

A Follow-Up Audit Report on

Internal Controls and Financial Processes at the Board of Barber Examiners

February 2005

Report No. 05-025



**State
Auditor's
Office**

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Internal Controls and Financial Processes at the Board of Barber Examiners

Overall Conclusion

Although the Board of Barber Examiners (Board) has made an effort to address findings identified in the October 2003 audit (*An Audit of Internal Controls and Financial Processes at the Board of Barber Examiners*, SAO Report No. 04-006), computer-related issues have hampered the Board's ability to fully implement the recommendations related to its licensing and enforcement functions and financial processes. Overall data integrity issues and missing data fields in the Board's computer system hamper the Board's efforts to capture reliable information. The Board has developed a number of manual processes to address these issues; however, not all of them are effective in addressing the deficiencies. Specifically, follow-up audit work identified the following:

- The Board should improve its licensing and enforcement functions to ensure that they are efficient, effective, and managed in accordance with laws and regulations. The following deficiencies currently exist:
 - At least 17 percent of shops have not been inspected in the last year; the Board's policy requires it to inspect each shop at least once every 12 months. The actual percentage may be higher because the Board has incomplete information on the number of shops available for inspection.
 - The Board is not able to ensure that payments of fines are credited to the correct violation.
 - The Board's risk-based approach to inspecting shops/licenses does not appear to be used by inspectors to determine which licensee/shop to inspect or how often to inspect them. This is in part because the computer system does not provide enough relevant information to inspectors.
 - The Board does not ensure that all the fields in the computer system have appropriate data; therefore, the Board does not have reliable data for decision-making.
- The Board has improved some weaknesses identified in its financial controls. Financial transactions tested were appropriately reviewed and sufficiently supported. However, the Board should ensure that it consistently follows its procedures regarding USAS transactions. Additionally, the Board should develop and track accounts receivable to present a more accurate picture of its fee and penalty collection efforts. We estimate

Implementation Status

The status of the 13 prior audit recommendations is as follows:

- **Five** have been **implemented**. All actions have been taken to implement the recommendations.
- **Four** have been **substantially implemented**. The majority of actions necessary to implement the recommendations have been taken.
- **Three** have been **minimally implemented**. Some action has been taken to implement the recommendations, but the action is not sufficient to show substantial progress toward completion.
- **One** is **not implemented**. No action has been taken to implement the recommendation.



that the outstanding fines that should be included in accounts receivable should be \$129,000 (41 percent of all fines assessed) for fiscal years 2000 through 2004.

Summary of Information Technology Review

A number of changes need to occur for the Board to be able to effectively use its computer system and rely on the data in the system. The Board's computer system is made up of several modules that capture information, including a cash module, a licensing module, and a violations module. These modules are not configured to relate to one another for the best use of the system. Because the violations module does not contain the necessary data and is missing a number of critical fields, this module cannot share data with the cash module. The result is that the Board cannot use the system to monitor portions of its revenue collections. Additionally, the violations data in the system is not accurate, which hampers the Board's ability to effectively monitor violations.

The Board has not determined appropriate access levels for its employees based on their job duties because the system lacks the functionality needed to restrict access to certain functions. Our review of the Board's computer system revealed significant vulnerabilities in the system, which was discussed with management.

The Board has developed a number of manual processes to address these issues; however, not all of them are effective in addressing the deficiencies.

Recent SAO Work		
Number	Product Name	Release Date
04-006	An Audit of Internal Controls and Financial Processes at the Board of Barber Examiners	October 2003

Detailed Results

Chapter 1

The Board's Progress Has Been Minimal in Implementing Recommendations Related to Its Licensing and Enforcement Functions

The first finding in the October 2003 report was that the Board of Barber Examiners (Board) does not ensure that its licensing and enforcement functions are efficient, effective, and managed in accordance with laws and regulations. Follow-up work identified additional improvements that are needed in the licensing and enforcement functions. For example, 17 percent of shops have not been inspected in the last year; the Board's policy requires that each shop be inspected once every 12 months. In addition, the Board is not able to ensure that fines paid are credited to the correct violation.

A number of changes need to occur for the Board to be able to effectively use its computer system and rely on the data in the system, as the following examples show:

- The Board's violations module is missing a number of critical fields, such as a common field that would allow it to share information with the cash module. Because of this missing field, the cash module and the violations module do not reconcile, and the system cannot apply the cash amounts paid to the individual violations.
- Inspectors do not appear to be using the Board's risk-based approach to determine which licensees and shops to inspect or how often to inspect them because the computer system does not provide enough relevant information to inspectors.

The Board has developed some manual processes to address the computer weakness; however, these processes are not sufficient to address the issues.

The Board and the Cosmetology Commission have developed a shared inspection agreement that consolidates inspection territories and uses inspectors from both agencies to inspect all shops governed by both agencies. The number of shops that the Board's inspectors will cover will increase by 43 percent under this agreement. However, the physical amount of territory covered by the inspectors will be reduced.

The tables below discuss the actions the Board has taken to implement each recommendation and the implementation status for each.

Recommendation from SAO Report No. 04-006	Status as of January 2005 and Action Taken by the Board to Implement Recommendation
<p>Recommendation 1</p> <p>Implement corrections to its licensing and enforcement system to ensure that it has accurate and up-to-date information to monitor whether inspectors are inspecting barber shops as required.</p>	<p>The Board has minimally implemented this recommendation.</p> <p>The Board indicated that the initial steps it has taken to address this recommendation include (1) removing shops from the database when inspectors report them as being out of business; (2) adding the last inspection date and last attempted inspection date to the inspectors' quarterly report (beginning with the report dated July 14, 2004) to help the Board identify and prioritize shops that need to be inspected, and (3) eliminating the four-month backlog of entering inspection reports into the system.</p> <p>While the Board has made improvements to correct its enforcement database, we found the following when we tested the actions it reported it had taken:</p> <ol style="list-style-type: none"> (1) The Board could not provide documentation to support whether shops removed from the system were actually out of business. As a result, we could not validate the Board's assertion of the number of active shops. (2) Testing showed that 4 percent of shops listed in the enforcement system (227 of 5,807) have never been inspected by the Board. These include shops that have been in the system from May 1997 through November 2003. It is unclear if this missing information is the result of incomplete data or if these shops have never been inspected. Further, the reports that inspectors use to choose shops for inspection may not be complete because the report does not include any shops that have been cancelled but are still operating. The Board cancelled these shops from the system to prevent renewal of their licenses because of unpaid fines. (3) Because the Board does not have a list of shops that should be inspected for a given period in relation to the shops that were inspected, it is difficult to conclusively determine that a backlog no longer exists. However, it does appear that the Board is entering inspection reports into the system in a more timely manner. All inspections reported on travel vouchers tested were entered into the system.
<p>Additional Computer-Related Issues</p> <p>A number of changes need to occur for the Board to be able to effectively use its computer system. The Board's computer system is made up of several modules that capture information, including a cash module, a licensing module, and a violations module. These modules are not configured to relate to one another for the best use of the system. Testing of the Board's system identified the following:</p> <ul style="list-style-type: none"> ▪ The cash module does not capture fine and book sale data. ▪ The Board's violations module is missing a number of critical fields, such as a common field that would allow it to share information with the cash module. Because of this missing field, the cash module and the violations module do not reconcile, and the system cannot apply the cash amounts paid to the individual violations. To address this issue, the Board developed a manual spreadsheet to capture cash collected for fines. However, this spreadsheet also does not reconcile to the violation data. Therefore, the Board cannot ensure that the fines paid are applied to the correct violation. ▪ Currently all six staff members in the Board's Austin office who have access to the system can block and unblock the renewal of licensees who have unpaid fines. The Board asserts that data integrity issues exist in the violations data, and our testing confirmed this. For example: <ol style="list-style-type: none"> 1) A number of fields default to zero, including the fine assessed and fines collected. 2) Test data is included with live data; therefore, the number of records is overstated by 10.5 percent (208 of 1,983). 3) The Board cannot ensure that all violations are included in the system. This is because violations are related to tickets issued by inspectors. These tickets are sequentially numbered. The system shows that tickets are missing from the number sequence with no explanation. ▪ Our review of the Board's computer system revealed significant vulnerabilities in the system, which we have discussed with management. <p>Subsequent Event</p> <p>The Board began reconciling violations in its system to its manual spreadsheet in January 2005. It anticipates completing the reconciliation in May 2005.</p>	
<p>Management's Response</p> <p><i>The Board will develop a form to use to remove out-of-business shops from its active files. Inspectors will be required to fill out the form and sign it before the agency changes the shop record to indicate that it is out of business. Date of Implementation (DOI) target is April 1, 2005.</i></p>	

Recommendation from SAO Report No. 04-006	Status as of January 2005 and Action Taken by the Board to Implement Recommendation
<p>Recommendation 2</p> <p>Perform a risk assessment on barber and dual shops to identify high-risk or repeat offenders on which to focus inspection resources.</p>	<p>The Board has minimally implemented this recommendation.</p> <p>The Board indicated that it completed the initial steps to address this recommendation as of June 7, 2004. The Board has developed a risk-based license inspection policy that allows inspectors to categorize shops/licensee by the perceived need for inspection. However, the inspectors are not told which shops are assigned to which category. As a result, each inspector judgmentally assigns categories for each shop, but there is not a record of this. This makes it difficult to determine what role the risk categories play in determining when a shop/licensee is inspected or whether inspectors assign categories consistently.</p>
<p>Management's Response</p> <p><i>Agency management will bring to the Board a recommendation for revising its inspection process to focus more on complaints and shops in which health risks are highest. The recommendations will be brought to the Board in the summer of 2005, following the end of the 79th Legislative Session, with target DOI of December 1, 2005. A concurrent development of a new computer and database system will be implemented in the Spring of 2006 to add additional tools to the risk-based system.</i></p>	

Recommendation from SAO Report No. 04-006	Status as of January 2005 and Action Taken by the Board to Implement Recommendation
<p>Recommendation 3</p> <p>Develop and implement a plan to ensure effective enforcement. This may include performing more frequent follow-up inspections, increasing the amounts for individual penalties, and monitoring inspectors' results. The Board should also use the full range of sanctions available to it, including imposing penalties for each day a violation remains uncorrected and revoking licenses.</p>	<p>The Board has minimally implemented this recommendation.</p> <p>The Board should make further improvements to ensure effective enforcement. The following items need improvement:</p> <ul style="list-style-type: none"> • Shop inspections are not occurring according to the policy of once every 12 months. Seventeen percent (965 out of 5,807) of shops have not been inspected in the last year. • The Board's computer system has limitations that do not allow it to ensure effective enforcement. For example: <ul style="list-style-type: none"> ○ The Board states that the system does not include inspection history, which is required to identify the shops needing follow-up inspections. Additionally, the Board does not have a follow-up inspection policy. ○ The Board stated that it is still trying to determine the data needed in order to hold inspectors accountable, what system changes are needed, and how to measures inspector accountability. ○ The Board has not made any changes in the way it imposes penalties because the system does not capture the information needed in order to determine when a case has become legally collectible. This means that the Board cannot apply an additional daily fine as allowed by law. • On December 13, 2004, the Board developed policies and procedures for the inspections process, including frequency of inspections. <p>Subsequent Event</p> <p>The Board proposed and amended rules that were approved by its governing board in January 2005 and were to be effective February 1, 2005. The amended rules include the ability to make shop owners responsible for ensuring that individual licenses for those who work in their shops are current and the ability to suspend licenses or permits for those who do not pay fines within 30 days of final Board approval.</p>
<p>Management's Response</p> <p><i>The plan will be developed and implemented in conjunction with the development and implementation of a true risk-based inspection system and a new computer database system as described above in Recommendation 2.</i></p>	

Recommendation from SAO Report No. 04-006	Status as of January 2005 and Action Taken by the Board to Implement Recommendation
<p>Recommendation 4 Implement corrections to the licensing and enforcement system to ensure that licenses are renewed for the statutorily required period and that blocked licenses are not renewed.</p>	<p>The Board has substantially implemented this recommendation.</p> <p>The system is able to renew licenses with the proper expiration date and has improved its ability to block licenses. Ninety-five percent of the license renewals tested had the proper expiration date calculated by the computer system.</p> <p>Although the system has the ability to block renewals for individuals, it does not have the ability to block shop renewals because it lacks a data field to capture that a block has occurred. To ensure that it does not renew a license for a blocked shop, the Board inactivates blocked shops within the system even though these shops are still in operation. As a result, the Board cannot accurately assess the number of shops that are in operation and may be in need of inspection. The Board has inactivated 1.3 percent of shops in operation (77 out of 5,807) due to non-payment of fine amounts.</p>
<p>Management's Response <i>The new computer and database system will include the function of being able to block any license or permit issued by the agency for all applicable reasons. Until the new system is in place, the agency will have to manually verify that shop permits are eligible for renewal. DOI is Spring, 2006.</i></p>	

Recommendation from SAO Report No. 04-006	Status as of January 2005 and Action Taken by the Board to Implement Recommendation
<p>Recommendation 5 Determine and implement the most efficient and effective option for putting the portable computers to use.</p>	<p>The Board has implemented this recommendation.</p> <p>The Board determined that it could not use the portable computers because the regions in which the inspectors work (and from which they would be electronically entering their reports) lack wireless towers. It transferred the computers to the Department of Information Resources in November 2004.</p>

Recommendation from SAO Report No. 04-006	Status as of January 2005 and Action Taken by the Board to Implement Recommendation
<p>Recommendation 6 When its agreement with the Cosmetology Commission is renewed, consider whether that agreement should require the Cosmetology Commission to reimburse the Board for a portion of the costs it incurs in inspecting dual shops.</p>	<p>The Board has implemented this recommendation.</p> <p>Effective December 2004, the Board and the Cosmetology Commission developed a shared inspection agreement in which 7 inspectors from the Board and 19 inspectors from Cosmetology Commission will be divided into 26 new geographic regions comprised of both barber and beauty shops. The inspectors will be responsible for inspecting both agencies' shops in each of their regions. The number of shops that the Board's inspectors will cover will increase by 43 percent. However, the physical amount of territory covered by the inspectors will be reduced. The agencies agreed that there will not be any reimbursements for this plan.</p>

Chapter 2

The Board Has Made Progress in Implementing Recommendations Related to Its Financial Processes

The second finding in the October 2003 report was that the Board's financial processes do not ensure that financial transactions are properly supported and that they allow inaccurate and unreliable financial information to be reported. The Board has improved some weaknesses identified in its financial controls. Financial transactions tested were appropriately reviewed and sufficiently supported. However, the Board should develop and track accounts receivable to present a more accurate picture of its fee and penalty collection efforts. The Board's progress is discussed in the tables below.

Recommendation from SAO Report No. 04-006	Status as of January 2005 and Action Taken by the Board to Implement Recommendation
<p>Recommendation 7</p> <p>Develop and implement policies and procedures for financial transactions to ensure that documentation is complete, duties are properly segregated, and transactions are appropriately approved.</p>	<p>The Board has substantially implemented this recommendation.</p> <p>A sample of revenues and expenditures tested were appropriately reviewed and had sufficient supporting documentation. In addition, the Board developed general guidelines for internal controls on September 1, 2004, that detail segregation of duties of transactions as well as detailed mailroom procedures. Although these guidelines exist, they do not contain detailed procedures concerning how to prepare and process various transactions.</p> <p>Further, the Board should ensure that it consistently follows these procedures. Eight percent of the journal voucher transactions tested did not have documented approval. In addition, the Board should improve its segregation of duties regarding transactions that affect the presentation of its financial statements. We identified 11 of 24 transactions that were entered and released into Uniform Statewide Accounting System (USAS) by one person.</p> <p>The Board has documented an indirect cost allocation plan for fiscal year 2005.</p>
<p>Management's Response</p> <p><i>The agency will continue to develop and document internal operational procedures. DOI for internal documentation is August 31, 2005.</i></p>	

Recommendation from SAO Report No. 04-006	Status as of January 2005 and Action Taken by the Board to Implement Recommendation
<p>Recommendation 8</p> <p>Ensure that its reports and records present a complete and accurate picture of its financial activities and position. Specifically, it should:</p> <ul style="list-style-type: none"> ▪ Implement a quality control process for preparing its financial statements. ▪ Perform a quality control examination on the completed financial statements to detect and prevent errors. ▪ Maintain supporting documentation for its financial activities in accordance with the state records retention policies. 	<p>The Board has substantially implemented this recommendation.</p> <p>The Board stated that it is reviewing financial data for the annual financial report during preparation and upon completion. The chief financial officer certified that he had reviewed all entries on the Fiscal Year 2004 Annual Financial Report Certification. A sample of revenues and expenditures tested were appropriately reviewed and had sufficient supporting documentation. However, we identified some exceptions with USAS transactions as discussed in Recommendation 7.</p>
<p>Management's Response</p> <p><i>The agency will continue to improve its internal controls so that all financial transactions have a complete audit trail and are entered, reviewed and released by more than one person. DOI is March 1, 2005.</i></p>	

Recommendation from SAO Report No. 04-006	Status as of January 2005 and Action Taken by the Board to Implement Recommendation
<p>Recommendation 9 Establish an allowance for doubtful accounts, a bad debt expense account, criteria defining uncollectible accounts, and procedures to age accounts receivable to determine which accounts receivable are not likely to be collected.</p>	<p>The Board has not implemented this recommendation.</p> <p>The Board did not include accounts receivable in its fiscal year 2004 annual financial statements. We estimate that the outstanding fines that should be included in accounts receivable should be \$129,000 (41 percent of all fines assessed) for fiscal years 2000 through 2004. This actual amount is difficult to determine because the fines are entered into the computer system prior to Board approval when the fine becomes legally collectible, and the computer system does not have a field to capture the date the Board approved the fine. The Board does not agree that fines and penalties should be accounted for as receivables in its financial statements.</p> <p>Government Accounting Standards Board (GASB) Statement No. 33 states that the Board's accounts receivable should include administrative penalties once the agency goes through due process and the fines become legally collectible.</p> <p>Also, the Board does not have a procedure for budgeting bad debts expense and monitoring the bad debt expense through its financial accounting system.</p>
<p>Management's Response <i>The agency will implement this Recommendation as soon as it receives detailed guidance from the Comptroller's Office on how to set up the accounts. The date of implementation is projected to be April 30, 2005. Agency staff deferred the implementation of this Recommendation because it believed that it was receiving conflicting information from the SAO and the Comptroller's Office on this issue.</i></p>	

Recommendation from SAO Report No. 04-006	Status as of January 2005 and Action Taken by the Board to Implement Recommendation
<p>Recommendation 10 Periodically review its USAS user access capabilities, match user access with current job responsibilities, and revise necessary access accordingly.</p>	<p>The Board has substantially implemented this recommendation.</p> <p>The Board has made efforts to revise its USAS access by limiting the executive director's access in February 2005.</p>
<p>Management's Response <i>The agency will implement internal procedures that prohibit the same individual from entering and releasing any USAS documents. DOI for full implementation is March 1, 2005.</i></p>	

Recommendation from SAO Report No. 04-006	Status as of January 2005 and Action Taken by the Board to Implement Recommendation
<p>Recommendation 11 Implement a process to ensure that cash receipts are consistently deposited within three business days of receipt.</p>	<p>The Board has implemented this recommendation.</p> <p>Testing revealed that all cash receipts were deposited within three days of receipt.</p>

The Board Has Implemented Recommendations Related to Information Technology Controls

The third finding in the October 2003 report was that the Board has not implemented certain key information technology controls to protect the security of operational and financial data. Although the Board has implemented these two recommendations, Recommendation 1 identified a number of changes that need to occur for the Board to be able to effectively use its computer system.

Recommendation from SAO Report No. 04-006	Status as of January 2005 and Action Taken by the Board to Implement Recommendation
<p>Recommendation 12 Ensure that it matches network access rights to employees' responsibilities and cancels old user accounts.</p>	<p>The Board has implemented this recommendation. Testing revealed that all users on the network are current employees and that their access is properly restricted based on their job needs.</p>
Recommendation from SAO Report No. 04-006	Status as of January 2005 and Action Taken by the Board to Implement Recommendation
<p>Recommendation 13 Implement password security features including standard password lengths, forced password changes, and forced lockout.</p>	<p>The Board has implemented this recommendation. The Board has implemented the recommended password security features.</p>

Other Information

Objective, Scope, and Methodology

Objective

The objective of this audit was to determine what corrective action the Board of Barber Examiners (Board) has taken to address the findings identified in *An Audit of Internal Controls and Financial Processes at the Board of Barber Examiners* (SAO Report No. 04-006, October 2003).

Scope

We reviewed each recommendation based on the date the agency stated it had been implemented. The Board implemented recommendations throughout fiscal years 2004 and 2005.

Methodology

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 Board's management and staff. We collected financial and operational information. We also obtained various databases from the Board. We tested revenues, expenditures, journal vouchers, and various financial statement accounts to ensure accuracy. We also reviewed selected controls over the Board's automated systems and performed some tests to verify the data. We did not conduct an applications review of the system.

Project Information

Our fieldwork was conducted from October 2004 to January 2005. This audit was conducted in accordance with generally accepted government auditing standards. The following members of the State Auditor's staff conducted the audit:

- Stacey Williams (Project Manager)
- Nick Ballard
- Anthony Patrick, MBA
- Stephanie Sherrill
- Michael Yokie, CISA
- J. Scott Killingsworth, CIA, CGFM (Quality Control Reviewer)
- Verma L. Elliott, MBA (Audit Manager)

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