An Audit Report on

The Board of Professional Engineers: A Semi-Independent, Self-Directed Agency

December 2003

Report No. 04-015

State Auditor's Office

Lawrence F. Alwin, CPA

State Auditor

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Overall Conclusion

The Board of Professional Engineers (Board) lacks basic controls needed to track, carry out, and report financial activities. This lack of control coupled with incorrect accounting practices over the Board's cash expenditures, cash receipts, and cash in bank place Board funds at significant risk through error or fraud. These problems also caused the Board to provide materially inaccurate information in its fiscal year 2002 Annual Financial Report, which could result in financial statement users' making incorrect decisions based on information in the annual report, such as the Board's financial viability as a self-directed, semi-independent agency. The Board's Statement of Activities inaccurately reported that the Board incurred a $331,906 loss during fiscal year 2002 when, in fact, it had a net income of $347,448.

Background

The Board regulates the practice of professional engineering in Texas. There are about 49,000 licensed engineers in Texas who practice 27 engineering disciplines. The Board handles about 900 enforcement inquiries per year.

The Board is one of three agencies that come under the Self-Directed Semi-Independent Agency Project Act (Vernon's Texas Civil Statutes, Article 8930). This pilot program, which also involves the Board of Architectural Examiners and the State Board of Professional Accountancy, removed these agencies from the State's appropriations process. Instead, these agencies establish their own budgets, which they have to support with the revenue they generate.

The 78th Legislature passed Senate Bill 1382 to continue the Self-Directed Semi-Independent Agency Pilot Project until September 1, 2009.

Although we did not find evidence of fraud, Board funds are extremely susceptible to misappropriation, which the Board would be unlikely to detect in a timely manner. This situation exists because:

- Personnel in the Board's Finance Team do not have the necessary knowledge, skills, and abilities to account for transactions in accordance with generally accepted accounting principles.
- The Board does not have certain necessary controls over its funds, including ensuring that persons performing certain duties are excluded from performing other duties that would enable them to commit undetected errors or fraud. For example, Finance Team personnel who account for the cash and checks the Board receives also on occasion have access to the actual checks. Having these two duties makes it possible for these employees to divert a check and not be detected.

The Board's report to the State's leadership did not include any of the performance data that is statutorily required to be in the report. In addition, the Board reported inaccurate results to the Legislative Budget Board for one of the two measures we audited.

The Board is in the process of replacing its automated regulatory system and an accounting system. It initiated this project without documenting the requirements and functionality of the final system. Consequently, the project's time line and total cost are uncertain.

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Lawrence F. Alwin, CPA
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This audit was conducted in accordance with Vernon's Texas Civil Statutes, Article 8930 (7).

For more information regarding this report, please contact Nick Villalpando, Audit Manager, at (512) 936-9500.

In addition, the Board needs to establish complete information technology policies and procedures to ensure the availability, security, maintainability, and data integrity of all its systems.

Summary of Information Technology Review

As stated previously, the Board is in the process of replacing its automated regulatory system and an accounting system. The Board initiated its Licensing and Financial Information System project without documenting the requirements and functionality of the final system. Consequently, the Board has not calculated an estimated cost of the completed project. The final system as currently estimated will cost significantly more than the $86,760 contract for phase one (acquisition and implementation). For example, the Board has budgeted an additional $70,000 for fiscal year 2004 phase two enhancements. Without a formal, documented information technology project management plan, the project's time line and cost are uncertain.

In addition, the Board needs to establish complete information technology policies and procedures to ensure the availability, security, maintainability, and data integrity of all its systems.

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Detailed Results

Chapter 1

The Board's Accounting Practices Resulted in Materially Inaccurate Financial Data and Significantly Increased the Risk of Fraud

Weaknesses in key financial controls and incorrect accounting practices place Board funds at significant risk through fraud, abuse, or error. They also caused the Board's fiscal year 2002 Annual Financial Report (AFR) to be materially inaccurate. As a result, financial statement users could make incorrect decisions based on information in the AFR.

Due to the significant risks that we identified at the Board, we performed additional audit procedures. These included:

- Tracing all funds received by the Board during fiscal year 2002 from receipt in the mailroom to deposit.
- Reconciling the Board's cash accounts to all three of its accounting systems.
- Testing an extra sample of payments to vendors that were unique to the Board.

Although we did not find evidence of fraud, Board funds are extremely susceptible to misappropriation. Under current conditions, it is unlikely that the Board would detect fraud or abuse in a timely manner because one position is authorized to perform many critical accounting functions that should be segregated among several individuals. For example, the employee in this position:

- Has both entered the majority of the Board's purchases—including two vouchers in which this employee was the payee[1]—into the Board's primary accounting system, the Uniform Statewide Accounting System (USAS), and released them for processing without any documented review or approval of these transactions.
- Can also enter and release transactions into Micro Information Products (MIP), which is the accounting system used to generate financial information for use by Board members and management. MIP and USAS are not reconciled, so it is possible for someone to use USAS to generate an inappropriate payment and keep the payment from appearing in MIP.
- Reconciles both of the Board's accounts in the State Treasury. Because no one else either performs or approves these reconciliations, it is unlikely that management would detect any errors or irregularities in a timely manner.

[1] Both the expenditures, which were a combined $73, were for appropriate Board purposes.

Chapter 1-A

Weak Controls over Expenditures and Transfers Create a Strong Risk for Error or Fraud

Board funds are highly susceptible to loss through error or fraud because of the lack of effective accounting controls over expenditures. The Board has not segregated the duties of creating, approving, and processing expenditures, which creates a risk that the person with all these duties could process unauthorized transactions. Also, the Board does not have documented comprehensive policies and procedures for staff to follow when processing expenditures.

In addition, financial statement users could make incorrect decisions based on information in the AFR. The Board materially misstated expenditures and transfers in its AFR, showing a $751,637 fund transfer as an expenditure, because there were not sufficient safeguards to detect or correct this error. The Board's Statement of Activities inaccurately reported that the Board incurred a $331,906 loss during fiscal year 2002 when, in fact, it had a net income of $347,448.

Lack of Segregation of Duties. The Board's procedures for processing cash disbursements do not adequately segregate duties (see text box). Ideally, separate people would authorize, process, record, and review transactions and handle any assets related to the transactions, such as warrants. However, one Board employee regularly performs all of these duties. Specifically, this person:

Segregation of Duties

Key duties and responsibilities need to be divided or segregated among different people to reduce the risk of error or fraud. This should include separating the responsibilities for authorizing transactions, processing and recording them, reviewing the transactions, and handling any related assets. No one individual should control all key aspects of a transaction or event.

Source: *Standards for Internal Control in the Federal Government*, United States Government Accounting Office, p. 14

- Created purchase vouchers, including two in which this person was the payee (the vouchers were for a combined $73 and were for appropriate Board purposes) without documented review or approval by Board management or staff. We found 5 transactions, including an interagency payment of $9,783, out of 25 tested (20 percent) in which there was no evidence that anyone except this person had taken any part in processing the transaction. All purchases we tested were for appropriate Board purposes. The amount of potential loss is increased because the Finance Team processes purchase vouchers for more than $500 without documented approval by the executive director, which violates Board policy.

- Entered and released more than half the Board's fiscal year 2002 purchases into the Board's primary accounting system, USAS, without any documented review or approval. This person can also enter and release transactions into MIP, which is the accounting system used to generate financial reports for Board management. MIP and USAS are not reconciled, so it is possible for someone to use USAS to generate a fraudulent payment and keep the payment from appearing in MIP.

- Is authorized to receive warrants and warrant reports from the Office of the Comptroller of Public Accounts (Comptroller's Office) without any other Board employee reviewing them.

- Reconciles both of the Board's accounts in the State Treasury. Because no one else either performs or approves these reconciliations, it is unlikely that management would detect fund diversion by this person in a timely manner.

Lack of Comprehensive Expenditure Policies. The Board's disbursements policies and procedures are not detailed, comprehensive, or current. They do not fully describe the procedures for processing expenditures. Instead, the Board has a two-page set of policies and procedures that discusses certain steps of processing expenditures and other documents. The Finance Team supplements these documented policies with informal, undocumented policies and procedures for processing expenditures. During our testing, we found instances in which the Finance Team did not follow procedures, either documented or informal. Finance Team staff stated that they do not consistently follow the documented policies because they are outdated. For example:

- We identified vouchers in our sample that were for more than $500 and that did not have purchase requisitions signed by the executive director, which violates the Board's policy. A policy that requires transaction approval by executive management, if followed, substantially reduces the risk of material fraud.

- There is no policy requiring additional approval of large transfers of funds between the Board's strategies. During our testing, we found a journal voucher that transferred $200,000 between strategies that was signed by the Finance Team leader. While this transfer was for an appropriate purpose, large transfers should be approved by executive management, and that approval should be documented to reduce the risk that funds are not spent in accordance with executive management's and the Board's priorities and state law.

- The Board's current policies do not adequately describe how to process expenditure transactions. For example, we found that, statistically, as many as 13 percent of the Board's payments may not have adequate supporting documentation.

Use of Incorrect Accounting Practices. The Board did not use the correct accounting entries to transfer cash, resulting in a material misstatement of expenditures and transfers in the Board's fiscal year 2002 AFR. The AFR inaccurately showed $805,326 in General Funds–Other Expenditures. Two transactions, which should have been recorded as transfers, make up this balance:

- The Board received a loan in an amount equal to half its prior-year appropriation ($751,637) as start-up funds from the State's General Revenue Fund, as did all the agencies in the self-directed semi-independent agency pilot program. Per Comptroller instructions, the Board transferred the cash from the General Revenue Fund to the Board of Professional Engineers Operating Trust Fund (Fund 860) by processing an expenditure transaction through USAS. This transaction was meant to expedite the movement of funds to the Board rather than to accurately report what had occurred. In April 2002, the Comptroller issued instructions to the three pilot agencies on how to correctly record the movement of these funds as a transfer. The Board stated that it did not receive these instructions. As a result, the Board's year-end financial records continued to show this transaction as an expenditure. Therefore, the Board inaccurately reported its responsibility to repay these funds in its AFR.

- The Board unsuccessfully attempted to transfer $52,643 of Deferred Revenues from the General Revenue Fund to Fund 860. It then processed the transaction as an expenditure to move the funds.

Chapter 1-B

Incorrect Revenue Accounting Practices Resulted in Inaccurate Data

When accounting for revenue, the Finance Team engages in incorrect procedures that compromise the accuracy of the Board's revenue data in USAS, its primary accounting system, and in its AFR. Specifically:

- The Board does not record revenue in USAS when the Board receives it. Instead, the Board records revenue when it transfers funds from its account in the Texas Treasury Safekeeping Trust Company (Safekeeping Trust) to its State Treasury account to pay expenses. This practice is not in accordance with generally accepted accounting principles.

  For example, the Board did not record in USAS any professional fee revenue that it collected during June 2002. This failure to record these transactions caused revenues from Professional Fees to be understated by $358,380 in USAS. In addition, the occupational tax portion of license fees that the Board collected for the State's General Revenue Fund in June 2002 ($1.2 million) was not recorded in USAS until early August, when the funds were transferred to the State Treasury to remit these fees to the State.

- When the Board enters revenue into USAS, it records the revenue into strategies for which it needs money to cover planned expenses rather than the strategies in which the revenue is earned. For example, money earned from exam fees may be recorded as receipts from the Board's executive management functions instead. Funds should be recorded in the strategy earned and then transferred as needed and where appropriate.

- The Board uses three different accounting systems but does not reconcile them. Not reconciling these systems increases the risk that data from one of the systems will be inaccurate due to undetected errors. According to the Board, it tried to reconcile these systems once, but it could not resolve a discrepancy of $50,000 and has not tried to reconcile the systems since.

- The Board incorrectly recorded as revenue funds that it collected in fiscal year 2002 for professional examinations it administered in fiscal year 2003. Because the funds were not yet earned, the Board should have recorded them as Deferred Revenues. The Board never differentiated these funds from license and fee revenues. As a result, revenues were overstated on the Board's Statement of Activities.

- The Board does not make adjusting entries to USAS or MIP for checks that were previously deposited but then returned by the Safekeeping Trust. As a result, revenue in both systems could be overstated.

Chapter 1-C

The Board's Reconciliations Are Not Adequate to Protect Cash Balances

The Board does not perform the necessary cash reconciliations needed to protect its cash deposits in the Safekeeping Trust and the State Treasury. As a result, there is an increased risk that the Board will not detect errors or unauthorized transactions in a timely manner:

- The Board reconciles USAS and its cash balances in the Safekeeping Trust only once a year. The reconciliation is incomplete because it does not include reconciling the current cash balance to revenue recorded in USAS, and it does not generate a detailed list of deposits in transit and other outstanding items. If the reconciliation had included USAS revenue, it is likely that the Board would have identified its failure to record professional fee revenue earned in June 2002 (see Chapter 1-B).

- The reconciliation of the Board's cash in the State Treasury, which it states it performs every six weeks, may not identify other potential issues with cash. We found a $550 warrant that the Board issued in April 2002 for an expense that it later properly paid through other means. The Board should have canceled the initial warrant when it later paid the expense, but it did not. Subsequent reconciliations failed to identify that this warrant was still active. The warrant was not canceled until we identified it through our fieldwork in July 2003.

  In addition, no one reviews this reconciliation once it is prepared. This lack of review is problematic because the Board employee who performs this reconciliation is involved in all stages of expenditure transactions (see Chapter 1-A).

Chapter 1-D

Other Financial Reporting Errors

In addition to the errors previously discussed, the Board also incorrectly:

- Presented the majority of its financial activity in proprietary funds instead of special revenue funds. This error resulted in the incorrect classification of the Board's $829,688 as Net Assets rather than the correct classification of as Designated Fund Balance, per the Comptroller's reporting instructions.

- Reported receipt of $40,846 in additional appropriations during fiscal year 2002. The majority of these funds were payments from the State's General Revenue Fund and made by the Employees Retirement System on behalf of the Board for group insurance contributions for retirees. However, the Self-Directed Semi-Independent Agency Project Act (Vernon's Texas Civil Statutes, Title 132, Chapter 19, Article 8930) explicitly states that no costs will be incurred by the State's General Revenue Fund on behalf of the project agencies.

Recommendations

Board management should improve the Board's accounting and safeguards over its funds. Specifically, the Board should ensure that the Finance Team and Board management have the knowledge, skills, and abilities needed to account for and track the Board's financial activities; segregate duties; and establish, document, and implement controls.

Ensure that the Finance Team and Board management have the knowledge, skills, and abilities needed to account for and track the Board's financial activities. To ensure that its financial information is accurate and to protect funds from fraud, the Board should:

- Ensure that Finance Team personnel are competent to account for the Board's finances in accordance with generally accepted accounting principles. Management should increase the Finance Team's expertise by training current personnel and adding personnel who already have the necessary skills.

- Ensure that the members of executive management who supervise the Finance Team have a sufficient understanding of agency finances and internal controls to provide meaningful oversight.

- Require in future contracts with financial statement preparers that they discuss any accounting problems they detect with the Finance Team and Board executive management.

Segregate Duties. Adequately segregating duties will decrease the risk of fraud and error. Although it is difficult to achieve ideal segregation of duties in a small agency like the Board, the Board has a sufficient number of employees to make the following changes:

- Require that employees other than those who enter transactions into USAS handle cash and ensure that USAS is reconciled to the Board's other accounting systems.

- Designate employees who are not part of the Finance Team to receive and mail out the warrants.

- Have someone other than the preparer review reconciliations. Management should consider having the Director of Administrative Services perform a thorough review of cash reconciliations and reconciliations between accounting systems after receiving adequate training on how to do such a review.

- Ensure that more than one person is involved with each disbursement. The Board should require that each voucher have at least two signatures. It would be preferable if one signature were that of a Finance Team member who entered the transaction into USAS and the second signature were that of a different Finance Team member who released the transaction into USAS. The executive director should sign all transactions over a certain amount documented by policy (currently $500).

Establish, document, and implement controls. The Board should establish, document, and implement the following controls, which will decrease the risk for error or fraud:

- Reconcile cash accounts with the State Treasury monthly. These reconciliations should account for all deposits and withdrawals from both accounts.
- Reconcile its accounting systems regularly. The new accounting system that the Board is procuring to replace its two in-house accounting systems should simplify this process. (See Chapter 3 for further discussion of this acquisition.)
- The Board should update and complete its current policies to reflect its current operations and address the recommendations in this report. Among the policies the Board should create are the following:
    - No person should be the sole processor of a voucher for which he or she is the payee.
    - Executive management should approve significant transfers between strategies.
    - Minimum documentation, which the policies should define, should be required for vouchers.
- The Board should review its AFR for completeness and accuracy before submitting it.

Repay the State. The Board should repay the Employees Retirement System the $40,846 it was incorrectly appropriated in fiscal year 2002.

Management's Response

Recommendation-Ensure that the Finance Team and Board management have the knowledge, skills, and abilities needed to account for and track the Board's financial activities.

The Board takes internal controls and financial accuracy very seriously. Using the flexibility of our Self Directed Semi-Independent (SDSI) status, we have been able to reorganize our staffing to include another person on the financial team and to bring in a new Director of Financial Services. The Board will also no longer be outsourcing the preparation of our financial statements.

The Director of Financial Services position requires a substantial state government accounting and financial background including experience with state accounting practices and systems, experience preparing AFR's and other required reports. This position will have responsibility for all funds management and financial reporting for the agency. This position has been successfully filled.

The new Financial Services Director will have lead responsibility for defining roles and responsibilities for our financial team and for identifying training needs and ensuring that training is provided. New written job descriptions for the financial team will be in place by Feb. 1, 2004 and a training plan for financial staff covering *the remainder of FY 2003 and all of 2004 will also be documented and ready to be implemented by that date.*

While agreeing with the need for upgraded and better trained financial staff one issue cited as showing these needs merits special discussion. This issue relates to the SDSI seed money transfer of $751,637. The audit cites this transaction and the way it was reported as a material misstatement of expenditures in the Board's FY 2002 AFR. The money was a one-time repayment of start-up money from the new SDSI program, and as the money has been repaid in full, this situation will never arise again. It is important to note that the money was never lost or unaccounted for, and posed no risk to the agency or to the program. The money was simply listed incorrectly in the AFR.

Recommendations- Establish, document and implement controls and segregate duties.

Response-*The Board appreciates the thoroughness of the audit in identifying these needed improvements. Developing written procedures and policies addressing these issues will be a primary new responsibility of the new Financial Director position and will be in place by March 31, 2004. We recognize that the audit undertook extensive and costly efforts to ensure to detect fraud and we are pleased that no evidence of fraud was found.*

We recognize that segregation of duties is one of the key areas where new, formalized and unfailingly applied procedures are needed. New policies and procedures for segregation of duties will receive foremost attention and be in place by February 1, 2004. These policies will include back up provisions for when all personnel involved in segregated duties are not present. As a small agency this we recognize has been a particular vulnerability.

Recommendation-Repay the State.

Response-*This was done in September 2003, as soon as the audit team made us aware that in following their usual practice the Employees Retirement System had used their appropriations to pay benefits for the Board's retirees. TBPE had budgeted funds to pay employee benefits and had never spent or intended to spend those funds for any other purpose. To further prevent a repeat of this issue the Board will send a letter to ERS each year reminding ERS of our SDSI status and the need to bill us for the cost of our benefits.*

Chapter 2

Performance Data Provided by the Board Is Incomplete and Inaccurate

The Board did not include the performance data that is statutorily required to be in its biennial report to the State's leadership. For one of the two performance measures we audited (Complaints Resolved), the Board reported inaccurate results to the Legislative Budget Board. The Board is replacing the automated regulatory system that it had in place during audit fieldwork, which had significant system utility and accuracy issues that increased the Board's risk of generating inaccurate data.

Chapter 2-A

The Board Did Not Include Any of the Statutorily Required Performance Data in Its Report to State Leaders

The Board did not include any of the performance data required by the Self-Directed Semi-Independent Agency Project Act in its biennial report to the State's leadership. The act requires the self-directed semi-independent agencies to report the number of exam candidates, licensees, certificate holders, and enforcement activities. The Board erroneously stated in its biennial report that this performance information would be provided in its AFR.

Recommendation

The Board should ensure that its biennial report contains all statutorily required information.

Management's Response

The Board regularly collects and reports performance data, as well as other kinds of data to many different state agencies. The missing data in the biennial report in question had been collected but was omitted during the preparation of the final report. To further ensure accuracy and completeness all future reports will undergo an additional review, generally by the appropriate director.

Chapter 2-B

We Certify One of the Two Performance Measures We Audited as Accurate

We certify one of the two measures (Number of New Licenses Issued to Individuals) we audited as accurate. We certify the other measure we audited (Complaints Resolved) as inaccurate because the Board used incomplete data to calculate it. Specifically, the Board understated the number of Complaints Resolved by 9 percent because it did not include the number of preliminary investigations resolved in its calculation. The Board reported that it had resolved 327 complaints, while the actual result was 357. The Board has not documented how its employees should collect performance data and calculate the results, which may have contributed to this error.

Recommendations

To improve its performance reporting, the Board should:

- Document current policies and procedures for calculating all performance measures.
- Institute a quality control process to check data produced for all performance measures.

Management's Response

The audited measure that was uncertified was uncertified due to data collection and calculation methods required by our previous obsolete database. This particular condition will not exist with the new database system we have successfully implemented. To further ensure the accuracy of performance measures Board staff will review and document all definitions and methods for calculating measures by March 1, 2004 and institute an additional review prior to submittal.

Chapter 2-C

Limitations and Weaknesses in the Board's Legacy Regulatory Software Reduced Its Ability to Provide Accurate Information

The regulatory software that the Board was using during our fieldwork has significant system utility and accuracy issues. The system was designed by the same vendor that designed the system discussed in *An Audit Report on the Board of Architectural Examiners: A Self-Directed, Semi-Independent Agency* (SAO Report No. 03-035, June 2003). The following problems have caused the Board to procure a replacement system:

- The Board was unable to process license applications and payments for more than a week because the system assigned duplicate application numbers to applicants when a Board employee released a batch into the system to revise date information.
- The system has limited ability to generate ad hoc reports to meet the Board's informational needs. Board personnel have to create workarounds and external databases to compensate for this lack of system utility.
- The system will generate inaccurate social security numbers if fewer than nine numbers are entered by adding a zero for each missing number. The system also allows entry of duplicate social security numbers and entry of existing licensees' social security numbers into the application portion of the system.

Recommendation

The Board should ensure its new system does not have the same deficiencies as its current system.

Management's Response

The new database that has been implemented has successfully addressed the deficiencies of the old system. The deficiencies identified by the audit team are good examples of why the Board was already developing the new system when the audit was performed.

Chapter 3

The Board Needs to Improve the Management of Its Licensing and Financial Information System Project to Control Costs

The Board initiated its Licensing and Financial Information System project without documenting the requirements and functionality of the final system. Consequently, the Board has not calculated an estimated cost of the completed project. The final system as currently estimated will cost significantly more than the $86,760 contract for phase one (acquisition and implementation). For example, the Board has budgeted an additional $70,000 for fiscal year 2004 phase two enhancements. Without a formal, documented information technology project management plan, the project's time line and cost are uncertain.

In addition, the Board needs to establish complete information technology policies and procedures to ensure the availability, security, maintainability, and data integrity of all its systems.

Chapter 3-A

Insufficient Project Management Contributes to the System's Need for Significant Enhancements

The Board has not used sufficient, formal information technology project management tools to oversee the acquisition and implementation of its licensing and financial information system. Consequently, the Board has already identified 55 significant enhancements needed for phase two of the system. In fact, phase two work began before phase one was complete.

As of mid-November 2003, the Board expects to be billed a total of $23,242 for phase two enhancements already completed. A review of the supporting documentation for these enhancements' costs did not provide any indication of when the work was done or by whom. This lack of information makes it difficult for the Board to ensure that it does not pay for a phase two enhancement that should have been completed as part of phase one. Additionally, some phase one requirements, such as the ability to import exam data, are actually going to be completed in phase two. As a consequence, the Board has been already charged for some work that has not yet been performed.

Furthermore, there is no documentation to indicate that the 55 enhancements will complete the system. In addition to the $70,000 that the Board budgeted for these enhancements, it has budgeted $20,600 and $21,200 for fiscal years 2005 and 2006, respectively, for additional system enhancements and maintenance.

The Board has also not determined how or whether it will integrate its MIP accounting system with the new licensing and financial information system. Ideally, such a decision would be made before a new system is implemented so that the new system is designed to function with existing systems.

Other examples of the Board's insufficient project management include the following:

- By its own admission, the Board did not verify that 100 percent of the data was transferred from the legacy system. Verification of data transfer was made on a sample basis.
- The Board did not use formal test cases to ensure that phase one met all requirements. The Board documented its system testing with a handwritten list of issues it had identified. However, it is not clear from the handwritten notes how or when the issues were resolved.
- The phase one contract specified that 40 reports were to be delivered, but the Board accepted 30 reports. The Board negotiated this change with the contractor; however, the contract was not modified to reflect this change.
- The phase one test plan states that numeric-only fields are to be tested against accepting alpha characters. However, 1 of the 55 enhancements is to correct year, ZIP, and phone number fields that accept alpha characters. This correction should have been made during phase one, at no additional cost to the Board, rather than being identified later in the project as an enhancement.

Recommendations

The Board should take immediate steps to improve its project management practices to ensure that it plans and controls project costs, delivered functionality, and timing associated with implementing the licensing and financial information system. One of these steps should be to require the Board's vendor to provide bills that adequately document what work the Board is being charged for.

The Board should prepare a comprehensive project management plan that identifies the scope of the entire project as currently envisioned and with the near future (3–5 years) in mind. The plan should incorporate all systems costs, including contractor cost, Board staff members' time, and hardware/software purchases.

Management's Response

For the enhancements to our new database and any future projects the Board will use more formal project management practices as recommended, with a formal plan for the enhancements in place by March 1, 2004. However, we consider the development and implementation of the new database to have been a successful project. The intended performance specifications have been achieved and within the amount budgeted to achieve those project objectives. The audit states that our less formalized approach to the project planning caused the need for 55 enhancements and that we had not calculated a cost for the completed project. We do not agree with those characterizations or the broader implication that the project has not been well managed. The fact that we are undertaking enhancements at some additional cost does not negate the fact that the original objectives were achieved within the original budget and the Board is satisfied with the current progress of the project. The enhancements result from the fact that as we neared our successful primary *objective of replacing the old obsolete database we had an opportunity to build on that success and to further enhance our capabilities.*

Auditor's Follow-up Comment

There have been significant deficiencies in the Board's management of its Licensing and Financial Information System project. Because the Board did not document the requirements and functionality of the final system, it is impossible to determine whether the Board has achieved its original objectives within the original phase one $86,760 budget. We found evidence to the contrary:

- The Board has paid for work not yet performed. For example, the Board has allowed its vendor to move certain phase one requirements, such as the ability to import exam data into the system, to phase two without reducing the contract cost. Such management practices increase the risk that the Board will pay the vendor twice for the same work.

- One of the phase two enhancements is to ensure that certain fields that should only accept numeric data, such as the ZIP code field, do not accept alpha characters. This correction should have been made before the Board accepted phase one, at no additional cost.

- The Board allowed its vendor to begin phase two work before phase one was accepted. Our review of the billing for this work did not provide any indication of when the work was done or by whom, increasing the risk that the Board could be double-billed for phase one work.

The billing for phase two enhancements already completed will increase the project cost more than 25 percent ($23,242) of its original phase one budget. The Board has budgeted even more funds for this project and has indicated a desire to increase the new system's functionality. Effective project management would reduce the Board's risk of overpaying its vendor and improve its ability to control project costs.

Chapter 3-B

The Board Lacks Complete Information Technology Policies And Procedures

The Board's information technology policies and procedures currently consist of only undated and unsigned policies regarding e-mail and the use of the Internet. Information technology policies and procedures are necessary to ensure the proper implementation of controls; to help guide product selection and the development process; and to achieve consistent, complete security. Specifically, the Board currently does not have:

- A formal disaster recovery plan that includes backup and recovery procedures for Board data, including the licensing and financial information system.

- Logs or receipts for backup tapes sent to offsite storage. (Management stated that as of November 2003, the Board was storing its backup tapes at the Board of Architectural Examiners.)

- A policy for access controls such as the proper use of passwords and administration of systems.

Additionally, formally documented and approved policies and procedures will help the Board:

- Demonstrate management's clear support for the information technology function

- Achieve lower technology costs by standardizing controls

- Establish a basis for disciplinary actions

Recommendation

The Board should develop and implement formal information technology policies and procedures that include physical security, application security, disaster recovery, and data security.

Management's Response

The Board has not experienced significant difficulties due to using less formal and documented procedures in the areas noted, however, the Board agrees there are benefits to developing a more comprehensive and formal set of written procedures. The Board will prepare a formal written set of information technology policies by May 31, 2004.

Appendices

Appendix 1

Objectives, Scope, and Methodology

Objectives

Our audit objectives were:

- To verify the accuracy of certain key financial statement balances and the effectiveness of key financial controls at the Board of Professional Engineers (Board).
- To verify the accuracy of certain key Board performance measures and the controls responsible for ensuring that they are accurate.

Scope

The scope of this audit included examining data submitted by the Board to the 78th Legislature to fulfill the requirements of Vernon's Texas Civil Statutes, Article 8930 (8), Self-Directed Semi-Independent Agency Project Act.

Methodology

We gained an understanding of the Board's overall control structure (control environment, control procedures, and accounting systems) to determine the extent of our audit plan.

We became aware of significant internal control weaknesses as a result of our initial audit planning, especially in regard to the Board's cash and cash receipts. As a result, we significantly expanded our work in these areas.

- Because the Board's Finance Team did not perform an effective reconciliation of its cash in the Texas State Treasury Safekeeping Trust Company, we reconciled this account with all three of the Board's accounting systems for all of fiscal year 2002.
- We traced all funds received by the Board during fiscal year 2002 from receipt in the mailroom to deposit to gain assurance that funds had not been diverted by Finance Team personnel.
- We tested a supplemental sample of purchase vouchers from vendors who were not used by any state agency except the Board to attempt to detect payments to nonexistent vendors.

We tested internal controls and significant accounts as deemed necessary to determine the accuracy of financial statements in the Board's 2002 Annual Financial Report. In addition, we tested select performance data that the Board was required to include in its report to the Legislature and the internal controls in the system that produced that data.

Tests of significant account balances and classes of transactions included tests of detailed supporting transactions. For performance measures, we gained an understanding of the performance measure definitions and compared actual results with reported results. In addition, we performed analytic procedures, interviewed Board personnel, and reviewed the annual financial statements.

Other Information

Fieldwork was conducted between April and September 2003. We conducted this audit in accordance with generally accepted government auditing standards. The following members of the State Auditor's staff performed the audit:

- Greg Adams, CPA, CGFM, MPA (Project Manager)
- Victoria Harris (Assistant Project Manager)
- Rodney Almaraz, CISA, CPA, MBA
- Fred Bednarski
- Lori Field
- Gary Leach, CQA, MBA
- Jennifer Lehman
- Dennis Bushnell, CPA (Quality Control Reviewer)
- Nick Villalpando, CPA (Audit Manager)
- Frank N. Vito, CPA (Audit Director)

Appendix 2

Adjusted Financial Statements

Statement of Net Assets as of August 31, 2002

Account		Statement of Net Assets		Adjustments			Adjusted Net Assets
Assets							
Currents Assets:							
Cash and Cash Equivalents:							
Cash in Bank	$	0	$	23,186	a	$	23,186
Cash in State Treasury		379,040		0			379,040
Cash Equivalents		0		0			0
Short-Term Investments		1,584,794		(23,186)	a		1,561,608
Consumable Inventories		7,753		0			7,753
Total Current Assets	$	**1,971,587**	**$**	**0**		**$**	**1,971,587**
Non-Current Assets:							
Restricted							
Capital Assets:							
Non-depreciable							
Land and Land Improvements	$	267,037	$	0		$	267,037
Depreciable							
Building and Building Improvements		645,540		0	b		645,540
Accumulated Depreciation		(465,058)		0	b		(465,058)
Furniture and Equipment		31,604		10,563	c b		42,167
Accumulated Depreciation		(20,229)		(1,812)	c b		(22,041)
Interfund Receivables		0		751,637	d		751,637
Total Non-Current Assets	**$**	**458,894**	**$**	**760,388**		**$**	**1,219,282**
Total Assets	**$**	**2,430,481**	**$**	**760,388**		**$**	**3,190,869**
Liabilities and Fund Balance							
Current Liabilities:							
Payables from							
Vouchers Payable	$	37,934	$	0		$	37,934
Payroll Payable		110,274		0			110,274
Deferred Revenue		0		101,315	e		101,315
Employees Compensable Leave		44,971		0	b		44,971
Funds Held for Others		1,391,766		(751,637)	d		548,000
				(71,690)	f		
				6,241	c		
				(26,680)	g		
Total Current Liabilities	**$**	**1,584,945**	**$**	**(742,451)**		**$**	**842,494**

Statement of Net Assets as of August 31, 2002

Account		Statement of Net Assets		Adjustments			Adjusted Net Assets
Non-Current Liabilities:							
Interfund Payables	$	0	$	751,637	d	$	792,483
				40,846	h		
Employees Compensable Leave		15,847		0	b		15,847
Total Non-Current Liabilities	**$**	**15,847**	**$**	**792,483**		**$**	**808,330**
Total Liabilities	**$**	**1,600,792**	**$**	**50,032**		**$**	**1,650,824**
Fund Financial Statement-Fund Balances:							
Fund Balances (Deficits):							
Reserved for:							
Other	$	0	$	751,637	d	$	751,637
Unreserved Designated for:							
Other		0		(6,241)	c		381,581
				26,680	g		
				71,690	f		
				(101,315)	e		
				(40,846)	h		
				431,613	b		
Undesignated		0		0			0
Total Fund Balance	**$**	**0**	**$**	**1,133,218**		**$**	**1,133,218**
Total Liabilities and Fund Balance	**$**	**1,600,792**	**$**	**1,183,250**		**$**	**2,784,042**
Government-wide Statement-Net Assets							
Net Assets:							
Invested in Capital Assets, Net of Related Debt	$	458,893	$	10,563	c	$	467,644
				(1,812)	c		
Restricted for:							
Unrestricted		370,796		(431,613)	b		(60,817)
Total Net Assets	**$**	**829,689**	**$**	**(422,862)**		**$**	**406,827**

Explanation of Adjustments on pages 21 and 22.

Statement of Activities for the Fiscal Year Ended August 31, 2002

Account	Statement of Activities	Adjustments		Adjusted Statement of Activities
Revenue				
Legislative Appropriations:				
Original Appropriation	$ 0	$ 0		$ 0
Additional Appropriations Revenue	40,846	(40,846)	h	0
Licenses, Fees, and Permits	2,524,799	(52,643)	i	2,462,052
		(101,315)	e	
		71,690	f	
		26,680	g	
		(7,159)	j	
Sales of Goods and Services	0	7,159	j	7,159
Interest and Investment Income	25,602	0		25,602
Other	100	0		100
Total Revenue	**$ 2,591,347**	**$ (96,434)**		**$ 2,494,913**
Expenditures				
Salaries and Wages	$ 1,016,123	$ 0		$ 1,016,123
Payroll Related Costs	297,417	0		297,417
Professional Fees and Services	143,967	0		143,967
Travel	36,428	0		36,428
Materials and Supplies	130,864	(65,083)	k	65,781
Communications and Utilities	43,688	0		43,688
Repairs and Maintenance	21,284	0		21,284
Rentals and Leases	17,851	0		17,851
Printing and Reproduction	12,398	0		12,398
Claims and Judgments	0	0		0
Other Operating Expenditures	1,176,164	(751,637)	d	436,967
		65,083	k	
		(52,643)	i	
Capital Outlay	0	0	c	0
Depreciation Expense	27,068	1,812	c	28,880
Interest	1	0		1
Total Expenditures/Expenses	**$ 2,923,253**	**$ (802,468)**		**$ 2,120,785**
Excess of Revenues over Expenditures	**$ (331,906)**	**$ 706,034**		**$ 374,128**

Statement of Activities for the Fiscal Year Ended August 31, 2002

Other Financing Sources (Uses)							-
Net Change in Reserve for Inventories	$	(14,208)	$	0		$	(14,208)
Transfers In		751,637		52,643	i		804,280
Transfers Out		0		(52,643)	i		(52,643)
Legislative Transfers In		0		0			0
Legislative Transfers Out		(50,000)		0			(50,000)
Increase/Decrease in Net Assets Due to Interagency Transfer of Capital Assets		0		0			0
Total Other Financing Sources (Uses)	**$**	**687,429**	**$**	**0**		**$**	**687,429**
Net Change in Fund Balances	**$**	**(59,748)**	**$**	**717,948**		**$**	**658,200**
Net Change in Net Assets	**$**	**415,271**	**$**	**(11,914)**		**$**	**403,357**
Fund Financial Statement-Fund Balances							
Fund Balances, Beginning	$	110,987	$	0		$	110,987
Restatement		0		0			0
Fund Balances, September 1, 2001, as Restated		110,987		0			110,987
Net Change in Consumable Inventories	$	0	$	0		$	0
Appropriations Lapsed		(51,239)		0			(51,239)
Restatement		0		431,613	b		415,270
				(27,068)	b		
				10,725	b		
Fund Balances, August 31, 2002	**$**	**0**	**$**	**1,133,218**		**$**	**1,133,218**
Change in Net Asset	$	415,271	$	4,429	c	$	(11,913)
				(431,613)	b		
Net Assets-Beginning							
FY01 Capital Assets Balances in GFAAG	$	1,089,362	$	0	b	$	1,089,362
Assets to Not Previously Reported Intra/CIP		0		4,322	c		4,322
Reduce for Threshold Increase of Capital Assets		(125,232)		0	b		(125,232)
Accumulated Depreciation from Prior Years		(478,170)		0	b		(478,170)
FY01 Compensable Leave Balance in GLTDAG		(71,542)		0	b		(71,542)
Net Assets, September 1, 2001, as Restated and Adjusted	**$**	**414,418**	**$**	**4,322**		**$**	**418,740**
Net Assets-August 31, 2002	**$**	**829,689**	**$**	**(422,862)**		**$**	**406,827**

Explanation of Adjustments on pages 21 and 22.

Explanation of Adjustments

[a] The Board incorrectly recorded $23,186 invested in the Safekeeping Trust Company as Short-Term Investments rather than Cash in Bank.

[b] As discussed in Chapter 1-D, the Board incorrectly reported its financial activity in the Texas Board of Professional Engineers Operating Trust Fund (Fund 860) as a Proprietary Fund instead of a Special Revenue Fund. The majority of the Board's financial activity occurs within Fund 860. There are significant differences in accounting for financial activities in these two fund types:

- For Proprietary Funds, the difference between assets and liabilities is reported as Net Assets, and Capital Assets and Long-Term Liabilities are reported within Proprietary Funds.
- For Special Revenue Funds, the difference between assets and liabilities is reported as Fund Balance. In addition, Capital Assets and Long-Term Liabilities are reported outside Special Revenue Funds, in separate adjustment columns.

The following adjustments are needed to report Fund 860 as a Special Revenue Fund rather than a Proprietary Fund:

- All Capital Assets, including Land, Buildings, Furniture and Equipment and the accumulated depreciation associated with those accounts is moved to the Capital Assets Adjustments column, which is not shown on these summarized statements.
- Employees' Compensable Leave is moved to the Long-Term Liabilities Adjustments column, which is not shown on these summarized statements.
- Unreserved Fund Balance Designated for Other increases by $431,613.
- Unrestricted Net Assets decrease by the same amount.
- There is a $415,270 Restatement of Fund Balance on the Statement of Activities that consists of three adjustments:
- An increase of $431,613 due to the Board restating Net Assets as Fund Balance
- A decrease of $27,068 due to the Board reporting fiscal year 2002 depreciation expenses as fiscal year 2003 expenses
- An increase of $10,725 which is the difference between fiscal year 2002 and 2003 Employees Compensable Leave balances
- There is a $431,613 decrease in the Change in Net Assets on the Statement of Activities.

[c] The Board understated Furniture and Equipment by $10,563, resulting in the following adjustments:

- Furniture and Equipment increases by $10,563.
- Accumulated Depreciation for Furniture and Equipment increases by $1,812.
- Funds Held for Others increases by $6,241. (See Note g.)
- Unreserved Fund Balance Designated for Other decreases by $6,241.
- Net Assets - Invested in Capital Assets, Net of Related Debt increases by $10,563.
- Net Assets - Invested in Capital Assets, Net of Related Debt decreases by $1,812.
- In Capital Outlay Expense on the Statement of Activities, the Special Revenues Funds column increases by $6,241 and the Capital Assets Adjustments decreases by the same amount. For the purposes of this report, we did not show all the financial statement columns, but we wanted to provide information about this movement between columns.
- Depreciation Expense on the Statement of Activities increases by $1,812.
- This increase of $4,429 in Interfund Payables in Change in Net Asset is the sum of the following adjustments:
- An increase of $6,241 due to the previously unrecognized Capital Outlay expense
- A decrease of $1,812 due to previously unrecognized Depreciation Expense
- Assets to Not Previously Reported Intra/CIP on the Statement of Activities increases by $4,322.

d As discussed in Chapter 1-A, the Board incorrectly showed the movement of $751,637 in start-up funds from the General Revenue Fund as an expenditure. Instead, it should have been shown as a Transfer In to the General Fund. The money should have then been moved to the Special Revenue Fund by creating an Interfund Receivable, with corresponding Reserved Fund Balance, in the General Fund and reclassifying $751,637 of Funds Held for Others as an Interfund Payable in the Special Revenue Fund. Correcting this error results in the following adjustments:

- Interfund Receivables increases by $751,637.
- Funds Held for Others decreases by the same amount.
- Interfund Payables increases by $751,637.
- Fund Balance Reserved for Other increases by the same amount.
- Other Operating Expenditures on the Statement of Activities decreases by $751,637.

e As discussed in Chapter 1-B, the Board incorrectly recorded as Revenue $101,315 in fees it collected in fiscal year 2002 for examinations that it administered in fiscal year 2003. Correcting this error requires the following adjustments:

- Deferred Revenue increases by $101,315.
- Unreserved Fund Balance Designated for Other decreases by $101,315.
- Licenses, Fees, and Permits on the Statement of Activities decreases by the same amount.

f The Board understated Professional Fee Revenue by $71,690 because the Board did not furnish complete information regarding these revenues to the contractor it hired to prepare its Annual Financial Report. Correcting this error resulted in the following adjustments:

- Funds Held for Others decreases by $71,690. (See Note g.)
- Unreserved Fund Balance Designated for Other increases by the same amount.
- Licenses, Fees, and Permits on the Statement of Activities increases by the same amount.

g The Board overstated Funds Held for Others by $843,766. Of this amount, $751,637 was start-up funds that should have been recorded in Interfund Payables (see Note d) and $92,129 (the remaining difference between reported and actual Funds Held for Others) that should have been recorded as Unreserved Fund Balance Designated for Other. The $92,129 is made up of three amounts: (1) $6,241 discussed in Note c, (2) $26,680 that should have been recorded in Licenses, Fees, and Permits, and (3) $71,690 discussed in Note f.

h As discussed in Chapter 1-D, the Board incorrectly reported that it had received $40,846 in Additional Appropriations. Almost all these funds were from the State's General Revenue Fund that the Employees Retirement System used to pay the Board's group insurance contributions for retirees. The Board was not entitled to this payment and should have considered it a loan. Correcting this error results in the following adjustments:

- Interfund Payables increases by $40,846.
- Unreserved Fund Balance Designated for Other decreases by the same amount.
- Additional Appropriations on the Statement of Activities decreases by $40,846.

i As discussed in Chapter 1-A, the Board incorrectly showed a transfer of $52,643 as an expenditure and corresponding revenue. The following adjustments are needed to correct this error.

- Licenses, Fees, and Permits on the Statement of Activities decreases by $52,643.
- Other Operating Expenditures on the Statement of Activities decreases by $52,643.
- Transfers In increases by $52,643.
- Transfers Out decreases by $52,643.

j The Board incorrectly recorded revenue of $7,159 from selling lists and labels as Professional Fees rather than Sales of Goods and Services. The following changes are necessary to correct this error:

- A decrease of $7,159 in Licenses, Fees, and Permits
- An increase of $7,159 in Sales of Goods and Services

k The Board incorrectly recorded expenditures of $65,083 in Materials and Supplies rather than Other Operating Expenditures.

Distribution Information

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The Honorable Teel Bivins, Senate Finance Committee
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Texas Board of Professional Engineers

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Ms. Victoria Hsu, P.E., Executive Director