payments for those services.

Department of Transportation

The Department of Transportation (TxDOT) reported estimated obligations of \$858 million of state funds as of August 31, 2002. Based on a limited review of TxDOT's obligations, this amount appears to be reasonable. The majority of the encumbrances and payables are in the State Highway Fund 6, which is constitutionally dedicated for use by TxDOT and for which the agency has unexpended balance carry-forward authority.

Due to the nature of contracting and the contractors' billing process for highway construction completed in 2002, TxDOT uses an estimation/projection approach for recording year-end encumbrances. At the end of the fiscal year, each of TxDOT's 25 divisions submits information to the main accounting department regarding outstanding obligations. TxDOT uses the divisions' information and historical payment data to project encumbrances.