March 8, 1995

Ms. Mary Sapp, Executive Director
Texas Department on Aging
1949 IH-35 South, 3rd Floor
Austin, Texas 78741

Dear Ms. Sapp:

A material weakness exists in the control environment over the Department's accounting function. This material weakness is indicated by the type and number of problems identified. The problems include the following issues:

- The Department has not established procedures to ensure accurate and timely federal reports for the $23 million Nutrition Services Program.
- Supervision of the federal and related internal reporting processes is inadequate.
- Reconciliations related to federal reports include unsupported adjusting entries.
- Accounting system policies and procedures are not documented.

Although known problems in the accounting system were not corrected during fiscal year 1994, the Department has indicated a commitment to correcting the situation.

The attached findings and Department responses will appear in the 1994 Financial and Compliance Audit Results report. This report contains the audit results of all agencies and universities we visited during the statewide financial and compliance audit.

When this report is published in May 1995, copies will be distributed to the board chairperson and chief executive officer for each agency included. Additional copies can be obtained from Production Services at 479-4700.

A copy of this letter has been sent to each board member. If you have any questions, please call me at 479-4700.

Sincerely,

Lynn Gray Redwine, CPA
Project Manager

LGR:ggh

cc: Russell Gregorczyk, Internal Auditor

Key Points Of Report

Texas Department on Aging
1994 Statewide Financial and Compliance Audit

March 1995

Overall Conclusion

A material weakness exists in the control environment over the Department's accounting function. Both the type and number of problems identified emphasize the lack of adequate controls. These problems include the following issues:

- The Department has not established procedures to ensure accurate and timely federal reports for the $23 million *Nutrition Services Program*.
- Supervision of the federal and related internal reporting processes is inadequate.
- Reconciliations related to federal reports include unsupported adjusting entries.
- Payments to subrecipients are maintained on a subsidiary ledger which cannot be reconciled to the Department's internal accounting system.
- Accounting system policies and procedures are not documented.

Although known weaknesses in the accounting system were not corrected during fiscal year 1994, the Department has indicated a commitment to correcting the situation.

Key Findings

- Known control weaknesses in the accounting system were not corrected during fiscal year 1994. Although the Department took action to address problems within the accounting system in early 1994, significant weaknesses continued at the end of the fiscal year.
- The Department has not established procedures to ensure accurate and timely federal reports, and related internal reports, for the *Nutrition Services* Program (CFDA 93.635). Supervision of the reporting process is inadequate. Reconciliations related to federal reports include unsupported adjusting entries. While the errors found were not material to the $23 million Title III program, this lack of procedures indicates a control weakness within the accounting system.
- The Department does not ensure that subrecipients comply with federal cash management requirements. Subrecipients' cash balances are not monitored as their requests for advances are processed. As a result, subrecipients may be holding cash in excess of immediate needs.

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Material Weakness In Control Environment

The type and number of problems identified in the two Internal Control Issues and the first Federal Compliance Issue indicate a material weakness in the control environment over the accounting function. The control environment reflects the attitude, awareness, and actions of employees concerning the importance of controls within the organization. A weakness in the control environment increases the risk that material errors (unintentional mistakes) and irregularities (intentional improprieties) could occur and go undetected. Also, a control environment weakness can have a detrimental effect on management's decision-making process.

Internal Control Issues

Internal Control Issue 1:

Correct Significant Accounting System Control Weaknesses

Known control weaknesses in the accounting system were not corrected during fiscal year 1994. In early 1994, Department management took action to address problems within the accounting system. However, when a May 1994 draft internal audit report informed management of continued significant weaknesses within the accounting system, certain factors contributed to the delay in taking effective corrective action.

- Management did not provide written responses to the internal audit report and did not formally issue it until October 1994. It was presented to the Board at the same time. The five-month delay between the draft and final reports postponed both management's formal response and effective corrective action. The Board's oversight was also postponed.

- Management's response to an internal audit represents its commitment to an action plan for implementing audit recommendations. For maximum benefit these responses should be timely. For example, the State Auditor's Office policy is to request responses within two weeks after submission of audit recommendations.

- Accounting system policies and procedures are not documented. Important controls such as adequate supervision, clearly defined responsibilities, segregation of duties, and reconciliations between information systems are not defined or practiced. Determining and implementing an appropriate course of action, and taking timely corrective action, without documentation from a "systems" perspective is difficult.

Also, problem performance was not documented. Existing Department personnel policies and procedures were not used to address personnel issues within the accounting department. Evaluations were not timely or adequate. Accountability and the designation of responsibility were delayed.

Since August 1994, the Department has paid over $18,000 to contract accountants to reconstruct fiscal year accounting records so that the 1994 Annual Financial Report could be prepared. A new financial director was appointed in August. He has developed work plans and evaluation schedules for accounting employees.

Recommendation: We recommend that the Department take immediate action to improve controls over the accounting system. We recommend that this action include developing a comprehensive control system which integrates policies and procedures, evaluation and accountability, and proper accounting controls. This system should also consider the accounting system in terms of other areas of agency operations it impacts, including federal, state, and internal reporting.

Management's Response: During FY 1994, significant agency/management effort was directed to identifying and addressing weaknesses within the accounting system. The Department became an internal user of the new uniform statewide accounting system this past fiscal year, which had a significant impact on our fiscal services. The transition to a new accounting system created additional time demands for training and troubleshooting, which, while holding the potential for long term benefit, caused additional demands and pressure on staff and the system during FY 1994. Simultaneously, efforts were being made to address areas of concern within the system. Corrective action during FY 1994 included some significant staff changes and the request by management of a special internal audit (referenced above) to identify and assess priority/problem areas needing immediate attention. While official Board review of the report occurred in October, findings were used immediately upon completion of the study to guide and assist corrective action. As reported above, all corrective action was not completed by the close of the 1994 fiscal year. However, all areas addressed within the internal audit have been addressed/corrected or significant activity is currently underway to complete corrective action.

Internal Control Issue 2:

Implement Procedures For Contracted Services

The Department has contracted with one individual to provide both internal audit services and the accounting-related services used to implement one of his own internal audit recommendations. This contracting practice impairs the objectivity of the internal audit function.

Acting on an internal audit report recommendation, the Department, in August 1994, installed the accounting system recommended by the internal auditor. This system was in addition to the existing Uniform Statewide Accounting System (USAS). The internal auditor was paid over $9,000 for services related to installing the accounting system, reconstructing fiscal year accounting records on the new system, and reconciling the two accounting systems.

The internal auditor provided these services both indirectly through a third-party contractor (recommended by the internal auditor) and directly through a contract with the Department. Both contracts were for less than $10,000, so no formal bids were used.

The Department decided the fiscal year annual financial reports could not be generated without the additional accounting system and timely reconstruction of the accounting records. The internal auditor was considered an experienced reliable source to recommend a contract accountant and to later contract for the services himself.

Recommendation: We recommend the Department develop policies and procedures to ensure that contractors and employees do not participate in decisions which affect their personal pecuniary interests. This process should include a review of the types of services for which the Department contracts, or plans to contract, in terms of the potential for conflicts of interest. We recommend that a representative of the Attorney General's Office be consulted as part of this process.

Management's Response: We concur with the recommendation. However, we believe the finding should be clarified regarding the involvement of the Internal Auditor in the accounting services provided. We do not believe that the accounting contract work performed impairs the objectivity of the internal audit function. The Internal Auditor recommended that we install the MIP fund accounting system that we had used until the USAS was implemented at the beginning of FY 1994. We concurred with this recommendation because we had been unable to utilize the USAS to obtain the accounting and budget reports necessary to manage the agency's financial operations.

At our request, the Internal Auditor recommended a CPA firm that he believed could provide the services we required. This CPA firm was contracted to design, implement, and test the MIP accounting system for implementation in FY 1995. Because this firm did not have any knowledge of TDoA, they subcontracted to use an employee of the Internal Auditor's firm to provide technical assistance on the project. The TDoA Internal Auditor did not perform any services under this contract. Part of the contract work included coding, entering and reconciling the first quarter accounting records for FY 1995 to ensure the system would work in FY 1995, and this work was performed by the subcontract employee. The project was completed by the CPA firm in accordance with the contract.

After the successful completion of the contract, we determined that we would not be able to utilize the USAS to develop our annual financial report or to provide accurate information about the TDoA operating budget and expenditures for FY 1994 . Since the accounting records for the first quarter of FY 1994 had been entered into MIP, we decided to reconstruct the accounting records for the last three quarters of the fiscal year using the MIP system. Because TDoA staff did not have time to do this work, we decided the most cost effective way to complete the project was to use the individual who had performed the subcontract work for the CPA firm, and who was most familiar with the work to be performed. A contract was executed with the Internal Auditor for his employee to complete this work and the work was successfully completed. The Internal Auditor did not perform any of the work. Although the Internal Auditor was not directly involved in the project, we agree that he did benefit financially from the work performed, and for this reason we concur with, and will implement, the audit recommendation. This will ensure that we avoid potential conflicts of interest in the future.

Federal Compliance Issues

Federal Compliance Issue 1:

Establish Procedures For Federal Report Preparation

The Department has not established procedures for federal reporting, including related internal reports, for the *Nutrition Services Program* (CFDA 93.635). On a quarterly basis, the Department submits Federal Reports PMS 272 and SFR 269 to the Federal Government. The Department also prepares internal reports to adjust subrecipient payments at the end of grant periods and to allocate funds (among Title III programs) carried over from one grant period to the next.

Reconciling procedures are either not performed or include improper practices. The chief accountant judgmentally determines reconciling amounts when reconciling funds received from the Federal Government per USAS records to the amounts reported on Federal Report PMS 272. The judgmentally determined amounts are not supported by a known methodology or documentation of how the amounts are derived.

The chief accountant also uses the same judgmental process to allocate carry-over funds among Title III programs reported on Federal Report SFR 269. Carry-over funds can be used in a subsequent grant period.

Procedures are not performed to compare final subrecipient grant payment and expenditure amounts to ensure that refunds due the Department are collected. A refund due the Department was not identified for one of three subrecipients tested. There are 28 subrecipients.

Payments to subrecipients are recorded on the SFR 269 Report using information recorded on a subsidiary ledger which cannot be reconciled to USAS, the Department's internal accounting system.

Reconciling procedures are important tools to identify errors in record keeping and improper activities. The lack of reconciliations and poor reconciliations practices, increase the risk that material errors and irregularities could occur and go undetected.

Eighty-six percent of the Title III federal reports submitted were not reviewed. Related internal reports were also not reviewed. The federal reports tested contained a number of calculation errors. Also, the Title III closeout report, an internal report, incorrectly included Title VII funds. This end of grant period report is used to determine the amounts to carry over for use in the next grant period.

The errors found were not material to the $23 million Title III program, but do indicate a lack of review. Proper review procedures reduce the risk that material errors will go undetected.

Seventy five percent of the required Title III reports were submitted late. Six of eight Title III federal reports were submitted after the required deadline, periods ranging from 9 to 84 days. Two reports were submitted on time.

Since the Department lacks policies and procedures over the preparation of reports, it is difficult determine who is responsible, and accountable, for the various steps in report preparation. It is also difficult to identify controls which are lacking; for example, no one is responsible for tracking regulations relevant to the preparation of federal reports. While the errors found were not material, they are further indication of control weaknesses within the accounting system.

Recommendation: We recommend that the Department establish controls over the federal reporting process. Immediate steps should be taken to establish and document policies and procedures. The deficiencies noted above should be considered as a starting point for developing policies and procedures for report preparation, rather than an inclusive listing of the policies and procedures to be documented.

Management's Response: The Department's Fiscal Division did incur significant difficulty preparing reports during FY 1994 . While not totally responsible, factors relating to the implementation of the new accounting system and the timely availability of data certainly had a significant impact on the agency's reporting system.

The new Division director is working with the Chief Accountant on all federal reports. Upon completion, all reports are thoroughly reviewed and approved by the Division Director prior to submission.

Due to the difficulties of conducting the agency's accounting through USAS in FY 1994, the Department has converted to MIP as its internal accounting system. Having the immediate access to data provided by MIP will allow timely reporting to the Department's federal funding agencies.

Judgmental actions by the Chief Accountant to provide reconciliations between USAS, MIP and any of the Department's federal reports will be allowed only when supported by verifiable and documented data using an accepted methodology.

Procedures are in place to ensure that all refunds due from FY 1994 grant payments are recovered and accounted for by a systematic and documented method. The MIP accounting system will provide reconciliation of subrecipient payments and will promote easier reconciliation to USAS.

Supervision of the reporting process has been greatly enhanced to ensure appropriate and effective review and approval prior to submission. Process review is ongoing to identify and implement any other changes which will strengthen this function.

Federal Compliance Issue 2:

Ensure Compliance With Federal Cash Management Requirements

(Prior Audit Issue)

The Department does not ensure that subrecipients comply with federal cash management requirements. As a result, subrecipients may be holding cash in excess of immediate needs. Federal regulations require that subrecipient cash advances not be drawn in excess of immediate cash needs. Immediate cash needs, as addressed in *Title 45 of the Code of Federal Regulations (CFR), part 92,* are generally considered to be an amount equal or less than three days' disbursements.

The Department does not monitor subrecipients' cash balances as it processes their requests for advances.

Recommendation: We recommend the Department require all subrecipients to submit information about federal funds used and cash balances with each cash request. The Department should use this information to determine compliance with the three-day requirement. Subrecipients who request funds in excess of three days' disbursements should be put on a reimbursement basis.

Management's Response: Procedures have been put in place to ensure that each draw of federal funds is monitored for excess funds. Strict guidelines have been put in place to ensure cash management compliance and all area agencies on aging were notified via a technical assistance memorandum on November 10, 1994. All procedures were reviewed and approved by the State Auditor's Office.

Audit Scope

The primary focus of our audit was testing the Title III, Part C - *Nutrition Services Program*, totaling $23.2 million. We gained an understanding of the general control environment and tested controls related to this federal program. We also performed procedures to test for compliance with program requirements.