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**State Auditor**

State of Texas Financial Portion of the  
**Statewide Single Audit Report**  
**For the Year Ended**  
**August 31, 2009**

March 2010  
Report No. 10-555



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**Statewide Single Audit Report for the**  
**Year Ended August 31, 2009**

SAO Report No. 10-555  
March 2010

## **Overall Conclusion**

The basic financial statements presented in the Comprehensive Annual Financial Report (CAFR) for the State of Texas present fairly, in all material respects, the financial position and activities of the State for the fiscal year ended August 31, 2009. These financial statements provide a comprehensive disclosure of the State's use of resources during the fiscal year and a picture of the balance of assets and obligations at the end of the fiscal year.

The State successfully contends with significant complexities in preparing its basic financial statements. Compiling financial information and ensuring its accuracy for more than 200 state agencies and higher education institutions is a major undertaking. The financial statements convey the use of nearly \$109.2 billion during the fiscal year.

Auditing financial statements is not limited to reviewing the numbers in those statements. Conducting this audit also requires the State Auditor's Office to obtain a sufficient understanding of the agencies and higher education institutions, including the controls over systems and processes that agencies and higher education institutions use to record their financial activities, to assess the risk of material misstatement of the financial statements. Through that effort, auditors identified specific weaknesses that five agencies and four higher education institutions should correct to improve the reliability of their financial information.

The State Auditor's Office also audited the State's Schedule of Expenditures of Federal Awards (SEFA) for fiscal year 2009, which is prepared by the Office of the Comptroller of Public Accounts (Comptroller's Office) using SEFA data from all state agencies and higher education institutions that made federal expenditures during the fiscal year. The State Auditor's Office and KPMG LLP audited the processes for preparing SEFA information at 16 agencies and 21 higher education institutions. Auditors identified errors caused by inadequate review of SEFA information at 9 agencies and 17 higher education institutions. These errors are discussed in Chapter 1-J of this report.

### **Basic Financial Statements**

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.

The State Auditor's Office audited material line items of major funds at 13 of the State's largest agencies and higher education institutions.

The State Auditor's Office conducts this audit so that the State can comply with legislation and federal grant requirements to obtain an opinion regarding the fair presentation of its basic financial statements and a report on internal controls related to those statements. The results of this audit are used primarily by companies that review the State's fiscal integrity to rate state-issued bonds and by federal agencies that award grants.

## ***Key Points***

**The financial systems and controls at the agencies and higher education institutions audited were adequate to enable the State to prepare materially accurate basic financial statements.**

Overall, financial systems and controls were adequate at the 13 agencies and higher education institutions audited (see Appendix 2 for a list of all agencies and higher education institutions audited). However, auditors identified control weaknesses at five agencies and four higher education institutions. For example:

- The Health and Human Services Commission (Commission) should strengthen information technology controls over payment processing. To avoid disclosure of potential security weaknesses, auditors communicated the details of this issue in writing to management for corrective action. This issue represented a material weakness in the Commission's internal control structure.
- The Department of Transportation (Department) should implement a process to capture information for all completed bridges and historical cost of bridges in its financial records as required by generally accepted accounting principles. The Department understated fiscal year 2009 Capital Assets Depreciable by approximately \$669.7 million. This issue represented a material weakness in the Department's internal control structure.
- The Comptroller's Office should improve controls over tax collections and tax liability reductions. Specifically, the Comptroller's Office should implement certain automated controls, improve manual controls, and update policies and procedures over the tax collection process.

Additionally, auditors identified:

- System access or password management issues at 6 (46.2 percent) of the 13 agencies and higher education institutions audited. Examples of these issues included not removing access for terminated employees, granting access rights without establishing proper segregation of duties, and having password controls that did not meet minimum security standards. These issues represented noncompliance with Title 1, Texas Administrative Code, Chapter 202, or documented agency or higher education institution policies.
- Significant deficiencies in preparing annual financial reports at 3 (23.1 percent) of the 13 agencies and higher education institutions audited. For example, one agency initially provided annual financial report information for the wrong fiscal year, but it later corrected this error. Agencies' annual financial reports provide information on cash flow activity and notes that the Comptroller's Office uses when preparing the CAFR for the State of Texas.
- Weaknesses in accounting for capital assets, revenues, or expenditures at 7 (53.8 percent) of the 13 agencies and higher education institutions.

#### Summary of Issues

Auditors identified system access or password management issues at:

- Health and Human Services Commission
- Department of Transportation
- Comptroller's Office
- Water Development Board
- The University of Texas Health Science Center at Houston
- The University of Texas Southwestern Medical Center at Dallas

Auditors identified significant deficiencies in the annual financial reporting process at:

- Health and Human Services Commission
- Department of Transportation
- Water Development Board

Auditors identified weaknesses in reporting capital assets, revenues, or expenditures at:

- Health and Human Services Commission
- Department of Transportation
- Comptroller's Office
- Texas Workforce Commission
- The University of Texas at Austin
- The University of Texas at San Antonio
- The University of Texas Health Science Center at Houston

Agencies and higher education institutions also should strengthen their reviews of their SEFAs. Auditors identified a lack of adequate review of SEFA information at 26 of the 37 agencies and higher education institutions at which SEFA information was reviewed.

## Summary of Management's Responses

The agencies and higher education institutions to which auditors addressed recommendations generally agreed with the recommendations, with the exception of the Comptroller's Office as discussed in Chapter 1-C.

## ***Summary of Information Technology Review***

Auditors reviewed the internal controls over significant accounting and information systems at the agencies and higher education institutions audited. To do that, auditors identified systems that compiled and contained data used to prepare financial statements and then reviewed basic data protection controls such as user access rights, location of data, and backup processes. As discussed in the detailed findings, auditors identified certain user access control and password weaknesses at the Comptroller's Office, the Department of Transportation, the Health and Human Services Commission, the Water Development Board, the University of Texas Health Science Center at Houston, and the University of Texas Southwestern Medical Center at Dallas. Correcting these weaknesses will help to ensure the reliability of those entities' financial information.

Auditors also reviewed internal controls over the Uniform Statewide Accounting System (USAS). The Comptroller's Office provides the primary controls over USAS access; however, agencies and higher education institutions are responsible for adequately assigning access. Agencies and higher education institutions should ensure that they grant access only as needed and that access rights provide adequate segregation of duties for day-to-day activities.

Auditors also reviewed access to the State Property Accounting system and did not identify any significant control weaknesses.

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

The audit objective was to determine whether the State's basic financial statements present fairly, in all material respects, the balances and activities for the State of Texas for the fiscal year ended August 31, 2009.

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 Act Amendments of 1996 and Office of Management and Budget (OMB) Circular A-133.

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. The opinion on the basic financial statements, *The State of Texas Comprehensive Annual Financial Report for the Fiscal Year Ended August 31, 2009*, was dated February 22, 2010.

The scope of the federal portion of the Statewide Single Audit included an audit of the State's SEFA, a review of compliance for each major program, and a review of significant controls over federal compliance. The State Auditor's Office contracted with KPMG LLP to provide an opinion on compliance for each major program and internal control over compliance. The State Auditor's Office provided an opinion on the State's SEFA. The report on the federal portion of the Statewide Single Audit is included in a separate report issued by KPMG LLP entitled *State of Texas*

*Federal Portion of the Statewide Single Audit Report for the Fiscal Year Ended August 31, 2009, dated February 22, 2010.*

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

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# Schedule of Findings and Responses

*State of Texas Financial Portion of the  
Statewide Single Audit Report for the  
Year Ended August 31, 2009*

This chapter identifies the significant deficiencies and material weaknesses related to the financial statements that are required to be reported in accordance with *Government Auditing Standards*.

Chapter 1-A

**The Health and Human Services Commission Should Strengthen the Design and Operations of its Internal Control Structure over Validating Payments for Public Assistance Programs**

Issue 1

**The Health and Human Services Commission Should Strengthen Controls over Payment Processing**

Reference No. 10-555-01

Type of finding: Material Weakness

**Material Weakness  
in Internal Control**

A material weakness is an internal control weakness of such magnitude that it could potentially result in a material misstatement of the financial statements.

Source: *Governmental Accounting, Auditing, and Financial Reporting*, Stephen J. Gauthier, Government Finance Officers Association, 2005.

The Health and Human Services Commission (Commission) had inadequate controls to address risks related to system and server access, security over sensitive documentation, and physical security over computing resources. Additionally, the Commission does not review interfaced or manual payment transactions prior to releasing those transactions for payment into the Uniform Statewide Accounting System (USAS).

The payment transaction batch size for the first two weeks of August 2009 ranged from 600 to more than 22,000 transactions, with an average of more than 7,000 transactions per batch. Due to this large volume of payment transactions, there is a possibility that an error in payment could go undetected.

Auditors identified multiple issues in the payment process which, when combined, represent a material weakness. To minimize the risks associated with disclosure, auditors communicated details regarding these issues directly to the Commission.

Nothing came to the auditors' attention to indicate that the Commission had processed and made erroneous or excessive payments.

**Recommendations**

The Commission should:

- Strengthen information technology controls over payment processing.

- Develop, document, and implement an approval process for all payment transactions.
- Establish a list of individuals who are authorized to submit transactions for client service payments for both interfaced and manual transactions and limit payment submission to the individuals on that list. The Commission also should develop policies with specific criteria and documentation requirements for making modifications to the list of authorized submitters.
- Establish and implement procedures to verify and reconcile USAS payment batch files by payee and amount to source documentation from interface partners prior to releasing payment transactions into USAS.
- Enable audit trail tracking for its internal accounting system for changes made to key fields on interfaced payment transactions.

### Management's Response

*HHSC management recognizes the importance of a strong control structure that provides assurance that manual and automated batch processing results in accurate, complete, and properly authorized payments. While the existing control structure results in correct payments for public assistance programs, HHSC understands the need to improve controls to more comprehensively address unexpected and less likely risks. For example, stronger controls would increase HHSC's ability to prevent and detect unauthorized access and inappropriate changes to payment data.*

*In an effort to further develop its control structure, HHSC will form a workgroup that includes representatives from major program areas, financial management, and information technology. The workgroup will identify potential risks associated with payment processing, assess the effectiveness of current controls to address these risks, and identify opportunities for improvement. Based on the results of its assessment, the group will make recommendations to executive management that include suggested action plans, responsible parties, and timelines.*

*Estimated Completion Date: August 2010*

*Responsible Person: Chief of Staff and Deputy Executive Commissioner for Financial Services*

## Issue 2

### The Health and Human Services Commission Should Enhance Its Monitoring of the Vendor Drug Program

Reference No. 10-555-02  
(Prior Audit Issues 09-555-08, 08-555-05, and 07-555-01)

#### Type of finding: Significant Deficiency

The Commission has improved its oversight of Vendor Drug Program monitoring by hiring additional staff in its monitoring unit and requiring the submission of monthly tracking reports from the field administration regional pharmacist to track monitoring activities (see text box for additional details). However, the monthly tracking reports for at least 4 months (which included 56 reports in fiscal year 2009) were inaccurate. Specifically:

#### Field Administration Regional Pharmacist

The Vendor Drug Program uses regional and sub-regional pharmacists to review expenditure claims submitted by the approximately 4,244 pharmacies participating in the Vendor Drug Program. The regional pharmacists submit monthly tracking reports to the field administration manager to document their monitoring activities. These reports include information such as the number of site visits completed, the number of claims reviewed, and the type of claims reviewed. Each of the 14 regions submits a monthly tracking report to the field administration regional pharmacist.

- Thirty-four (60.7 percent) of the 56 reports reviewed did not include the correct number of claims.
- Two (25.0 percent) of the 8 reports reviewed for recoupment were not reported accurately.

During fiscal year 2009, the Commission began developing policies and procedures to ensure that regional pharmacist activities and reporting are done in a consistent manner.

#### Recommendations

The Commission should:

- Continue to enhance its monitoring of pharmacies to ensure that payments for the Vendor Drug Program are accurate, allowable, and paid to eligible parties.
- Continue to improve oversight of regional pharmacists.
- Develop, document, and implement policies and procedures to ensure that it documents monitoring activities accurately and consistently.

#### Management's Response

*The purpose of monthly tracking reports is to give Vendor Drug Program managers a view of the work performed by Field Administration staff and to compare sub-region to sub-region performance. An unusual trend or occurrence on the report will create a starting point from which the Field Manager may pursue the issue and request more detailed reports through the pharmacy claims administrator.*

*The data in the monthly regional pharmacist tracking reports are compiled manually. The Vendor Drug Program will work to improve procedural consistency across all sub-regions in an effort to increase reporting accuracy.*

*Estimated Completion Date: September 2010*

*Responsible Person: Deputy Director for Vendor Drug*

### **Issue 3**

#### **The Health and Human Services Commission Should Review User Access to Two Information Systems and Ensure That Related Duties Are Properly Segregated**

Reference No. 10-555-03  
(Prior Audit Issues 09-555-10, 08-555-10, and 07-555-05)

#### **Type of finding: Significant Deficiency**

The Commission does not adequately manage user access to the State's accounting system (the Uniform Statewide Accounting System, or USAS) and its internal accounting system (the Health and Human Service Administrative System, or HHSAS). Specifically:

- Five users have access to sensitive financial data; can enter, edit, and delete accounting transactions; and can release any accounting transactions into USAS.
- Nine users have USAS class codes that conflict with their job duties. All nine users have access to transaction codes for accounts receivable and accounts payable and can enter, edit, and delete accounting transactions. In addition, three of these nine users can release revenue transactions into USAS. This represents a weakness in segregation of duties, which increases the risk that inappropriate financial transactions could be made without detection.
- Three users have HHSAS roles and responsibilities that conflict with their job duties. Two have security coordinator responsibilities and can also final approve payments. One has administrative privileges for the accounts payable module and can also final approve payments.

After auditors brought this matter to its attention, the Commission asserted that it had removed the ability of the eight individuals discussed above who could enter or edit and then release accounting transactions into USAS.

In fiscal year 2009, the same Commission employee both entered and released 323 documents totaling \$21,398,732 in USAS. Without mitigating controls, this increases the risk that intentional or unintentional errors could go undetected.

## Recommendations

The Commission should:

- Continue to implement its process to identify individuals for whom access to USAS and HHSAS should be adjusted.
- Develop and implement procedures to monitor and mitigate the risk of employees performing incompatible duties.

## Management's Response

*HHSC has taken the following action with regard to the five users that had access to sensitive financial data, and could enter, edit, and delete accounting transactions, as well as release USAS accounting transactions. The security access of the users has been modified to restrict their access so that they can either enter or release transactions, but not both.*

*Nine users in HHSC's Accounts Receivable section have transaction code access to both accounts receivable and accounts payable data. These users are responsible for recording deposits, as well as recording refunds of revenues. Access to both accounts receivable and accounts payable transaction codes is requisite to their duties. HHSC's Accounts Receivable section has internal policy that prohibits any section employee from both editing and releasing USAS transactions. The ability to enter transactions of the three users that could also release revenue transactions has been removed.*

*HHSC Security Coordinators review HHSAS access requests after the employees' supervisors have requested access by signing the appropriate forms and before the forms are submitted to the HHSAS Security Team for setup. The HHSC Security Coordinators cannot add, change, modify, or delete users, or modify their access to HHSAS.*

*Estimated Completion Date: Complete*

*Responsible Person: Deputy Executive Commissioner for Financial Services*

#### Issue 4

### The Health and Human Services Commission Should Adequately Review Its Annual Financial Report

Reference No. 10-555-04

#### Type of finding: Significant Deficiency

The Commission does not have an adequate review process to ensure that its annual financial report is complete and is for the current reporting period

***Comptroller's Office's Reporting Requirements for Annual Financial Reports of State Agencies and Universities***

Annual financial reports should be submitted to the State Auditor's Office, Governor's Office, Legislative Budget Board, Legislative Reference Library, and Texas State Library.

Source: *Reporting Requirements for Annual Financial Reports of State Agencies and Universities*, Office of the Comptroller of Public Accounts, July 2009.

before it submits that report to various oversight agencies. The required fiscal year 2009 annual financial statements submitted by the Commission to agencies (see text box) were incomplete. The financial statements did not include all annual financial report transactions. It also incorrectly included financial statements that were from fiscal year 2008 instead of fiscal year 2009.

After auditors brought these matters to the Commission's attention, the Commission resubmitted its annual financial report with complete financial statements and for the correct reporting period.

#### Recommendation

The Commission should strengthen its annual financial report review process to ensure that it submits complete financial statements for the correct reporting period.

#### Management's Response

*Fiscal Management will incorporate a checklist as part of the management review process for the Annual Financial Report. Utilization of the checklist will ensure that the hard copy version of the report includes the correct version of the printed financial statements and exhibits from USAS.*

*Estimated Completion Date: November 2010*

*Responsible Person: Deputy Executive Commissioner for Financial Services*



## Issue 5

### The Health and Human Services Commission Should Track All Accounts Receivable, Improve Collection Efforts, and Report Accounts Receivables on the Financial Statements and in the Uniform Statewide Accounting System

Reference No. 10-555-05

#### Type of finding: Significant Deficiency

The Commission understated non-current accounts receivable in its fiscal year 2009 financial statements and did not adequately track all accounts receivable during 2009. A Commission internal audit report noted issues related to collection efforts for delinquent accounts receivable and non-compliance with requirements of the Office of the Attorney General and the Office of the Comptroller of Public Accounts (Comptroller's Office).

#### Texas Medicaid and Healthcare Partnership (TMHP)

The Texas Medicaid and Healthcare Partnership (TMHP) is a coalition of contractors that provides services to the Commission in several areas. TMHP's primary contractor is Affiliated Computer Services (ACS), which subcontracts with Health Management Systems, Inc. (HMS), Accenture, and other smaller contractors. ACS is ultimately responsible for the payments and its subcontractors' performance. TMHP's services and processing activities include:

- Provider enrollment.
- Processing claims for service.
- Services for children with special needs.
- Long-term care program.
- STAR (State of Texas Access Reform Dental and Medical, an insurance program) services.
- Prior authorization services for certain procedures.
- Primary care case management (PCCM).
- Policy development.

#### Accounts Receivable Understated

The Commission is not reporting the full amount of the non-current accounts receivable arising from overpayments to Medicaid providers on its financial statements and in the Uniform Statewide Accounting System (USAS, the State's accounting system). The Commission reported \$27,658,852 in non-current accounts receivable. However, based on reports received from the Texas Medicaid and Healthcare Partnership (TMHP, see text box) and provided by Commission staff, auditors determined the total balance of non-current accounts receivable due from overpayments to Medicaid providers was \$84,666,450, resulting in an understatement on the financial statements and in USAS of \$57,007,598.

#### Internal Audit Report Findings

Additionally, the Commission's Internal Audit Division conducted a review of the accounts receivable processes for the Medicaid, Children with Special Health Care Needs (CSHCN), and Family Planning programs and issued a report on September 26, 2008. The report noted the following:

- The claims processing system at TMHP cannot recoup provider accounts receivable balances across programs using the unique identifiers specified in the contract.
- Providers may have multiple Texas Provider Identifier (TPI) numbers. This allows providers to receive payments under one identifying number while maintaining an accounts receivable balance under a different identifying number.
- TMHP makes no further collection efforts on receivables after 90 days.

- The Commission has not established a policy providing guidance to address delinquent debts and comply with related requirements of the Office of the Attorney General and the Comptroller's Office.
- The Commission does not report delinquent providers to the Office of the Attorney General for further collection efforts or to the Comptroller's Office for placement on vendor hold.
- Neither the Commission nor TMHP compares vendors to the vendor hold lists available from the Comptroller's Office before payments are made. Reviewing the vendor hold lists can identify vendors with outstanding liabilities to the State. These liabilities can be recovered through withholding future claims payments.

### Accounts Receivable Tracking

#### Medicaid Upper Payment Limit

The Medicaid Upper Payment Limit requires that the Medicaid agency find that the estimated average proposed payment rate is reasonably expected to pay no more in the aggregate for inpatient hospital services or long-term care facility services than the amount that the agency reasonably estimates would be paid for the services under the Medicare principles of reimbursement.

Source: Title 42, Code of Federal Regulations, Section 447.253 (b)(2).

The Commission also does not ensure that it records overpayments to hospital districts participating in the Urban Hospital Upper Payment Limit (UPL) program as accounts receivable. The Commission makes UPL payments to urban hospitals on a quarterly basis, and these payments are based in part on previous year UPL payments. Due to the amount of time allowed to finalize Medicaid claims, the Commission is not able to determine whether an urban hospital is overpaid or underpaid for a year after the payments have been made. Without setting up the overpayments to urban hospitals, the Commission has to rely on program staff to track the amount of the overpayments, and the Commission's Fiscal Management unit is unaware of the amount of accounts receivable that the Commission needs to collect.

### Recommendations

The Commission should:

- Improve communication between the program areas and accounting staff to ensure that all overpayments to providers or clients and any additional receivables due to the Commission are tracked for collection purposes and reported appropriately on the financial statements and in USAS.
- Develop and implement policies and procedures related to the recording, tracking, and reporting of accounts receivable balances.
- Address recommendations made by its Internal Audit Division in its report dated September 26, 2008.

## Management's Response

### *Accounts Receivable*

*Fiscal Management will revise its policies and procedures related to the reporting of accounts receivable balances on the Annual Financial Report and in USAS to ensure that receivables include all overpayments to Medicaid providers from the Medicaid/CHIP program area.*

*Estimated Completion Date: November 2010*

*Responsible Person: Deputy Executive Commissioner for Financial Services*

### *Implementation of Internal Audit Recommendations*

*HHSC is addressing Internal Audit recommendations relating to accounts receivable processes. On an ongoing basis (quarterly), executive management monitors implementation of action plans through a review of status updates management provides to Internal Audit and the results of follow up audits that validate implemented action plans.*

*Estimated Completion Date: Ongoing*

*Responsible Person: Chief of Staff*

## Issue 6

### **The Health and Human Services Commission Should Disclose the Contingent Financial Liability Associated with the Open Investigations of its Office of Inspector General**

Reference No. 10-555-06  
(Prior Audit Issues 09-555-11 and 08-555-09)

#### **Type of finding: Significant Deficiency**

The Commission does not adequately track its Office of Inspector General's open investigations to determine related dollar amounts paid to providers and recipients for these cases.

As of August 31, 2009, the Commission's list of active open investigation cases included 5,301 cases. The Commission did not analyze these cases to determine whether it should report them in its annual financial report as contingent liabilities. This resulted in the Commission not reporting a contingent liability in its annual financial report for fiscal year 2009. After auditors brought this to the Commission's attention, the Commission provided a contingent liability note to the Comptroller's Office for inclusion in the State's Comprehensive Annual Financial Report for fiscal year 2009.

### Contingent Liability

A loss contingency arising from a claim must be disclosed when it is reasonably possible that a loss will eventually be incurred and it is either not probable or not subject to reasonable estimation. The disclosure should indicate the nature of the contingency and give an estimate of the possible loss or range of loss. However, if an estimate of the loss cannot be made, the disclosure must state this fact.

A loss contingency arising from a claim is accrued as of the balance sheet date when both of the following conditions are true:

- Information available before the financial statements are issued indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements. It must be probable that one or more future events will also occur confirming the fact of the loss.
- The amount of the loss can be reasonably estimated.

Source: *Reporting Requirements for Annual Financial Reports of State Agencies and Universities*, Office of the Comptroller of Public Accounts, July 2009.

The Comptroller's Office requires that notes to the financial statements communicate information that is necessary for a fair presentation of the financial position and the results of operations, but not readily apparent from, or not included in, the financial statements themselves (see text box for additional details).

### Recommendation

The Commission should comply with the Comptroller's Office's requirement to prepare financial statements that are presented fairly and that include all required notes.

### Management's Response

*HHSC submitted a revised 2009 HHSC Contingency Liability Note to the Comptroller of Public Accounts as part of the 2009 Comprehensive Annual Financial Report. Future reports will contain the same contingent liability disclosure. As noted above, Fiscal Management will*

*incorporate a checklist as part of the management review process for the Annual Financial Report, including all required notes.*

*Estimated Completion Date: November 2010*

*Responsible Person: Deputy Executive Commissioner for Financial Services*

### Issue 7

#### The Health and Human Services Commission Should Evaluate the Need to Accrue Expenditures

Reference No. 10-555-07  
(Prior Audit Issue 09-555-12)

#### Type of finding: Significant Deficiency

The Commission did not evaluate the need for a potential accrual of \$13.2 million in expenditures with a fiscal year 2009 service date related to the Supplemental Nutrition Assistance Program (SNAP, formerly known as the Food Stamp Program), which it oversees. Delays in eligibility processing for SNAP were well publicized, and Commission accounting staff did not work with program staff to quantify any potential financial statement impact. Once approved, benefits for SNAP begin from the date the applicant submitted his or her application.

In fiscal year 2009, the Commission partially implemented a prior State Auditor's Office recommendation to accrue necessary expenditures by recording an accrual related to the Medicaid Upper Payment Limit Program.

According to the Comptroller's Office's *Reporting Requirements for Annual Financial Reports of State Agencies and Universities*, expenditures should be recognized as soon as a liability is incurred, regardless of the timing of related cash flows.

## Recommendations

The Commission should:

- Establish a process to ensure that it reports all appropriate accrued expenditures in its annual financial report in accordance with the Comptroller's Office's *Reporting Requirements for Annual Financial Reports of State Agencies and Universities*.
- Improve communication and coordination between the program areas and accounting staff to ensure that accounting staff identify and evaluate any events with a potential financial statement impact for inclusion in the annual financial report.

## Management's Response

*Fiscal Management has implemented policies and procedures to accrue material expenditures in the Annual Financial Report, as recommended. In addition to the procedures already in place, Fiscal Management will actively seek feedback, and improve communications with, program areas when unanticipated events and/or actions in client service delivery or ongoing operations are known and/or anticipated which could have a material effect on the accrual of expenditures.*

*Estimated Completion Date: November 2010*

*Responsible Person: Deputy Executive Commissioner for Financial Services*

## Issue 8

### The Health and Human Services Commission Should Fully Document Policies and Procedures for Two Key Accounting Functions

Reference No. 10-555-08  
(Prior Audit Issues 09-555-09, 08-555-08, 07-555-04, and 06-555-09)

#### Type of finding: Significant Deficiency

The Commission has continued to operate two key accounting functions since fiscal year 2005 without finalized, approved policies and procedures. These key accounting functions are related to the recording of public assistance payments. Specifically, the Commission did not have finalized and approved policies and procedures for:

- Recording and approving Medicaid and CHIP expenditures.
- Recording and approving Vendor Drug program expenditures.

The Commission began developing draft policies and procedures for these two key functions during fiscal year 2008; however, the draft policies and procedures were not finalized and approved until fiscal year 2010. The Commission has documented many of its other key accounting functions and has trained backup personnel to perform those functions.

Having finalized and approved policies and procedures is a key control over the Commission's financial reporting. It is important for management to communicate and monitor, through policies and procedures, staff members' responsibilities and expectations related to their job functions. In addition, policies and procedures are beneficial for new employees and backup personnel.

#### Recommendation

The Commission should implement a process to ensure that appropriate levels of management routinely review, update, and approve policies and procedures.

#### Management's Response

*HHSC has fully documented processes and procedures for both Fiscal Agent and Vendor Drug payments to ensure that expenditures are recorded, approved, and processed in a timely manner.*

*These processes and procedures (and related explicative flowcharts) are reviewed on a regular basis and are updated accordingly for staffing and other changes to ensure accuracy and timeliness.*

*A new internal process has been implemented to ensure that the policies and procedures are securely maintained on our network share drive and can only be updated by select Accounting Operations management staff. The policies and procedures (and related explicative flowcharts) are available as read only files for all other Accounting Operations staff.*

*Estimated Completion Date: Complete*

*Responsible Person: Deputy Executive Commissioner for Financial Services*

#### **Issue 9**

### **The Health and Human Services Commission Should Strengthen Password Requirements for its Premium Payable System**

Reference No. 10-555-09  
(Prior Audit Issue 09-555-13)

#### **Type of finding: Significant Deficiency**

Auditors reviewed the Commission's Premium Payable System (PPS) during the audit of fiscal year 2008 and identified certain control weaknesses. The version of the system in use at that time and until July 2009 has been retired. Auditors were unable to confirm the condition of the prior system; therefore, the issues from fiscal year 2008 are repeated below, with the current condition as asserted by the Commission.

**Title 1, Texas Administrative Code,  
Section 202.25(3)(A)**

Each user of information resources shall be assigned a unique identifier except for situations where risk analysis demonstrates no need for individual accountability of users. User identification shall be authenticated before the information resources system may grant that user access.

**Title 1, Texas Administrative Code,  
Section 202.25(3)(D)**

Information resources systems which use passwords shall be based on industry best practices on password usage and documented state agency security risk management decisions.

The Commission should ensure that password requirements for its PPS comply with the Texas Administrative Code (see text box). Passwords for this system are not required to have a minimum length, and there is no system-enforced requirement to change passwords at regular intervals. The PPS also did not maintain a history of passwords to prevent reuse of recent passwords.

In the audit of fiscal year 2008, 7 (63.6 percent) of the 11 user accounts on the PPS online application were generic accounts. Use of generic user accounts, particularly in light of the password issues discussed above, prevents accountability for user actions and places the Commission's data at risk of unauthorized changes.

To mitigate the risks associated with weaknesses in passwords, the Commission asserted that it removed the user access accounts from PPS and that certain tasks previously performed through the PPS were accomplished by pulling the requested information directly from the data tables. However, the Commission did not do this until July 2009. The Commission also asserted that it has updated the PPS with a new system that has up-to-date security. However, the update occurred in August 2009 and, therefore, was not in place for the calculation of premium payments for fiscal year 2009.

## Recommendation

The Commission should ensure that its new payment system complies with Texas Administrative Code requirements.

## Management's Response

*A production version of the new application was made operationally available in August 2009, which has allowed HHSC to implement user password requirements that are aligned with industry best practices, HHS information security standards, and Texas Administrative Code requirements. In addition, generic user accounts are no longer used, and an audit log is maintained to monitor unusual activities and ensure accountability of individual users.*

*Estimated Completion Date: Complete*

*Responsible Person: Director Commission IT*

Chapter 1-B

## The Department of Transportation Should Strengthen Certain Aspects of Its Financial and Information Technology Operations

### Issue 1

The Department Of Transportation Should Establish a Process to Accurately Account for Bridges

Reference No. 10-555-10

#### Material Weakness in Internal Control

A material weakness is an internal control weakness of such magnitude that it could potentially result in a material misstatement of the financial statements.

Source: *Governmental Accounting, Auditing, and Financial Reporting*, Stephen J. Gauthier, Government Finance Officers Association, 2005.

#### Type of finding: Material Weakness

The Department of Transportation (Department) did not have a process to capture all completed bridges in its financial records. In addition, when reporting bridge costs, the Department used multiple cost estimation methodologies, rather than using actual historical costs as required by generally accepted accounting principles and the Office of the Comptroller of Public Accounts (Comptroller's Office). These issues represent a material weakness in the Department's internal controls (see text box for more information).

#### Lack of a Process to Capture All Bridges in the Financial Records

The Department did not have a formal process to capture information regarding all completed bridges. As a result, the Department understated



Capital Assets Depreciable by approximately \$669.7 million<sup>1</sup> in its fiscal year 2009 financial statements. Specifically:

- The Department incorrectly omitted at least 378 bridges from Capital Assets Depreciable. The bridges were completed between 1970 and 2009 and had a total estimated value of approximately \$670.9 million. Individually, the bridges ranged in value from approximately \$0.5 million to approximately \$20.0 million.
- The Department incorrectly included two bridges in Capital Assets Depreciable. The two bridges, valued at approximately \$1.2 million, are owned by the Central Texas Turnpike System and not by the Department.

The errors noted above resulted in the following inaccuracies in the Department's fiscal year 2009 financial statements:

- Capital Assets Depreciable was understated by approximately \$669.7 million and Capital Assets Nondepreciable was overstated by the same amount.
- Accumulated Depreciation was understated by approximately \$193.3 million.
- Depreciation Expense was understated by approximately \$25.0 million.

While the Department's Finance Division relies on the district and area offices to notify it when a bridge is complete, there is no formal process or documented procedure to ensure that this notification occurs. Additionally, the Finance Division does not have a process to determine whether the information it receives is complete. In fiscal year 2009, there were 25 district offices and 106 area offices across the state.

#### Use of Estimated Costs, Rather Than Historical Costs, for Bridges

- In its fiscal year 2009 financial statements, the Department reported estimated costs for its bridges, rather than actual historical costs as required by generally accepted accounting principles and the Comptroller's Office's *Reporting Requirements for Annual Financial Reports of State Agencies and Universities*. Additionally, the Department used multiple methodologies to estimate bridge costs, and it had not used those methodologies consistently.

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<sup>1</sup> Dollar amounts in Issue 1 are based on the Department's estimated amounts because the Department did not maintain information on actual amounts for individual bridges. The Department used multiple methodologies to estimate bridge costs.

#### The Department's Bridge Cost Estimation Methodologies

**Square Footage Methodology:** Under this methodology, the Department estimates a bridge's costs by multiplying the average price per structure type by the square footage of the bridge.

**Adjustment to Original Estimate Methodology:** Under this methodology, the Department estimates a bridge's costs by using the estimated structure cost along with percentages from formulas for construction costs, preliminary engineering costs, and construction engineering costs.

- For bridges completed in or prior to fiscal year 2001, the Department based the estimated cost on the square footage of the bridge. For bridges completed after fiscal year 2001, the Department estimated the value by adjusting the original estimated cost. (See text box for details on the Department's cost estimation methodologies.) If the historical cost is not used to value the individual bridge, the value of the bridge could be misstated.
- The Department's current policy requires district offices to report bridge values when a bridge is open for traffic using the formulas and percentages in effect for the current year, regardless of when the bridges were completed. However, the district offices do not always report a bridge's value in the same year in which a bridge was open for traffic. As a result, if a bridge was completed in fiscal year 2002 and not reported until fiscal year 2009 for example, the district office would use the formulas and percentages in effect for fiscal year 2009 to value the bridge.

After auditors brought this matter to the Department's attention, the Department provided necessary adjustments to the Comptroller's Office to ensure that, in the State's Comprehensive Annual Financial Report, (1) the estimated value of the bridges initially recorded as non-depreciable was reported correctly as Capital Assets Depreciable and (2) the estimated adjusted depreciation expense and accumulated depreciation were reported correctly.

#### Recommendations

The Department should:

- Ensure that it properly reports, values, and depreciates all bridges in its financial statements.
- Establish controls to ensure that it records information concerning ownership of bridges accurately.

#### Management's Response

*The Department concurs with the recommendations and will implement corrective actions by May 2010.*

*Person Responsible: Finance Division Director*

## Issue 2

### The Department of Transportation Should Strengthen System Access Controls and Password Requirements

Reference No. 10-555-11  
(Prior Audit Issue 09-555-06)

#### Type of finding: Significant Deficiency

To protect the integrity of its information resources, the Department should ensure that it properly restricts access to certain automated systems and that user passwords are sufficiently complex.

The Department should regularly update and restrict user access rights for its automated systems.

Title 1, Texas Administrative Code,  
Section 202.20(1)

Information resources residing in the various state agencies of state government are strategic and vital assets belonging to the people of Texas. These assets shall be available and protected commensurate with the value of the assets. Measures shall be taken to protect these assets against unauthorized access, disclosure, modification or destruction, whether accidental or deliberate, as well as to assure the availability, integrity, utility, authenticity, and confidentiality of information. Access to state information resources shall be appropriately managed.

Title 1, Texas Administrative Code,  
Section 202.25(3)(B)

A user's access authorization shall be appropriately modified or removed when the user's employment or job responsibilities within the state agency change.

According to the Department's *Information Security Manual* dated October 2008, "when a user's employment status or job functions change, a user's access authorization must be removed or modified appropriately and immediately." The manual also states that "system and administrative rights must be restricted to persons responsible for system administration management or security." The Texas Administrative Code also specifies requirements related to user access (see text box for additional details). In fiscal year 2009, the Department did not regularly update access rights to its automated systems, nor did it properly restrict user access. Specifically:

- Five (17.2 percent) of 29 users tested had inappropriate access rights to the Equipment Operating System (EOS) based on their job duties. EOS is the Department's system of record for all information on major equipment. The Department subsequently removed these users' access rights.
- Four (13.3 percent) of 30 users tested had inappropriate access rights to the Automated Purchasing System (APS) based on their job responsibilities. APS is the Department's internal real-time purchasing system through which it requests and purchases all of its goods and services. Auditors identified 25 additional employees who had inappropriate access rights to APS based on their job titles and Department, district, or division criteria. In addition, 2 (2.9 percent) of 70 users had both purchaser and receiver access roles within APS. A lack of segregation of duties such as this increases the risk that inappropriate purchases could be made without detection. The Department subsequently removed inappropriate access rights for most of these users.
- Four (13.3 percent) of 30 users tested had inappropriate access rights to the Minor Equipment System (MES) based on their job functions. MES is the Department's system of record for all information on minor equipment. The Department subsequently removed these users' access rights.

- For one user whose employment was terminated, the Department did not deactivate access rights to the Right of Way Information System (ROWIS) until 26 months after the user's employment had been terminated. ROWIS is the Department's proprietary right of way acquisition, data storage, tracking, and retrieval application.
- For one user whose employment was terminated, the Department did not deactivate access rights to the Uniform Statewide Accounting System (USAS) until four months after the user's employment termination date. USAS is the State's accounting system. The Office of the Comptroller of Public Accounts uses the information in USAS to create the State's comprehensive annual financial report.
- One user had inappropriate access rights to the Design and Construction Information System (DCIS) based on the employee's job functions and the Department's access criteria. Auditors also identified three external users for whom the Department could not provide documentation explaining why access was needed from the time access rights were initially granted. The Department uses DCIS to plan, program, and develop projects. After auditors brought this to the Department's attention, the Department obtained justification for each of these users having access and reapproved their access rights.
- The Department did not remove one user's administrative rights to SiteManager after the employee was promoted and a change in job functions eliminated the need for those rights. Additionally, seven contractor users had unnecessary access to SiteManager. The Department uses SiteManager to monitor construction projects, generate daily work reports, and process contractor payment estimates for projects funded through the Highway Planning and Construction Cluster of federal programs. After auditors brought this issue to the Department's attention, the Department deactivated these access rights.
- Three users had inappropriate access rights to the Financial Information Management System (FIMS). One user was an auditor but had the capability to modify the information in FIMS. The Department did not immediately remove two other users' access rights to FIMS after these users' job responsibilities changed. FIMS is the Department's internal accounting system. After auditors brought this issue to the Department's attention, the Department removed these users' access rights.

Removing users' access to automated systems immediately upon termination of employment or a change in job functions helps to ensure that information resources are protected against unauthorized access, disclosure, modification, or destruction. It also helps to ensure the availability, integrity, authenticity, and confidentiality of information.

The Department should strengthen network, SiteManager, and ROWIS password settings.

Employees and users of the Department's automated systems must have access to the Department's network to access those systems. To access the network, SiteManager, and ROWIS, users must enter a password. According to the Department of Information Resources and the Department's *Information Security Manual*, state agencies should use unique passwords that contain both alphanumeric characters and special characters. In addition, the *Information Security Manual* states that passwords used to gain access to network entry points must be changed every 60 days. The Texas Administrative Code also specifies requirements related to passwords (see text box for additional details). Auditors noted the following:

Title 1, Texas Administrative Code, Section 202.25(3)(D)

Information resources systems which use passwords shall be based on industry best practices on password usage and documented state agency risk management decisions.

- Network password settings do not conform to *Information Security Manual* requirements concerning maximum password age.
- Network password settings do not conform to *Information Security Manual* requirements concerning the use of alphanumeric and special characters.
- SiteManager password settings do not conform to *Information Security Manual* requirements at the database and application levels.
- Access to ROWIS at the server and database levels is dependent on network authentication.
- Passwords at the application level for ROWIS do not meet *Information Security Manual* requirements because passwords are assigned and cannot be changed.

Requiring the use of passwords that include both alphanumeric and special characters; have a minimum password age, history, and length; and have a maximum number of failed password attempts helps to ensure that information resources are protected against unauthorized access, disclosure, modification, or destruction. It also helps to ensure the availability, integrity, authenticity, and confidentiality of information.

## Recommendations

The Department should:

- Remove or modify users' access authorization appropriately and immediately upon a change in their employment status or job functions, as required by its *Information Security Manual*.

- Restrict users' access rights to only what is needed to perform their job responsibilities, and maintain documentation related to access requests and accompanying approvals, including justifications for the requested access.
- Strengthen network, SiteManager, and ROWIS password settings to comply with its *Information Security Manual*.

### Management's Response

*TxDOT implemented a compliance monitoring program several years ago to monitor user accounts and access rights, and to identify terminated users with active accounts. The program was originally designed to monitor all TxDOT mainframe applications; however, since the initial implementation the program has been continually expanded to monitor TxDOT applications outside of the mainframe environment. The ROWIS application is scheduled to be added to the compliance monitoring program in March 2010 to ensure user accounts are properly suspended or deleted upon termination.*

*TxDOT currently maintains an access criteria document for every enterprise application. The documented access criteria defines the appropriate application access based on users' job responsibilities. These documents are used by TxDOT Security Administrators to assign appropriate user access for each application. To ensure that appropriate access is assigned, TxDOT's current policy requires each application's Office of Primary Responsibility (OPR) to conduct a periodic review of user access to the application.*

*TxDOT has also enhanced the roles and responsibilities for the Division/District/Office/Region (D/D/O/R) directors requiring them to direct an annual independent review of the D/D/O/R's security administrator files. In addition, the results of these reviews must be provided to the Technology Services Division (TSD) – Information Systems Security branch to allow TSD to validate that the reviews are properly conducted. A revised Information Security Manual will be published on March 1, 2010 which contains these policy changes.*

*TxDOT has also enhanced the roles and responsibilities for the D/D/O/R Security Administrators, requiring them to annually review user access capabilities to ensure access is appropriate based on the current job duties and/or management requirements. The results of these reviews must be provided to the TSD Information Systems Security branch to ensure the reviews are properly conducted. A revised Information Security Manual will be published on March 1, 2010 which contains these policy changes.*

*The enhancements to the compliance monitoring program to include additional reviews of user access from both the D/D/O/R and OPR level will improve TxDOT's compliance with the TxDOT Information Security Manual policies.*

*TxDOT has modified its password policies in the Information Security Manual to be consistent with industry best practices. Specifically, the 60 day password change requirement has been changed to 90 days. On September 30, 2009, TxDOT implemented additional controls and requirements for network passwords, requiring at least one capital letter and at least one numeric character. These changes bring the TxDOT network password controls into compliance with the Information Security Manual.*

*TxDOT is currently investigating methods to allow applications, such as SiteManager, ROWIS, and database systems, to leverage existing network controls for user management and password authentication. Successful integration of these network controls will address the recommendation to strengthen the password controls for these applications. A tentative timeline for a detailed recommendation is scheduled for May 2010.*

*Responsible Person: Technology Service Division Director*

### Issue 3

#### The Department of Transportation Should Implement Additional Controls to Ensure That Its Annual Financial Report Complies with Financial Reporting Requirements

Reference No. 10-555-12

#### Type of finding: Significant Deficiency

##### Annual Financial Report (AFR) Matching Requirements

For AFR purposes, the balance sheet and statement of net assets must match the capital asset note (Note 2) in the AFR.

Specifically:

- The classifications increase in the interagency transfer column in AFR Note 2 should match the increase in interagency transfers on the operating statement.
- The reclassifications decrease in the interagency transfer column in AFR Note 2 should match the decrease in interagency transfers on the operating statement.
- The total asset addition should match total capital outlay plus any capital contributions.
- The deletions column should match the net proceeds from the sale of capital assets and any gain or loss on the sale of assets.

Source: *Reporting Requirements for Annual Financial Reports of State Agencies and Universities*, Office of the Comptroller of Public Accounts, July 2009.

During preparation of the Department's annual financial report (AFR), the Department performs several levels of review, including reviews by various individuals in upper management, prior to submitting the AFR to the Comptroller's Office. The purpose of these reviews is to ensure that the AFR is accurate and that it complies with the Comptroller's Office's *Reporting Requirements for Annual Financial Reports of State Agencies and Universities* (reporting requirements). However, auditors identified instances of noncompliance with the reporting requirements that the Department's reviews did not identify.

The reporting requirements specify that the balance of each column within the capital asset note to the AFR (Note 2) must tie to the operating statement, which is in Exhibit II of the Department's AFR (see text box for specific items that should match). However, the Department did not comply with requirements that certain items should match.

In addition, the Department did not include an explanation of the \$219,455,353 deficit in State Highway Fund 006 in Note 20 of the AFR as required by the reporting requirements. According to the

Department, that deficit is primarily due to a timing difference between the recognition of the expenditure of funds and the recognition of revenues. After auditors brought this matter to the Department's attention, the Department provided an explanation to the Comptroller's Office for inclusion in the State's comprehensive annual financial report.

### Recommendation

The Department should improve the review of its AFR to ensure compliance with the Comptroller's Office's reporting requirements.

### Management's Response

*The Department concurs with the recommendation and will implement policies and procedures to address the finding by May 2010.*

*Responsible Person: Finance Division Director*

Chapter 1-C

## **The Office of the Comptroller of Public Accounts Should Strengthen Certain Aspects of Its Financial and Information Technology Operations**

### Issue 1

**The Office of the Comptroller of Public Accounts Should Strengthen Controls to Ensure That Taxes It Collects Are Accurate, Supported, and Verified**

Reference No. 10-555-13

### Type of finding: Significant Deficiency

The Office of the Comptroller of Public Accounts (Comptroller's Office) relies on certain controls to ensure that data it receives from taxpayers is accurate, complete, and verified. This is important to ensure that the Comptroller's Office assesses and collects the proper amount of taxes. Verifying taxpayer-submitted data also is important to ensure that taxes are applied consistently to all taxpayers. However, certain controls do not exist or are not working as intended.

Control weaknesses in information system. The Comptroller's Office has implemented automated controls within its tax-related information system to prevent data entry errors and to ensure that it assesses and collects taxes in accordance with statute. However, certain automated controls do not exist, and the Comptroller's Office has not corrected all errors created during information system conversions. As a result, the Comptroller's Office's tax-



related information system contains incorrect taxpayer data. Auditors analyzed 50,156 records and identified the following errors:

- Instances in which taxpayers received tax liability reductions that exceeded statutorily allowable amounts. Auditors tested the largest 7 of these instances and determined that for 6 (85.7 percent) of these 7 instances, tax liability reductions exceeded statutorily allowable amounts by a total of \$8,326,798. For an additional 348 instances, certain data in the information system indicates that taxpayers could have received tax liability reductions that exceeded statutorily allowable amounts. These errors occurred because the information system does not contain sufficient automated controls to prevent tax liability reductions from exceeding statutorily allowable amounts. Management asserts it was aware that automated controls were not sufficient and that there are manual checks of tax refunds and overpayments applied to different periods to identify this type of error. These manual checks do not always occur in a timely manner. Prior to the audit, the Comptroller's Office indicated that it had not identified tax returns with tax liability reductions exceeding statutorily allowed amounts, and it had not updated written policies and procedures to include a manual check for this error.
- 7 instances in which tax discount eligibility periods were incorrect. As a result, 6 taxpayers could have received liability reductions from tax deductions for which they were not eligible, and 1 taxpayer might not have received liability reductions for which the taxpayer was eligible because the information system contained an incorrect eligibility period.
- Instances in which statutorily required dates that are used to determine tax exemption eligibility were unreliable (for example, dates were in the year 2200).

Control weaknesses in recording and retaining taxpayer data. Title 34, Texas Administrative Code, Section 3.21, requires taxpayers to submit supporting documentation to support taxes due. Controls over data entry are not sufficient to ensure that taxpayer data the Comptroller's Office enters manually is accurate.

For 4 (16.0 percent) of 25 amounts used to calculate taxes due that auditors tested, amounts in the Comptroller's Office's information system did not match supporting documentation submitted by the taxpayer. In addition, the Comptroller's Office could not provide supporting documentation for 1 (3.8 percent) of 26 amounts used to calculate taxes due in its information system. Prior to August 2009, the Comptroller's Office indicated that it performed only spot checks of manual data entry. Because the Comptroller's Office calculates tax credits, tax discounts, and tax due amounts from the data in its information system, it is important that this data is accurate and adequately supported.

After the conclusion of audit testing, the Comptroller's Office management asserted that it implemented a quality control review of data manually entered into its information system to address the types of errors auditors identified.

Control weaknesses in verifying taxpayer data. The Comptroller's Office relies on its Tax Audit Division to ensure that taxpayers self-report correct information. However, not all taxpayers are subject to audit by the Tax Audit Division, tax audits do not always occur in a timely manner, and the Tax Audit Division does not always audit all time periods.

According to the Tax Audit Division's schedules of completed audits, not all taxpayers, including taxpayers paying a large amount of taxes, are subject to audit. In addition, there is not appropriate audit coverage. Ensuring appropriate audit coverage helps to deter fraudulent reporting and ensure that taxpayers apply the tax code correctly.

For ongoing audits of taxpayers as of November 23, 2009, 62 (11.4 percent) of 544 audits tested had audit periods that exceeded four years. However, the statute of limitations for assessing a tax is four years after the tax is due, unless it is extended for two years with the taxpayer's consent. Additionally, 30 (5.5 percent) of 544 audits tested were not complete as of November 23, 2009, but the time periods these audits covered had ended more than four years earlier. Not conducting audits in a timely manner increases the risk that not all of the audit periods will be audited.

Because the Tax Audit Division relies on the taxpayer to cooperate with audits, it should be noted that the timeliness of audits is not entirely within the control of the Tax Audit Division.

## Recommendations

The Comptroller's Office should:

- Review the automated controls in its tax-related information system to ensure that all intended automated controls exist and work as intended and to identify instances in which automated controls should be implemented.
- Update written policies and procedures to include all steps in the manual review of tax data.
- Identify and correct instances in which it processed a tax return for which tax liability reductions exceeded statutorily allowed amounts.
- Review data currently in its tax-related information system to ensure that data is captured correctly.

- Update data entry procedures to include a review of manual data entry into its tax-related information system to ensure that data entered into these systems is correct and matches supporting documentation.
- Retain all taxpayer-submitted documentation in accordance with records retention schedules.
- Strengthen its Tax Audit Division's processes to ensure that the Tax Audit Division conducts audits in a timely manner and provides appropriate audit coverage.

## Management's Response

### *Revenue Administration Division Responses*

*We agree that the Comptroller's Office is responsible for ensuring that taxpayer-submitted data is reviewed for completeness and accuracy. We recognize that improvements need to be implemented to mitigate risk of taxpayers' exceeding statutory requirements for exemption programs. Management was not aware that all automated controls were not fully implemented. Management was aware that legacy converted data would require additional steps when validating refund requests or transfers but these steps were dependant on automated controls working as intended. Our staff is committed to ensuring that tax statutes are applied consistently to all taxpayers.*

*The corrective actions outlined below will be monitored to ensure that they are effectively implemented and achieve the desired results.*

- *Crude Oil and Natural Gas Tax Section (CONG) staff will test automated controls to identify system deficiencies. CONG staff will work with Innovation & Technology (ITD) and Tax Policy Division (TPD) to clearly define system requirements and corrective actions in accordance with statute. CONG staff will ensure that ITD delivered system corrections work as intended.*

*Persons Responsible: Manager, Account Maintenance  
Manager, Innovation & Technology*

*Implementation Date: 8/31/2010*

- *CONG staff will thoroughly review and update section policies and procedures ensuring that all steps required in performing tasks are clearly written.*

*Persons Responsible: Manager, Account Maintenance*

*Implementation Date: 3/31/2010*

- *CONG staff will manually identify and correct data processed allowing taxpayer credits that exceeded statutory limits. CONG staff will address the leases with the largest accumulated savings before the end of May. There are 100 leases that account for 94 percent of the total credits that exceeded 50 percent of accumulated savings. During the following three months they will correct the remaining lease data. CONG staff will continue identifying leases that exceed the cap until controls are fully implemented.*

*Persons Responsible: Manager, Account Maintenance*

*Implementation Date: No Later Than 8/31/2010*

- *CONG staff will review existing data in tax-related information system to ensure that data is captured correctly. CONG staff will correct discrepancies.*

*Persons Responsible: Manager, Account Maintenance*

*Implementation Date: 4/30/2010*

- *CONG staff will update data entry procedures to ensure that entry errors are identified and corrected. Additionally, the exemptions approval business process will be reviewed for improvements.*

*Persons Responsible: Manager, Account Maintenance*

*Implementation Date: 3/31/2010*

- *CONG staff will work with ITD to identify a sound process for imaging exemption applications and refund request documentation that will improve their ability to maintain and retrieve documentation in accordance with records retention schedules.*

*Persons Responsible: Manager, Account Maintenance  
Director, Business Process Improvement*

*Implementation Date: 12/31/2010*

#### *Tax Audit Division Response*

*We respectfully disagree that audits are not completed in a timely manner and that audit coverage is not appropriate. First, all taxpayers are subject to audit. The Audit Division employs several different processes in audit selection including lead cards generated from informants or auditors performing other audits – as a result even non permitted taxpayers may be selected for audit. To maximize audit coverage, Audit utilizes the full statute*

*period and statute waivers to ensure that statute does not lapse. Audit either formally audits or reviews all large taxpayers prior to lapsing of statute. This allows Audit to cover 65% of all revenue generated in major taxes while only auditing 1% of permitted taxpayers. These decisions are made to increase coverage and efficiency and maximize the State's limited resources. The report also noted that Audit did not audit two tax types out of the over 50 available. Audit correctly determined that adequate coverage for these tax types was achieved by verifying associated refunds.*

*Audit effectively balances the need for audit coverage, the hundreds of thousands of tax accounts, the budget/manpower (550 auditors and travel resources) at Audit's disposal to arrive at proper coverage plans and audit selection. In doing so, Audit recognizes and accepts certain risks in producing \$2661 per audit hour for the state. This dollar per audit hour has increased from \$1691 in the last two years alone, an increase of over 50%.*

*While Audit agrees that a small percentage of audits are not completed timely, it is instructive to point out that an audit is a shared process between Audit and the taxpayer/consultant involved. This issue often relates to taxpayer cooperation and additional efforts to resolve issues without proceeding to costly litigation. The 90% completion rate determined by the review would be more than acceptable as is. In reality it is more of a 99% timely completion rate when you account for all audits completed within a year not just the number in inventory on a given day. In conclusion; audit selection, and completions are all part of a balancing act between resources, goals and the realization that Audit must also be concerned with taxpayer service and Audit's impact on other processes such as future hearings.*

*Audit Division management remains committed to maximize audit coverage given our available resources and will continue to explore options to strengthen our audit processes.*

*Person Responsible: Audit Division Manager*

*Implementation Date: 8/31/2010*

#### **Auditor's Follow-up Comment**

For the audit period, auditors verified that the Comptroller's Office did not conduct any tax audits for crude oil and conducted seven tax audits for natural gas. Crude oil and natural gas accounted for \$2.3 billion of the total tax revenue collected for fiscal year 2009. Auditors' findings and recommendations were intended to identify issues and help ensure that the tax audit process achieves maximum effectiveness.

**Issue 2**

**The Office of the Comptroller of Public Accounts Should Reconcile Tax Deposits and Tax Refunds in a Timely Manner**

Reference No. 10-555-14  
(Prior Audit Issue 09-555-04)

**Type of finding: Significant Deficiency**

In April 2009, the State Auditor’s Office reported that the Comptroller’s Office did not reconcile tax payments and tax refunds recorded in its Integrated Tax System (ITS) with information in the Uniform Statewide Accounting System (USAS) in a timely manner (see State of Texas Financial Portion of the Statewide Single Audit Report For the Year Ended August 31, 2008, State Auditor’s Office Report No. 09-555). Auditors identified this same issue during the audit of fiscal year 2009. ITS processed approximately \$37.6 billion in tax payments and \$2.4 billion in tax refunds in fiscal year 2009.

The Comptroller’s Office is responsible for reconciling tax deposits processed in ITS to the amounts of taxes collected and refunded in USAS. This reconciliation helps to ensure that the Comptroller’s Office correctly applies credits and debits to taxpayer accounts. However, in fiscal year 2009, the Comptroller’s Office did not conduct this reconciliation in a timely manner for 16 tax types that auditors tested.

Table 1 provides information on the Comptroller’s Office reconciliations of tax payments and tax refunds.

Table 1

Summary of the Comptroller’s Office’s Reconciliations of Tax Payments and Refunds in ITS with Tax Payments and Refunds in USAS			
Tax Type	Date Last Reconciled	USAS Unreconciled Balance	Difference Between ITS and USAS
<b>Tax Payment Reconciliations</b>			
Prepaid Sales	October 2008	\$ 6,605,646,188	\$ 20,391
State Sales	September 2008	\$ 13,159,950,020	\$ 17,301,049
Franchise	January 2009	\$ 587,261,426	\$ (38,504,584)
Franchise Margin	May 2009	\$ 280,160,266	\$ 6,863,289
Motor Vehicle Sales	May 2009	\$ 592,157,430	\$ (1,011,032)
Motor Vehicle Rental	October 2008	\$ 176,773,406	\$ (609)
Motor Vehicle Sales Seller Finance	August 2008	\$ 112,825,681	\$ (205,474)
Motor Fuel	May 2009	\$ 602,917,136	\$ 707
Diesel Fuel	May 2009	\$ 176,420,742	\$ (69,414)

Summary of the Comptroller's Office's Reconciliations of Tax Payments and Refunds in ITS with Tax Payments and Refunds in USAS			
Tax Type	Date Last Reconciled	USAS Unreconciled Balance	Difference Between ITS and USAS
Liquefied Gas	September 2008	\$ 1,098,513	\$ 17,470
Crude Oil	May 2009	\$ 213,653,701	\$ (130)
Natural Gas	June 2009	\$ 166,041,950	\$ 165,626
Cigarette and Tobacco Products	May 2009	\$ 32,376,660	\$ (183,298)
Cigarette Stamp	November 2008	\$ 1,075,236,561	\$ 3,057,035
Manufactured Housing	November 2008	\$ 7,382,943	\$ (52,102)
Insurance Premium	October 2008	\$ 1,186,833,592	\$ 9,419,581
Tax Refund Reconciliations			
Prepaid Sales	Not reconciled in fiscal year 2009	\$ (325,727,737)	\$ (870,466)
State Sales	Not reconciled in fiscal year 2009	\$ (319,811,403)	\$ (7,091,850)
Franchise	Not reconciled in fiscal year 2009	\$ (209,442,608)	\$ 882,327
Franchise Margin	Not reconciled in fiscal year 2009	\$ (806,099,327)	\$ 15,565,536
Natural Gas	Not reconciled in fiscal year 2009	\$ (513,901,264)	\$ (432,454)

Source: Unaudited reports supplied from the Comptroller's Office.

For sales taxes, the Comptroller's Office did not perform any tax payment reconciliations for 11 months of fiscal year 2009. For franchise margin taxes, natural gas taxes, and sales taxes, the Comptroller's Office did not perform any tax refund reconciliations in fiscal year 2009. A portion of the differences between these systems is attributable to the fact that these systems begin and close the fiscal year on a different date.

Comptroller's Office management asserted that it has not performed reconciliations in a timely manner due to the volume of reconciliations that it performs and unexpected employee turnover. Additionally, management asserted that it is taking steps to train remaining staff to perform reconciliations.

### Recommendations

The Comptroller's Office should improve financial reconciliations to ensure that it detects and corrects errors in a timely manner. Specifically, it should:

- Reconcile tax payments and tax refunds in ITS and USAS in a timely manner by completing reconciliations within one month of the end of the month being reconciled.
- Finalize the review of the reconciliations between ITS and USAS within one month from the date the reconciliations are prepared.

#### Management's Response

*The Revenue Accounting Division agrees the financial reconciliations for tax payments and tax refunds in ITS and USAS should be completed in a timely manner.*

*Our current turnaround time provides for a 30-day period after a 5-day period to receive, sort and match the reports generated from the tax systems and USAS.*

*As indicated in our response to the FY08 audit, the Comptroller's office experienced a tremendous loss of highly experienced personnel who worked these reconciliations. The Comptroller's office has taken aggressive steps to rebuild the staff through recruitment and extensive training. The new staff is continuing to gain expertise and build depth of knowledge for reconciliations for all tax/fee types and transaction types. They have made significant progress toward bringing the reconciliations current.*

*The current status for deposit and refund reconciliations is shown below.*

- *Deposit reconciliations for the 16 tax types identified by the State Auditor's Office (SAO) for FY09 have been completed.*
- *Deposit reconciliations for the same 16 tax types for FY10 have been completed to date, with December 2009 having been completed within turn-around time (January 2010 is still within turn-around time).*
- *Refund reconciliations for the six tax types identified by the SAO for FY09 have been completed through February 2009 and progress continues.*
- *All completed reconciliations have been reviewed for accuracy.*

*Responsible Person: Manager, Revenue Accounting*

*Implementation Date: We anticipate the refund reconciliations for the remainder of FY09 will be completed by 8/31/2010.*



### Issue 3

## The Office of the Comptroller of Public Accounts Should Continue to Strengthen Access Controls for the Treasury Division Technology Operations

### Type of finding: Significant Deficiency

Reference No. 10-555-15  
(Prior Audit Issues 09-555-02 and 08-555-01)

In April 2008 and April 2009, the State Auditor's Office reported that the Comptroller's Office allowed internal system program developers to have access to production data for the State Treasury's automated systems.<sup>2</sup> Auditors identified this same issue during the audit of fiscal year 2009.

The Comptroller's Office allows two internal system program developers to have access to production data for the State Treasury's automated systems. These systems were developed using a programming language that has limited security options. After auditors brought this issue to the Comptroller's Office's attention during the audit of fiscal year 2007, the Comptroller's Office's Treasury Division reduced the access from 15 developers to 2 developers. The Comptroller's Office's Treasury Division is in the process of replacing the current systems with another application that can be implemented with more advanced security features. It also has strengthened controls over obtaining access to its automated systems.

#### Title 1, Texas Administrative Code, Section 202.20 (1)

Information resources residing in the various state agencies of state government are strategic and vital assets belonging to the people of Texas. These assets shall be available and protected commensurate with the value of the assets. Measures shall be taken to protect these assets against unauthorized access, disclosure, modification, or destruction, whether accidental or deliberate, as well as to assure the availability, integrity, utility, authenticity, and confidentiality of information. Access to state information resources shall be appropriately managed.

The Texas Administrative Code requires agencies to take measures to protect data from unauthorized access, disclosure, modification, or destruction, whether accidental or deliberate (see text box). Granting excessive access and not providing for proper segregation of duties increases the risk of fraud, data corruption, potential service disruption, and loss of state revenue. Because the Treasury Division processes billions of dollars in revenue, the loss of even a single day's interest due to data manipulation or destruction would affect state revenue. However, nothing came to auditors' attention to indicate that automated systems had been compromised.

### Recommendations

The Comptroller's Office should:

- Continue to monitor end user and developer access to Treasury Division automated systems to ensure that the short-term compensating controls effectively address proper segregation of duties.

<sup>2</sup> See *State of Texas Financial Portion of the Statewide Single Audit Report For the Year Ended August 31, 2008*, State Auditor's Office Report No. 09-555, and *State of Texas Financial Portion of the Statewide Single Audit Report For the Year Ended August 31, 2007*, State Auditor's Office Report No. 08-555.

- Ensure that the security features of the planned new application enable the Treasury Division to manage end user and developer access for its automated systems.

#### Management's Response

- *The Treasury Operations Division agrees to continue to monitor end user and developer access to our automated systems to ensure that the short-term compensating controls effectively address proper segregation of duties. After auditors brought this issue to our attention during the fiscal year 2007 statewide financial audit, we implemented a new security access process using the agency's Help Desk ticket system. The ticket system now requires multiple levels of approval before access is granted to files and automated systems. The user or developer requesting access must first obtain approval through their designated security coordinator, and then obtain approval through Treasury Operations Division's designated security coordinator before staff or developer access is granted. The process is monitored and approved at several check points throughout the process.*

*The finding notes access to the Treasury Operations Division's automated systems is still granted to two developers. These individuals provide ongoing operations support to the automated system. We believe this access is a critical need given the large amount of dollars processed daily by the division. Any interruption in the daily processing could result in loss of interest earnings, directly affecting state revenue.*

- *We will continue to ensure that the security features of the new system will allow for us to properly manage end user and developer access.*

*The completion date was revised primarily because of an increase in the original scope of the project to include the integration of requirements for SB 638 – Local Pooled Collateral, which passed during the 81st Legislative Session, into the Treasury Solution. These requirements were not anticipated or known at the time the original target/implementation date was set.*

*Responsible Person: Director, Treasury Operations*

*Implementation Date: 5/2010*

## The Texas Workforce Commission Should Strengthen Controls Over Tax Payments and Returns and Document Policies and Procedures for Certain Unemployment Insurance Program Processes

### Issue 1

#### The Texas Workforce Commission Should Implement Controls to Ensure That It Adequately Secures Tax Payments and Returns

Reference No. 10-555-16

#### Type of finding: Significant Deficiency

The Texas Workforce Commission (Commission) does not always secure the unemployment insurance tax payments and tax returns it receives in its mailroom. Employers paid more than \$1 billion in unemployment taxes in fiscal year 2009. Of that amount, the Commission asserted that it received approximately 38 percent in payments and returns that arrived in its mailroom.

While the Commission does have certain security measures in its mailroom, such as cameras, some areas where staff temporarily store tax payments are not viewed by those cameras. In addition, during business hours the Commission does not lock the room where it receives and processes tax payments, which increases the risk of loss or theft.

Not adequately safeguarding tax payments and tax returns increases the risk that these documents might be misplaced or stolen, which would prevent the Commission from processing payments and/or return information and applying the correct information to taxpayers' accounts. Auditors did not identify any instances in which tax payments were misplaced or stolen during the time period under review.

#### Recommendation

The Commission should strengthen its internal controls over safeguarding tax payments and tax returns, as well as any other documents it receives through the mail.

#### Management's Response

*The Commission concurs that adding more security cameras in some Revenue and Trust Management work areas would help strengthen controls over the processing of unemployment insurance tax payment remittances. The additional security cameras will be installed by August 31, 2010.*

*We will also strengthen current internal controls procedures over remittance processing by ensuring multiple staff are always able to directly observe any mail that has not been secured in the vault. The implementation of these additional controls along with the current use of an armed guard stationed*

*between the main entrance and the door to the Exceptions/Batch unit will help ensure the adequate safeguarding tax payments and tax returns, as well as any other documents received through the mail.*

*Implementation Date: August 31, 2010*

*Responsible Person: Chief Accounting Officer*

## **Issue 2**

### **The Texas Workforce Commission Should Fully Document Policies and Procedures for Certain Unemployment Insurance Program Processes**

Reference No. 10-555-17

#### **Type of finding: Significant Deficiency**

In two areas, the Commission does not have formal policies and procedures to guide staff. This could affect the reliability of financial information related to the Unemployment Insurance Program. Specifically:

- When a daily tax rate changes during the year, an account examiner reviews the new rate to ensure that the Commission's Unemployment Insurance Tax System accurately calculated the rate. The Commission's Tax Department has policies and procedures requiring account examiners to verify changes in daily tax rates; however, there are no formal policies and procedures requiring supervisors to review the work that the account examiners perform, specifying how often such reviews should be conducted, and outlining what should be reviewed.
- Personnel in the Commission's Unemployment Insurance Support Services Division perform an informal review of unemployment insurance benefit payments made by Chase Bank to data in the Commission's automated system to ensure that all payments made to recipients match amounts recorded in the Commission's automated system. However, the Commission does not have formal policies and procedures for this review.

Having documented policies and procedures is a key control to help ensure that management directives are carried out and that necessary actions are taken to address the risks to achievement of the Commission's objectives. Without formal policies and procedures, key processes may not be performed or performed completely and accurately. In addition, policies and procedures are beneficial for employees who may be new to their positions and for backup personnel.

## Recommendations

The Commission should:

- Develop and document formal policies and procedures for reviews of daily tax rate changes and reviews of unemployment insurance benefit payments.
- Keep policies and procedures current by updating them as needed.

## Management's Response

*The Commission agrees that a formal policy be developed and documented requiring supervisors to review the work of the accounts examiners ensuring that the Tax System accurately calculated the employer's tax rate. The Tax rate supervisor currently reviews and samples work for each examiner in the Daily Activity list in the Quarterly Chargeback Adjustment run, and the Partial Transfer Application process along with sampling and reviewing complex tax assignments. These reviews are required and necessary to complete the performance reviews for each rates tax examiner. As of February 2010, an updated "Supervisor Review of Rates Accounts Examiner Work" section has been added to the Status Procedures Manual. Section 15.6 of the Status Procedures Manual will be kept current and will be updated as needed.*

*Implementation Date: March 1, 2010*

*Responsible Person: Deputy Director Unemployment Insurance Tax*

## The Water Development Board Should Strengthen Its Review of Adjustments to Its Annual Financial Report and Its Password Requirements

### Issue 1

The Water Development Board Should Accurately Account for Adjustments It Makes to the Loans and Contracts Balances in its Annual Financial Report

Reference No. 10-555-18

#### Components of Receivables

Governmental Accounting Standards Board (GASB) Statement No. 38, *Certain Financial Statement Note Disclosures*, paragraph 13, requires that governments provide details regarding the components of receivables. It further requires that significant receivable balances not expected to be collected within one year of the date of the financial statements be disclosed.

Components of receivables must be separately recorded in the Uniform Statewide Accounting System using the appropriate general ledger accounts, as well as presented as separate line items on the fund financial statements. This includes components such as accounts receivable, federal receivable and notes, and loans and contracts receivable.

Source: *Reporting Requirements for Annual Financial Reports of State Agencies and Universities*, Office of the Comptroller of Public Accounts, July 2009.

#### Type of finding: Significant Deficiency

The Water Development Board (Board) entered a loan of \$322,000 that it made into its accounting system early so that payment of the loan could be processed on time. The loan consisted of non-current funds receivable. When preparing its annual financial report for fiscal year 2009, the Board incorrectly removed the total loan amount from the current portion of the loans and contracts balance, instead of removing it from the non-current portion of the loans and contracts balance. The Board did not detect this error during its review of adjustments to its annual financial report.

The Board classifies all of its loan balances as current loans and contracts during the fiscal year. It then makes an adjusting entry at the end of the fiscal year to reclassify the balance between current and non-current. Part of the reclassification process involves removing from the correct loan balance any amounts for loans the Board entered into the accounting system early.

#### Recommendation

The Board should strengthen its review process to ensure that the adjustments it makes to its annual financial report are accurate.

#### Management's Response

*Management has already reviewed its processes and has discussed changes in the responsibilities for preparation, review of adjustments, and setting aside the appropriate time to address these functions during the Annual Financial Report preparation. Management is also encouraged that the \$322 thousand deficiency was the only one found in the reporting of \$4.5 billion of current and non-current loans.*

*Implementation Date: Fully implemented.*

*Responsible Person: Director of Accounting.*

## Issue 2

### The Water Development Board Should Strengthen Password Requirements for Its Accounting and Financial Systems

Reference No. 10-555-19

#### Type of finding: Significant Deficiency

The Board uses two internal systems to compile financial data for its annual financial report: (1) Micro Information Products (MIP), which is the Board's internal accounting system, and (2) Financial Information System (FIS), which is a financial system that records loan and bond information. The passwords required to access these two systems contain weaknesses that could put the data in these systems at risk.

The Board's password policy states that:

- Passwords must have a minimum length of seven alphanumeric and special characters.
- Passwords must be changed at least once every six months.
- Password history must be kept to prevent the reuse of a password.
- Passwords must contain a mix of uppercase and lowercase characters and must have at least two numeric characters.

#### Industry Best Practices for Passwords

The Texas Administrative Code requires that passwords be based on industry best practices on password usage and documented state agency risk management decisions.

According to Microsoft, a strong password:

- Is at least seven characters long.
- Expires as often as necessary for the environment, typically, every 30 to 90 days.
- Is significantly different from previous passwords.
- Contains characters from each of the following four groups: uppercase letters, lowercase letters, numerals, and symbols found on the keyboard (all keyboard characters not defined as letters or numerals).

Sources: Title 1, Texas Administrative Code, Section 202.25(3)(D), and Microsoft best practices at [http://technet.microsoft.com/en-us/library/cc784090\(WS.10\).aspx](http://technet.microsoft.com/en-us/library/cc784090(WS.10).aspx) and [http://technet.microsoft.com/en-us/library/cc756109\(WS.10\).aspx](http://technet.microsoft.com/en-us/library/cc756109(WS.10).aspx).

The Board purchased MIP from a vendor, and the Board has the option to (1) either require a password or not require a password and (2) determine the minimum length of passwords. The Board has set up MIP to require a password that is at least seven characters in length. However, there are no requirements for passwords to contain non-alphanumeric characters, for users to change passwords, or for the system to record password history.

A consultant developed FIS for the Board. FIS is programmed to require passwords that are at least six characters in length and contain at least one non-alphanumeric character. There are no requirements for users to change passwords or for the system to record password history.

All Board employees must log into the Board's network before they can access FIS or MIP, and password requirements for that network meet the Board's password policy and industry best practices (see text box for best practices). This helps to prevent unauthorized external access to FIS and MIP. However, because of the password weaknesses for FIS and MIP discussed above, current employees of the Board who have a valid network user ID and password could potentially alter data in FIS and MIP without detection.

## Recommendations

The Board should:

- Work with the developer of MIP to determine whether stronger passwords can be required. Alternately, the Board should implement a compensating control to ensure that Board employees are not able to easily access MIP and alter data without detection.
- Reprogram the password setting in FIS to require stronger passwords.

## Management's Response

*Management would like to point out that in addition to accessing MIP and FIS through the network:*

- *Neither FIS nor MIP can generate a payment on its own. Transactions must also pass through the Uniform Statewide Accounting System or paperwork must be sent to the Safekeeping Trust with the necessary authorizations.*
- *Only staff who are authorized MIP users have MIP loaded on their computers, so there is limited access to the MIP software.*
- *In order to log in to MIP, an individual must have membership in an active directory group (MIP\_Users) prior to actually logging in to MIP accounting.*
- *MIP and FIS are reconciled to each other, as well as to external systems.*

*Management is of the opinion that the items above provide compensating controls such as those recommended by SAO.*

*Management will contact Sage MIP Fund Accounting to request that stronger passwords be implemented in future versions of MIP, and will notify other state agencies using MIP regarding this concern.*

*The TWDB IT department will modify the FIS to require stronger passwords as follows:*

- *Passwords must have a minimum length of 7 alphanumeric and special characters.*
- *Passwords must contain a mix of upper and lower case characters and have at least 2 numeric characters. The numeric characters must not be at the beginning or the end of the password. Passwords must contain at least one special character. The special characters are (!@#\$\$%^&\*+=?/~' ;:;<>\/).*



*This will be implemented in FIS in production by 4/30/10.*

*Implementation Date: March 2010 for contacting Sage MIP  
April 2010 for implementing stronger passwords  
within FIS*

*Responsible Persons: Director of Information Technology and Financial  
Systems Analyst*

Chapter 1-F

## **The University of Texas at Austin Should Strengthen Certain Aspects of Its Financial Operations**

### **Issue 1**

#### **The University of Texas at Austin Should Strengthen Its Inventory Controls**

Reference No. 10-555-20  
(Prior Audit Issues 09-555-14 and 08-555-15)

#### **Type of finding: Significant Deficiency**

The University of Texas at Austin (University) did not consistently follow state property accounting requirements in the Office of the Comptroller of Public Accounts' *SPA Process User's Guide* and the University's *Handbook of Business Procedures*. Specifically:

- As of August 31, 2009, the University had not entered 947 capital assets valued at \$12.7 million into its fixed asset system as a permanent inventory record. The University purchased 723 of those capital assets, with a value of \$10.6 million, between September 4, 2008, and July 31, 2009. However, these capital assets were reflected in the University's August 31, 2009, financial statements. The University should enter information into its fixed asset system in a timely manner to ensure that inventory records are accurate and current.
- The University did not correctly value 6 (20.0 percent) of 30 asset acquisitions tested. Specifically:
  - ♦ The University did not capitalize freight and shipping costs for 5 (16.7 percent) of 30 asset acquisitions that auditors tested. The University should have capitalized \$1,011 in freight and shipping costs for these five assets, as required by the *SPA Process User's Guide* and the *Handbook of Business Procedures*.
  - ♦ The University did not account for \$856 in discounts when valuing 1 (3.3 percent) of 30 assets that auditors tested. For that same asset, the University incorrectly expensed the cost of components purchased for \$1,230 that were necessary for the operation of equipment. The

University should have capitalized the cost of those components as required by the *SPA Process User's Guide* and the *Handbook of Business Procedures*.

- The University asserted that it reconciled its fixed asset system to the State Property Accounting (SPA) system on an annual basis, rather than on a quarterly basis. According to the *SPA Process User's Guide*, the University, as a “reporting agency,” should reconcile balances from its fixed asset system to the SPA system on a quarterly basis, and it should clear the reconciling items it identifies (that is, corrections should be made) as soon as possible. The University should clear all reconciling items before it prepares the capital asset note to its financial statements.

Ensuring that the University enters accurate information into its fixed asset system and the SPA system helps to ensure that the University accurately reports capital asset balances, depreciation, and accumulated depreciation in its financial statements.

## Recommendations

The University should:

- Update permanent inventory records in its fixed asset system in a timely manner. As part of this effort, the University's Inventory Services unit should periodically monitor the assets that departments purchase to ensure that departments submit inventory information and that inventory tags are assigned to capitalized assets within 30 days of receipt.
- Follow its written policies and procedures for accounting for shipping and freight costs, maintenance costs, and discounts. Specifically, it should:
  - ♦ Capitalize the freight and shipping costs associated with capital assets.
  - ♦ Capitalize the cost of all modifications, attachments, accessories, or apparatus necessary to make assets usable and render them into service.
  - ♦ Ensure that all discounts are appropriately reflected in its asset valuation records.
- Strengthen guidance available to departments that are responsible for recording and tagging assets.
- Reconcile its fixed asset system to the SPA system on a quarterly basis.

## Management's Response

*The University concurs with the finding.*

*The University has made significant progress improving the timeliness of recording inventory by assigning temporary numbers to assets, primarily at year end. The temporary numbers become part of the asset permanent record along with the permanent number and related payment information. There are many factors that contribute to the timing of entering permanent tag number into the University's computerized inventory system. The system design requires that it be closed at year-end to daily processing in order to perform fiscal year end procedures, and then reopened in late October. During that time departments and Inventory Services continue to tag items that are received by the University creating a delay in processing the permanent records by Inventory Services. In addition to the design changes to the University's electronic inventory system, other changes are needed to expedite the time it takes to enter each item into the inventory system including policy changes to allow the item serial number to function as the official University tag number, and better integration between the inventory system, the University's procurement systems, and departmental procedures. This is a long-term initiative and will involve communications with the State Comptroller, software modifications, and procedural modifications throughout the community. Implementation of system changes will be dependent on value and availability of limited resources with implementation date of August 2011.*

*To assist the University to follow its written policies and procedures for capitalizing certain costs for an inventory item, spot audits of department's inventory have been implemented and will continue allowing Inventory Services to monitor department inventory procedures and information. Semi-annual focus group meetings with departments continue to be held and enhanced training has been implemented. To strengthen guidance available to departments responsible for recording and tagging assets, Inventory Services developed written procedures for self-tagging departments and forwards these instructions to departments who are new to self-tagging or if someone is new to the process due to a change in job responsibilities.*

*Inventory data from the University's system is sent to SPA electronically via data uploads on a monthly basis. Data quality issues and limited staffing resources have prohibited more frequent reconciliations and made the current process manual and time consuming. Due to limited resources, Inventory Services plans to reconcile the University fixed asset system to the State Property Accounting (SPA) system on a semi-annual basis, rather than on a quarterly basis. This procedure will be implemented in April 2010. To meet the goal of quarterly reconciliations, the University will continue to review the utilization of the the University's IQ (data warehousing) System and*

*improving the automation processes in order to maximize limited resources with implementation date of August 2011.*

*Implementation Date: August 2011*

*Responsible Person: Finance Manager, Inventory Services, Office of Accounting*

Chapter 1-G

## **The University of Texas at San Antonio Should Strengthen Its Capital Asset Records**

### **Issue 1**

Reference No. 10-555-21  
(Prior Audit Issue 09-555-15)

#### **Type of finding: Significant Deficiency**

The University of Texas at San Antonio (University) did not always follow state property accounting requirements for capital assets. During fiscal year 2008, the University did not maintain documentation supporting the acquisition cost of assets for the life of the assets plus three years, as required by the *SPA Process User's Guide* and the Library and Archive Commission's Texas State Records Retention Schedule. The University's record retention policy requires the University to maintain this documentation for the fiscal year in which assets are acquired plus three years. For fiscal year 2009, the University asserted that it had not implemented a policy to ensure that it maintains documentation for the life of the asset plus three years.

#### **Recommendation**

The University should comply with the *SPA Process User's Guide* and the Texas State Records Retention Schedule and retain documentation supporting the acquisition cost of each capital asset for the life of the asset plus three years.

#### **Management's Response**

*To comply with the SPA Process User's Guide and the Texas State Records Retention Schedule, UTSA has retained invoices for capital assets from Fiscal Year 2006 forward. For capital assets purchased prior to Fiscal Year 2006, DEFINE electronic record will be relied on to establish a capital asset's value. Financial Affairs is reviewing the use of Banner Xtender for imaging invoices and related documents to better understand the costs and business process requirements to implement electronic invoice retention going*

*forward. Until Banner Xtender can be implemented, UTSA will retain a hard copy of the invoices for the life of the capital assets plus three years.*

*Implementation Date: 09/01/2009*

*Responsible Person: Associate Vice President for Financial Affairs*

Chapter 1-H

## **The University of Texas Health Science Center at Houston Should Strengthen Access Controls and Capital Asset Documentation**

### **Issue 1**

**The University of Texas Health Science Center at Houston Should Ensure That Access to Its Financial Systems Is Appropriate**

Reference No. 10-555-22

#### **Type of finding: Significant Deficiency**

Access to automated financial systems at the University of Texas Health Science Center at Houston (Health Science Center) did not consistently comply with state information resources policies and Health Science Center policies. This represents a weakness in the Health Science Center's internal controls. Auditors reviewed access rights to the Health Science Center's internal accounting system and the State's accounting system (the Uniform Statewide Accounting System, or USAS) and identified the following:

- Eleven individuals had access to both enter and approve transactions in the general ledger module of the Health Science Center's internal accounting system.
- Four individuals had access in USAS to enter, edit, and post transactions and to release batches of transactions into USAS.
- Five individuals had access to screens in USAS that were not necessary or appropriate based on their job duties.

**Title 1, Texas Administrative Code,  
Section 202.70 (1)**

Information resources residing in the various institutions of higher education of state government are strategic and vital assets belonging to the people of Texas. These assets shall be available and protected commensurate with the value of the assets. Measures shall be taken to protect these assets against unauthorized access, disclosure, modification or destruction, whether accidental or deliberate, as well as to assure the availability, integrity, utility, authenticity, and confidentiality of information. Access to state information resources shall be appropriately managed.

After auditors brought these matters to the Health Science Center's attention, the Health Science Center removed the access of individuals who were former employees and began reviewing access rights for the other individuals to identify and remove inappropriate access levels.

The Texas Administrative Code requires higher education institutions to take measures to protect data from unauthorized access, disclosure, modification, or destruction, whether accidental or deliberate (see text box). Not removing access for former employees or not providing for proper segregation of

duties increases the risk of fraud.

In addition, the Health Science Center's policy requires that different individuals enter and release journal vouchers. However, the Health Science Center does not have a review process to ensure that staff do not both enter and post their own financial transactions. The Health Science Center did have a compensating control requiring a separate individual to review vouchers that were entered and approved by the same individual in the general ledger module of its internal accounting system. Eight (28.6 percent) of 28 journal vouchers that auditors tested were both entered and approved by the same individual during fiscal year 2009 and were not reviewed by a separate individual. These eight journal vouchers totaled \$20,123,955.

The Health Science Center also does not have a compensating control for reviewing transactions that the same individual both enters and releases in USAS. However, no transactions were entered and released by the same individual in USAS in fiscal year 2009.

## Recommendations

The Health Science Center should:

- Review the access process for its internal accounting system to ensure that data owners review staff's access rights.
- Regularly review staff's USAS access rights to ensure that they are appropriate and ensure segregation of duties.
- Enforce its policy of segregation of duties by updating user access rights in the general ledger or by implementing a monitoring process to ensure that the same individual does not both enter and post financial transactions.

## Management's Response

*The Financial business owners periodically review the security access to the PeopleSoft Financial Management System to ensure access is appropriate. As part of this review, we will also implement a review of USAS security access to ensure there is appropriate access and segregation of duties. USAS access issues identified in the review, were a result of a security training deficiency. The deficiency and the access issue have been corrected, however there were mitigating controls beyond USAS security preventing unauthorized access. Network access which is automatically dropped upon employee separation, and client software required for USAS access, would not be available to a terminated employee. No unauthorized access was noted in the review.*

*While no manual journal entries submitted outside of Finance are posted without review centrally, the process for Finance initiated entries into the UTHSC-Houston General Ledger has been modified to ensure entries entered and posted by the same person are reviewed (and signed off on) by a separate individual.*

*Implementation Date: April 30, 2010*

*Responsible Person: Sr. Vice President, Finance & Business Services*

## Issue 2

### The University of Texas Health Science Center at Houston Should Strengthen Its Documentation for Capital Assets

Reference No. 10-555-23

#### Type of finding: Significant Deficiency

To determine whether the Health Science Center presented beginning capital asset balances fairly, auditors tested the Health Science Center's documentation for a sample of 73 capitalized assets from the Health Science Center's asset management system. The sample tested \$101,336,105 in assets from the total asset balance of \$760,123,686. The Health Science Center:

#### Definitions

Capitalized Assets - Real or personal property that has an estimated life of greater than one year and has a value equal or greater than the capitalization threshold established for that type of asset. Capitalized assets are reported in an agency's annual financial report.

Real Property - Land, buildings, infrastructure, facilities and other improvements, and leasehold improvements.

Personal Property - Tangible and intangible movable items, such as furniture, equipment, vehicles, boats, aircraft, books, works of art, historical treasures and computer software.

Source: *State Property Accounting Process User's Guide*, Office of the Comptroller of Public Accounts, February 2008.

- Was able to locate documentation for 55 (75.3 percent) of the assets tested, and that documentation supported each asset's beginning valuation.
- Was not able to locate documentation to support the beginning valuations in its asset management system for 18 (24.7 percent) of the assets tested. Those 18 assets included 3 personal property assets and 15 real property assets (see text box for definitions). As a result, auditors were unable to verify the beginning valuations for those 18 assets. According to the Health Science Center's records, the value of those 18 assets totaled \$12,528,098, or 12.4 percent of the assets tested.

The Health Science Center implemented a new financial system in 2003. This made locating documentation for the 18 assets described above more difficult because the Health Science Center acquired each of those 18 assets prior to 2004. However, without documentation it would be difficult for the Health Science Center to prove ownership of an asset or its valuation in the event of theft or destruction of the asset.

## Recommendation

The Health Science Center should develop and implement a process to enable it to more easily locate documentation for capitalized assets it acquired prior to 2004.

## Management's Response

*UTHSC-Houston has now isolated within the university content management repository (Documentum) a separate file folder for real property asset information. A file folder for each fiscal year will contain the details for the real property additions. The documents in the file folder will include references to voucher number, purchase order number and componentization breakdowns. Information currently being entered into Documentum for personal property acquisitions include voucher number and purchase order number. UTHSC-Houston will aggregate available information supporting acquisitions prior to 2004 in this repository.*

*Implementation Date: July 31, 2010*

*Responsible Person: Sr. Vice President, Finance & Business Services*



## The University of Texas Southwestern Medical Center at Dallas Should Strengthen Certain Aspects of Its Financial Operations

### Issue 1

#### The University of Texas Southwestern Medical Center at Dallas Should Strengthen Its Management of System Access

Reference No. 10-555-24

#### Type of finding: Significant Deficiency

Auditors reviewed access to the University of Texas Southwestern Medical Center at Dallas's (Medical Center) internal patient accounting system and identified 43 (11.4 percent) of 376 active user accounts that did not comply with the Medical Center's *System Access Management* policy and the Texas Administrative Code. These 43 user accounts did not comply because these

accounts were associated with users whose employment or contracts had been terminated or could not be substantiated.

According to the Medical Center's *System Access Management* policy dated April 2005, "In the event a User terminates employment, contract expires or otherwise no longer requires access to information systems, the User's supervisor or sponsor will have the responsibility for submitting a request for termination of access to the Information Owner or centralized process (System Access Management group) to have the User's account disabled."

The Texas Administrative Code requires agencies to take measures to protect data from unauthorized access, disclosure, modification, or destruction, whether accidental or deliberate (see text box for additional details).

Monitoring and modifying access as required reduces the risk of fraud, data corruption, and potential service disruption.

#### Excerpts from The Texas Administrative Code

According to Title 1, Texas Administrative Code, Section 202.70(1), "Information resources residing in various institutions of higher education are strategic and vital assets belonging to the people of Texas. These assets shall be available and protected commensurate with the value of the assets. Measures shall be taken to protect these assets against unauthorized access, disclosure, modification or destruction, whether accidental or deliberate, as well as assure the availability, integrity, utility, authenticity, and confidentiality of information. Access to state information resources shall be appropriately managed."

According to Title 1, Texas Administrative Code, Section 202.75(3)(B), "A user's access authorization shall be appropriately modified or removed when the user's employment or job responsibilities within the institution of higher education change."

### Recommendations

The Medical Center should:

- Ensure that it manages access to state information resources in compliance with its policy and the Texas Administrative Code.
- Enforce its policy and ensure that it disables user accounts immediately upon termination of a user's employment or contract.
- Strengthen its process for review of user accounts to ensure that it manages employee, contractor, and vendor access appropriately.

## Management's Response

*We agree with the recommendations associated with your review of the patient accounting system of the University Hospitals and believe the corrective actions below will appropriately address the issues.*

- *Ensure that it manages access to state information resources in compliance with its policy and the Texas Administrative Code.*

*UT Southwestern (the Medical Center) makes every attempt to comply with Texas Administrative Code (TAC). The Medical Center will enhance procedures to ensure that we remain in full compliance with our own policy and TAC requirements regarding management of system accounts. These procedures, outlined below, will apply to those applications managed by our Information Security division, as well as, applications managed by other central Information Resources divisions*

- *Enforce its policy and ensure that it disables user accounts immediately upon termination of a user's employment or contract.*

*The Medical Center identified a specific opportunity for improvement as a result of the findings of this audit. We discovered that certain types of HR appointments for non-employee associates (FNEAs), when entered with an auto-expiration date, were not reported to system owners when those appointments automatically expired. As a result, the system accounts for those individuals may have remained active after account expiration. Most of the accounts identified in this audit finding fell into this category. It is important to note that it is likely all of these accounts would have been deactivated as part of the scheduled accounts reconciliation process for that was completed in January 2010.*

*To address the issue of appointments created with auto expirations, the Medical Center will develop a daily report from our HRMS system of all auto-expiring FNEAs. This report will be delivered to all sponsoring departments and to those individuals responsible for system account management, including both the Information Security division and other central IR divisions.*

*This report will be the basis for disabling access for those individuals who may not otherwise be reported as account terminations. We expect that the report process will be in place and operating as planned by March 31, 2010.*

- *Strengthen its process for review of user accounts to ensure that it manages employee, contractor, and vendor access appropriately.*

*The Medical Center Information Security group will work with application owners/custodians to develop a process for utilizing the daily FNEA exceptions report to remove unneeded systems access in a more timely*

*fashion. Additionally, a quarterly review of all system accounts in each centrally managed application, including the Siemens system will be performed. This procedure will ensure that accounts do not remain in active status for employees, contractors or vendors when not appropriate. As a final check and balance, Information Security will perform a follow-up review after each quarter to ensure that inactive employees/contractors/vendors do not maintain active accounts in those systems. These processes will be developed and documented by March 31, 2010 and will be implemented with the first review of the Siemens system beginning on April 1, 2010.*

*Responsible Person: AVP IR Administration and CISO*

*Implementation Date: March 2010*

## **Issue 2**

### **The University of Texas Southwestern Medical Center at Dallas Should Strengthen Its Patient Billing Process**

Reference No. 10-555-25  
(Prior Audit Issue 09-555-18)

#### **Type of finding: Significant Deficiency**

As of August 31, 2009, the Medical Center had not implemented a policy to ensure that it reviews and addresses unbilled patient transactions in a timely manner and that it receives all information needed to process bills for medical services provided. Unbilled patient charges are identified on the Medical Center's *Discharged Not Final Billed Report*.

In October 2009 (fiscal year 2010), the Medical Center asserted that it implemented a policy to address the deficiencies related to patient billing that auditors identified during fiscal year 2008. Because the process was not implemented until fiscal year 2010, auditors did not test the process.

#### **Recommendation**

The Medical Center should continue to implement its policy to ensure that it reviews and addresses unbilled patient transactions in a timely manner.

#### **Management's Response**

*We agree with the recommendation and will continue to implement PFS Policy #5-305 that addresses the review and processing of the DNFB Report. The Policy addresses specific responsibilities of various departments and individuals involved in monitoring the report (e.g. Health Information Management, Billing and Denials Management departments of PFS) as well*

*as guidance on how to interpret the unbilled patient charges on the DNFB report. The DNFB report is produced daily, and two departments within PFS review the DNFB report daily and take appropriate action. The Assistant Director of the Hospital Revenue Cycle University Hospitals also scans the report each day.*

*Responsible Person: Director of Revenue Cycle University Hospitals*

*Implementation Date: October 2009*

## Agencies and Higher Education Institutions Should Strengthen Their Reviews of Their Schedules of Expenditures of Federal Awards

Reference No. 10-555-26  
(Prior Audit Issues 09-555-19)

### Type of finding: Significant Deficiency

**Schedule of Expenditures of Federal Awards (SEFA)**

Each agency, college, and university that expends federal awards is required to prepare a Schedule of Expenditures of Federal Awards (SEFA). Federal awards include federal financial assistance and federal cost-reimbursement contracts that non-federal entities receive directly from federal awarding agencies or indirectly from pass-through entities [Office of Management and Budget (OMB) Circular A-133, Section .105].

Federal financial assistance includes any assistance that non-federal entities receive or administer in the form of grants, loans, loan guarantees, property (including donated surplus property), cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, and other assistance (OMB Circular A-133, Section .105).

Source: *Reporting Requirements for Annual Financial Reports of State Agencies and Universities*, Office of the Comptroller of Public Accounts, July 2009.

The agencies and higher education institutions listed in Table 2 did not perform an adequate review of their fiscal year 2009 Schedules of Expenditures of Federal Awards (SEFAs) (see text box for additional information).

Because they did not perform an adequate review, the SEFAs these agencies and higher education institutions submitted to the Office of the Comptroller of Public Accounts (Comptroller’s Office) contained errors. Table 2 summarizes the errors that auditors identified in these agencies’ and higher education institutions’ fiscal year 2009 SEFAs.

The 9 agencies and 17 higher education institutions listed below reported \$36.4 billion in federal expenditures, or 78.7 percent of the total federal expenditures reported by the State of Texas for fiscal year 2009. The errors listed below were not material to the fiscal year 2009 SEFA for the State of Texas or to the fiscal year 2009 Comprehensive Annual Financial Report for the State of Texas.

Table 2

Summary of Errors Identified in Agency and Higher Education Institution Fiscal Year 2009 SEFAs								
Agency or Higher Education Institution	Incorrect Program Clustering <sup>a</sup>	Incorrect Pass-through Reporting <sup>b</sup>	Incorrect Preparation of SEFA Using Revenues <sup>c</sup>	Incorrect Classification of Expenditures <sup>d</sup>	Incorrect Inclusion of Expenditures <sup>e</sup>	Incorrect Exclusion of Expenditures <sup>f</sup>	Incorrect Exclusion of Indirect Cost Recovery <sup>g</sup>	Errors in Notes to the SEFA <sup>h</sup>
Adjutant General’s Department				X				X
Department of Aging and Disability Services				X	X	X		
Department of Agriculture		X					X	

Summary of Errors Identified in Agency and Higher Education Institution Fiscal Year 2009 SEFAs

Agency or Higher Education Institution	Incorrect Program Clustering <sup>a</sup>	Incorrect Pass-through Reporting <sup>b</sup>	Incorrect Preparation of SEFA Using Revenues <sup>c</sup>	Incorrect Classification of Expenditures <sup>d</sup>	Incorrect Inclusion of Expenditures <sup>e</sup>	Incorrect Exclusion of Expenditures <sup>f</sup>	Incorrect Exclusion of Indirect Cost Recovery <sup>g</sup>	Errors in Notes to the SEFA <sup>h</sup>
Department of State Health Services								X
Department of Transportation		X		X				
Health and Human Services Commission		X		X				
Office of the Attorney General		X			X			
Parks and Wildlife Department			X					
Sam Houston State University	X							X
Tarleton State University	X			X				
Texas A&M University					X			X
Texas A&M University - Commerce		X						
Texas A&M University - Kingsville	X							
Texas State University - San Marcos					X	X		X
Texas Workforce Commission		X						
The University of Texas at Arlington	X			X				X
The University of Texas at Austin	X			X				X
The University of Texas at El Paso				X				X

**Summary of Errors Identified in Agency and Higher Education Institution Fiscal Year 2009 SEFAs**

Agency or Higher Education Institution	Incorrect Program Clustering <sup>a</sup>	Incorrect Pass-through Reporting <sup>b</sup>	Incorrect Preparation of SEFA Using Revenues <sup>c</sup>	Incorrect Classification of Expenditures <sup>d</sup>	Incorrect Inclusion of Expenditures <sup>e</sup>	Incorrect Exclusion of Expenditures <sup>f</sup>	Incorrect Exclusion of Indirect Cost Recovery <sup>g</sup>	Errors in Notes to the SEFA <sup>h</sup>
The University of Texas - Pan American				X				X
The University of Texas Health Science Center at Houston				X		X		X
The University of Texas Health Science Center at San Antonio	X							
The University of Texas Medical Branch at Galveston	X			X	X			X
University of Houston						X		X
University of Houston - Clear Lake					X	X		X
University of North Texas	X							
University of North Texas Health Science Center at Fort Worth	X			X	X			X

<sup>a</sup> Reported federal programs in an incorrect cluster.

<sup>b</sup> Incorrectly classified expenditures as direct expenditures. The expenditures should have been classified as "Pass-Through to Non-State Entities" and "Pass-Through to Agencies or Universities."

<sup>c</sup> Incorrectly prepared SEFA using federal revenues rather than expenditures.

<sup>d</sup> Incorrectly classified expenditures between federal programs.

<sup>e</sup> Over-reported federal expenditures on its SEFA. Expenditures were reported based on the federal award year rather than the state fiscal year.

<sup>f</sup> Under-reported federal expenditures on its SEFA.

<sup>g</sup> Did not include indirect cost recovery.

<sup>h</sup> Errors were noted in the notes to the SEFAs.

Performing an adequate review of their SEFAs and supporting documentation would help the agencies and higher education institutions ensure that the SEFA information they submit to the Comptroller's Office is accurate.

#### **Recommendation**

Agencies and higher education institutions should implement an adequate review process to ensure that the SEFA information they submit to the Comptroller's Office is accurate.

#### **Management's Response**

See Appendix 3 for management's response from each agency and higher education institution.



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

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A finding regarding the Schedule of Expenditures of Federal Awards for fiscal year 2009 was included in Chapter 1-J of this report. All other fiscal year 2009 federal award information was issued in a separate report. See *State of Texas Federal Portion of the Statewide Single Audit Report for the Fiscal Year Ended August 31, 2009*, by KPMG LLP, dated February 22, 2010.

# Summary Schedule of Prior Audit Findings

*State of Texas Financial Portion of the  
Statewide Single Audit Report for the  
Year Ended August 31, 2009*

## *Summary Schedule of Prior Audit Findings*

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Federal regulations (Office of Management and Budget Circular A-133) state that “the auditee is responsible for follow-up and corrective action on all audit findings.” As part of this responsibility, the auditees report the corrective actions they have taken for the findings reported in:

- *State of Texas Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2005* (State Auditor’s Office Report No. 06-555, March 2006).
- *State of Texas Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2006* (State Auditor’s Office Report No. 07-555, April 2007).
- *State of Texas Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2007* (State Auditor’s Office Report No. 08-555, April 2008).
- *State of Texas Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2008* (State Auditor’s Office Report No. 09-555, April 2009).

The Summary Schedule of Prior Audit Findings (for the year ended August 31, 2009) has been prepared to address these responsibilities.

## The Office of the Comptroller of Public Accounts Should Strengthen Certain Aspects of Its Financial and Information Technology Operations

### Issue 1

#### The Office of the Comptroller of Public Accounts Should Strengthen Its Comprehensive Annual Financial Report Consolidation Process

Reference No. 09-555-01  
(Prior Audit Issue 08-555-03)

#### Type of finding: Significant Deficiency

##### Definition of Significant Deficiency

A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

Source: Codification of Statements on Auditing Standards AU, Section 325.06, American Institute of Certified Public Accountants.

Although the Office of the Comptroller of Public Accounts (Comptroller's Office) relies on state agencies and public higher education institutions to provide accurate financial information, the Comptroller's Office is ultimately responsible for the accurate presentation of the State's Comprehensive Annual Financial Report (CAFR) and Schedule of Expenditures of Federal Awards (SEFA).

Control weaknesses exist in the Comptroller's Office's process for preparing the State's CAFR and SEFA that allowed errors to occur without being detected or corrected in a timely manner. Auditors identified errors in financial data, consolidation adjustments, CAFR note disclosures, and supporting documentation. Based on the audit, the Comptroller's Office corrected most known errors before finalizing the CAFR.

Control weaknesses in tax-related information. The Comptroller's Office did not record tax revenues according to generally accepted accounting principles for taxes, and it did not update the fiscal year 2008 CAFR to reflect all effects of tax transactions that occurred after the end of fiscal year 2008 but that were related to tax account balances for fiscal year 2008. Specifically, the Comptroller's Office:

##### Tax Revenue Recognition

Generally accepted accounting principles require that tax revenues be recognized, net of estimated refunds and estimated uncollectible amounts, when the transaction the tax is assessed upon occurs or when resources are received, whichever occurs first.

Source: Governmental Accounting Standards Board, Statement 33, paragraph 16.

- Incorrectly based tax revenues on the amount of taxes collected, rather than on the amount of taxes assessed. Generally accepted accounting principles require that revenues should be recognized when the underlying exchange transaction occurs.
- Did not adjust the CAFR to reflect \$606 million in tax overpayments for fiscal year 2008 as required by generally accepted accounting principles (see text box). Franchise taxpayers initially overpaid \$606 million in

fiscal year 2008. The Comptroller's Office refunded the \$606 million to taxpayers after the end of fiscal year 2008. However, it did not initially reduce tax revenues or record the refunds due back to taxpayers on the fiscal year 2008 CAFR. This error caused franchise tax revenues to be overstated and accounts payable to be understated by \$606 million on the fiscal year 2008 CAFR. After auditors identified the issue, the Comptroller's Office adjusted tax revenues and accounts payable before finalizing the fiscal year 2008 CAFR.

- Reported negative deferred revenues related to natural gas production taxes. Natural gas producers can claim severance tax exemptions for low-producing gas wells to reduce their tax liability. In most cases, taxpayers remit their tax payments prior to qualifying for the exemptions and initially pay more than their final liability. The Comptroller's Office asserted that these overpayments represented resources collected but not yet earned. Because most of these credits would not be available to the taxpayer in time to reduce current year obligations, the Comptroller's Office did not reduce tax revenues, even though these overpayments represented cash collected that was not legally due to the Comptroller.

As part of the tax revenue reporting process, the Comptroller's Office used information from its Integrated Tax System (ITS) to adjust the amount of tax revenues collected. However, the staff preparing the CAFR did not have a thorough understanding of how ITS processed tax assessments, payments, credits, and refunds. Having a better understanding of ITS and all transactions related to tax revenue would help ensure that tax revenue is presented correctly in the CAFR. Auditors verified that the Comptroller's Office entered franchise tax payments into ITS correctly.

Control weaknesses in review of financial information. The Comptroller's Office did not always review financial information that agencies and higher education institutions submitted for reasonableness, accuracy, and completeness. For example, several agencies misclassified investment categories or reported investment balances that were not included in their annual financial reports when they reported investment balances through the Comptroller's Office's Web-based agency reporting system. Additionally, the Comptroller's Office did not verify the appropriateness of negative expenditures on one higher education institution's SEFA until auditors noted it during the audit.

Control weaknesses in following policies and procedures. The Comptroller's Office did not always follow established policies and procedures. For example, explanations provided for one adjustment to the CAFR did not match the proposed adjusting entries. According to Comptroller's Office staff, the explanations had not been updated from the previous fiscal year.

The Comptroller's Office did not always conduct a thorough supervisory review process to detect errors and ensure that they were corrected in a timely manner. Conducting a thorough supervisory review could have enabled the Comptroller's Office to identify the errors noted above. While the individual errors that auditors identified did not materially affect the fair presentation of the CAFR, they demonstrated weaknesses in internal controls over the Comptroller's Office's process for reporting financial transactions.

The State's Uniform Statewide Accounting System (USAS) provides a systematic process for agencies and higher education institutions to record their financial data, but this data must be analyzed and adjusted by the Comptroller's Office Financial Reporting Section (FRS) before the State's CAFR can be completed. FRS also uses database applications to collect financial detail from agencies and higher education institutions to prepare notes to the CAFR and the SEFA.

### **Corrective Action and Management's Response**

*Corrective action was taken.*

#### **Issue 2**

#### **The Office of the Comptroller of Public Accounts Should Continue to Strengthen Access Controls for the Treasury Division Technology Operations**

Reference No. 09-555-02  
(Prior Audit Issue 08-555-01)

#### **Type of finding: Significant Deficiency**

The Comptroller's Office continues to allow two developers to have access to production data for the State Treasury's automated systems. These systems were developed using a programming language that has limited security options. After auditors brought this issue to the Comptroller's Office's attention during the fiscal year 2007 Statewide financial audit, the Comptroller's Office's Treasury Division reduced the access from 15 developers to 2 developers. The Comptroller's Office's Treasury Division is in the process of replacing the current systems with another application that can be designed with more advanced security features. It also has established compensating controls until the new application is completed.

**Title 1, Texas Administrative Code,  
Section 202.20 (1)**

Information resources residing in the various state agencies of state government are strategic and vital assets belonging to the people of Texas. These assets must be available and protected commensurate with the value of the assets. Measures shall be taken to protect these assets against unauthorized access, disclosure, modification or destruction, whether accidental or deliberate, as well as to assure the availability, integrity, utility, authenticity, and confidentiality of information. Access to state information resources must be appropriately managed.

The Texas Administrative Code requires agencies to take measures to protect data from unauthorized access, disclosure, modification, or destruction, whether accidental or deliberate (see text box). Granting excessive access and not providing for proper segregation of duties increases the risk of fraud, data corruption, potential service disruption, and loss of state revenue. Because the Treasury Division processes billions of dollars in revenue, the loss of even a single day's interest due to data manipulation or destruction would affect state revenue. However, nothing came to auditors' attention to indicate that automated systems had been compromised.

### Corrective Action and Management's Response

*See current year finding 10-555-15.*

#### Issue 3

#### The Office of the Comptroller of Public Accounts Should Continue to Strengthen Procedures Regarding Central Profile Change Requests

Reference No. 09-555-03  
(Prior Audit Issue 08-555-02)

#### Type of finding: Significant Deficiency

The Comptroller's Office's Application Security Division should continue to improve the central profile change request process to ensure proper segregation of duties. All of the 25 change requests tested from fiscal year 2008 contained the initials of the Application Security Division employee entering the change. However, 2 (8 percent) of the 25 change requests had approvals that could not be verified as authorized using the Comptroller's Office Central Profile Action Request Authorized Approver Listing. One change request was not approved by an authorized approver and another change request was not signed by a reviewer. The Application Security Division had difficulty substantiating that authorized approvers had reviewed and approved change requests because the approver listing was incomplete or needed clarification.

**Title 1, Texas Administrative  
Code, Section 202.20**

(5) The integrity of data, its source, its destination, and processes applied to it must be assured. Changes to data must be made only in an authorized manner.  
(8) State agencies must ensure adequate controls and separation of duties for tasks that are susceptible to fraudulent or other unauthorized activity.

The Texas Administrative Code requires agencies to take measures to protect data from unauthorized access, disclosure, modification, or destruction, whether accidental or deliberate. Granting excessive access and not providing for proper segregation of duties increases the risk of fraud, data corruption, and potential service disruption (see text box).

The central profile change management process should be designed to ensure that all proposed system modifications are approved and that changes are tested and approved before they are placed into production. The risk of inaccurate financial data decreases when the required levels of approvals are obtained. Improper or unauthorized changes should not be made if the same individual both requests and approves a change.

### Corrective Action and Management's Response

*Corrective action was taken.*

#### Issue 4

#### The Comptroller's Office Should Continue to Strengthen Its Financial Reconciliations

Reference No. 09-555-04

#### Type of finding: Significant Deficiency

The Comptroller's Office should improve its Integrated Tax System reconciliation process. The Comptroller's Office should strengthen the timely preparation and review of its tax reconciliation process. The Comptroller's Office's Integrated Tax System (ITS) processed approximately \$37 billion in tax payments for fiscal year 2008. Auditors' test of 20 reconciliations of ITS collections to the cash balances in USAS determined that these reconciliations were not always prepared or reviewed in a timely manner. Specifically:

- 19 reconciliations (95 percent) were not prepared in a timely manner.
- 9 reconciliations (45 percent) were not reviewed in a timely manner.

The Comptroller's Office should improve its monthly fund-to-cash reconciliation process. The Comptroller's Office should strengthen its review of its fund-to-cash reconciliations. The Comptroller's Office performs the fund-to-cash reconciliations on a monthly basis to reconcile the Treasury Division's Fund Accounting System to USAS cash balances. It performs accurate and complete fund-to-cash reconciliations in a timely manner; however, there was no evidence of a formal review of these reconciliations for accuracy.

Performing cash reconciliations in a timely manner is a key management control for ensuring that errors are detected and corrected promptly. Review of these reconciliations by a knowledgeable, independent person ensures that the reconciliation control is in place and operating effectively.



## Corrective Action and Management's Response

*See current year finding 10-555-14.*

Chapter 3-B

### The Department of State Health Services Should Complete Required Reconciliations

#### Issue 1

#### The Department of State Health Services Did Not Complete the Reconciliation of Its Internal Accounting System with the State's Accounting System

Reference No. 09-555-05

#### Type of finding: Significant Deficiency

The Department of State Health Services (Department) did not complete the reconciliation of its internal accounting system (the Health and Human Services Administrative System, HHSAS) with the State's accounting system (the Uniform Statewide Accounting System, USAS) as required by the Office of the Comptroller of Public Accounts (Comptroller's Office). The Department substantially completed its cash reconciliation for fiscal year 2008 (see prior year finding 08-555-11) but, as of December 22, 2008, it had not completed its general ledger reconciliation and it had not made the required adjusting entries for fiscal year 2008.

As a result, information in HHSAS did not agree with information in USAS. For example, there was a difference of \$230,318,445 for fiscal year 2008 between total assets recorded in HHSAS and total assets recorded in USAS. (Specifically, information in HHSAS showed that total assets totaled \$586,417,317, but information in USAS showed that total assets totaled \$816,735,762.) Without a complete reconciliation, it is not possible to determine whether either system accurately reflected the Department's financial position as of August 31, 2008.

Additionally, the Department did not comply with the Comptroller's Office requirement that each agency post and reconcile its annual financial data to USAS and the agency's accounting system on a generally accepted accounting principles basis by November 20. Despite its noncompliance with that requirement, the Department submitted the certification form required by the Comptroller's Office certifying that its financial data correctly reflected its financial position as of August 31 of the current fiscal year as recorded in USAS and in the agency's accounting system.

## Corrective Action and Management's Response

*Corrective action was taken.*

Chapter 3-C

### The Department of Transportation Should Strengthen Certain Aspects of Its Information Technology and Financial Operations

#### Issue 1

#### The Department of Transportation Did Not Regularly Update User Access Rights for Its Automated Systems

Reference No. 09-555-06

#### Type of finding: Significant Deficiency

In fiscal year 2008, the Department of Transportation (Department) did not regularly update access rights to its automated systems. Specifically:

**Title 1, Texas Administrative Code,  
Section 202.20(1)**

Information resources residing in the various state agencies of state government are strategic and vital assets belonging to the people of Texas. These assets must be available and protected commensurate with the value of the assets. Measures shall be taken to protect these assets against unauthorized access, disclosure, modification or destruction, whether accidental or deliberate, as well as assure the availability, integrity, authenticity, and confidentiality of information. Access to state information resources must be appropriately managed.

**Title 1, Texas Administrative Code,  
Section 202.25(3)(B)**

A user's access authorization shall be appropriately modified or removed when the user's employment or job responsibilities within the state agency change.

- Eight users whose employment with the Department had been terminated still had access rights to the Automated Purchasing System (APS) and the Material and Supply Management System (MSMS). APS is the Department's internal real-time purchasing system through which it requests and purchases all of its goods and services. MSMS is the Department's real-time inventory system.
- Six users whose employment with the Department had been terminated still had access rights to APS.
- Five users whose employment with the Department had been terminated still had access rights to the Financial Information Management System (FIMS). FIMS is the Department's internal accounting system.
- Four users whose employment with the Department had been terminated still had access rights to APS, MSMS, and the Equipment Operating System (EOS). EOS is

the Department's system of record for all information on major equipment.

- Two users whose employment with the Department had been terminated still had access rights to APS and EOS.
- One user whose employment with the Department had been terminated still had access rights to APS and FIMS.

- One user whose employment with the Department had been terminated still had access rights to APS and the Minor Equipment System (MES). MES is the Department's system of record for all information on minor equipment.
- One user whose employment with the Department had been terminated still had access rights to EOS and MSMS.
- One user whose employment with the Department had been terminated still had access rights to MES.

According to the Department's *Information Security Manual* dated November 2007, "when a user's employment status or job functions changes, a user's access authorization must be removed or modified appropriately and immediately."

None of the users discussed above had accessed the automated systems after their employment was terminated. The Department removed the inappropriate access rights for 26 of those users after auditors brought this matter to its attention.

#### **Corrective Action and Management's Response**

*See current year finding 10-555-11.*

## Issue 2

### The Department of Transportation Did Not Consistently Amortize Bond Premiums in Accordance with Requirements

Reference No. 09-555-07

#### Type of finding: Significant Deficiency

In fiscal year 2008, the Department did not consistently amortize its bond premiums in accordance with the Office of the Comptroller of Public Accounts' (Comptroller's Office) *Reporting Requirements for Annual Financial Reports of State Agencies and Universities*. Specifically:

#### Amortizing Bond Discounts and Premiums

If bond discounts, premiums, issuance costs, and gain/(loss) on refunding are individually greater than five percent of the par value of the bond issue, the amount must be capitalized and amortized over the remaining life of the bonds using the straight-line or interest method. Amounts less than five percent of the par value may be capitalized or expensed at the time of bond issuance as determined by each individual agency. The five percent applies to each category, not the combined total of all.

Source: *Reporting Requirements for Annual Financial Reports of State Agencies and Universities*, Office of the Comptroller of Public Accounts, July 2008.

- The Department did not amortize bond premiums greater than 5 percent of the issuance cost for State Highway Fund 006. After this error was brought to the Department's attention, the Department amortized these premiums using the "bonds outstanding" method and submitted the amortization information to the Comptroller's Office. However, the "bonds outstanding" method is not one of the two methods outlined in the Comptroller's Office's *Reporting Requirements for Annual Financial Reports of State Agencies and Universities* (see text box for additional details).

- The Department used the "straight-line" method to amortize all bond premiums for the Central Texas Turnpike System. The straight-line method is one of the two methods outlined in *Reporting Requirements for Annual Financial Reports of State Agencies and Universities*. However, the Department used the "bonds outstanding" method to amortize all bond premiums for the Texas Mobility Fund. As discussed above, the "bonds outstanding" method is not outlined in the *Reporting Requirements for Annual Financial Reports of State Agencies and Universities*. There was not a material difference between the amortization cost calculated using the "bonds outstanding" method and the amortization cost calculated using the methods outlined in *Reporting Requirements for Annual Financial Reports of State Agencies and Universities*.

#### Corrective Action and Management's Response

*Corrective action was taken.*

## The Health and Human Services Commission Should Strengthen the Design and Operation of Its Internal Control Structure over Validating Payments for Public Assistance Programs

### Fiscal Year 2008 Federal Expenditures from Public Assistance Programs

Medicaid: 40 million claims paid, payments totaled \$9.5 billion.

Children's Health Insurance Program (CHIP): 4.7 million member months, payments totaled \$676 million.

Vendor Drug Program: More than 28 million prescriptions filled. Total payments are included within the Medicaid and CHIP payments.

Sources: *Summary of Federal Expenditures by State Agencies* prepared by the Office of the Comptroller of Public Accounts and Health and Human Services Commission self-reported service levels for fiscal year 2008.

Public assistance program payments that the Health and Human Services Commission (Commission) reported in its fiscal year 2008 financial statements were materially accurate. The Commission relies on an internal control structure, including pre- and post-payment controls, to help ensure that public assistance program payments for eligible clients are allowable and accurate. These internal controls exist at both the Commission and its contractors. However, there are weaknesses in the design and operation of these internal controls that limit the assurances it can make regarding the validity of payments made for public assistance programs in fiscal year 2008. The programs affected by these weaknesses spent \$10.2 billion in federal funds in fiscal year 2008 (see text box).

Several of the internal control weaknesses auditors identified during the audit of fiscal year 2008 had also been identified in prior audits and had not been fully corrected or mitigated. For example, the Commission's lack of documented policies and procedures for certain functions has been identified as a weakness in four consecutive years. Weaknesses in the Commission's payment monitoring system have been identified for three consecutive years. Weaknesses in user access have been identified for five consecutive years.

In addition, the Commission has only partially implemented prior year recommendations to correct identified internal control weaknesses in the Vendor Drug program and Medicaid. The Commission implemented prior year recommendations for Children's Medicaid, the Food Stamp program, and Temporary Assistance for Needy Families (TANF). The Commission also implemented a prior year recommendation to reconcile its internal accounting system with the Uniform Statewide Accounting System in a timely manner. The Commission took no action to implement prior year recommendations to track the open investigations of the Office of Inspector General and the Office of the Attorney General to account for contingent liabilities.

Auditors identified the following weaknesses during the audit of fiscal year 2008:

- The Commission did not fully implement all components of its payment monitoring process.

- The Commission did not sufficiently document policies and procedures for two key accounting functions.
- The Commission did not ensure that access to the Uniform Statewide Accounting System was properly segregated.
- The Commission did not disclose the potential financial liability associated with the open investigations of its Office of Inspector General.
- The Commission did not accrue \$430.3 million in expenditures associated with the Medicaid Upper Payment Limit program.
- The Commission did not have adequate password restrictions for its Premium Payment System.

#### Issue 1

#### The Health and Human Services Commission Should Implement All Components of Its Payment Monitoring System

Reference No. 09-555-08  
(Prior Audit Issues 08-555-05 and 07-555-01)

#### Type of finding: Significant Deficiency

The Commission relies on an internal control structure, including pre- and post-payment controls, to help ensure that public assistance program payments for eligible clients are allowable and accurate. However, it should make improvements in its payment monitoring system for the Vendor Drug program and managed care plans.

#### Vendor Drug Program

As the State Auditor's Office has reported in two previous audits, the Commission did not fully staff its regional pharmacists. As a result, the Commission continued to have vacancies in four highly populated regions: Fort Worth (two vacant positions), Houston (two vacant positions), Lubbock (one vacant position), and San Antonio (one vacant position).

During fiscal year 2008, only 4 of the Commission's 10 regional and sub-regional pharmacist positions were filled. The Commission uses regional and sub-regional pharmacists to review expenditure claims submitted by the approximately 4,150 pharmacies participating in the Vendor Drug program. However, it has not maintained a full complement of regional pharmacists to perform these reviews since prior to 2000.

The Commission hired a regional pharmacist manager during fiscal year 2008, and it has hired two regional pharmacists since August 31, 2008. The Vendor Drug program still needs to hire four more regional pharmacists in order to have all 10 regional and sub-regional pharmacist positions filled.

Additionally, the Commission did not maintain adequate monitoring records of the regional pharmacists' activities during fiscal year 2008. The monthly tracking reports the Commission provided to auditors for fiscal year 2008 were incomplete and included activities only through March 2008.

The Commission also did not ensure that the claims processing system at the Vendor Drug program service provider was operating as intended during fiscal year 2008. In fiscal year 2007, the Commission had a Statement on Auditing Standards No. 70 (SAS 70) review conducted on the service provider's claims processing system. As of September 2008, the Commission was finalizing a plan to address the issues identified in that review. The Commission made \$2.45 billion in Vendor Drug program expenditures during fiscal year 2008. On December 11, 2008, the Commission contracted with a vendor to perform a SAS 70 review of the service provider's claims processing system for fiscal year 2008 and a portion of fiscal year 2009 (through December 2008).

### Managed Care Plans

The Medicaid/Children's Health Insurance Program (CHIP) Division did not approve and sign off on all purchase vouchers related to managed care plan payments. Of 18 vouchers tested, 14 (77.8 percent) were not approved. As a result, the Medicaid/CHIP Division was not fully aware of the final amounts that were paid to the managed care organizations it oversees.

The Commission's Internal Audit Division also identified this issue in its *Audit of Medicaid/CHIP Division Managed Care Contract Monitoring Processes* (April 2008). Eight of the 18 vouchers tested that did not have program approval were paid after that internal audit report was published.

### **Corrective Action and Management's Response**

*See current year finding 10-555-02.*

#### **Issue 2**

#### **The Health and Human Services Commission Should Fully Document Policies and Procedures for Two Key Accounting Functions**

Reference No. 09-555-09  
(Prior Audit Issues 08-555-08, 07-555-04, and 06-555-09)

#### **Type of finding: Significant Deficiency**

The Commission has continued to operate two key accounting functions since fiscal year 2005 without documented policies and procedures. These key accounting functions are related to the recording of public assistance

payments. Specifically, the Commission does not have documented policies and procedures for:

- Recording and approving Medicaid and CHIP expenditures.
- Recording and approving Vendor Drug program expenditures.

The Commission began developing draft policies and procedures for these two key functions during fiscal year 2008; however, the draft policies and procedures are not sufficiently detailed to enable an individual to perform these key functions in the absence of individuals currently performing the functions. The Commission has documented many of its other key accounting functions and has trained backup personnel to perform those functions.

Having documented policies and procedures is a key control over the Commission's financial reporting. It is important for management to communicate and monitor, through policies and procedures, staff members' responsibilities and expectations related to their job functions. In addition, policies and procedures are beneficial for new employees and backup personnel.

### **Corrective Action and Management's Response**

*See current year finding 10-555-08.*

#### **Issue 3**

#### **The Health and Human Services Commission Should Review User Access to the Uniform Statewide Accounting System and Ensure That Related Duties Are Properly Segregated**

Reference No. 09-555-10  
(Prior Audit Issues 08-555-10 and 07-555-05)

#### **Type of finding: Significant Deficiency**

The Commission does not adequately manage user access to the Uniform Statewide Accounting System (USAS). Specifically:

- Seven users have access to sensitive financial data; can enter, edit, and delete accounting transactions; and can release any accounting transactions in USAS.
- Eight users have user USAS class codes that conflict with their job duties. All eight users have access to transaction codes for accounts receivable and accounts payable and can enter, edit, and delete accounting transactions. In addition, three of these eight users also can release revenue transactions. This represents a weakness in segregation of duties,



which increases the risk that inappropriate financial transactions could be made without detection.

- Four users have higher access levels in USAS than is appropriate for their job titles.

In fiscal year 2008, 385 documents totaling \$9,873,973 were entered and/or modified and released by the same individual. Without mitigating controls, this increases the risk that intentional or unintentional errors could go undetected.

### **Corrective Action and Management's Response**

*See current year finding 10-555-03.*

#### **Issue 4**

#### **The Health and Human Services Commission Should Disclose the Potential Financial Liability Associated with the Open Investigations of Its Office of Inspector General**

Reference No. 09-555-11  
(Prior Audit Issue: 08-555-09)

#### **Type of finding: Significant Deficiency**

The Commission does not adequately track its Office of Inspector General's open investigations to determine related dollar amounts overpaid to providers for these cases.

As of August 31, 2008, the Commission's list of active open investigation cases included 3,646 cases. Due to their complexity, it takes more than one year to investigate the majority of those cases. The Commission did not analyze these cases to determine whether it should report them in its annual financial report as contingent liabilities. This resulted in the Commission not reporting a contingent liability in its annual financial report for fiscal year 2008. After this was brought to the Commission's attention, it provided a contingent liability note to the Office of the Comptroller of Public Accounts (Comptroller's Office) for inclusion in the State's Comprehensive Annual Financial Report for fiscal year 2008.

### Contingent Liability

A loss contingency arising from a claim must be disclosed when it is reasonably possible that a loss will eventually be incurred and if it is either not probable or not subject to reasonable estimation. The disclosure should indicate the nature of the contingency and give an estimate of the possible loss or range of loss. However, if an estimate of the loss cannot be made, the disclosure must state this fact. A loss contingency arising from a claim is accrued as of the balance sheet date when both of the following conditions are true:

- Information available before the financial statements are issued indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements. It must be probable that one or more future events will also occur confirming the fact of the loss.
- The amount of the loss can be reasonably estimated.

Source: *Reporting Requirements for Annual Financial Reports of State Agencies and Universities*, Office of the Comptroller of Public Accounts, July 2008.

The Comptroller's Office requires that notes to the financial statements communicate information that is necessary for a fair presentation of the financial position and the results of operations, but not readily apparent from, or not included in, the financial statements themselves (see text box for additional details).

### Corrective Action and Management's Response

*See current year finding 10-555-06.*

### Issue 5

### The Health and Human Services Commission Should Accrue Necessary Expenditures

Reference No. 09-555-12

### Type of finding: Significant Deficiency

### Medicaid Upper Payment Limit

The Medicaid Upper Payment Limit requires that the Medicaid agency find that the estimated average proposed payment rate is reasonably expected to pay no more in the aggregate for inpatient hospital services or long-term care facility services than the amount that the agency reasonably estimates would be paid for the services under the Medicare principles of reimbursement.

Source: Title 42, Code of Federal Regulations, Section 447.253 (b) (2).

In fiscal year 2008, the Commission did not accrue \$430.3 million in expenditures with a fiscal year 2008 service date related to the Medicaid Upper Payment Limit (see text box) program, which it oversees. The Commission accrued the necessary expenditures in previous fiscal years.

After this issue was brought to the Commission's attention, the Commission prepared an adjustment to accrue the necessary expenditures. In future fiscal years, the Commission has asserted it will provide the adjustment to the Comptroller's Office.

According to the Comptroller's Office's *Reporting Requirements for Annual Financial Reports of State Agencies and Universities*, expenditures should be recognized as soon as a liability is incurred, regardless of the timing of related cash flows.

## Corrective Action and Management's Response

*See current year finding 10-555-07.*

### Issue 6

#### The Health and Human Services Commission Should Strengthen Password Requirements for its Premiums Payable System

Reference No. 09-555-13

#### Type of finding: Significant Deficiency

The Commission should strengthen the password requirements for its Premiums Payable System (PPS). Passwords for that system are not required to have a minimum length and do not have a system-enforced requirement to change the passwords at regular intervals. The PPS also does not maintain a history to prevent reuse of recent passwords. In addition, 7 (63.6 percent) of the 11 user accounts on the PPS online application are generic accounts. Use of generic user accounts prevents accountability for user actions and places the Commission's data at risk of unauthorized changes.

Title 1, Texas Administrative Code, Section 202.25(3)(A), requires that "each user of information resources shall be assigned a unique identifier except for situations where risk analysis demonstrates no need for individual accountability of users. User identification shall be authenticated before the information resources system may grant that user access." Title 1, Texas Administrative Code, Section 202.25(3)(D), requires that "Information resources systems which use passwords shall be based on industry best practices on password usage and documented state agency security risk management decisions."

The Commission informed auditors that it is replacing the PPS with a new system that has up-to-date security. The new system is expected to be in production after finalization of the State Data Center environment.

## Corrective Action and Management's Response

*See current year finding 10-555-09.*

## The University of Texas at Austin Should Strengthen Certain Aspects of Its Financial Operations

### Issue 1

#### The University of Texas at Austin Should Strengthen its Inventory Controls

Reference No. 09-555-14  
(Prior Audit Issue 08-555-15)

#### Type of finding: Significant Deficiency

The University of Texas at Austin (University) did not always follow state property accounting requirements established by the Office of the Comptroller of Public Accounts. Specifically:

- As of August 15, 2008, the University had not entered 799 capital assets valued at \$41.4 million into the inventory system as a permanent inventory record. This amount includes a single item for \$22.8 million. Of those capital assets, 644 with a value of \$38.4 million were purchased between September 5, 2007 and July 15, 2008. However, this activity was reflected in the August 31, 2008 financial statements. Inventory information should be entered on a timely basis into the permanent record of the item to ensure that inventory records are accurate and current.
- According to the University's Inventory Services unit, purchased items are required to be tagged within 30 days of receipt. Although the University's training documents include this expectation, the University had not updated its Handbook of Business Procedures (Handbook) to reflect this expectation as of September 2, 2008. Currently, the University Handbook has been updated and accurately reflects the tagging requirement.

- The University did not correctly value 8 (21.6 percent) of 37 assets that auditors tested. Specifically:

- ♦ The University did not account for \$3,742 in discounts when valuing 1 (2.7 percent) of the 37 assets that auditors tested.
- ♦ The University incorrectly expensed 1 (2.7 percent) of the 37 assets that auditors tested. The asset, purchased for \$2,125, was necessary for the operation of equipment and should have been capitalized as required by the *SPA Process User's Guide* (see text box for additional details).

#### Excerpts from the SPA Process User's Guide

Capital assets should be recorded at their historical costs, which include invoice, sales tax, initial installation costs, modifications, attachments, accessories or apparatus necessary to make the asset usable and render it into service. Historical costs also include ancillary charges, such as freight and transportation charges, site preparation costs, and professional fees.

Incidental charges, such as extended warranties or maintenance agreements, additional parts, or consumable items are no longer considered part of the capital asset cost.

Source: *SPA Process User's Guide*, Office of the Comptroller of Public Accounts, February 2008.

- ♦ The University did not correctly value 4 (10.8 percent) of the 37 assets that auditors tested. These four assets had freight costs of \$671 that should have been capitalized as required by the *SPA Process User's Guide* (see text box on the previous page for additional details).
- ♦ The University incorrectly capitalized \$1,758 in information technology support and maintenance costs associated with 2 (5.4 percent) of the 37 assets that auditors tested. These costs should have been expensed as required by the *SPA Process User's Guide* (see text box on the previous page for additional details).
- The University asserted that it reconciles its fixed asset system to the State Property Accounting (SPA) system on an annual basis, rather than on a quarterly basis. According to the *SPA Process User's Guide*, the University, as a reporting agency, should reconcile balances from its fixed assets system to the SPA system on a quarterly basis, and reconciling items identified should be cleared (that is, corrections should be made) as soon as possible. All reconciling items should be cleared before the preparation of the capital asset note in the financial statements.

Ensuring that accurate information is entered into the University's fixed asset system and the SPA system helps to ensure that capital asset balances, depreciation, and accumulated depreciation are reported accurately on the State's Comprehensive Annual Financial Report.

#### Corrective Action and Management's Response

*See current year finding 10-555-20.*

Chapter 3-F

### The University of Texas at San Antonio Should Strengthen Certain Aspects of Its Financial Operations and Information Technology

#### Issue 1

#### The University of Texas at San Antonio Should Strengthen Its Capital Asset Records

Reference No. 09-555-15

#### Type of finding: Significant Deficiency

The University of Texas at San Antonio (University) did not always follow state property accounting requirements established by the Office of the Comptroller of Public Accounts (Comptroller's Office). Specifically:

- The University did not have documentation supporting the acquisition costs for 21 (43.8 percent) of 48 assets that auditors tested. The University's record retention policy requires the University to maintain this documentation for the fiscal year in which it purchased an asset plus three years. However, the Comptroller's Office's *SPA Process User's Guide* and the Library and Archive Commission's *Texas State Records Retention Schedule* require state entities to maintain property records for the life of the asset plus three years. The University acquired these 21 assets between June 1993 and August 2004, which was beyond the retention requirements of the University's record retention schedule but still within the retention requirements of the *SPA Process User's Guide* and the *Texas State Records Retention Schedule*. Six of the 21 assets were fully depreciated. Auditors performed additional procedures to substantiate the asset balances for the remaining 15 assets.
- The University made numerous clerical errors (including posting errors, incorrect classifications of furniture as building costs, and calculation errors) in the schedules within its annual financial report that related to buildings and depreciation. Auditor testing determined that the University overstated capital assets by \$164,249 or 0.02 percent, overstated depreciation expenses by \$296,194 or 1.1 percent, and understated accumulated depreciation by \$290,013 or 0.1 percent on its fiscal year 2008 annual financial report. The University's financial statements reported \$849,566,355 in capital assets; \$26,317,313 in total depreciation and amortization expenses; and \$220,181,573 in total accumulated depreciation for fiscal year 2008.

Ensuring that accurate information is entered into the University's fixed asset system and the State Property Accounting system helps to ensure that capital asset balances, depreciation, and accumulated depreciation are reported accurately on the State's Comprehensive Annual Financial Report.

#### **Corrective Action and Management's Response**

*See current year finding 10-555-21.*

**Issue 2**  
**The University of Texas at San Antonio Should Restrict Access to the Uniform Statewide Accounting System**

Reference No. 09-555-16

**Type of finding: Significant Deficiency**

In fiscal year 2008, five users at the University had inappropriate access rights to the Uniform Statewide Accounting System (USAS, the State's accounting system). These users had the ability to enter, edit, and release transactions. The ability to perform all three of these actions in USAS enables users to alter data.

After auditors brought this issue to the University's attention, it removed the release access rights for these five users. University management asserted that these five users do not release transactions into USAS in accordance with their job descriptions.

**Corrective Action and Management's Response**

*Corrective action was taken.*

**Title 1, Texas Administrative Code,**

**Section 202.20(1)**

Information resources residing in the various state agencies of state government are strategic and vital assets belonging to the people of Texas. These assets must be available and protected commensurate with the value of the assets. Measures shall be taken to protect these assets against unauthorized access, disclosure, modification or destruction, whether accidental or deliberate, as well as assure the availability, integrity, authenticity, and confidentiality of information. Access to state information resources must be appropriately managed.

Chapter 3-G

**The University of Texas Southwestern Medical Center at Dallas Should Strengthen Certain Aspects of Its Financial Operations**

**Issue 1**

**The University of Texas Southwestern Medical Center at Dallas Should Strengthen Its Capital Asset Records**

Reference No. 09-555-17

**Type of finding: Significant Deficiency**

The University of Texas Southwestern Medical Center at Dallas (Medical Center) did not always follow state property accounting requirements established by the Office of the Comptroller of Public Accounts and its own policies. Specifically:

- The Medical Center did not value 3 (5.6 percent) of 54 assets that auditors tested using a reasonable method. The three assets were works of art that the Medical Center valued at \$301,376 (one of the assets was valued at \$300,000). The Medical Center based the value of these donated assets on the donor's assertion of their value. According to the Office of the Comptroller of Public Accounts' *SPA Process User's Guide* (February

2008), donated property must be recorded at its estimated fair market value on the date of acquisition using a reasonable method. The method must be fully documented, maintained on file, and reported to the State Property Accounting (SPA) system. Examples of reasonable methods include the use of appraisals, tax assessment records, manufacturer price lists, and industry publications.

- The Medical Center capitalized and depreciated 1 (1.9 percent) of 54 assets that auditors tested, rather than expensing it in accordance with its unofficial policy. As a result, the Medical Center overstated capital assets by \$62,700 and overstated accumulated depreciation by \$18,661 on its fiscal year 2008 financial statements. The Medical Center did not consistently follow its unofficial policy of expensing research and laboratory animals after they are purchased.
- Auditors were unable to locate 2 (3.7 percent) of 54 assets that auditors tested. One asset was the laboratory animal discussed in the preceding bullet, and the other asset was a piece of equipment that the Medical Center had salvaged but had not removed from its fixed asset system. According to the *SPA Process User's Guide*, state entities should maintain a detailed description of the exact location of assets and update the location as necessary.
- The Medical Center did not have documentation supporting the acquisition costs for 4 (7.4 percent) of 54 assets that auditors tested. The Medical Center acquired these 4 assets at least 10 years ago. According to the *SPA Process User's Guide* and the Library and Archive Commission's *Texas State Records Retention Schedule*, state entities are required to maintain property records for the life of the asset plus three years.
- The Medical Center did not have documentation supporting the disposal of 15 (50 percent) of 30 fiscal year 2008 asset disposals that auditors tested. As discussed above, the *SPA Process User's Guide* requires that property records be maintained for the life of the asset plus three years. Specifically:
  - ♦ The Medical Center disposed of 7 (46.7 percent) of the 15 assets by having an auctioneer sell the assets. However, the assets were not individually identified in the receipts the Medical Center received from the auctioneer. Starting in fiscal year 2009, the Medical Center asked the auctioneer to individually identify the assets in each lot on receipts.
  - ♦ Other than screen prints from its fixed asset system, the Medical Center did not have supporting documentation for 8 (53.3 percent) of the 15 assets.



- Of the 30 fiscal year 2008 asset disposals that auditors tested, auditors determined that one asset had been disposed of in the prior fiscal year. The Medical Center had disposed of this asset in April 2007, but it did not remove the asset from its fixed assets system until April 2008. According to the *SPA Process User's Guide*, once property is disposed of it should be removed from the fixed asset system.
- The Medical Center did not expense warranty costs for two assets. The warranty costs associated with these two assets totaled \$83,060. As a result of this issue, the Medical Center overstated accumulated depreciation by \$6,222 on its fiscal year 2008 financial statements. According to the *SPA Process User's Guide*, warranty costs should be expensed if they are itemized on the invoice or purchase order. In addition, the Medical Center did not deduct a credit of \$1,087 from the acquisition cost of one of these assets.

Ensuring that accurate information is entered into the Medical Center's fixed asset system and the SPA system helps to ensure that capital asset balances, depreciation, and accumulated depreciation are reported accurately on the State's Comprehensive Annual Financial Report.

#### **Corrective Action and Management's Response**

*Corrective action was taken.*

Issue 2

The University of Texas Southwestern Medical Center at Dallas Should Strengthen Its Patient Billing Process

Reference No. 09-555-18

Type of finding: Significant Deficiency

The Medical Center did not review and address in a timely manner uncharged outpatient transactions for the two hospitals that it manages. Unbilled outpatient transactions are identified on the Medical Center's *Discharged Not Final Billed Report*.

As of August 31, 2008, the Medical Center had not billed for 6,126 patient accounts with charges totaling \$7,151,027 (see Table 1).

Table 1

Summary of Accounts for which the Medical Center Had Not Billed As of August 31, 2008		
Number of Days Account Had Not Been Billed	Number of Accounts	Balance
0-30 days	3,341	\$4,657,184
31-60 days	1,548	1,232,488
61-90 days	212	318,147
More than 90 days	1,025	943,208
Totals	6,126	\$7,151,027

Of the 1,025 accounts for which the Medical Center had not billed for more than 90 days, 194 (18.9 percent) were from fiscal years 2005, 2006, and 2007. These 194 accounts represented 23.1 percent or \$217,530 of the total balance of accounts not billed for more than 90 days. According to Medical Center personnel, 13 of the accounts were previously billed.

In addition, numerous patient accounts did not have associated billing amounts. As a result, it was not possible to determine from the *Discharged Not Final Billed Report* how much these patients owed the Medical Center. Some of these accounts had registration dates from October 2004.

There are several reasons that the Medical Center may not have billed an account. For example:

- In some cases, doctors have not provided a final diagnosis.
- The Medical Center sometimes places holds on accounts because the accounts are awaiting insurance verification, lack an emergency room

level charge, or are awaiting the entry of a national drug code for Medicaid.

**Corrective Action and Management's Response**

*See current year finding 10-555-25.*

## Agencies and Higher Education Institutions Should Strengthen Their Reviews of Their Schedules of Expenditures of Federal Awards

Reference No. 09-555-19

**Type of finding: Significant Deficiency**

**Schedule of Expenditures of Federal Awards (SEFA)**

Each agency, college, and university that expends federal awards is required to prepare a Schedule of Expenditures of Federal Awards (SEFA). Federal awards include federal financial assistance and federal cost-reimbursement contracts that non-federal entities receive directly from federal awarding agencies or indirectly from pass-through entities [Office of Management and Budget (OMB) Circular A-133, Section .105].

Federal financial assistance includes any assistance that non-federal entities receive or administer in the form of grants, loans, loan guarantees, property (including donated surplus property), cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, and other assistance (OMB Circular A-133, Section .105).

Source: *Reporting Requirements for Annual Financial Reports of State Agencies and Universities*, Office of the Comptroller of Public Accounts, July 2008.

The agencies and higher education institutions listed in Table 2 did not perform an adequate review of their fiscal year 2008 Schedules of Expenditures of Federal Awards (SEFAs) (see text box for additional information).

Because they did not perform an adequate review, the SEFAs these agencies and higher education institutions submitted to the Office of the Comptroller of Public Accounts (Comptroller’s Office) contained errors. Table 2 summarizes the errors auditors identified in these agencies’ and higher education institutions’ fiscal year 2008 SEFA.

The 22 agencies and higher education institutions listed below reported \$7.7 billion in federal expenditures, or 21.9 percent of the total federal expenditures reported by the State of Texas for fiscal year 2008. The errors listed

below were not material to the fiscal year 2008 SEFA for the State of Texas or to the fiscal year 2008 Comprehensive Annual Financial Report for the State of Texas.

Table 2

Summary of Errors Identified in Agency and Higher Education Institution Fiscal Year 2008 SEFAs								
Agency or Higher Education Institution	Incorrect Program Clustering <sup>a</sup>	Incorrect Pass-through Reporting <sup>b</sup>	Incorrect Preparation of SEFA Using Revenues <sup>c</sup>	Incorrect Classification of Expenditures <sup>d</sup>	Incorrect Exclusion of Expenditures <sup>e</sup>	Errors in Notes to the SEFA <sup>f</sup>	Inadequate Support <sup>g</sup>	Incorrect Exclusion of Indirect Cost Recovery <sup>h</sup>
Angelo State University	X							
Department of Agriculture		X		X	X			X
Department of Public Safety	X			X	X			
Department of State Health Services			X	X				X
Department of Transportation		X						
Parks and Wildlife Department			X					
Texas A&M University	X							

**Summary of Errors Identified in Agency and Higher Education Institution Fiscal Year 2008 SEFAs**

Agency or Higher Education Institution	Incorrect Program Clustering <sup>a</sup>	Incorrect Pass-through Reporting <sup>b</sup>	Incorrect Preparation of SEFA Using Revenues <sup>c</sup>	Incorrect Classification of Expenditures <sup>d</sup>	Incorrect Exclusion of Expenditures <sup>e</sup>	Errors in Notes to the SEFA <sup>f</sup>	Inadequate Support <sup>g</sup>	Incorrect Exclusion of Indirect Cost Recovery <sup>h</sup>
Texas A&M University - Corpus Christi	X		X					
Texas AgriLife Research	X			X				
Texas Southern University	X				X			
Texas State University - San Marcos	X			X				
Texas Tech University				X				
University of North Texas Health Science Center at Fort Worth	X			X				
The University of Texas at Austin	X			X				
The University of Texas at Dallas	X							
The University of Texas at El Paso						X		
The University of Texas of the Permian Basin	X			X				
The University of Texas Southwestern Medical Center at Dallas				X		X		
The University of Texas Health Science Center at Houston				X				
The University of Texas Health Science Center at San Antonio	X							
The University of Texas Medical Branch at Galveston	X			X			X	
West Texas A&M University	X							

<sup>a</sup> Reported federal programs in an incorrect cluster. Texas Southern University incorrectly included one federal program on its SEFA. That program should have been reported by the Higher Education Coordinating Board on its SEFA.

<sup>b</sup> Incorrectly classified expenditures as direct expenditures. The expenditures should have been classified as "Pass-Through to Non-State Entities" and "Pass-Through to Agencies or Universities."

<sup>c</sup> Incorrectly prepared SEFA using federal revenues rather than expenditures.

<sup>d</sup> Incorrectly classified expenditures between federal programs.

**Summary of Errors Identified in Agency and Higher Education Institution Fiscal Year 2008 SEFAs**

Agency or Higher Education Institution	Incorrect Program Clustering <sup>a</sup>	Incorrect Pass-through Reporting <sup>b</sup>	Incorrect Preparation of SEFA Using Revenues <sup>c</sup>	Incorrect Classification of Expenditures <sup>d</sup>	Incorrect Exclusion of Expenditures <sup>e</sup>	Errors in Notes to the SEFA <sup>f</sup>	Inadequate Support <sup>g</sup>	Incorrect Exclusion of Indirect Cost Recovery <sup>h</sup>
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<sup>e</sup> Texas Southern University did not include all federal expenditures from its general ledger. The Department of Agriculture and the Department of Public Safety did not include accrued expenditures on their SEFAs.

<sup>f</sup> The University of Texas Southwestern Medical Center at Dallas incorrectly excluded the ending balance of previous year's loan for one program in the notes to their SEFA. Summaries of the prior year ending loan balances and new loans are required to be presented in the SEFA. The University of Texas at El Paso incorrectly classified an expenditure between federal programs in the reconciliation note to its SEFA.

<sup>g</sup> On September 13, 2008, Hurricane Ike led to an extended closure of the University of Texas Medical Branch at Galveston (Medical Branch). During the transportation of files, the Medical Branch misplaced or misfiled some documents that supported the amounts on its SEFA.

<sup>h</sup> Did not include indirect cost recovery.

Performing an adequate review of their SEFAs and supporting documentation would help the agencies and higher education institutions ensure that the SEFA information they submit to the Comptroller's Office is accurate.

**Corrective Action and Management's Response**

Summary of Corrective Action	
Agency or Higher Education Institution	Corrective Action
Angelo State University	Corrective action was taken.
Department of Agriculture	See current year finding 10-555-26.
Department of Public Safety	Corrective action was taken.
Department of State Health Services	See current year finding 10-555-26.
Department of Transportation	See current year finding 10-555-26.
Parks and Wildlife Department	See current year finding 10-555-26.
Texas A&M University	See current year finding 10-555-26.
Texas A&M University - Corpus Christi	Corrective action was taken.
Texas AgriLife Research	Corrective action was taken.
Texas Southern University	Corrective action was taken.
Texas State University - San Marcos	See current year finding 10-555-26.
Texas Tech University	Corrective action was taken.
University of North Texas Health Science Center at Fort Worth	See current year finding 10-555-26.
The University of Texas at Austin	See current year finding 10-555-26.
The University of Texas at Dallas	Corrective action was taken.
The University of Texas at El Paso	See current year finding 10-555-26.
The University of Texas of the Permian Basin	Corrective action was taken.
The University of Texas Southwestern Medical Center at Dallas	Corrective action was taken.
The University of Texas Health Science Center at Houston	See current year finding 10-555-26.
The University of Texas Health Science Center at San Antonio	See current year finding 10-555-26.
The University of Texas Medical Branch at Galveston	See current year finding 10-555-26.
West Texas A&M University	Corrective action was taken.

# Independent Auditor's Report

*State of Texas Financial Portion of the  
Statewide Single Audit Report for the  
Year Ended August 31, 2009*

## Summary of Auditor's Results

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### Financial Statements

- |  |             |
|--|-------------|
| 1. Type of auditor's report issued:  | Unqualified |
| 2. Internal control over financial reporting:                                    |             |
| a. Material weakness identified?   | Yes         |
| b. Significant deficiencies identified not considered to be material weaknesses? | Yes         |
| c. Noncompliance material to financial statements noted?                         | No          |

### Federal Awards

A finding regarding the Schedule of Expenditures of Federal Awards for fiscal year 2009 was included in Chapter 1-J of this report. All other fiscal year 2009 federal award information was issued in a separate report (see *State of Texas Federal Portion of the Statewide Single Audit Report for the Fiscal Year Ended August 31, 2009*, by KPMG LLP, dated February 22, 2010).





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

The Honorable Rick Perry, Governor  
The Honorable Susan Combs, Comptroller of Public Accounts  
The Honorable David Dewhurst, Lieutenant Governor  
The Honorable Joe Straus III, Speaker of the House of Representatives  
and  
Members of the Texas Legislature  
State of Texas

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate discretely presented component units and remaining fund information of the State of Texas as of and for the year ended August 31, 2009, which collectively comprise the State's basic financial statements and have issued our report thereon dated February 22, 2010. Our report was modified to include a reference to other auditors. Except as discussed in the following paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Other auditors audited the financial statements of the entities listed below in the section titled "Work Performed by Other Auditors." This report does not include the consideration of results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors. The financial statements of the University of Texas Investment Management Company and the Texas Local Government Investment Pool (TexPool) were not audited in accordance with *Government Auditing Standards*.

We have chosen not to comply with a reporting standard that specifies the wording to be used in discussing restrictions on the use of the report. We believe this wording is not in alignment with our role as a legislative audit function.

### Internal Control over Financial Reporting

In planning and performing our audit, we considered the State's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies and other deficiencies that we consider to be material weaknesses.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the following deficiencies, which are described in detail in the accompanying schedule of findings and responses, to be significant deficiencies in internal control over financial reporting.

Summary of Findings	
Agency or Higher Education Institution	Finding Numbers
Health and Human Services Commission	10-555-02 10-555-03 10-555-04 10-555-05 10-555-06 10-555-07 10-555-08 10-555-09
Department of Transportation	10-555-11 10-555-12
Office of the Comptroller of Public Accounts	10-555-13 10-555-14 10-555-15
Texas Workforce Commission	10-555-16 10-555-17
Water Development Board	10-555-18 10-555-19
The University of Texas at Austin	10-555-20
The University of Texas at San Antonio	10-555-21
The University of Texas Health Science Center at Houston	10-555-22 10-555-23
The University of Texas Southwestern Medical Center at Dallas	10-555-24 10-555-25
Multiple agencies and higher education institutions	10-555-26

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity’s internal control. We believe the following deficiencies, which are described in detail in the accompanying schedule of findings and responses, constitute material weaknesses.

Summary of Findings	
Agency	Finding Numbers
Health and Human Services Commission	10-555-01
Department of Transportation	10-555-10

### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State’s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

### Work Performed by Other Auditors

The State Auditor’s Office did not audit the entities and funds listed in the table below. These entities were audited by other auditors.

Entities Audited by Other Auditors	Scope of Work Performed
Permanent School Fund	An audit of the financial statements of the Permanent School Fund was conducted as of and for the year ended August 31, 2009.
Texas Local Government Investment Pool	An audit of the statements of pool net assets and the related statements of changes in pool net assets of the Texas Local Government Investment Pool (TexPool) was conducted as of and for the years ended August 31, 2009 and 2008.
Permanent University Fund	An audit of the statements of fiduciary net assets and changes in fiduciary net assets of the Permanent University Fund was conducted as of and for the years ended August 31, 2009 and 2008.
The University of Texas System General Endowment Fund	An audit of the statements of fiduciary net assets and changes in fiduciary net assets of the University of Texas System General Endowment Fund was conducted as of and for the years ended August 31, 2009 and 2008.
The University of Texas System Intermediate Term Fund	An audit of the statements of fiduciary net assets and changes in fiduciary net assets of the University of Texas System Intermediate Term Fund was conducted as of and for the years ended August 31, 2009 and 2008.
The University of Texas System Long Term Fund	An audit of the statements of fiduciary net assets and changes in fiduciary net assets of the University of Texas System Long Term Fund was conducted as of and for the years ended August 31, 2009 and 2008.

Entities Audited by Other Auditors	Scope of Work Performed
The University of Texas System Permanent Health Fund	An audit of the statements of fiduciary net assets and changes in fiduciary net assets of the Permanent Health Fund was conducted as of and for the years ended August 31, 2009 and 2008.
The University of Texas M.D. Anderson Cancer Center	An audit of the consolidated balance sheets and the related consolidated statement of revenues, expenses, and changes in net assets and of cash flows of the University of Texas M.D. Anderson Cancer Center was conducted for the years ended August 31, 2009 and 2008.

This report, insofar as it relates to the entities listed in the table above, is based solely on the reports of the other auditors.

### Other Work Performed by the State Auditor's Office

We issued opinions in the reports on the following financial statements, which are consolidated into the basic financial statements of the State of Texas:

- *A Report on the Audit of the Office of the Fire Fighters' Pension Commissioner's Fiscal Year 2009 Financial Statements* (State Auditor's Office Report No. 10-018, January 2010)
- *A Report on the Audit of the Teacher Retirement System's Fiscal Year 2009 Financial Statements* (State Auditor's Office Report No. 10-019, January 2010)
- *A Report on the Audit of the Employees Retirement System's Fiscal Year 2009 Financial Statements* (State Auditor's Office Report No. 10-020, January 2010)
- *A Report on the Audit of the Department of Transportation's Texas Mobility Fund Financial Statements for the Fiscal Year Ended August 31, 2009* (State Auditor's Office Report No. 10-021, February 2010)
- *A Report on the Audit of the Department of Transportation's Central Texas Turnpike System's Financial Statements for the Fiscal Year Ended August 31, 2009* (State Auditor's Office Report No. 10-022, February 2010)

The State's response to the findings identified in our audit are described in the accompanying schedule of findings and responses. We did not audit the State's response, and accordingly, we express no opinion on it.

This report is intended for the information and use of the Governor, the Legislature, audit committees, boards and commissions, and management. However, this report is a matter of public record and its distribution is not limited.

Sincerely,

John Keel, CPA  
State Auditor

February 22, 2010

# Appendices

Appendix 1

## ***Objective, Scope, and Methodology***

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### **Objective**

The audit objective was to determine whether the State's basic financial statements present fairly, in all material respects, the balances and activities for the State of Texas for the fiscal year ended August 31, 2009.

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 Act Amendments of 1996 and Office of Management and Budget (OMB) Circular A-133.

### **Scope**

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. The opinion on the basic financial statements, *The State of Texas Comprehensive Annual Financial Report for the Fiscal Year Ended August 31, 2009*, was dated February 22, 2010.

The scope of the federal portion of the Statewide Single Audit included an audit of the State's Schedule of Expenditures of Federal Awards (SEFA), a review of compliance for each major program, and a review of significant controls over federal compliance. The State Auditor's Office contracted with KPMG LLP to provide an opinion on compliance for each major program and internal control over compliance. The State Auditor's Office provided an opinion on the State's Schedule of Expenditures of Federal Awards (SEFA). The report on the federal portion of the Statewide Single Audit is included in a separate report issued by KPMG LLP entitled *State of Texas Federal Portion of the Statewide Single Audit Report for the Fiscal Year Ended August 31, 2009*, dated February 22, 2010.

### **Methodology**

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

Information collected included the following:

- Agency and higher education institution policies and procedures.

- Agency and higher education institution systems documentation.
- Agency and higher education institution accounting data.
- Agency and higher education institution year-end accounting adjustments.
- Agency and higher education institution fiscal year 2009 annual financial reports.
- Agency and higher education institution fiscal year 2009 Schedule of Expenditures of Federal Award submissions to the Office of the Comptroller of Public Accounts.

Procedures and tests conducted included the following:

- Evaluating automated systems controls.
- Performing analytical tests of account balances.
- Performing detail tests of vouchers.
- Comparing agency and higher education institution accounting practices with Office of the Comptroller of Public Accounts' reporting requirements.

Information systems reviewed included the following:

- Agency and higher education institution internal accounting systems.
- Uniform Statewide Accounting System (USAS).
- State Property Accounting system (SPA).

Criteria used included the following:

- Texas statutes.
- Texas Administrative Code.
- General Appropriations Act (80th Legislature).
- The Office of the Comptroller of Public Accounts' policies and procedures.
- The Office of the Comptroller of Public Accounts' *Reporting Requirements for Annual Financial Reports of State Agencies and Universities*.
- The Office of the Comptroller of Public Accounts' *SPA Process User's Guide*.

- Generally accepted accounting principles.
- Agency and higher education institution policies.
- Office of Management and Budget Circular A-133.

### Other Information

Fieldwork was conducted from July 2009 through February 2010. Except as discussed in the following paragraph, we conducted this audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

We have chosen not to comply with a reporting standard that specifies the wording to be used in discussing restrictions on the use of the report. We believe this wording is not in alignment with our role as a legislative audit function.



The following members of the State Auditor's staff performed the audit work:

Michelle Ann Feller, CIA (Project Manager)  
Jules Hunter, CPA, CIA (Project Manager)  
Scott Ela, CPA (Assistant Project Manager)  
William J. Morris, CPA (Assistant Project Manager)  
Robert H. (Rob) Bollinger, CPA, CFE  
Robert Burg, MPA  
Rebekah Cartwright  
Mark A. Cavazos  
Joe Curtis, CPA  
Bruce W. Dempsey, CIA  
Melissa Dozier  
George Eure  
W. Chris Ferguson, MBA  
Sarah Flowers, MPA  
Nick Frey  
Michael A. Gieringer, CFE  
Rachel Goldman  
Cindy Haley, CPA  
Kathryn K. Hawkins, CFE  
Frances Anne Hoel, CIA, CGAP  
Anna E. Howe  
Elizabeth Hunt  
Joyce Inman, CGFM  
Tracy L. Jarratt, CPA  
Lindsay Johnson  
Ashlee C. Jones, MAcy, CGAP, CFE  
Robert G. Kiker, CGAP  
Joseph Kozak CPA, CISA  
Marlen Randy Kraemer, MBA, CISA, CGAP  
Brianna Lehman  
Jennifer Logston, MBA  
Thomas Andrew Mahoney  
Kenneth Manke  
Shahpar M. McIntyre, CPA, MS, JD  
Tessa Mlynar  
Jaime J. Navarro  
Jenay Oliphant  
Robert Pagenkopf  
Anca Pinchas, CPA, CIDA  
Jeannette Quiñonez, CPA  
Brad Reynolds  
Anthony W. Rose, MPA, CPA, CGFM  
Danielle C. Ross, CPA  
Mike Sanford  
Willie Showels  
Sonya Tao  
Tony White, CFE  
Stacey Williams, CGAP  
James Michael Yerich, CPA, CGFM

Leslie P. Ashton, CPA (Quality Control Reviewer)  
Dennis Ray Bushnell, CPA (Quality Control Reviewer)  
Charles P. Dunlap, Jr., CPA (Quality Control Reviewer)  
Angelica M. Ramirez, CPA (Audit Manager)  
Michael C. Apperley, CPA (Assistant State Auditor)

## ***Agencies and Higher Education Institutions Audited***

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Financial accounts at the following agencies and higher education institutions were audited:

- Department of Aging and Disability Services
- Department of Transportation
- Health and Human Services Commission
- Office of the Comptroller of Public Accounts
- Texas A&M University System
- Texas Education Agency
- Texas Workforce Commission
- The University of Texas at Austin
- The University of Texas at San Antonio
- The University of Texas Health Science Center at Houston
- The University of Texas Southwestern Medical Center at Dallas
- The University of Texas System
- Water Development Board

Schedules of expenditures of federal awards at the following agencies and higher education institutions were audited by either the State Auditor's Office or KPMG LLP:

- Health and Human Services Commission
- Department of Aging and Disability Services
- Department of Transportation
- Texas Workforce Commission
- Water Development Board
- Texas Education Agency
- Adjutant General's Department
- Office of the Attorney General
- Department of Agriculture
- Department of Assistive and Rehabilitative Services
- Department of Family and Protective Services
- Department of Housing and Community Affairs

- Department of Public Safety
- Department of State Health Services
- Higher Education Coordinating Board
- Lamar State College – Port Arthur
- Prairie View A&M University
- Sam Houston State University
- Stephen F. Austin State University
- Tarleton State University
- Texas A&M University
- Texas A&M University – Commerce
- Texas A&M University – Kingsville
- Texas State University – San Marcos
- Texas Department of Rural Affairs
- University of Houston
- University of Houston – Clear Lake
- University of North Texas
- University of North Texas Health Science Center at Fort Worth
- The University of Texas at Arlington
- The University of Texas at Austin
- The University of Texas Health Science Center at San Antonio
- The University of Texas M.D. Anderson Cancer Center
- The University of Texas Medical Branch at Galveston
- The University of Texas Health Science Center at Houston
- The University of Texas – Pan American
- The University of Texas at Tyler

Additionally, follow up on prior year comprehensive annual financial report and schedule of expenditures of federal awards findings was conducted at the following agencies and higher education institutions:

- Angelo State University
- Parks and Wildlife Department
- Texas Tech University
- The University of Texas at Dallas
- Texas AgriLife Research
- Department of State Health Services
- Texas A&M University – Corpus Christi
- Texas Southern University
- The University of Texas at El Paso
- The University of Texas of the Permian Basin
- The University of Texas Southwestern Medical Center at Dallas
- West Texas A&M University

## ***Agencies and Higher Education Institution Responses to Schedule of Expenditures of Federal Awards Finding***

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Below are the individual responses from management at agencies and higher education institutions included in the Schedule of Expenditures of Federal Awards (SEFA) finding in Chapter 1-J of this report.

### **Management's Response from the Adjutant General's Department**

*The Adjutant General's Department (department) agrees that expenditures from two other federal programs were misclassified under the incorrect CFDA and that Note 7 was not provided to the Schedule of Expenditures for Federal Awards (SEFA). The department has added additional personnel to assist in the annual financial report preparation and, additionally has added another layer of managerial review to ensure these ministerial errors are not made in the future.*

*Implementation Date: August 31, 2010*

*Responsible Person: Executive Director, State Services, and Chief Financial Officer*

### **Management's Response from the Department of Aging and Disability Services**

*Management agrees with the finding and will enhance the current review process to ensure that SEFA information submitted to the Comptroller's Office is accurate. Responsible management includes the Accounting Director, General Ledger Manager and the General Ledger Supervisor – Reporting. The corrective actions will be implemented in May 2010.*

### **Management's Response from the Department of Agriculture**

*Audit Comment: Incorrect Pass-through Reporting*

*Certification for pass through funds occurs within two weeks of fiscal year end. Throughout the year, coordination with federal and state pass through participants occurs to correctly classify these funds. TDA's year-end coordination with state pass through participants did not occur timely. Year end procedures have been updated and now require staff to initiate year end coordination and confirmation follow up with state pass through participants during the AFR preparation process which occurs the beginning of September. This will ensure that all state pass through fund certifications are confirmed within two weeks of fiscal year end.*

*Implementation Date: February 2010*

*Responsible Person: Coordinator for Accounting*

*Audit Comment: Incorrect Exclusion of Indirect Cost Recovery*

*The revenue related to indirect cost recovery (EFF) was included in the SEFA, while the expenditures related to these cost were not included. There was a misunderstanding of the definition of direct expenditures, which for the purpose of the SEFA should include EFF. The definition of direct expenditures for the purpose of the SEFA has been updated in TDA's year-end procedures. Procedures have been put in place to ensure that staff will now include EFF expenditures in direct expenditures when preparing the SEFA.*

*Implementation Date: February 2010*

*Responsible Person: Coordinator for Accounting*

#### **Management's Response from the Department of State Health Services**

*The Department of State Health Services (DSHS) through training, improved business processes and enhanced internal controls has resolved all prior year statewide audit finding. The DSHS review process did identify a significant change in the notes and questioned the material change. However, we will continue to enhance our process to mitigate the chance for errors in the Annual Financial Report to include notes in the Schedule of Expenditures of Federal Awards (SEFA).*

*Implementation Date: November 20, 2010*

*Responsible Person: Accounting Director*

#### **Management's Response from the Department of Transportation**

*The Department concurs with the recommendation and will implement policies and procedures to address the finding by May 2010.*

*Responsible Person: Finance Division Director*

#### **Management's Response from the Health and Human Services Commission**

*Fiscal Management will examine its SEFA preparation and review processes, and implement improvements necessary to help ensure all information HHSC submits to the Comptroller's Office is accurate.*

*Estimated Completion Date: August 2010*

*Responsible Person: Deputy Executive Commissioner for Financial Services*

#### **Management's Response from the Office of the Attorney General**

*Incorrect Pass-through Reporting - We concur with the audit finding that pass-through expenditures to certain non-State entities were reflected as direct agency expenditures on the SEFA . Total agency expenditures were accurately reported; however, payments totaling \$422,504.22 made under contract to vendors who were categorized as subrecipients were incorrectly reported as agency direct expenditures. Management has initiated additional review procedures to insure that all agency contractual expenditures are correctly classified and reported on the SEFA.*

*Incorrect Inclusion of Expenditures - A reclassification of federal funds received during fiscal year 2009 was required with the retroactive restoration of incentive match under ARRA which resulted in a year long reclassification of the funds received from federal to state revenue. The final adjusting entry to reclassify the funds was processed by the Accounting Division in October 2009, after the agency's accrual time period. Management accepted the auditor's recommendation to accrue and reflect the reclassification in the fiscal year 2009 SEFA reporting in lieu of recognizing the reclassification in fiscal year 2010, when the journal voucher actually processed. Management does not anticipate other retroactive changes like this in the future, but additional review processes have been developed to ensure accurate reporting in future reports if similar changes occur.*

*Responsible Person : Chief Financial Officer*

*Implementation Date: Already implemented.*

#### **Management's Response from the Parks and Wildlife Department**

*Texas Parks and Wildlife Department agrees with the recommendation that SEFA information should be prepared using federal expenditures rather than revenues. Our current financial system extracts expenditures for federal billing accurately but does not store the history of which qualifying expenses were actually billed.*

*However, this data is only available in detailed individual grant files making the preparation of SEFA in the correct manner a massive task. A new financial system is scheduled for a September 1, 2010 implementation date which will allow the SEFA schedule prepared for FY11 to utilize accurate data.*

*Responsible Person: Finance Director*

*Implementation Date: November 1, 2011*



### Management's Response from Sam Houston State University

*Sam Houston State University understands the critical importance of correctly clustering programs and providing the appropriate notes to those programs and agrees with the recommendations in the audit report. Therefore, for the FY 10 Annual Financial Report (AFR) the Office of Research Administration will prepare the Schedule of Expenditures of Federal Awards (SEFAs) and submit to the Office of the University Controller ten days prior to the due date of the AFR. Changing the current process, will ensure there is appropriate time to review and correct any errors prior to submission of the AFR.*

*Implementation Date: August 31, 2010 Annual Financial Report*

*Responsible Person: Controller*

### Management's Response from the Tarleton State University

*Tarleton State University financial staff will continue to conduct a thorough review of the research and development cluster against its financial system (FAMIS) for accuracy. The review will include utilization of financial reports from FAMIS to verify expenditures presented on the SEFA.*

*Implementation Date: September 1, 2009*

*Responsible Person(s): Assistant Vice President and Controller, and Director of Accounting*

### Management's Response from the Texas A&M University

*Texas A&M University has established SEFA preparation and review procedures. The University will continue to evaluate and strengthen internal procedures to further minimize reporting errors. Any amounts reported on the SEFA will require adequate detailed documentation from the providing office or source of the information.*

*Responsible Person: Director of Project Administration, TAMU-Research Services*

*Implementation Date: 10-31-2010*

### Management's Response from the Texas A&M University - Commerce

*We agree with your recommendation that higher education institutions implement an adequate review process to ensure that the SEFA information submitted is accurate, and we believe that we have already taken corrective action. Our Grants and Contracts Office has added an additional staff member as a result of the growth of this area, which will only strengthen our*

*review process. Our Senior Accountant will now have more time available to focus on this area.*

#### **Management's Response from the Texas A&M University - Kingsville**

*We respect the audit opinion and understand the importance of reporting federal programs in the correct cluster. We concur with the findings that CFDA 14.514 should not be in the R&D Cluster. However, CFDA 84.217 and CFDA 17.260 were identified as R&D based on the instructions from the State of Texas Comptroller's office. Our interpretation of the instructions indicated that we could override the original cluster to R&D with the exception of the Financial Assistance (SFA) cluster. In the future, we will not override clusters identified in specific programs to R&D.*

*Implementation Date: November 2010*

*Responsible Person: Director of Grants and Contracts and Assistant Director of Grants and Contracts*

#### **Management's Response from Texas State University - San Marcos**

*Management concurs with the State Auditor's Office conclusion and recommendation. The University will strengthen the review process procedures to ensure accurate reporting of SEFA information.*

*Implementation Date: June 30, 2010*

*Responsible Person: Director, Accounting; Interim Director, Financial Aid and Scholarships*

#### **Management's Response from the Texas Workforce Commission**

*The Commission agrees that \$3.4 million of TANF direct expenditures should have been reported as pass-through expenditures to non-state entities in order to ensure accurate reporting of the \$5.9 billion in total expenditures for fiscal year 2009. The Commission will include an additional level of review beginning with the fiscal year 2010 Schedule of Federal Awards. In addition, a new procedure will be implemented to help ensure accurate reporting of federal expenditures in the future.*

*Implementation Date: November 30, 2010*

*Responsible Person: Chief Accounting Officer*

## Management's Response from the University of Texas at Arlington

*UT Arlington agrees with the three audit findings and will implement the following procedures for future SEFA reporting requirements:*

### *Incorrect Program Clustering*

*Financial reporting has created a report that will combine the Nacubo function and CFDA information. This will eliminate the possibility of cluster classification errors due to manual input. This report will also be used to review and verify that Nacubo classifications are correctly recorded in the accounting system.*

*Responsible Person: Financial Reporting will process the report and send to Office of Research and Grant and Contract Accounting to review and verify Nacubo function.*

*Implementation Date: Currently implemented. Report was processed for first quarter of fiscal year 2009-2010 and is being reviewed.*

### *Incorrect Classification of Expenditures*

*Grant and Contract accounting will not establish a budget for an account if the CFDA is recorded in the accounting system with a .000 suffix. Financial reporting has created a report that will identify CFDA numbers.*

*Responsible Person: Grant and Contract accountants will not establish budgets for accounts with insufficient CFDA data. Office of Research personnel will review report of CFDA information to ensure accuracy. Financial reporting personnel will review report to ensure that all financial aid grants are properly coded in accordance with the federal CFDA website.*

*Implementation Date: Currently implemented.*

### *Errors in Notes to the SEFA*

*Pass through expenditures reported on Exhibit B will not include non-monetary assistance.*

*Responsible Person: Financial Reporting personnel will ensure that Exhibit B does not include non-monetary assistance as pass through revenue.*

*Implementation Date: Currently implemented. Procedures have been updated and this item will be reviewed at year end when non-monetary assistance amounts are received.*

### Management's Response from the University of Texas at Austin

*The University concurs with the finding.*

*The University has updated all CFDA codes to remove the cluster default. Procedures have been modified, for compiling cluster information, allowing a more accurate presentation of program clustering. Additionally, a more diligent review will occur prior to submission of the SEFA information in order to avoid errors in supplemental information.*

*Implementation Date: September 2010*

*Responsible Person: Finance Manager, Office of Accounting*

### Management's Response from the University of Texas at El Paso

*The University of Texas at El Paso concurs with the finding. An incorrect CFDA number was used in the notes section of the Schedule of Expenditure of Federal Awards due to an oversight during manual preparation. A new download is being created that can be cross matched against a table of CFDA numbers and titles. This should mitigate oversight errors while preparing the Schedule in the future.*

*Responsible Person: Director, Accounting and Financial Reporting*

*Implementation Date: April 30, 2010*

### Management's Response from the University of Texas - Pan American

*The University of Texas — Pan American concurs with the findings. An incorrect CFDA number was reported in the Schedule of Expenditure of Federal Awards. The same CFDA number was included in the Notes. A secondary check will be implemented prior to submission to ensure all programs are assigned the appropriate CFDA number.*

*Implementation date: September 30, 2010*

*Responsible Person: Supervisor Grants and Contracts*

### Management's Response from the University of Texas Health Science Center at Houston

*UTHSC-Houston will revisit its quality control processes related to SEFA preparation. Since the review we have added to our procedure a more descriptive outline of how these fields are to be completed and indicating from*

*where the data is to be retrieved, and will double check this data at submission.*

*Implementation Date: July 31, 2010*

*Responsible Person: Sr. Vice President, Finance & Business Services*

#### **Management's Response from the University of Texas Health Science Center at San Antonio**

*The SAO's finding related to The University of Texas Health Science Center at San Antonio's 2009 Statement of Expenditures of Federal Awards (SEFA) report discovered 2 out of 829 grant awards that had been improperly clustered. The two awards identified as incorrectly clustered represent an error rate of 0.2% of all awards reported and reviewed. This error rate indicates that the HSC classification and review processes are adequate. The cost of implementing additional controls to further reduce this error rate would exceed the value of such controls. We will remind our staff to utilize adequate scrutiny during award setup to ensure awards are properly classified in the correct cluster.*

*Implementation Date: March 1, 2010*

*Responsible Person: Director of Accounting*

#### **Management's Response from the University of Texas Medical Branch at Galveston**

*The University of Texas Medical Branch at Galveston agrees with the recommendations of the State Auditor. UTMB has already taken steps to conduct a detailed review of all Federal awards to assure program numbers are correct in accordance with the Notice of Award from each Federal sponsor and that each program is classified in the appropriate cluster.*

*Responsible Person: Director, Sponsored Programs Finance*

*Implementation Date: August 31, 2010*

#### **Management's Response from the University of Houston**

*The University of Houston concurs with the errors identified in the 2009 SEFA. The University will augment its existing review process to include verifications for the amounts reported in error on the SEFA and the Notes to the SEFA. Additional review procedures will be implemented to ensure that accurate information is obtained from source departments and reported on*

*the SEFA and accompanying notes in accordance with the audit recommendations.*

*Responsible Person: Executive Director of Financial Reporting*

*Implementation Date: April 2010*

#### **Management's Response from the University of Houston - Clear Lake**

*We agree with the findings. The university has written and implemented a policies and procedures statement, effective December 9, 2009. It will be followed in all future reviews and preparations of the SEFA report as part of the annual financial report.*

*Responsible Person: Director of General Accounting*

#### **Management's Response from the University of North Texas**

*(1) UNT Financial Reporting is in agreement with this recommendation.*

*(2) The SEFA is prepared by the Accountant IV Financial Reporting, and is reviewed by the Director Financial Reporting and Compliance.*

*(3) Action Plan: A reconciliation will be performed between those expenditures marked as Research and Development on the SEFA and those coded as class 20 (Research) on the general ledger.*

*(4) The action plan will be implemented beginning with the fiscal year 2010 SEFA report.*

*(5) Additional information: The online SEFA form requires checking an indicator box for any Research and Development related expenditures. When preparing the FY09 SEFA, this box was overlooked for one of the Department of Defense awards.*

#### **Management's Response from the University of North Texas Health Science Center at Fort Worth**

*(1) UNTHSC is in agreement with this recommendation.*

*(2) The SEFA is prepared by the Director of Accounting, with input and review from the Director Grants & Contracts.*

*(3) Action Plan: Written procedures and check lists will be prepared to strengthen accuracy and review in preparation of the SEFA.*

*(4) The action plan will be implemented beginning with the fiscal year 2010 SEFA report.*

Copies of this report have been distributed to the following:

### **Legislative Audit Committee**

The Honorable David Dewhurst, Lieutenant Governor, Joint Chair  
The Honorable Joe Straus III, Speaker of the House, Joint Chair  
The Honorable Steve Ogden, Senate Finance Committee  
The Honorable Thomas “Tommy” Williams, Member, Texas Senate  
The Honorable Jim Pitts, House Appropriations Committee  
The Honorable Rene Oliveira, House Ways and Means Committee

### **Office of the Governor**

The Honorable Rick Perry, Governor

### **Boards, Commissions, Chancellors, Executive Directors, and Presidents of the Following Agencies and Higher Education Institutions**

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Office of the Attorney General  
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Sam Houston State University  
Stephen F. Austin State University  
Tarleton State University  
Texas A&M University  
Texas A&M University - Commerce  
Texas A&M University - Corpus Christi  
Texas A&M University - Kingsville  
Texas A&M University System  
Texas AgriLife Research  
Texas Department of Rural Affairs  
Texas Education Agency  
Texas Southern University  
Texas State University - San Marcos  
Texas Tech University  
Texas Workforce Commission  
The University of Texas at Arlington



The University of Texas at Austin  
The University of Texas at Dallas  
The University of Texas at El Paso  
The University of Texas Health Science Center at Houston  
The University of Texas Health Science Center at San Antonio  
The University of Texas M.D. Anderson Cancer Center  
The University of Texas Medical Branch at Galveston  
The University of Texas - Pan American  
The University of Texas of the Permian Basin  
The University of Texas at San Antonio  
The University of Texas Southwestern Medical Center at Dallas  
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