

State of Texas Financial Portion of the
**Statewide Single Audit Report for the
Year Ended August 31, 2003**

SAO Report No. 04-555
March 2004

Overall Conclusion

The State's basic financial statements for the year ended August 31, 2003, are materially correct in accordance with accounting principles generally accepted in the United States of America. These financial statements provide a comprehensive picture of how the State used its resources during the year, as well as the State's remaining assets and obligations at the end of the year.

Auditing financial statements is not limited to reviewing the accuracy of the numbers in those statements. Conducting this audit also requires us to audit the underlying systems and processes that agencies and institutions of higher education use to record their financial activities. Through that review, we identified specific weaknesses that certain agencies and institutions of higher education need to address to ensure the accuracy of their financial information.

The ability to prepare materially correct financial statements represents a significant accomplishment for the State; however, the budget issues that have arisen during the past few years remain among the State's most significant financial challenges. In addition, preparing materially correct financial statements is only one aspect of financial accountability. As our prior audit reports have demonstrated, the State continues to face significant risks in areas such as contracting, revenue management, and information technology systems. Our office continues to monitor these significant risks and incorporate them into the risk assessment we use to identify additional audit work we will conduct.

Background Information

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

- Government-wide financial statements are designed to present an overall picture of the financial position of the State. These statements do not include retirement system assets, trust funds, or agency funds.
- Fund financial statements present financial information, focus on the most significant funds, and are presented in a form that is more familiar to experienced users of governmental financial statements.

New requirements of Governmental Accounting Standards Board (GASB) Statement No. 34 required us to conduct more extensive audit work to express an opinion on the State's basic financial statements this year. We audited material accounts of major funds at 20 of the State's largest agencies and institutions of higher education.

Key Points

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

We conducted audit work at 20 of the State's largest agencies and institutions of higher education and identified control weaknesses at only 6 of them. (Appendix 2 of this report lists the agencies and institutions of higher education we audited.) This reflects well on the State's ability to accomplish the complicated task of preparing materially accurate basic financial statements. With the third largest budget among all 50 states, nearly



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

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\$74 billion in annual expenditures, and more than 200 state agencies and institutions of higher education, the State of Texas must contend with significant complexities in preparing its basic financial statements.

Although the State's basic financial statements are materially correct, the State continues to face budget issues that remain among its most significant financial challenges. In addition, our prior audit reports have demonstrated that the State continues to face significant risks in areas such as contracting, revenue management, and information technology systems. We monitor these and other risks on an ongoing basis and incorporate them into our risk assessment. Based on that risk assessment, we identify additional audits focusing on more specific topics that would not typically be covered in an audit of basic financial statements.

Certain agencies and institutions of higher education need to address specific weaknesses to ensure the accuracy of their financial information.

- The University of Texas Southwestern Medical Center at Dallas (Medical Center) does not properly restrict its programmers' access to its accounting system's information and applications. We previously reported this same issue in 1999. Although nothing came to our attention indicating that errors or discrepancies had occurred because of this weakness, the access that programmers currently have could allow them to enter, change, or delete accounting transactions without timely detection.
- In fiscal year 2002, we reported that the Department of Health (Department) had a material weakness in its financial reporting. Although the Department has significantly strengthened certain aspects of its financial reporting, remaining weaknesses in its financial reporting reduce the reliability of its financial information. For example, the Department has not completed reconciling information in its internal accounting system with the Uniform Statewide Accounting System (USAS).
- The Health and Human Services Commission (Commission) understated its accounts payable by \$617.9 million on its fiscal year 2003 Annual Financial Report, which led to a material understatement of its liabilities and expenditures. Understating accounts payable makes it appear as if the Commission had more funds available than it actually had at the end of fiscal year 2003. The understatement occurred because the Commission misinterpreted a rider in the General Appropriations Act.
- We identified seven buildings valued at \$92 million that Prairie View A&M University (University) misclassified by including them in its Construction in Progress account instead of in depreciable capital assets. This is significant because assets classified as Construction in Progress are not depreciated, but depreciable capital assets are. In addition, three buildings (with a total cost of \$3.3 million and a current book value after depreciation of \$1.1 million) had actually been demolished but were still erroneously included on the University's list of capital assets.
- The Water Development Board (Board) does not consistently and promptly terminate users' access rights to its automated financial systems, nor does it require users to regularly change their passwords for those systems and the Board's local area network. We did not identify any financial discrepancies that resulted from these weaknesses. However, this increases the risk that unauthorized changes could be made to financial

information, could allow for misappropriation of agency assets, and could result in the material misstatement of financial reports.

- In April 2003, we reported that the Texas Education Agency (Agency) did not reconcile school district payment amounts calculated by its Foundation School Program system with school district payments actually made through USAS. Although the Agency reconciled those payments in June 2003 and August 2003, it should further enhance its reconciliation process by reconciling other funding that is processed through the Foundation School Program system. This is important because it helps to ensure that school districts receive correct payment amounts.

Summary of Managements' Responses

The agencies and institutions of higher education to which we addressed recommendations generally agreed with our recommendations.

Summary of Information Technology Review

We reviewed the internal controls over significant accounting and information systems at the agencies and institutions of higher education we audited. To do that, we identified systems that compiled and contained data used to prepare financial statements for agencies and institutions of higher education and then reviewed basic data protection controls such as user access rights, location of data, and back-up processes. As discussed above, we identified certain information technology control weaknesses that The University of Texas Southwestern Medical Center at Dallas and the Water Development Board need to address to help ensure the reliability of their financial information.

We also reviewed internal controls within USAS, the State Property Accounting system (SPA), and the Uniform Statewide Payroll/Personnel System (USPS). We did not identify any significant control weaknesses during our reviews of these systems.

Summary of Objective, Scope, and Methodology

Our objective was to determine whether the State's basic financial statements accurately reflect the balances and activities for the State of Texas for the fiscal year ended August 31, 2003.

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 of the Statewide Single Audit included an audit of the State's basic financial statements and a review of significant controls over financial reporting and compliance with applicable requirements. As required by the Single Audit

Act, this report also includes our Report on Compliance and on Internal Control over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*.

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.