

State of Texas Financial Portion of the

# Statewide Single Audit Report for the Year Ended August 31, 2002

April 2003  
Report No. 03-555



[www.sao.state.tx.us](http://www.sao.state.tx.us)

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

State of Texas Financial Portion of the  
**Statewide Single Audit Report for the  
Year Ended August 31, 2002**

---

SAO Report No. 03-555  
April 2003

## Overall Conclusion

The State's basic financial statements for the year ended August 31, 2002, are materially correct in accordance with accounting principles generally accepted in the United States of America (see text box).

While the State's basic financial statements are materially correct, our audit identified specific issues that a number of agencies need to address to ensure the accuracy of their financial information. For example, two agencies did not reconcile their internal accounting systems with the Uniform Statewide Accounting System (USAS), and other agencies had weaknesses in their reconciliation processes. Reconciling the information in various accounting systems and subsystems is critical in providing accurate financial information.

At certain agencies, we also identified weaknesses in information technology security that could compromise the integrity of financial information. Inadequate documentation in areas such as policies and procedures and information technology at several agencies also could make it difficult to ensure the accuracy of financial information.

### Basic Financial Statements

The basic financial statements include both government-wide and fund financial statements.

- The government-wide financial statements are designed to present an overall picture of the financial position of the State. It is important to note that the government-wide financial statements do not include retirement system assets, trust funds, or agency funds.
- Fund financial statements present financial information, focusing on the most significant funds, in a form more familiar to experienced users of governmental financial statements.

Source: *Texas 2002 Comprehensive Annual Financial Report for the Year Ended August 31, 2002.*

## Key Points

### A financial material weakness continues to exist at the Department of Health.

The Department of Health (Department) has a material weakness that significantly reduces the reliability of its financial information. This material weakness did not have a material impact on the accuracy of the State's financial statements. However, if that material weakness is not corrected or other material weaknesses are identified, the accuracy of the State's financial statements in the future could be affected. The Department has not fully corrected issues from prior years, and we identified additional issues in fiscal year 2002. These issues include the Department's lack of policies and procedures for reconciling financial systems, failure to reconcile the internal accounting system with USAS for fiscal year 2002, \$137 million understatement of accounts payable and corresponding expenditures in its fiscal year 2002 Annual Financial Report, and inadequate implementation and security controls for its internal accounting system.



---

This audit was conducted in accordance with Texas Government Code, Section 321.0131.

For more information regarding this report, please contact Joanna B. Peavy, CPA, Audit Manager, at (512) 936-9500.

**Certain agencies had weaknesses in reconciling their internal accounting systems.**

Two agencies that use the Health and Human Services Administrative System (HHSAS) as their internal accounting systems—the Department of Health and the Health and Human Services Commission—did not reconcile HHSAS with USAS from September 2001 through November 2002. Both agencies implemented HHSAS at the beginning of fiscal year 2002.

As more health and human services agencies implement HHSAS as their internal accounting systems, it is important that they develop processes for reconciling HHSAS with USAS. Agencies that expect to implement HHSAS for fiscal year 2004 include the Department of Human Services and the Department of Mental Health and Mental Retardation.

The General Land Office and Veterans' Land Board was unable to successfully reconcile information in its Veterans' Land Board Land Loan Servicing/Lockbox System with its general ledger.

**Weaknesses in the security of information technology could compromise the integrity of financial data.**

KPMG LLP and the Department of Health's (Department) internal auditor have both identified information technology security weaknesses surrounding the Department's implementation of HHSAS. Examples of these weaknesses include inadequate system auditing, improper user function restrictions, and inadequate user account and maintenance controls.

Although the Comptroller of Public Accounts generally has adequate controls to ensure the reliability of information in TEXNET (the system that receives electronic funds transfer payments from taxpayers), we identified specific areas that should be strengthened to prevent potential abuse, theft, or misuse of this system.

**Inadequate documentation could make it difficult to ensure the accuracy of financial information.**

The Department of Health, Health and Human Service Commission, and General Land Office and Veterans' Land Board lack documented policies and/or procedures for reconciling information in their accounting systems. This increases the risk that these agencies could provide erroneous and inconsistent financial information.

**The State implemented a new financial reporting model.**

The State implemented Governmental Accounting Standards Board (GASB) Statements 34, 35, and 37, as well as all required paragraphs of GASB Statement 38, for fiscal year 2002. The previous financial reporting model governed by prior GASB statements emphasized fund types (the total of all funds of a particular type). The new financial reporting model governed by current GASB statements focuses on the State as a whole in the government-wide financial statements and on major individual funds in the fund financial statements.

## ***Summary of Objectives, Scope, and Methodology***

Our objective was to determine whether the statewide financial statements accurately reflect the balances and activities for the State of Texas for the fiscal year ended August 31, 2002, and to comply with federal requirements to conduct a Statewide Single Audit.

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 Amendments of 1996 and the Office of Management and Budget (OMB) Circular A-133. The State Auditor's Office contracted with KPMG LLP to perform the federal portion of the Statewide Single Audit. The federal portion included a review of compliance and controls over the State's federal awards and an audit of the Schedule of Expenditures of Federal Awards. The State Auditor's Office performed the financial portion of the Statewide Single Audit.

The scope of the financial portion included an audit of the State's financial statements and a review of significant financial and compliance controls.

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

# Contents

## ***Auditor's Report***

---

Report on Compliance and on Internal Control over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards .....	1
--	---

## ***Schedule of Findings and Questioned Costs***

---

Chapter 1	
Summary of Auditor's Results .....	5
Chapter 2	
Financial Statement Findings .....	6
Chapter 2-A	
The Department of Health Continues to Have a Material Weakness in Financial Reporting .....	6
Chapter 2-B	
The Health and Human Services Commission Did Not Reconcile Its Internal Accounting System with USAS .....	10
Chapter 2-C	
The General Land Office and Veterans' Land Board Lacks Certain Controls over Loans and Contract Accounts Receivable and Overstated Interest Receivable for Fiscal Year 2002 .....	11
Chapter 2-D	
Specific Improvements Are Needed in the Comptroller of Public Accounts' Access and Security Controls over TEXNET .....	15
Chapter 2-E	
The Texas Education Agency Should Address Certain Information Technology Issues to Ensure that It Continues to Properly Administer the Foundation School Program .....	18
Chapter 3	
Federal Award Findings and Questioned Costs .....	19

## ***Summary Schedule of Prior Audit Findings***

---

Summary Schedule of Prior Audit Findings .....	21
Financial Weaknesses at the Department of Health .....	21

# **Auditor's Report**

*State of Texas Financial Portion of the  
Statewide Single Audit Report for the  
Year Ended August 31, 2002*



February 24, 2003

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

The Honorable Rick Perry, Governor  
and  
Members of the Texas Legislature  
State of Texas

Ladies and Gentlemen:

We have audited the financial statements of the State of Texas as of and for the year ended August 31, 2002, and have issued our report thereon dated February 24, 2003. 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.

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.

### **Compliance**

As part of obtaining reasonable assurance about whether the State's general purpose financial statements are free of material misstatement, we performed tests of compliance with certain provisions of laws, regulations, contracts, and grants. Noncompliance with those provisions 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 that are required to be reported under *Government Auditing Standards*.

### **Internal Control over Financial Reporting**

In planning and performing our audit, we considered the State's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters that come to our attention that relate to significant deficiencies in the design or operation of the internal control over financial reporting and that, in our judgment, could adversely affect the State's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The accompanying schedule of findings and questioned costs describes reportable conditions



for the Comptroller of Public Accounts, Texas Education Agency, General Land Office and Veterans' Land Board, Department of Health, and Health and Human Services Commission.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider only the reportable condition at the Department of Health to be a material weakness.

## 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
Employees Retirement System	An audit of the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information was conducted as of and for the year ended August 31, 2002. An audit was also conducted for the combining statements of fiduciary net assets and changes in fiduciary net assets of the pension plans administered by the Employees Retirement System as of August 31, 2002.
Texas Local Government Investment Pool	An audit of the financial statements of the Texas Local Government Investment Pool, an investment trust fund of the State of Texas, was conducted as of and for the year ended August 31, 2002.
Department of Housing and Community Affairs	An audit of the financial statements of the governmental activities, business-type activities, major funds, remaining fund information, and supporting schedules 1A through 1D was conducted as of and for the year ended August 31, 2002.
Texas Prepaid Higher Education Tuition Board	An audit was conducted of the financial statements of the business-type activities, the discretely presented component unit, each major fund, and fiduciary fund information as of and for the year ended August 31, 2002.
Texas Lottery Commission	An audit of the financial statements of the governmental activities, business-type activities, and each major fund and fiduciary fund information was conducted as of and for the year ended August 31, 2002.
Permanent Health Fund	An audit was conducted of the statements of assets and liabilities as of August 31, 2002 and 2001, the related statements of operations and changes in net assets for the years then ended, and the financial highlights for each of the three years in the period ended August 31, 2002.
Permanent University Fund	An audit was conducted of the statements of assets and liabilities and the comparison summary of investment of securities as of August 31, 2002 and 2001, the related statements of operations and changes in net investment assets for the years then ended, and the schedule of changes of cost of investments and investment income for the year ended August 31, 2002.
The University of Texas System Long-Term Fund	An audit was conducted of the statements of assets and liabilities as of August 31, 2002 and 2001, the related statements of operations and changes in net assets for the years then ended, and the financial highlights for each of the five years in the period ended August 31, 2002.
The University of Texas System Short-Intermediate Term Fund	An audit was conducted of the statements of assets and liabilities as of August 31, 2002 and 2001, including the schedule of investment in securities as of August 31, 2002, and the related statements of operations and changes in net assets for the years ended August 31, 2002 and 2001.
The University of Texas System General Endowment Fund	An audit was conducted of the statements of assets and liabilities and the comparison summary of the investment of securities as of August 31, 2002 and 2001, the related statements of operations and changes in net investment assets for the year ended August 31, 2002, and for the period from inception (March 1, 2001) to August 31, 2001, and the financial highlights for the year ended August 31, 2002, and for the period from inception (March 1, 2001) to August 31, 2001.

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 general purpose financial statements of the State of Texas:

- *An Audit of the Basic Financial Statements of the Teacher Retirement System for the Fiscal Year Ended August 31, 2002* (SAO Report No. 03-014, January 2003)
- *An Audit Report on the Financial Statements of the Permanent School Fund for the Fiscal Year Ended August 31, 2002* (SAO Report No. 03-024, March 2003)
- *An Audit of the Basic Financial Statements of the Office of the Fire Fighters' Pension Commissioner for the Fiscal Year Ended August 31, 2002* (SAO Report No. 03-027, March 2003)

This report is intended solely for the information and use of the Governor, the Legislature, audit committees, boards and commissions, management, and all federal awarding agencies and pass-through entities from which federal assistance was received. However, this report is a matter of public record and its distribution is not limited.

Sincerely,



Lawrence F. Alwin, CPA  
State Auditor

This page intentionally left blank.

# **Schedule of Findings and Questioned Costs**

*State of Texas Financial Portion of the  
Statewide Single Audit Report for the  
Year Ended August 31, 2002*

## **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?  | Yes         |
| b. Reportable conditions identified not considered to be material weaknesses? | Yes         |
| c. Noncompliance material to financial statements noted?                      | No          |

Although we identified a material weakness at the Department of Health, it did not have a material impact on the accuracy of the State's financial statements. However, if that material weakness is not corrected or other material weaknesses are identified, the accuracy of the State's financial statements in the future could be affected.

### **Federal Awards**

For fiscal year 2002, federal award information has been issued in a separate report. See *State of Texas Federal Portion of the Statewide Single Audit Report for the Year Ended August 31, 2002*, by KPMG LLP, dated February 24, 2003.

This chapter identifies the reportable conditions, material weaknesses, and instances of noncompliance related to the financial statements that are required to be reported in accordance with *Government Auditing Standards*.

Chapter 2-A

**The Department of Health Continues to Have a Material Weakness in Financial Reporting**

Reference No. 03-555-01  
(Prior audit issue 02-555-01 and 01-021)

The Department of Health (Department) has a material weakness that significantly reduces the reliability of its financial information. The Department has had prior findings regarding its financial systems, and it was relying on the implementation of its new internal accounting system (the Health and Human Services Administrative System, also known as HHSAS) to address the prior findings. The Department implemented HHSAS on September 4, 2001, and the Department's internal auditor has noted several weaknesses regarding this system. During fiscal year 2002, KPMG LLP, the State Auditor's Office, and the Department's internal auditor determined that the reliability of the Department's financial information was significantly diminished by the following issues:

- KPMG LLP noted five issues regarding the implementation of HHSAS in its *Federal Portion of the Statewide Single Audit Report for the Year Ended August 31, 2002*, dated February 24, 2003. These issues included problems regarding the Department's grants system and HHSAS, the monitoring of HHSAS security, HHSAS reconciliation, and the Department's preparation of its Annual Financial Report (AFR) (including the Schedule of Expenditures of Federal Awards within that report).
- The Department has not established policies and procedures for reconciling HHSAS with the Uniform Statewide Accounting System (USAS). In addition, the Department lacks policies and procedures for making and approving the correcting entries associated with this reconciliation. It also lacks a format and procedures to follow to ensure conformity in the reconciliation process, and it has not clearly established who is responsible for approving reconciling entries and who is responsible for actually making the reconciling entries in USAS. The Department also lacks a process to ensure that other policies and procedures it has established are implemented and followed.
- The Department did not reconcile the information in HHSAS with the information in USAS for fiscal year 2002 until after it submitted its AFR for fiscal year 2002. As a result, we estimated that as of February 7, 2003, the Department still needed to record up to \$312 million in transactions in HHSAS that it had initially recorded only in USAS. Recording these transactions will have the net effect of decreasing the cash balance in HHSAS by \$116 million to

reflect the actual cash in USAS. All adjustments will be made to HHSAS and will not affect the AFR, which the Department prepared based on USAS information.

In November 2002, the Department hired contractors who completed the reconciliation for fiscal year 2002 by January 2003. Reconciling the financial information in related systems is a critical control in ensuring the completeness and accuracy of financial information.

- The Department's staff did not know how to obtain a trial balance from HHSAS to begin the reconciliation process; therefore, the Department could not use the information in the internal accounting system to prepare its fiscal year 2002 AFR and had to use USAS information instead.
- The Department understated in its AFR the amount of its fiscal year 2002 accounts payable and corresponding expenditures by at least \$137 million. The Department reported only \$18 million in accounts payable in its AFR because it included only amounts paid during the first week of the new fiscal year. Section 403.021(b) of the Texas Government Code requires state agencies to report payables for all appropriation years annually to the Comptroller of Public Accounts, the State Auditor, and the Legislative Budget Board no later than October 30 of each year. Therefore, accounts payable is based on an estimate of the first 60 days of the new fiscal year. The majority of the \$137 million in accounts payable not recorded was related to federal funds. The Department's accounts payable for September 1, 2002, through October 30, 2002, totaled \$155 million. Accounts payable and corresponding expenditures in the State's *Comprehensive Annual Financial Report* were corrected to reflect the Department's adjusted total.
- The Department's internal auditor identified inadequate controls over the implementation and security of HHSAS in three reports from February 2002 to October 2002:
  - ♦ In February 2002, the internal auditor noted that the Department implemented HHSAS with inadequate (1) internal controls, (2) system set-up and testing, and (3) training. (See *Report of Our Examination of the Department's Progress in Implementing the Health and Human Services Statewide Administrative System (HHSAS)*, Internal Audit Report Number 200214.)
  - ♦ In August 2002, the internal auditor noted that HHSAS was operating with (1) inadequate system auditing, (2) improper user function restrictions, and (3) inadequate user account and maintenance controls (See *Report of Our Examination of the Department's Health and Human Services Statewide Administrative Systems (HHSAS) Security*, Internal Audit Report Number 200204.)
  - ♦ In October 2002, the internal auditor noted that the Department had partially implemented the issues identified in the February 2002 audit by improving the timeliness of its payment to vendors, reducing the number of duplicate payments it makes, providing partial HHSAS training, and providing the internal auditor with access to HHSAS. (See *Internal Audit Report Number*

*200214 of Our Examination of the Department's Progress in Implementing the Corrective Action Plan from the Health and Human Services Statewide Administrative System (HHSAS) Phase I Implementation, Internal Audit Report Number 200115.)*

- The Department did not fully implement prior State Auditor's Office findings from the *State of Texas Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2001* (SAO Report No. 02-555, May 2002). See the Summary Schedule of Prior Findings on page 21 for more information.

## **Recommendations**

The Department should:

- Make corrections to address findings noted by KPMG LLP in the *Federal Portion of the Statewide Single Audit report for the Year Ended August 31, 2002*.
- Establish policies and procedures for reconciling HHSAS with USAS and making and approving the correcting entries.
- Reconcile HHSAS with USAS and internal subsystems on a monthly basis and verify that HHSAS contains accurate and complete financial information.
- Provide staff with additional training on HHSAS.
- Estimate accounts payable based on the first 60 days of the new fiscal year.
- Implement its internal auditor's recommendations regarding HHSAS.
- Implement prior recommendations made by the State Auditor's Office.

## **Management's Response**

*TDH has taken steps to address the issues identified by the State Auditor's Office, which include contracting with the Comptroller of Public Accounts to assist in restructuring the Fiscal division; provide expertise and guidance in determining appropriate job descriptions and skill sets for accounts payable, general ledger and cash management; and assistance with hiring key positions. The Comptroller's Office will also assist TDH with training plans for staff on the Uniform Statewide Accounting System (USAS) and the Health and Human Services Administrative System (HHSAS), and ensuring appropriate reconciliation procedures are established and documented. Although TDH has identified that many of the new findings are one-time issues often found with the implementation of a new system, TDH recognizes that underlying systemic issues contributed to these findings.*

### KPMG Findings

*TDH provided detail responses to the five reporting issues identified by KPMG. As mentioned in those responses, TDH has implemented or is in the process of implementing procedures to address the findings.*



Establish policies and procedures for reconciling HHSAS and USAS and making and approving the correcting entries.

*We concur that in addition to reconciling the systems it is important to have policies and procedures that document the process and defines roles and responsibilities. The reconciliation processes are currently undergoing review. The final procedures will document the process and clearly define roles and responsibilities. The timeline for completion is June 1, 2003.*

*Additionally, the Fiscal Division is being restructured to establish a quality assurance section. This restructuring should assist in minimizing errors. The timeline for completion is June 1, 2003.*

Reconcile HHSAS and USAS and internal systems on a monthly basis and verify that HHSAS contains accurate and complete financial information.

*As mentioned above, TDH's reconciliation procedures are being revised. The procedures will provide for monthly reconciliation and timely entry of reconciling entries. The timeline for completion of these procedures is June 1, 2003.*

Provide staff with additional training on HHSAS

*TDH recognizes the importance of staff having the skills and competencies necessary to fulfill their job duties. TDH has recently filled critical positions in the Fiscal Division with staff who have attended the Comptroller's Integrated Statewide Administrative System (ISAS) General Ledger Training. HHSAS is a modified version of ISAS so this training will be helpful in usage of HHSAS. Additionally, TDH has contracted with the Comptroller's Office to develop a training plan specific to the needs of the Fiscal Division. TDH anticipates training will be ongoing.*

Estimate Accounts Payable Based on the first 60 days of the new fiscal year.

*As part of the corrective actions for the FY 2002 Annual Financial Report, we develop HHSAS queries that allow us to extract accounts payable transactions from the expenditures of the new fiscal year. These were used to provide correcting entries for FY 2002 and will be a part of our FY 2003 report preparation procedures. This will prevent a recurrence of the understatement that happened with the FY 2002 report.*

Implement its Internal Auditor's Recommendations on HHSAS

*Actions taken to address internal audit recommendations include regular monitoring of vendor interest liability, changes to the HHSAS payment matching criteria for detection of potential duplicate payments, and staff development and training efforts including both PeopleSoft and ISAS courses. We will continue to work closely with our internal auditors to address any new or remaining HHSAS issues.*

Implement Prior Recommendations by the State Auditor's Office (SAO)

See Management's Response to the prior year finding on pg. 21.

Implementation Date: June 1, 2003

Responsible Person: Chief Financial Officer

## **The Health and Human Services Commission Did Not Reconcile Its Internal Accounting System with USAS**

Reference No. 03-555-02

The Health and Human Services Commission (Commission) did not reconcile its internal accounting system (HHSAS) with USAS for fiscal year 2002. As a result, the Commission needed to record \$508 million in transactions (with a net amount of \$163 million) in HHSAS that it had initially recorded only in USAS. As of January 23, 2003, the Commission had reconciled all but four appropriations and had recorded \$160 million of the \$163 million in net transactions in HHSAS. The corrections already recorded have reduced the cash balance in HHSAS by \$160 million to reflect the actual USAS cash balance. The majority of the \$163 million in corrections is related to federal funds. The Commission had identified that it needed to conduct the reconciliation, proposed corrective action, and completed the majority of the reconciliation within an appropriate time frame. The Commission implemented HHSAS on September 1, 2001.

### **Recommendation**

The Commission should reconcile HHSAS with USAS on a monthly basis.

### **Management's Response**

*We agree that the Health and Human services Administrative System (HHSAS) to the Uniform Statewide Accounting System (USAS) reconciliation for Fiscal Year 2002 was not completed in a timely manner. The combination of implementing a new accounting system (HHSAS) and the transition of Medicaid Agency responsibility to HHSC contributed to the delay.*

*We have completed the Fiscal Year 2002 reconciliation and are reconciling monthly. The HHSAS to USAS reconciliation process will be current by the end of April, 2003.*

*Implementation Date: April 30, 2003*

*Responsible Person: Deputy CFO, Fiscal Management*

## **The General Land Office and Veterans' Land Board Lacks Certain Controls over Loans and Contract Accounts Receivable and Overstated Interest Receivable for Fiscal Year 2002**

### *Issue 1*

#### **The General Land Office and Veterans' Land Board Lacks Up-to-Date, Comprehensive, Written Procedures for Processing and Recording Loans and Contract Accounts Receivable**

Reference No. 03-555-03

The General Land Office and Veterans' Land Board (Office) lacks up-to-date, comprehensive, written procedures for the following critical steps and processes that its Financial Reporting and Information Systems Divisions perform.

- The Financial Reporting Division lacks written procedures for the monthly process it performs to reconcile information in the Veterans' Land Board Land Loan Servicing/Lockbox System (System) to the general ledger.
- The Financial Reporting Division's procedures for making entries into the general ledger based on reports that the Information Systems Division submits need to be updated.
- The Information Systems Division lacks written procedures for the data extraction/compilation process it performs in order to report land contract receivable information to the Financial Reporting Division.

Without written procedures, there is a risk that management's expectations are not clearly communicated. The lack of documented procedures also increases the risk of inconsistent and erroneous financial reporting. Written procedures also help reduce the loss of knowledge that occurs when there is turnover among key staff.

### **Recommendations**

The Office should:

- Develop, update, and implement written procedures for all critical steps and processes related to its loans and land contract accounts receivable (including the specific reconciliation, accounting system data entry, and extraction/compilation processes discussed above).
- Regularly review staff's compliance with written procedures it develops.
- Periodically review the procedures it develops for completeness, effectiveness, and efficiency.

### **Management's Response**

*We agree that documentation of our procedures needs to be updated and reviewed. The Financial Reporting Division is in the process of writing or updating procedures for all responsibilities in the division, including those related to the land contract*

accounts receivable. These procedures will be completed by June 30, 2003. For Fiscal Year 2003, the agency implemented a new general ledger system and other subsystems. As part of this implementation, in July 2002, a re-write of all the division's relevant procedures was initiated.

In addition to updating our physical procedures manual, we have created a shared directory on the agency's network that will contain the most recent version of procedures for Financial Reporting. This will ensure that the procedures are accessible to all Financial Reporting Division staff. The Division will take proactive measures to review the procedures more frequently and to ensure staff compliance.

Information Systems is developing written documentation of the critical steps in accumulating the general ledger data from the Veterans' Land Board Land Loan Servicing/Lockbox System. The documentation includes examples of each report and identifies the critical data elements within each report and their relevance to the general ledger posting/reconciliation process.

Implementation Date: August 31, 2003

Responsible Person: Deputy Commissioner of Administration and Deputy  
Commissioner of Information Systems

#### **Issue 2**

### **The General Land Office and Veterans' Land Board Lacks Sufficient Controls to Ensure the Accuracy of Land Contract Accounts Receivable Data**

Reference No. 03-555-04

The Office needs to strengthen controls and improve processes for reporting land contract accounts receivable. Specifically, concerns were expressed about the accuracy, reliability, and consistency of the reports produced by the Information Systems Division regarding land contract accounts receivable and payment information extracted from the Veterans' Land Board Land Loan Servicing/Lockbox System (System). The Financial Reporting Division uses this data to perform reconciliations and to make entries into the general ledger. For example:

- There were concerns about the accuracy, reliability, and consistency of the reports received from the Information Systems Division. As a result, the Financial Reporting Division questioned the effectiveness of its attempts to reconcile the land contract accounts receivable amounts in the System with information in the Office's general ledger. To address this problem, the Information Systems Division developed and used a new method to extract and compile data from the System. The Financial Reporting Division then used the data from that extract in an attempt to perform a reconciliation at the end of fiscal year 2002. However, it was unable to reconcile successfully and identified a \$1.4 million difference between the System and the general ledger. As a result, the Financial Reporting Division restated the land contract accounts receivable balance in the general ledger so that it was equal to the land contract accounts receivable balance in the System.
- The Financial Reporting Division's August 2002 Cash Reconciliation report contained reconciling items that dated back to fiscal year 1996 and sometimes even before 1996. This report attempts to reconcile information in the lockbox

control ledger (which is maintained by the Information Systems Division) with information in the Office's general ledger. These reconciling items exist because of issues involving the consistency of reports produced by the Information Systems Division.

- At the end of fiscal year 2002, the Land Purchases account had a debit balance of \$10.3 million. (That account is initially debited when warrants are issued for land purchases, and it should be credited when the land accounts receivable is recorded.) Of the \$10.3 million debit balance, \$7.8 million (76 percent) was classified as a restatement to reduce the prior fund balance to correct errors in the prior reporting of land loans accounts receivable balances. The restatement was made as part of the year-end adjusting entries for the Office's 2002 AFR. According to the Financial Reporting Division, this situation occurred because of its reliance on processes that may not have properly classified transactions that were later input into the general ledger.

## Recommendations

The Office should:

- Continue its efforts to improve coordination and communication between the Financial Reporting Division and the Information Systems Division.
- Continue to document and implement the processes and controls that staff should use to verify the completeness and accuracy of the data in Information Systems Division reports from the System.
- Continue to develop and document effective methods of reconciling the System to the general ledger, and clear reconciling items in a timely manner.
- Establish specific controls related to the Land Purchases account, including the monitoring of entries to prevent future misstatement.

## Management's Response

*We agree that controls over the Veterans' Land Board Land Loan Servicing/Lockbox System need to be improved. The Financial Reporting Division and Information Systems will continue to work toward improving coordination and communication. Information Systems has implemented a new process to extract and compile data for posting to the control ledgers and generating journal entries. To improve the method of communication, Information Systems is now sending its reports by email so that delivery of the ledger entries and control ledgers can be tracked.*

*Information Systems is summarizing the monthly detail in an Access database to verify the balances from month-beginning to month-end. The summary is compared to the month-end control ledgers to ensure all details have been processed. Information Systems is working to improve the processes so that timing issues with general ledger postings at end-of-month and beginning-of-month can be identified.*

*The Financial Reporting Division has re-designed the formats to reconcile principal, interest, and the land purchases account. Procedures for the reconciliations will be updated by June 30, 2003, and reconciliations will be performed monthly. Deadlines have been established for Information Systems to provide reconciliation data to Financial Reporting each month and for Financial Reporting to complete the reconciliations. Deadlines for resolving reconciling items will be established.*

*To assist the Financial Reporting Division in reconciling the Land Purchases account, Information Systems has developed a report to track the new land loan detail back to the issued warrant number. Information Systems has also developed a report to track the forfeited land sales back to the original account number to assist the Financial Reporting Division in reconciling the forfeited sales to accounts written off.*

*Implementation Date: August 31, 2003*

*Responsible Person: Deputy Commissioner of Administration and Deputy  
Commissioner of Information Systems*

### **Issue 3**

### **The General Land Office and Veterans' Land Board Overstated Interest Receivable for Housing Mortgages in Its Fiscal Year 2002 Annual Financial Report**

Reference No. 03-555-05

The Office overstated the balance for Interest Receivable for Housing Mortgages in its 2002 AFR by \$6.3 million. The Office reported \$16 million on its 2002 AFR, and the amount should have been \$9.7 million. The Office determined that it made an inaccurate assessment of how the housing administrator handled the application of the principal and interest payments and, because of that, it had made additional year-end interest accruals in error. While this overstatement of assets did not materially affect the Office's Combined Statement of Net Assets for fiscal year 2002, the Office should implement controls to detect or prevent this type of error. The Veterans' Housing Assistance Program is a self-supporting loan program funded through bond issuances.

### **Recommendations**

The Office should:

- Develop and implement detailed procedures for recording year-end adjusting entries.
- Perform an account fluctuation analysis prior to the release of its AFR to detect and research large reporting variances between fiscal years.

## Management's Response

*We agree that interest receivables for the Veterans Housing Assistance Program (VHAP) were over-accrued in the FY2002 AFR. The Financial Reporting Division has always made efforts to perform account fluctuation analysis prior to release of the AFR. However, with the implementation of GASB34 for FY2002, the restructured financial statements increased the degree of difficulty in performing these analyses. The fund type for the VHAP changed from Special Revenue to Enterprise Reporting; thus, prior year comparative data was not available.*

*The Financial Reporting Division will go to greater lengths to accurately perform such analysis and will improve procedures to ensure the completeness and accuracy of year-end adjustments. Since Fiscal Year 2003 will provide for two years of comparative data under the GASB 34 model, the fluctuation analysis process will be continued as in the past. Additionally, new general ledger software implemented in FY2003 allows the office to have information for multiple years open simultaneously. This allows all year-end entries to be recorded in the general ledger, which will provide greater controls over the completeness and accuracy of the data.*

*Implementation Date: November 2003*

*Responsible Person: Deputy Commissioner of Administration*

Chapter 2-D

## **Specific Improvements Are Needed in the Comptroller of Public Accounts' Access and Security Controls over TEXNET**

Reference No. 03-555-06

The Comptroller of Public Accounts (Comptroller) generally has adequate controls to ensure the reliability of TEXNET, the State's financial network that receives electronic funds transfer (EFT) payments from taxpayers. However, there are some opportunities to strengthen this system's access and security controls. In fiscal year 2002, the State collected \$24,786,408,319 (approximately 77 percent of total fiscal year 2002 tax revenues) via EFTs. TEXNET collected approximately 98.1 percent of that amount.

Strengthening access and security controls for TEXNET would help to prevent potential abuse of system components; theft of system resources; misuse of system software; improper access to system information; and improper use, modification, destruction, or disclosure of system information. The specific access and security issues we identified include the following:

- Comptroller staff do not review (1) the automated Login Fail Count report that identifies all instances in which TEXNET data has been accessed and who accessed the data or (2) the online log that lists updates that have been made to TEXNET production programs. Reviewing these logs could help to ensure that only authorized individuals access TEXNET data and modify TEXNET programs.

- The Comptroller does not require that an individual who is independent of programming move new or modified TEXNET programs into the production environment. Without this type of control, programmers could make unauthorized changes to programs and then move the modified programs into the production environment. Although Comptroller policy requires staff to perform walk-throughs of changes to program code, this is not an adequate tool for version control. In addition, the Comptroller does not have formal documentation for TEXNET programs; instead, program documentation is embedded in the program code. Changes to programs can be tracked only by reviewing the log in which access to production programs is recorded.
- Password protection for Crevou, the application that creates a file of TEXNET data that will be submitted to USAS, needs to be strengthened. Crevou has only one universal password rather than unique passwords for each user. Additionally, the universal password can be observed on the terminal screen when a user enters this password because the password is not hidden as a user types it. According to Comptroller management, the requirement for password access to Crevou is old and unnecessary. Management plans to remove that level of access when the current TEXNET programs are converted from the current software application (Clipper) to a new application and database within the next 12 to 18 months.
- Access to the Production Control Job Request online application, which notifies Production Control that a batch processing job is ready to transmit TEXNET payments to USAS, is not properly restricted. When accessing this application, all Treasury Operations personnel can see a list of jobs, some of which are not their responsibility. For example, in addition to including jobs for which Check and Electronic Processing staff are responsible, the list also includes jobs that are the responsibility of other divisions in Treasury Operations. As a result, intentionally or inadvertently, anyone in Treasury Operations can submit jobs for which they are not responsible.
- Access to the Excel spreadsheet titled “Funds Allocation Network,” which multiple Treasury divisions use, is not properly controlled. This spreadsheet is used to track the flow of funds and to balance banks’ postings with the Comptroller’s reports. Three Treasury divisions use this spreadsheet: Banking and Electronic Processing, Cash Management, and Investments. However, because access to the tabs on this spreadsheet is not restricted, it is possible for staff in one division to see and change information that is the responsibility of another division. Although staff are instructed to change only the data that they normally enter, there is no automated control to prevent them from making unauthorized or accidental changes to any of the data on this spreadsheet.

## Recommendations

The Comptroller should:

- On a regular basis, review the Login Fail Count report for TEXNET access and the log of updates to TEXNET production programs to identify unusual entries.



- Implement a program promotion process that requires an individual who is independent of programming to move new or modified TEXNET programs into the production environment.
- Formalize and document its plans to move all TEXNET programs from the current software application (Clipper) to a new application and database. In the interim, management should consider altering or disabling the password feature for Crevou.
- Work with Production Control to determine options for controlling access to the Production Control Job Request application.
- Consider converting the “Funds Allocation Network” Excel spreadsheet to a new software application that would allow automated controls to safeguard changes to the data currently maintained on this spreadsheet. In the interim, management should consider options for controlling access to this Excel spreadsheet.

### Management’s Response

- *Beginning immediately, on a regular basis (daily), the TexNet Login Fail Count report will be reviewed by an appropriate Treasury business user and the system administrator. The business user will have direct knowledge of who should and should not have access and therefore be in an appropriate position to make those determinations. Program update logs will be reviewed by the technical section supervisor with the section manager and other technical staff serving as backups to this process. This process will be incorporated into all current and future software development and will be performed as the log becomes available on each system. We plan to have the first Clipper redesign completed by June 30, 2003 and will continue the redesign work through August 31, 2004.*
- *Program promotion (migration from development or acceptance test regions to production) is being incorporated into all current and future software development. The procedures will have standard migration paths and emergency paths to be used during appropriate situations (other than standard working hours). During standard hours, this process will require an individual who did not perform the programming to migrate code to production. During non-standard hours, the emergency path may be used. Emergency migration procedures will require immediate email notification to section management and other appropriate technical staff of any proposed changes. The use of an electronic migration control tool will ensure no unauthorized code changes are made. This tool will require section management approval prior to the code migration. The procedures will require the same events to occur as during standard hours, but they will occur after the program promotion. The procedures will include peer reviews, migrating of code to other regions (e.g., development), system and user documentation, etc. Management will review options for emergency migrations to include the use of an emergency ID and one-time use password. Program update logs will reflect all activity. In the interim, management will investigate options for an electronic change control tool to manage the Clipper application changes. The target date for implementation is June 30, 2003.*

- *Management is working to formalize and document the Clipper Redesign projects. Management is considering options for Crevou's password feature. Options include modifying the program to not display the password and changing the password. We are not considering disabling the password in the current Clipper application because that would reduce the level of security. Since this program executes the creation of USAS inbound records, security access will be employed in the new design. The Clipper Redesign project is estimated to be completed by August 31, 2004.*
- *As part of the Clipper Redesign project, the Production Control Job Request application will be designed to control user access to only those programs the users have authority to initiate. The Clipper Redesign project is estimated to be completed by August 31, 2004.*
- *Management is considering options to control access to the spreadsheet called "FAN". One option is to separate the spreadsheet by Treasury divisions (e.g., Banking and Electronic Processing and Cash Management). This effort is expected to be completed by July 1, 2003.*

*Implementation Date: August 31, 2004*

*Responsible Person: Supervisor of Information Technology Treasury System*

Chapter 2-E

## **The Texas Education Agency Should Address Certain Information Technology Issues to Ensure that It Continues to Properly Administer the Foundation School Program**

Reference No. 03-555-07

The Texas Education Agency (Agency) administers the Foundation School Program as statute requires. However, there are certain information technology issues that the Agency should address to ensure that it continues to properly administer the Foundation School Program. Additional information, including recommendations and management's response, will be available in *An Audit Report on the Texas Education Agency's Administration of the Foundation School Program*, which the State Auditor's Office will release in the next few weeks.

## ***Federal Award Findings and Questioned Costs***

---

For fiscal year 2002, federal award information has been issued in a separate report. See *State of Texas Federal Portion of the Statewide Single Audit Report for the Year Ended August 31, 2002*, by KPMG LLP, dated February 24, 2003.

This page intentionally left blank.

# **Summary Schedule of Prior Audit Findings**

*State of Texas Financial Portion of the  
Statewide Single Audit Report for the  
Year Ended August 31, 2002*

## 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 auditee reports the corrective action it has taken for the finding reported in the *State of Texas Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2002* (SAO Report No. 02-555, May 2002). The Summary Schedule of Prior Audit Findings (year ended August 31, 2002) has been prepared to address these responsibilities.

### Financial Weaknesses at the Department of Health

Reference No. 02-555-01  
(Prior audit issue - SAO Report No. 01-021)

Of the five issues identified in the prior audit finding, the Department of Health (Department) has addressed one issue, has partially addressed one issue, and has not addressed three issues:

Initial Year Written:	2000
Status:	Partially Implemented

U.S. Department of Health and Human Services
---

- The Department has addressed budget transfer issues we identified in our prior report and has implemented procedures to ensure that appropriation transfers are made within the limits of Board approval.
- The Department has addressed issues regarding user access in the Uniform Statewide Accounting System (USAS). However, it has not addressed security control issues regarding its internal accounting system, the Health and Human Services Administrative System (HHSAS). The Department’s internal auditor identified insufficient security controls in HHSAS including (1) inadequate system auditing, (2) improper user function restrictions, and (3) inadequate user account and maintenance controls.
- The Department has not addressed an issue regarding the interest liability it incurs when it makes expenditures adjustments. During fiscal year 2002, the Department incurred an interest liability of \$9,837 because it made expenditure adjustments that changed a transaction’s method of financing from federal to state funds.
- The Department has not addressed an issue regarding its submission of indirect cost-recovery plans. In a letter dated January 16, 2003, the federal government stated that the Department has not provided indirect cost-recovery plans to support its indirect cost rates for fiscal years 2002 through 2004. According to the U.S. Department of Health and Human Services, the continued noncompliance with this requirement could put the Department at potential risk for losing an estimated \$30 million in federal indirect costs reimbursements. The Department submitted indirect cost proposals for fiscal years 2002 through 2004 to the U.S. Department of Health and Human Services by February 28, 2003, as required.
- The Department has not addressed an issue regarding its expenditures adjustments and coding of vouchers. During fiscal year 2002, the Department

made expenditure adjustments totaling more than \$248 million. In addition, the Department incorrectly coded 29 (43 percent) of the 67 expenditure vouchers we tested. These types of errors and adjustments impair the comparability of the Department's expenditures and weaken the reliability and consistency of the information the Department presents to decision makers and other users.

Additional information on the above issues is included in *An Audit Report on the Department of Health's Implementation of a Business Improvement Plan* (SAO Report No. 03-023, March 2003).

### **Corrective Action**

*As the SAO has indicated, TDH has addressed budget transfer issues previously identified as well. Additionally, TDH has addressed issues regarding user access in the Uniform Statewide Accounting System (USAS). TDH has further restricted USAS access by separating journal release capability from journal entry capability in the General Ledger area. Release capability is now restricted not only for expenditure and revenue related data, but also transactions made with General Ledger impact. The Department continues to confirm USAS access in compliance with the Comptroller's Semiannual Verification of USAS Users' Security Access procedures. The TDH USAS Security Coordinator prints Comptroller Access Reports twice monthly to validate revocation and receives confirmation from Comptroller on security deletions.*

*The Department is implementing similar procedures regarding security of their internal system, HHSAS. With the implementation of a third party product in conjunction with the HHSC Enterprise Service Center (ESC), the five audit recommendations of the Department's internal audit of HHSAS are completed including implementation of audit tables. Security coordinators have attended the SAO sponsored class on PeopleSoft security and will continue to work with the ESC to provide a secure environment for this system.*

*TDH will calculate the interest liability arising from the expenditure adjustment changing the method of financing from federal to state as instructed by the U.S. Department of Treasury in its June, 2002 correspondence and work with them to settle the interest liability. Further, TDH will work with the SAO to improve its cost benefit analysis for determining potential interest liability for any future expenditure adjustments. TDH has now established procedures requiring Executive management approval for such expenditure adjustments. These procedures will be revised to include presentation of expenditure adjustments exceeding \$500,000 to the Board of Health.*

*As the SAO has indicated, TDH was delayed in submitting the 2003 indirect cost plan. In preparing that plan, TDH recognized an error in the 2002 indirect cost plan and provided this information to the U.S. Department of Health and Human Services. TDH submitted the corrected 2002 and the 2003 indirect cost plan when it submitted its 2004 by the February 28, 2003 deadline. TDH continues to look at its indirect cost plan to determine where efficiencies and flexibility can be gained.*

*Activities are underway to improve voucher coding and minimize the necessity for certain adjustments while recognizing that expenditure adjustments are a necessary business practice. TDH has contracted with the Comptroller's of Public Accounts to*

*assist with hiring of key personnel, review of position classification and coordination of training on USAS, including object codes, transaction codes, and uses and interpretation of reports and inquiry screens. Policies and procedures developed by the Fiscal and Administrative Improvement Response (FAIR) teams are being implemented to centralize accounts payable processing which reduces the number of staff involved in the processing and coding decisions and better targets the training needs of TDH.*



This page intentionally left blank.

Copies of this report have been distributed to the following:

### **Legislative Audit Committee**

The Honorable Tom Craddick, Speaker of the House, Chair  
The Honorable David Dewhurst, Lieutenant Governor, Vice Chair  
The Honorable Teel Bivins, Senate Finance Committee  
The Honorable Bill Ratliff, Senate State Affairs Committee  
The Honorable Talmadge Heflin, House Appropriations Committee  
The Honorable Ron Wilson, House Ways and Means Committee

### **Office of the Governor**

The Honorable Rick Perry, Governor

### **Comptroller of Public Accounts**

The Honorable Carole Keeton Strayhorn, Comptroller

### **Department of Health**

Dr. Eduardo Sanchez, Commissioner of Health  
Mr. George H. McCleskey, Chair, Texas Board of Health  
Members of the Texas Board of Health

### **General Land Office and Veterans' Land Board**

The Honorable Jerry Patterson, Land Commissioner  
Col. Ladd Pattillo, U.S.A.R. (Ret.), Board Member  
Mr. M.S. Mike Ussery, Board Member

### **Health and Human Services Commission**

Mr. Albert Hawkins, Commissioner

### **Texas Education Agency**

Dr. Felipe Alanis, Commissioner of Education  
Mrs. Geraldine Miller, Chair, State Board of Education  
Members of the State Board of Education



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

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

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

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