An Audit Report on

Internal Controls and Financial Processes at the Cosmetology Commission

SAO Report No. 04-019
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Overall Conclusion

There was gross fiscal mismanagement at the Cosmetology Commission (Commission) during fiscal years 2002 and 2003. During that time, the Commission significantly mismanaged its fiscal responsibilities and exposed state funds to the risk of loss and abuse. It did not maintain proper control over assets, did not discharge fiscal obligations in a timely manner, misused state funds, and did not keep adequate fiscal records. Most significantly, the Commission has not collected $2.8 million of the $4.8 million in penalties it assessed from September 1999 through June 2003 and has not followed statutory and regulatory requirements for the collection of administrative penalties. Control weaknesses in the Commission's financial operations could lead to future errors and violations of laws and regulations. In addition, the Commission had a budget shortfall at the end of fiscal year 2003 that caused it to place 38 employees (85 percent of its 44.5 full-time equivalent positions) on leave without pay and to receive an emergency deficiency grant from the Governor's Office.

Background Information

Texas Government Code, Section 2104.001, specifies four criteria that define gross fiscal mismanagement:

- Failure to maintain proper control over assets
- Failure to discharge fiscal obligations in a timely manner
- Misuse of state funds
- Failure to keep adequate fiscal records

The Commission has serious weaknesses in all four of these areas, which shows that there was gross fiscal mismanagement at the Commission during fiscal years 2002 and 2003. See Chapter 1 for additional detail.

The Commission had two executive directors during the time period that we audited. Throughout our audit, the Commission had difficulty locating records and providing explanations for issues we identified. The current executive director was hired in July 2002 and has begun to take steps to address our findings. These steps include beginning to draft financial policies and procedures, as well as resuming administrative hearings to collect unpaid penalties. We have not audited the new procedures the Commission has developed and therefore cannot assure that they are adequate. Fully correcting the Commission's gross fiscal mismanagement will require both immediate action to correct certain deficiencies and the implementation of a long-term financial remediation plan.

Key Points

The Commission has not maintained proper control over assets.

- The Commission does not follow statutorily required procedures and has not collected at least $2.8 million (58 percent) of the $4.8 million in administrative penalties it assessed from September 1999 through June 2003 for violations of cosmetology laws and regulations. This reduces the incentive for cosmetologists to comply with laws and regulations.
- The Commission's procedures for handling revenue place state funds at a high risk of loss or impropriety. In 2003, the State Auditor's Office Special Investigations Unit reported

that a former temporary employee of the Commission had been indicted for the alleged theft of more than $1,000 in revenues. The control weaknesses we identified could allow this kind of impropriety to occur again.

- The Commission was not able to demonstrate compliance with its authorized capital budget for construction of buildings and facilities in fiscal year 2002. Our analysis indicated that the Commission overspent its capital budget for this item by $19,699 (59.3 percent).
- Control weaknesses in the Commission's expenditure processes could allow inappropriate transactions to be processed. For example, a single employee has the ability to add data for new employees, revise salaries, and generate state warrants. This creates a risk that the employee could create fictitious employees and generate payments to them. Although we found no instances of such payments, this increases the risk that inaccurate or inappropriate activity could occur without detection.

The Commission has not discharged fiscal obligations in a timely manner.

- The Commission underpaid TexasOnline subscription fees and did not make payments for these subscription fees in a timely manner.
- The Commission did not deposit 23.5 percent of revenue deposits we tested within three business days as required by the Texas Government Code.
- The Commission's failure to collect administrative penalties shows that it is not managing its finances in a timely way.

The Commission misused state funds.

- The Commission's former Chief Financial Officer circumvented the Commission's purchasing process to award a $1,000 contract to a personal associate. The Commission is currently pursuing recovery of these funds with the assistance of the Office of the Attorney General.
- As discussed above, our analysis indicated that the Commission overspent its capital budget for construction of buildings and facilities in fiscal year 2002 and used funds for a purpose other than those allowed by the General Appropriations Act (77th Legislature).
- As discussed above, the Commission has control weaknesses over revenue collection that place state funds at a high risk of loss and impropriety.

The Commission has not maintained adequate fiscal records.

- Throughout our audit, missing or inadequate documentation made it difficult for the Commission to provide information in response to our requests.
- The Commission does not reconcile the cash balance in its State Treasury account to identify errors or discrepancies. Without proper and timely reconciliations, errors or misappropriation of funds could go undetected. Reconciliations are also an important part of ensuring that management has accurate information for managing the budget. This is particularly important because the Commission experienced a budget shortfall at the end of fiscal year 2003.

- We found errors in or missing supporting documentation for 63.7 percent of the expenditures we randomly sampled. Based on that, we estimate that nearly $1.3 million of the Commission's expenditures from September 2001 through May 2003 could be in error or missing adequate support.
- The Commission could not locate any supporting documentation for journal vouchers that resulted in accounting entries totaling more than $1.6 million. It also lacked approval documentation for 83 percent of the journal vouchers for which it had partial supporting documentation.
- The Commission's fiscal year 2002 Annual Financial Report contained significant errors, and the Commission lacked documentation to support certain items in that report. These errors resulted in understatements totaling $111,203. In addition, the Commission did not report accounts receivable in the Annual Financial Report. As discussed above, because the Commission is not collecting all administrative penalties, the total amount of accounts receivable could have been $1,923,600 or higher.
- The Commission does not consistently assess administrative penalties in compliance with its own regulations. The result of these errors is that the Commission overcharged licensees $25,725 for some offenses and undercharged licensees $56,600 for other offenses.
- Weaknesses in the Commission's information technology controls have resulted in lost financial information and could allow the entry of duplicate inspection and violation reports.

Summary of Management's Response and Auditor Follow-up Comments

The Commission generally agrees with our findings and recommendations. However, we have provided specific follow-up comments in Appendix 2 to further clarify the Commission's responses. Our follow-up comments note that, in 2002, we recommended to the Commission that it request an audit. In addition, we reiterate that it is the Commission's responsibility (not the responsibility of the Office of the Attorney General) to schedule administrative hearings. Our follow-up comments also reinforce our contention that failure to collect administrative penalties reduces the incentive to comply with laws and regulations. We also note that the Commission was not able to show us documentation that clearly demonstrates that it did not exceed its capital budget for construction of buildings and facilities.

Summary of Information Technology Review

We reviewed selected application controls over the Commission's licensing and enforcement system. We found that the Commission lost financial information when its server crashed because it did not test to ensure that backups were working properly prior to upgrading its server. Furthermore, because the Commission did not update a table in its licensing and enforcement system when it changed its schedule of administrative penalties set in the Texas Administrative Code, it charged the incorrect amount for certain administrative penalties from September 1999 through June 2003.

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Summary of Objective, Scope, and Methodology

Our objective was to determine whether the Commission's processes and operations ensure that it is meeting statutory responsibilities, safeguarding resources, and complying with applicable laws and regulations. To accomplish that objective, we:

- Determined whether the Commission's operational processes are effective and efficient.
- Determined whether the Commission is complying with applicable laws and regulations.
- Determined whether the Commission's financial processes ensure accurate, complete, and reliable financial information.

Our audit covered licensing, enforcement, and financial processes from fiscal years 2000 to 2003. Testing of transactions focused on fiscal years 2002 and 2003 and included licenses, revenues, expenditures, and journal vouchers. We also tested compliance with laws and regulations.

The audit methodology consisted of collecting information and documentation, performing selected tests and other procedures, analyzing and evaluating the results of the tests, and conducting interviews with the Commission's management and staff.

Recent SAO Work		
Number	**Product Name**	**Release Date**
04-002	A Special Investigations Unit Report Regarding the Cosmetology Commission	September 2003
00-023	2000 Small Agency Management Control Audit	March 2000