

A Report on The

1994 Financial And Compliance Audit Results



Office of the State Auditor
Lawrence F. Alwin, CPA

May 1995

Report No. 95-124

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Executive Summary

The information contained in the financial statements of Texas' 1994 *Comprehensive Annual Financial Report (CAFR)* is presented fairly and can be relied upon to evaluate the State's financial condition. At the end of fiscal year 1994, Texas reported the following for its primary government funds:

- Total assets increased by 9.6% to over \$105 billion. Liabilities totaled \$29.2 billion and fund balance and retained earnings grew by 9.5% to \$76.1 billion.
- Texas received \$33.9 billion in total revenues and expended \$33.1 billion. This represents increases of 7% and 8%, respectively.
- Texas administered 647 federal financial assistance programs with expenditures exceeding \$15.4 billion.
- The State had 276 bond issues outstanding totaling \$10 billion. Bonds payable increased by approximately 10% during the fiscal year.

Most of the agencies and universities we visited have controls in place to protect the State's resources and to help ensure compliance with bond

and federal requirements. The following issues, however, need to be addressed.

Four Agencies Have Material Internal Control Weaknesses

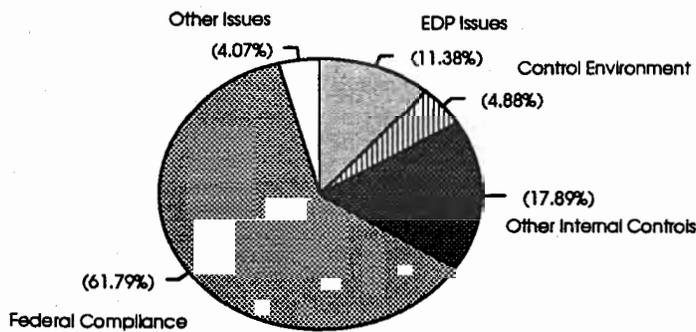
A material weakness exists in the control environment over the Block Grants for Prevention and Treatment of Substance Abuse (CFDA 93.959) at the Texas Commission on Alcohol and Drug Abuse. The administrative controls over contract monitoring and rate setting do not provide reasonable assurance that federal funds are spent in accordance with applicable laws and regulations. In fiscal year 1994, this program represented 81% of the Commission's \$89.9 million in federal assistance.

The type and number of problems identified at the Department on Aging indicate a material weakness in the control environment over the accounting function. Important controls such as adequate supervision, clearly defined responsibilities, segregation of duties, and reconciliations between information systems are not defined or practiced. In addition, accounting system policies and procedures are not documented.

The Department administers 11 federal programs with annual expenditures exceeding \$58.4 million or .4% of the State's total federal financial assistance. A control environment weakness can reduce the effectiveness of management's decision-making process.

A material weakness exists in the control environment over the Donation of Federal Surplus Personal Property Program (CFDA 39.003) at the General Services Commission. The number and complexity of problems identified, ineffective communication of policies and procedures, and a net loss in operations may indicate that the \$34 million program (valued at original acquisition cost) may not be able to continue operations. In addition, the Commission does not have adequate controls to ensure inventory received under the program is properly accounted for and stored.

Findings Distribution By Issue Category



Source: "Summary Listing Of All Issues," 1994 Financial And Compliance Audit Results

Figure 1

Over 61% of the 123 recommendations made to management relate to the administration of federal programs. The costs associated with the federal compliance work will be reimbursed by the Federal Government.

Key Terms

Material Weakness relates to operations as a whole and results when a lack of procedures exists which could allow large errors or illegal acts to occur and not be detected during the normal course of operations.

Material Noncompliance results when errors are found indicating that at least 5% of the federal program expenditures were not spent properly or that 5% of the federal assets administered were not used or reported properly. (The 5% criteria is a general guideline. Other factors may be considered in making this determination.)

Control Environment reflects the attitude, awareness, and actions of management concerning the importance of controls within the organization.

The Texas Department of Human Services does not provide sufficient oversight of commercial distributors in the Food Distribution Program (CFDA 10.550). Because of this material weakness, the operating environment will not readily prevent or detect errors, fraud, and material noncompliance with federal laws and regulations. The Department is responsible for receiving, allocating, and distributing commodities valued at approximately \$65 million to eligible recipient agencies. This program accounted for 1.3% of the Department's total federal funds administered during fiscal year 1994.

Federal Funds At Risk % Of Expenditures Affected By Material Weaknesses/Noncompliance

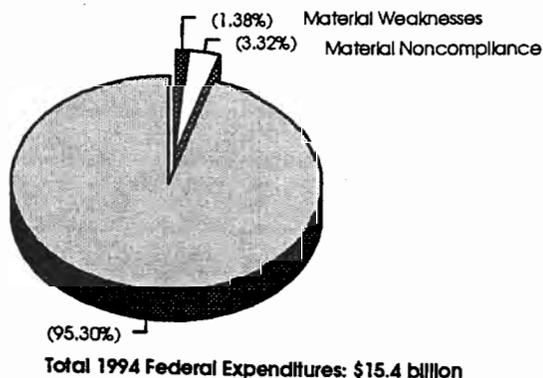


Figure 2

Material weaknesses and material noncompliance with federal regulations increase the risk that program objectives will not be met. The risk that large errors and intentional improprieties will occur and not be quickly detected is also increased.

Three Agencies Had Instances Of Material Noncompliance With Federal Regulations

The Department of Protective and Regulatory Services is in material noncompliance with the federal eligibility and allowable cost requirements for the Child Welfare Services (CFDA 93.645) Program. Twenty-two percent of clients tested received services without sufficient eligibility documentation. The Department expended \$21.9 million on Child Welfare Services in fiscal year 1994.

The General Services Commission did not ensure only eligible donees participated in the Donation of Federal Surplus Property Program (CFDA 39.003). Fifty-eight percent of the donees tested were ineligible to receive property. This resulted in questioned costs of \$669,000 (valued at original acquisition cost). In addition, the Commission does not properly monitor property items to ensure they are used in accordance with federal regulations. The Commission received approximately \$34 million of federal property from this program valued at original acquisition cost.

The Department of Human Services is in material noncompliance with special provisions of the Job Opportunities and Basic Skills Training (JOBS) Program (CFDA 93.561). Thirty-three percent of the case files tested did not contain documentation that the Aid to Families with Dependent Children (CFDA 93.560) clients were informed of their rights to JOBS services and responsibility to participate in the program. Special provisions are important because noncompliance could increase the risk that the objectives of the program are not realized and could result in the loss of program funding. JOBS expenditures at the Department of Human Services exceeded \$40 million in fiscal year 1994.

The State's Financial Reporting Process Can Be Improved

The Uniform Statewide Accounting System (USAS) could be more effective if an automated reporting function was implemented to prepare the State's annual financial report. Currently, the State compiles its financial statements once a year

through an extensive, mostly manual, consolidation process. The data is obtained from approximately 300 state agency and university financial reports and from analysis of information in USAS.

In addition, the Comptroller of Public Accounts should improve the effectiveness of the Financial Reporting Section's quality control function to ensure that errors in draft versions of the Comprehensive Annual Financial Report (CAFR) are detected and corrected prior to review by the State Auditor's Office.

Statewide Cash Reconciliation Process Needs To Be Improved

The Comptroller of Public Accounts and the State Treasury need to improve the cash reconciliation process between the Uniform Statewide Accounting System (USAS) and the Treasury's cash accounting system. With the implementation of USAS in fiscal year 1994, the old reconciliation method proved ineffective since the new system requires a higher level of sophistication in the reconciliation process. This improved process had not been perfected when USAS became the State's primary accounting system. As a result, the Comptroller and Treasury had continuing difficulties with the reconciliation process during fiscal year 1994.

An effective reconciliation system provides monitoring and control to ensure the accuracy of the State's cash records, including individual agency accounting records. The lack of an effective reconciliation process increases the risk that errors and irregularities will not be detected in a timely manner by management.

Summary Of Audit Objective And Scope

The objectives of the Statewide Audit were to:

- Determine whether the financial statements of the State present fairly the financial position, results of operations, and cash flows in accordance with generally accepted accounting principle.

- Fulfill the audit requirements of the Single Audit Act (Federal Compliance).
- Determine compliance with significant bond covenants.
- Issue management letters on reportable conditions.

We performed the following procedures:

- We gained an understanding of the overall control environment and the financial controls over the significant statewide and bond-related accounts. We also gained an understanding of administrative controls relevant to the federal programs examined.
- We tested accounts significant to the statewide financial statements. We also performed procedures to determine whether information reported in the general purpose financial statements was consolidated properly.
- We determined compliance with federal program requirements in accordance with Office of Management and Budget Circular (OMB) A-128. We audited 44 federal programs comprising 91.5% of the total federal assistance received during the year.
- We determined compliance with significant bond covenants for all of the State's 276 bond issues. We also determined that the information presented in the supplementary bond schedules is presented fairly.
- We followed up on prior audit issues.

Summary Of Managements' Responses

Management of the agencies and universities mentioned in the "Detailed Findings" section of this report generally concur with the findings and recommendations. They have included corrective action plans for implementing many of the recommendations.



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February 17, 1995

Auditor's Report On Internal Controls

The Honorable George W. Bush, Governor
and
Members of Texas State Legislature
State of Texas

Ladies and Gentlemen:

We have audited the general purpose financial statements of the State of Texas as of and for the year ended August 31, 1994, and have issued our report thereon dated February 17, 1995. We have also audited the State's compliance with requirements applicable to major federal financial assistance programs and have issued our report thereon dated February 17, 1995.

We do not express an opinion:

- on the effectiveness of the design and operation of internal control structure policies and procedures that we considered relevant to preventing or detecting material noncompliance with federal financial assistance program requirements because our procedures were less in scope than would be necessary to render such an opinion.

With respect to the items tested, we found:

- material weaknesses in certain elements of the internal control structure at the Texas Department of Human Services, Texas Department on Aging, Texas Commission on Alcohol and Drug Abuse, and General Services Commission; and
- material noncompliance with federal laws and regulations for various programs at the Texas Department of Protective and Regulatory Services, Texas Department of Human Services, and General Services Commission.

Each of these conclusions is discussed in more detail below. This report also discusses the scope of our audit.

Overview

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions¹ under standards established by the American Institute of Certified Public Accountants. Our consideration of the internal control structure policies and procedures would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses.²

We considered the conditions described below, involving the internal control structure and its operation, to be material weaknesses. The detailed findings relating to these reportable conditions are included in the "Detailed Findings with Management's Responses" and the "Schedule of Findings and Questioned Costs" sections of the *1994 Financial And Compliance Audit Results* report dated May 1, 1995. These conditions were considered in determining the nature, timing, and extent of the procedures to be performed in our audit of the State's general purpose financial statements for the year ended August 31, 1994.

Material Weaknesses Relating To Internal Controls Over The General Purpose Financial Statements

Our audit disclosed material weaknesses in certain elements of the internal control structure affecting the general purpose financial statements at:

- Texas Department on Aging
- Texas Commission on Alcohol and Drug Abuse

Although these weaknesses are material to the internal control structure of individual agencies, they are not material to the State of Texas as a whole.

Material Weaknesses Relating To Internal Controls Over Federal Financial Assistance Programs

We noted material weaknesses in certain elements of the internal control structure used in administering federal financial assistance programs at:

-
- 1 **Reportable conditions** involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the State's ability to:
 - (1) record, process, summarize, and report financial data consistent with the assertions of management in the general purpose financial statements, or
 - (2) administer federal financial assistance programs in accordance with applicable laws and regulations.
 - 2 **Material weaknesses** are reportable conditions in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors in amounts that would be material in relation to:
 - (1) the general purpose financial statements being audited, or
 - (2) a federal financial assistance programmay occur and not be detected by management within a timely period in the normal course of operations.

- Texas Department of Human Services
- General Services Commission
- Texas Commission on Alcohol and Drug Abuse

Although these weaknesses are material to the individual federal programs, they are not material to the State of Texas as a whole.

During the 1993 financial and compliance audit, we identified a material weakness in the control environment of the Student Financial Aid Office at Texas Southern University. In order to allow the University sufficient time to eliminate the material weakness, we performed limited follow-up procedures during the 1994 audit. Although progress has been made in implementing corrective measures, a full review will be performed in fiscal year 1995 to determine the status of the material weakness.

Material Noncompliance With Federal Laws And Regulations

Our audit identified material noncompliance with federal laws and regulations for the following programs:

- *Child Welfare Services* program (CFDA 93.645) at the Texas Department of Protective and Regulatory Services
- *Job Opportunities and Basic Skills Training* program (CFDA 93.561) at the Texas Department of Human Services
- *Donation of Federal Surplus Personal Property* program (CFDA 39.003) at the General Services Commission

The circumstances surrounding these instances of material noncompliance are more fully described in the "Auditor's Report On Compliance" dated February 17, 1995, and in the "Detailed Findings With Managements' Responses" section of the *1994 Financial And Compliance Audit Results* report.

Other Internal Control Issues

We identified other matters involving the internal control structure and its operation that have been included in the *1994 Financial And Compliance Audit Results* report as well as the management letters issued to the individual agencies and universities. These reports are available upon request through the State Auditor's Office.

Methodology

In planning and performing our audit for the year ended August 31, 1994, we considered the State's internal control structure in order to determine our auditing procedures for the purpose

of expressing our opinion on the State's general purpose financial statements and on its compliance with requirements applicable to major federal financial assistance programs, and to report on the internal control structure in accordance with *Office of Management and Budget* (OMB) Circular A-128.

We did not audit the following entities which are component units of the State for financial reporting purposes. These entities were audited by other auditors:

Entities Reviewed by Other Auditors	Scope of Work Performed
Texas Guaranteed Student Loan Corporation	An audit was conducted under the provisions of <i>OMB Circular A-133</i> and regulations issued by the U.S. Department of Education for the period ending 9/30/94.
Texas Turnpike Authority	An audit of its general purpose financial statements was conducted for the year ended 12/31/93.
Texas A&M University System Research Foundation	An audit was conducted under the provisions of <i>OMB Circular A-133</i> for the period ended 8/31/94.
Texas A&M University Development Foundation (Corporation and Trust)	An audit of its general purpose financial statements was conducted for the years ended 12/31/93 and 12/31/94.
Texas Lottery Commission	An audit of its general purpose financial statements was conducted for the years ended 8/31/93 and 8/31/94.
Texas Local Government Investment Pool	An audit of its general purpose financial statements was conducted for the year ended 8/31/94.
Texas Department of Housing and Community Affairs	An audit was conducted under the provisions of <i>OMB Circular A-128</i> for the period ended 8/31/94.
Texas Department of Housing and Community Affairs - Revenue Bond Enterprise Fund	An audit of its general purpose financial statements was conducted for the years ended 8/31/93 and 8/31/94.
Texas Workers' Compensation Insurance Fund	An audit of its general purpose financial statements was conducted for the years ended 12/31/92 and 12/31/93.
Texas Workers' Compensation Insurance Facility	An audit of its general purpose financial statements was conducted for the years ended 12/31/92 and 12/31/93.
Life, Accident, Health and Hospital Service Insurance Guaranty Association	An audit of its general purpose financial statements was conducted for the year ended 12/31/93.
Texas Title Insurance Guaranty Association	An audit of its general purpose financial statements was conducted for the year ended 12/31/93.

Entities Reviewed by Other Auditors	Scope of Work Performed
Surplus Lines Stamping Office of Texas	An audit of its general purpose financial statements was conducted for the year ended 12/31/93.

This report, insofar as it relates to these entities, is based solely on the reports of the other auditors. The management letters for the Employees Retirement System, the Teacher Retirement System, and the Fire Fighters' Pension Commission will be issued separately from this report.

For the purpose of this report, we have classified the significant internal control structure policies and procedures used in administering federal financial assistance programs in the following categories:

Internal Accounting Controls

- Control environment
- Cash balances
- Cash disbursements/
accounts payable
- Cash receipts/receivables
- Debt/bonds payable
- Investments
- Financial reporting
- Inventories
- Fixed assets
- Journal vouchers
- Payroll/personnel
- Due to/due from other funds

General Compliance Controls

- Political activity
- Davis-Bacon Act
- Civil rights
- Cash management
- Relocation assistance/property acquisition
- Federal financial reports
- Allowable costs/cost principles
- Drug-free workplace
- Administrative requirements

Specific Compliance Controls

- Types of services
- Eligibility
- Matching, level of effort
and/or earmarking
- Reporting
- Special requirements
- Monitoring subrecipients

Claims for Advances and Reimbursements

Amounts Claimed or Used for Matching

For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures at the state entities documented in the statewide audit plan and determined whether they have been placed in operation. We also assessed control risk.

Scope For Major Federal Programs

A summary of the state entities where we examined major federal programs is presented in the "Schedule of Major Federal Programs Examined" section of the *1994 Financial And Compliance Audit Results* report. The programs and entities examined by other auditors are not included on this Schedule.

Major federal programs are defined for the State as federal financial assistance programs with annual expenditures exceeding \$20 million. During the year ended August 31, 1994, the State expended 92 percent of its federal financial assistance under major federal financial assistance programs. All of the major federal financial assistance programs received audit coverage except for the *Cancer Treatment Research* (CFDA 93.395); *Heart and Vascular Research* (CFDA 93.837); and *Special Education - Preschool Grants* (CFDA 84.173) programs. This resulted in 91.5 percent audit coverage of federal financial assistance program expenditures. Because of the decentralized administration of major Student Financial Assistance (SFA) programs presented in the Schedule, these programs were audited in accordance with our risk assessment. Our procedures during the current year covered 23.3 percent of SFA major program expenditures.

We performed tests of controls, as required by *OMB Circular A-128*, to evaluate the effectiveness of the design and operation of internal control structure policies and procedures that we considered relevant to preventing or detecting material noncompliance with specific requirements, general requirements, and requirements governing claims for advances and reimbursements and amounts claimed or used for matching that are applicable to the State's major federal financial assistance programs audited. Our procedures were less in scope than would be necessary to render an opinion on these internal control structure policies and procedures. Accordingly, we do not express such an opinion.

Scope For Nonmajor Federal Programs

Because of the large number of nonmajor programs and the decentralized administration of these programs, we obtained an understanding of the internal control structure policies and procedures relevant to nonmajor programs on a cyclical basis and determined that the policies and procedures were in place. Because of conditions noted in prior audits, we applied the procedures described in the preceding paragraph to the *Donation of Federal Surplus Personal Property* program (CFDA 39.003). Our procedures during the current year covered 18.7 percent of the nonmajor program expenditures administered by the State as a whole. Nonmajor program expenditures represent eight percent of the total federal assistance received by the State.

Responsibilities

Management at the individual state entity level is responsible for establishing and maintaining an internal control structure. In fulfilling that responsibility, estimates and judgments made by management are required to assess the expected benefits and related costs of internal control structure policies and procedures.

The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that:

- Assets are safeguarded against loss from unauthorized use or disposition.
- Transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of general purpose financial statements in accordance with generally accepted accounting principles.
- Federal financial assistance programs are managed in compliance with applicable laws and regulations.

Because of inherent limitations in any internal control structure, errors, irregularities, or instances of noncompliance may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

We conducted our audits in accordance with generally accepted auditing standards; *Government Auditing Standards*, issued by the Comptroller General of the United States; and *Office of Management and Budget (OMB) Circular A-128, Audits of State and Local Governments*. Those standards and *OMB Circular A-128* require that we plan and perform the audit to obtain reasonable assurance about whether the general purpose financial statements are free of material misstatement and about whether the State of Texas complied with laws and regulations, noncompliance with which would be material to a major federal financial assistance program.

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

Sincerely,



Lawrence F. Alwin, CPA
State Auditor



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First Assistant

February 17, 1995

Auditor's Report on Compliance

The Honorable George W. Bush, Governor
and
Members of the Legislature
State of Texas

Ladies and Gentlemen:

We have audited the general purpose financial statements of the State of Texas as of and for the year ended August 31, 1994, and have issued our report thereon dated February 17, 1995. We also audited the State's compliance with certain requirements applicable to its major federal financial assistance programs as identified in the Schedule of Federal Financial Assistance and as required by the *Office of Management and Budget (OMB) Circular A-128, Audits of State and Local Governments*.

In our opinion:

- except for those instances of noncompliance referred to below under "Opinion on Compliance With Specific Requirements Relating to Major Federal Programs," the State of Texas complied, in all material respects, with the specific requirements we tested applicable to each of its major federal financial assistance programs.

With respect to the items tested, we found:

- no material noncompliance with the selected general requirements applicable to federal financial assistance programs;
- material noncompliance with certain requirements applicable to nonmajor federal financial assistance programs described below under "Compliance With Requirements Applicable to Nonmajor Federal Financial Assistance";
- no material noncompliance with the selected provisions of applicable laws and regulations tested relating to the general purpose financial statements.

With respect to the items not tested:

- nothing came to our attention that caused us to believe that the State had not complied, in all material respects, with the above provisions.

Each of these conclusions is discussed in more detail below. This report also discusses the scope of our audit.

Opinion On Compliance With Specific Requirements Relating To Major Federal Programs

We have audited the State's compliance with the following requirements that are applicable to its major federal financial assistance programs:

- allowability of services
- matching, level of effort and/or earmarking
- monitoring subrecipients
- claims for advances and reimbursements
- eligibility
- reporting
- special requirements
- matching

These programs are identified in the Schedule of Federal Financial Assistance and in the "Schedule of Major Federal Programs Examined" section of the *1994 Financial And Compliance Audit Results* report.

We noted various instances of material noncompliance which are summarized below. The detailed findings along with managements' responses are described in the "Detailed Findings With Managements' Responses" section of the *1994 Financial And Compliance Audit Results* report. Material instances of noncompliance consist of failures to follow requirements that caused us to conclude that the misstatements resulting from those failures are material to the following major federal programs:

- The *Child Welfare Services* program (CFDA 93.645), administered by the Texas Department of Protective and Regulatory Services, had material noncompliance in the area of providing services to eligible clients.
- The *Job Opportunities and Basic Skills Training* program (CFDA 93.561), administered by the Texas Department of Human Services, had material noncompliance in the area of informing applicable clients of their rights and responsibilities under the program.

The results of our audit procedures also disclosed instances of noncompliance that, while not material, were considered significant. These instances of noncompliance are described in the accompanying "Schedule of Findings and Questioned Costs" and the "Detailed Findings With Managements' Responses" sections of the *1994 Financial And Compliance Audit Results* report. In addition, instances of insignificant noncompliance were communicated to the federal grantors separately. We considered these instances of noncompliance in forming our opinion on compliance, which is expressed in the following paragraph.

In our opinion, except for those instances of noncompliance referred to above, the State of Texas complied, in all material respects, with the requirements governing types of services allowed or unallowed; eligibility; matching, level of effort, and/or earmarking; reporting; special requirements; claims for advances and reimbursements; amounts claimed or used for matching; and monitoring subrecipients that are applicable to each of its major federal financial assistance programs for the year ended August 31, 1994.

Compliance With General Requirements Applicable To Federal Financial Assistance Programs

We performed procedures to test the State's compliance with the following general requirements applicable to its federal financial assistance programs, which are identified in the "Schedule of Federal Financial Assistance" of the Comprehensive Annual Financial Report (CAFR), for the year ended August 31, 1994:

- political activity
- civil rights
- federal financial reports
- drug-free workplace
- Davis-Bacon Act
- cash management
- allowable costs
- administrative requirements

Our procedures were limited to the significant procedures described in the Office of Management and Budget's (OMB) *Compliance Supplement for Single Audits of State and Local Governments*. Our procedures were substantially less in scope than an audit, the objective of which is the expression of an opinion on the State's compliance with the requirements listed in the preceding paragraph. Accordingly, we do not express such an opinion.

With respect to our tests of compliance with general requirements applicable to federal financial assistance programs, the results of our procedures disclosed no material instances of noncompliance with the requirements listed in this report. With respect to items not tested, nothing came to our attention that caused us to believe that the State of Texas had not complied, in all material respects, with those requirements. However, the results of our procedures disclosed instances of noncompliance that, while not material, were considered significant. These instances of noncompliance are described in the accompanying "Schedule of Findings and Questioned Costs" and the "Detailed Findings with Managements' Responses" sections of the 1994 Financial and Compliance Audit Results. In addition, instances of insignificant noncompliance were communicated to the federal grantors separately.

Compliance With Requirements Applicable To Nonmajor Federal Financial Assistance Programs

In connection with our audit of the general purpose financial statements of the State of Texas and with our consideration of the State's control structure used to administer federal financial assistance programs, as required by *OMB Circular A-128, Audits of State and Local Governments*, we performed selected procedures applicable to certain nonmajor federal financial assistance programs for the year ended August 31, 1994.

We gained an understanding of the internal control structure policies and procedures and determined that the policies and procedures were in place. We also tested the *Federal Work Study* program (CFDA 84.033) at The University of Texas at Austin for allowable costs and the *Donation of Federal Surplus Personal Property* program (CFDA 39.003) at the General Services Commission for compliance with general and specific requirements. As required by *OMB Circular A-128*, we have performed auditing procedures to determine compliance with the requirements governing subrecipient monitoring that are applicable to the nonmajor transactions tested. Our procedures were substantially less in scope than an audit, the objective

of which is the expression of an opinion on the State's compliance with these requirements. Accordingly, we do not express such an opinion.

Material instances of noncompliance consist of failures to follow the requirements that caused us to conclude that the misstatements resulting from those failures are material to the following nonmajor federal program:

- The *Donation of Federal Surplus Personal Property* program (CFDA 39.003), administered by the General Services Commission had material noncompliance in the areas of property usage and eligibility.

We considered these material instances of noncompliance in forming our opinion on whether the State of Texas' 1994 general purpose financial statements are presented fairly, in all material respects, in conformity with generally accepted accounting principles, and this report does not affect our report dated February 17, 1995, on those financial statements.

Except as described above, the results of our procedures to determine compliance indicate that, with respect to the items tested, the State of Texas complied, in all material respects, with the requirements applicable to nonmajor federal financial assistance transactions. With respect to items not tested, nothing came to our attention that caused us to believe that the State had not complied, in all material respects, with those requirements. However, the results of our procedures disclosed instances of noncompliance that, while not material, were considered significant. These instances of noncompliance are described in the accompanying "Schedule of Findings and Questioned Costs" and the "Detailed Findings with Managements' Responses" sections of the 1994 Financial and Compliance Audit Results report. In addition, instances of insignificant noncompliance were communicated to the federal grantors separately.

Compliance With Laws, Regulations, And Requirements Relating To the General Purpose Financial Statements

As part of obtaining reasonable assurance about whether the general purpose financial statements are free of material misstatement, we performed tests of the State's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of the audit was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests of compliance with laws and regulations material to the general purpose financial statements indicate that, with respect to the items tested, the State complied, in all material respects, with laws, regulations, contracts, and grants applicable to the State of Texas. With respect to items not tested, nothing came to our attention that caused us to believe that the State had not complied, in all material respects, with those provisions.

Material Weaknesses Relating To Internal Controls

As disclosed in the "Auditor's Report On Internal Controls" dated February 17, 1995, our audit identified material weaknesses in certain elements of the internal control structure at:

- Texas Department on Aging
- Texas Commission on Alcohol and Drug Abuse
- Texas Department of Human Services
- General Services Commission

Although these weaknesses are material to the internal control structure of individual agencies, they are not material to the State of Texas as a whole.

Responsibilities And Methodology

Management at each individual entity is responsible for compliance with the specific requirements listed above in the first paragraph under "Opinion On Compliance With Specific Requirements Relating To Major Federal Programs." In addition, management at the individual state entity is responsible for compliance with laws, regulations, contracts, and grants applicable to the general purpose financial statements of the State of Texas.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States, and *Office of Management and Budget (OMB) Circular A-128, Audits of State and Local Governments*. Those standards and OMB Circular A-128 require that we plan and perform the audit to obtain reasonable assurance about whether the general purpose financial statements are free of material misstatement and about whether material noncompliance with the requirements referred to above occurred. An audit includes examining, on a test basis, evidence about the State's compliance with those requirements. We believe that our audit provides a reasonable basis for our opinion.

We did not audit the following entities which are component units of the State for financial reporting purposes:

Entities Reviewed by Other Auditors	Scope of Work Performed
Texas Guaranteed Student Loan Corporation	An audit was conducted under the provisions of the <i>OMB Circular A-133</i> and regulations issued by the U.S. Department of Education for the period ending 9/30/94.
Texas Turnpike Authority	An audit of its general purpose financial statements was conducted for the year ended 12/31/93.
Texas A&M University System Research Foundation	An audit was conducted under the provisions of <i>OMB Circular A-133</i> for the period ended 8/31/94.
Texas A&M University Development Foundation (Corporation and Trust)	An audit of its general purpose financial statements was conducted for the years ended 12/31/93 and 12/31/94.
Texas Lottery Commission	An audit of its general purpose financial statements was conducted for the years ended 8/31/93 and 8/31/94.

Entities Reviewed by Other Auditors	Scope of Work Performed
Texas Local Government Investment Pool	An audit of its general purpose financial statements was conducted for the year ended 8/31/94.
Texas Department of Housing and Community Affairs	An audit was conducted under the provisions of <i>OMB Circular A-128</i> for the period ended 8/31/94.
Texas Department of Housing and Community Affairs - Revenue Bond Enterprise Fund	An audit of its general purpose financial statements was conducted for the years ended 8/31/93 and 8/31/94.
Texas Workers' Compensation Insurance Fund	An audit of its general purpose financial statements was conducted for the years ended 12/31/92 and 12/31/93.
Texas Workers' Compensation Insurance Facility	An audit of its general purpose financial statements was conducted for the years ended 12/31/92 and 12/31/93.
Life, Accident, Health and Hospital Service Insurance Guaranty Association	An audit of its general purpose financial statements was conducted for the year ended 12/31/93.
Texas Title Insurance Guaranty Association	An audit of its general purpose financial statements was conducted for the year ended 12/31/93.
Surplus Lines Stamping Office of Texas	An audit of its general purpose financial statements was conducted for the year ended 12/31/93.

The above entities were audited by other auditors. This report, insofar as it relates to those entities, is based solely on the reports of the other auditors. The management letters for the Employees Retirement System, the Teacher Retirement System, and the Fire Fighters' Pension Commissioner will be issued separately from this report.

This report is intended for the use of the Governor, the Legislature, management, and all applicable federal entities from which federal financial assistance was received. However, this report is a matter of public record and its distribution is not limited.

Sincerely,



Lawrence F. Alwin, CPA
State Auditor

Our Compliments To 30 Agencies

We are pleased to report that 30 of the 57 entities we visited have no findings in the areas tested. Management at these entities have established systems to ensure compliance with the state, federal, and/or bond regulations we examined during our audit. (See *Index 1: Index Of Agencies* for a complete listing of the agencies visited during the 1994 Financial and Compliance Audit.)

While we recognize this accomplishment, it is important to understand that we may have only audited a very specific portion of the entity's operations. For that reason, the scope of our work must be considered in combination with the audit results. (See *Appendix 1: Audit Scopes For Agencies With No Findings.*)

AGENCY	TYPE OF WORK PERFORMED
Agricultural Finance Authority, Texas	Statutory
Armory Board, Texas National Guard	Bonds
Criminal Justice, Texas Department of	Bonds
East Texas State University	Bonds
General Land Office and Veteran's Land Board	Financial and Bonds
Hospital Equipment Financing Council, Texas	Bonds
Insurance, Texas Department of	Financial
Midwestern State University	Bonds
National Research Laboratory Commission, Texas	Bonds
Parks and Wildlife Department, Texas	Federal and Bonds
Public Finance Authority, Texas	Financial and Bonds
Stephen F. Austin State University	Bonds

Our Compliments

AGENCY	TYPE OF WORK PERFORMED
Texas A&M System Texas A&M System Administration & General Offices Texas A&M University	Bonds Financial
Texas State Technical College	Bonds
Texas State University System System Office Angelo State University Sam Houston State University Southwest Texas State University Sul Ross State University	Bonds
Texas Tech University	Bonds
Texas Tech University & Health Sciences Center	Bonds
Treasury Department, Texas State¹	Financial
University of Houston System Administration	Bonds
University of North Texas	Bonds
University of North Texas Health Science Center	Bonds
The University of Texas System Administration	Financial and Bonds
Water Development Board, Texas	Federal and Bonds
Water Finance Resource Authority, Texas	Statutory
Woman's University, Texas	Bonds

¹The Comptroller of Public Accounts' management letter includes a finding that affects the State Treasury Department. The issue relates to the development of a system to reconcile cash balances in the Uniform Statewide Accounting System (USAS) to records at the State Treasury Department and will require coordination between the two agencies.

Summary 1:

Description Of Issue Categories

This information describes the nature of the categories used in the "Summary Listing of All Issues by Agency and University" table presented on the following pages.

INTERNAL CONTROLS

<i>EDP Access Controls</i>	Access controls are designed to minimize the risk of unauthorized access, modification, and/or damage to electronic data processing (EDP) programs and data.
<i>Other EDP Issues</i>	Other electronic data processing (EDP) issues encompass a broad range of recommendations intended to protect computer equipment, programs, and data. This category includes issues relating to data input controls, physical security, and disaster recovery.
<i>Control Environment</i>	The control environment reflects the overall attitude, awareness, and actions of the board, management, and others concerning the importance of controls in the organization. Because the control environment affects, either directly or indirectly, all fiscal operations of the organization, a strong control environment is critical.
<i>Other Internal Controls</i>	Other issues were identified in the areas of timely and effective reconciliations, program oversight, accounting system controls, inventory controls, and effective communication of policies and procedures.

COMPLIANCE

<i>Bond Compliance</i>	Contractual promises within bond resolutions, known as covenants, set forth repayment schedules of principal and interest and other restrictions to protect the bondholders' investments. This category includes areas of noncompliance with bond covenants such as transferring interest and sinking funds on time and ensuring that the required revenues are sufficient to pay scheduled maturities of bonded debt.
<i>Federal Compliance</i>	There are many rules and regulations regarding the accountability and use of federal financial assistance. These rules are designed to ensure that federal funds are used without waste or abuse for the purposes intended. There are general requirements which are applicable to all federal funds and specific requirements which apply to individual programs.
<i>State Compliance</i>	One issue was identified in this category relating to compliance with state contracting laws.

ACCOUNTING AND REPORTING

***Accounting
& Reporting***

Accounting & Reporting includes issues that could impact the accuracy and completeness of the financial statements such as: improving the effectiveness of the Uniform Statewide Accounting System and ensuring the accuracy of the financial reporting entity.

Summary Listing Of All Issues By Agency And University

Agency	Page	Agency No.	SAO Report No.	INTERNAL CONTROLS			
				EDP Access Controls	Other EDP Issues	Control Environ-ment	Other
Aging, Texas Department on	34	340	5-061			1	2
Alcohol & Drug Abuse, Tx. Commission on	40	517	5-114			1	4
Attorney General, Office of the	53	302	5-109				3
Blind & Visually Impaired, Tx. Comm. for the	65	318	5-080				
Commerce, Texas Department of	68	465	5-066		1		
Comptroller of Public Accounts	71	304	5-119				2
Education Agency, Texas	75	701	5-102	1			1
Employment Commission, Texas	81	322	5-096				
General Services Commission	83	303	5-104		2	1	3
Governor, Office of the	97	301	5-044				
Health, Texas Department of	99	501	5-106	1	1		
Higher Education Coordinating Board, Tx.	102	781	5-086				
Human Services, Texas Department of	104	324	5-098			1	3
Lamar University System: Lamar - Beaumont	115	734	5-101				
Lamar University System: Lamar - Orange	122	787	5-101				
Lamar University System: Lamar - Port Arthur	124	788	5-101				
Mental Health & Mental Retardation, Tx. Dept. of	126	655	5-097	1	1		
Natural Resources Conservation Commission, Tx.	128	582	5-045	1			
Protective & Regulatory Services, Tx. Dept. of	132	530	5-099				2
Rehabilitation Commission, Texas	140	330	5-064				
Texas A&M University System: A&M Galveston	142	718	5-079				
Texas Southern University	146	717	5-103			1	1
Transportation, Texas Department of	149	601	5-091	2	1		1
University of Houston System: Univ. of Houston	155	730	5-094				
University of Houston System: UofH- Downtown	156	784	5-094				
University of Texas System: UT at Austin	160	721	5-085		1		
University of Texas System: UT at San Antonio	164	743	5-085	1		1	
TOTAL				7	7	6	22

Summary Listing Of All Issues By Agency And University

Agency	Page	Agency No.	SAO Report No.	COMPLIANCE			Accounting & Reporting	TOTALS
				Bonds	Federal	State		
Aging, Texas Department on	34	340	5-061		2		5	
Alcohol & Drug Abuse, Tx. Commission. on	40	517	5-114		4	1	10	
Attorney General, Office of the	53	302	5-109		4		7	
Blind & Visually Impaired, Tx. Comm. for the	65	318	5-080		2		2	
Commerce, Texas Department of	68	465	5-066		1		2	
Comptroller of Public Accounts	71	304	5-119			2	4	
Education Agency, Texas	75	701	5-102		3		5	
Employment Commission, Texas	81	322	5-096		1		1	
General Services Commission	83	303	5-104		7		13	
Governor, Office of the	97	301	5-044		1		1	
Health, Texas Department of	99	501	5-106		2		4	
Higher Education Coordinating Board, Tx.	102	781	5-086		1		1	
Human Services, Texas Department of	104	324	5-098		4		8	
Lamar University System: Lamar - Beaumont	115	734	5-101	1	8		9	
Lamar University System: Lamar - Orange	122	787	5-101		2		2	
Lamar University System: Lamar - Port Arthur	124	788	5-101		2		2	
Mental Health & Mental Retardation, Tx. Dept. of	126	655	5-097				2	
Natural Resources Conservation Commission, Tx.	128	582	5-045		2		3	
Protective & Regulatory Services, Tx. Dept. of	132	530	5-099		5		7	
Rehabilitation Commission, Texas	140	330	5-064		2		2	
Texas A&M University System: A&M Galveston	142	718	5-079		4		4	
Texas Southern University	146	717	5-103			1	3	
Transportation, Texas Department of	149	601	5-091		2		6	
University of Houston System: Univ. of Houston	155	730	5-094		2		2	
University of Houston System: UofH - Downtown	156	784	5-094		4		4	
University of Texas System: UT at Austin	160	721	5-085		4		5	
University of Texas System: UT at San Antonio	164	743	5-085		7		9	
TOTAL				1	76	1	3	123

Federal Issues By Agency And University

Agency	Page	Agency No.	SAO Report No.	GENERAL PROGRAM REQUIREMENTS		
				Accurate & Timely Reports	Cash Management	Other
Aging, Texas Department on	34	340	5-061	1	1	
Alcohol & Drug Abuse, Tx. Comm. on	40	517	5-114		1	
Attorney General, Office of the	53	302	5-109			
Blind & Visually Impaired, Tx. Comm. for the	65	318	5-080			1
Commerce, Texas Department of	68	465	5-066		1	
Education Agency, Texas	75	701	5-102	1		1
Employment Commission, Texas	81	322	5-096		1	
General Services Commission	83	303	5-104			1
Governor, Office of the	97	301	5-044			
Health, Texas Department of	99	501	5-106			
Higher Education Coordinating Board, Tx.	102	781	5-086			
Human Services, Texas Department of	104	324	5-098			1
Lamar University System: Lamar - Beaumont	115	734	5-101	1	1	1
Lamar University System: Lamar - Orange	122	787	5-101			
Lamar University System: Lamar - Port Arthur	124	788	5-101			
Natural Resources Conservation Commission, Tx.	128	582	5-045	1		1
Protective & Regulatory Services, Tx. Dept. of	132	530	5-099		1	
Rehabilitation Commission, Texas	140	330	5-064		1	1
Texas A&M University System: A&M Galveston	142	718	5-079	1	1	
Transportation, Texas Department of	149	601	5-091	1		1
University of Houston System: Univ. of Houston	155	730	5-094			
University of Houston System: UofH - Downtown	156	784	5-094			
University of Texas System: UT at Austin	160	721	5-085			
University of Texas System: UT at San Antonio	164	743	5-085			
TOTAL				6	8	8

Federal Issues By Agency And University

Agency	Page	Agency No.	SAO Report No.	SPECIFIC COMPLIANCE			TOTALS
				Subrecipient Monitoring	Student Financial Aid	Other	
Aging, Texas Department on	34	340	5-061				2
Alcohol & Drug Abuse, Tx. Comm. on	40	517	5-114	2		1	4
Attorney General, Office of the	53	302	5-109	1		3	4
Blind & Visually Impaired, Tx. Comm. for the	65	318	5-080	1			2
Commerce, Texas Department of	68	465	5-066				1
Education Agency, Texas	75	701	5-102	1			3
Employment Commission, Texas	81	322	5-096				1
General Services Commission	83	303	5-104	2		4	7
Governor, Office of the	97	301	5-044	1			1
Health, Texas Department of	99	501	5-106	1		1	2
Higher Education Coordinating Board, Tx.	102	781	5-086	1			1
Human Services, Texas Department of	104	324	5-098	1		2	4
Lamar University System: Lamar -Beaumont	115	734	5-101		5		8
Lamar University System: Lamar - Orange	122	787	5-101		2		2
Lamar University System: Lamar - Port Arthur	124	788	5-101		2		2
Natural Resources Conservation Commission, Tx.	128	582	5-045				2
Protective & Regulatory Services, Tx. Dept. of	132	530	5-099			4	5
Rehabilitation Commission, Texas	140	330	5-064				2
Texas A&M University System: A&M Galveston	142	718	5-079		2		4
Transportation, Texas Department of	149	601	5-091				2
University of Houston System: Univ. of Houston	155	730	5-094		2		2
University of Houston System: UofH - Downtown	156	784	5-094		4		4
University of Texas System: UT at Austin	160	721	5-085		4		4
University of Texas System: UT at San Antonio	164	743	5-085		7		7
TOTAL				11	28	15	76

Schedule 1:

**Schedule Of Major Federal Programs Examined
For The Year Ended August 31, 1994**

The information presented in this schedule identifies the agencies and universities at which major federal programs were examined by the State Auditor's Office. It is organized by Catalog of Federal Domestic Assistance (CFDA) number.

Schedule Of Major Federal Programs Examined				% of State's Total Fed. Expend.
CFDA	Program Title	State Agency or University	Expenditures	
10.550	Food Distribution	Texas Department of Human Services	\$58,674,710	0.38%
10.551	Food Stamps	Texas Department of Human Services	2,321,536,061	15.01%
10.553	School Breakfast Program	Texas Education Agency	109,575,151	0.71%
10.555	National School Lunch Programs	Texas Education Agency	411,077,039	2.66%
10.557	Special Supplemental Food Program for Women, Infants, and Children	Texas Department of Health	252,135,630	1.63%
10.558	Child Care Food Program and Adult Care Food Program	Texas Department of Human Services	110,107,895	0.71%
10.561	State Administrative Matching Grants for Food Stamp Program	Texas Department of Human Services	159,855,142	1.03%
12.000	Department of Defense Contract # N00039-91-C-0082	The University of Texas at Austin	42,574,696	0.28%
16.579	Drug Control and System Improvement - Formula Grant	Office of the Governor	25,664,216	0.17%
17.207	Employment Service	Texas Employment Commission	56,269,326	0.36%
17.225	Unemployment Insurance	Texas Employment Commission	409,915,073	2.65%

Federal Schedules

Schedule Of Major Federal Programs Examined				% of State's Total Fed. Expend.
CFDA	Program Title	State Agency or University	Expenditures	
17.246	Employment and Training Assistance - Dislocated Workers	Texas Department of Commerce	27,031,168	0.17%
17.250	Job Training Partnership Act	Texas Department of Commerce	173,050,572	1.12%
20.205	Highway Planning and Construction	Texas Department of Transportation	1,069,547,252	6.91%
N/A ²	Petroleum Violation Escrow Fund	General Services Commission	57,673,993	0.37%
66.458	Capitalization Grants for State Revolving Funds	Texas Water Development Board	124,153,832	0.80%
66.802	Hazardous Substance Response Trust Fund	Texas Natural Resource Conservation Commission	37,714,209	0.24%
81.049	Basic Energy Sciences - University & Science Education	The University of Texas at Austin	11,626,448	0.08%
84.010	Chapter 1 Grants - Local Education Agencies	Texas Education Agency	493,251,793	3.19%
84.011	Migrant Education - Basic State Formula Grant Program	Texas Education Agency	37,425,110	0.24%
84.027	Special Education - State Grants	Texas Education Agency	216,514,880	1.40%
84.032	Federal Family Education Loans	Lamar University - Beaumont	3,705,149	0.02%
		Lamar University - Port Arthur	16,473	0.00%
		Texas A&M Univ. - Galveston	1,614,922	0.01%
		Texas Higher Education Coordinating Board	27,152,769	0.18%
		Univ. of Houston - Downtown	2,790,287	0.02%
		The University of Texas at Austin	75,428,604	0.49%
		The University of Texas at San Antonio	14,969,064	0.10%

²Petroleum Violation Escrow funds received by the State as restitution relative to litigation involving violations of federal price controls are not federal funds but are subject to Office of Management and Budget (OMB) A-128 requirements and were audited as a major federal program.

Schedule Of Major Federal Programs Examined				% of State's Total Fed. Expend.
CFDA	Program Title	State Agency or University	Expenditures	
84.048	Vocational Education - Basic Grants to States	Texas Education Agency	125,986,614	0.81%
		Texas Higher Education Coordinating Board	36,034,742	0.23%
84.063	Pell Grant Program	Lamar University - Orange	619,035	0.00%
		Lamar University - Port Arthur	1,130,691	0.01%
		Texas A&M Univ. - Galveston	374,528	0.00%
		Univ. of Houston - Downtown	2,875,902	0.02%
		The University of Texas at Austin	10,055,765	0.07%
		The University of Texas at San Antonio	5,093,240	0.03%
84.126	Rehabilitation Services - Vocational Rehab. of State Grants	Texas Commission for the Blind & Visually Impaired	28,124,275	0.18%
		Texas Rehabilitation Commission	114,598,509	0.74%
84.151	Federal, State & Local Partnerships for Educational Improvement	Texas Education Agency	31,426,656	0.20%
84.164	Eisenhower Math & Science Educ. - State Grants	Texas Education Agency	16,782,787	0.11%
84.186	Drug-Free Schools and Communities - State Grants	Texas Education Agency	41,439,373	0.27%
93.045	Special Programs for the Aging - Title, III, Part C	Texas Department on Aging	23,107,136	0.15%
93.560	Family Support Payments to States - Assistance Payments (AFDC)	Texas Department of Human Services	489,426,940	3.16%
93.561	Job Opportunities and Basic Skills Training Program	Texas Department of Human Services	40,036,642	0.26%
93.563	Child Support Enforcement	Office of the Attorney General	97,234,858	0.63%

Federal Schedules

Schedule Of Major Federal Programs Examined				% of State's Total Fed. Expend.
CFDA	Program Title	State Agency or University	Expenditures	
93.575	Payments to States for Child Care Assistance	Texas Department of Human Services	71,706,206	0.46%
93.645	Child Welfare Services - State Grants	Texas Department of Protective and Regulatory Services	21,901,929	0.14%
93.658	Foster Care - Title IV-E	Texas Department of Protective and Regulatory Services	77,685,106	0.50%
93.667	Social Services Block Grant	Texas Department of Human Services	108,335,158	0.70%
		Texas Department of Protective and Regulatory Services	70,872,152	0.46%
93.777	State Survey & Certification of Health Care Providers & Suppliers	Texas Department of Human Services	23,214,966	0.15%
93.778	Medical Assistance Program	Texas Department of Health	3,743,591,960	24.20%
		Texas Department of Human Services	1,635,268,958	10.57%
93.802	Social Security - Disability Insurance	Texas Rehabilitation Commission	71,598,152	0.46%
93.959	Block Grants for Prevention and Treatment of Substance Abuse	Texas Commission on Alcohol and Drug Abuse	72,406,127	0.47%
93.994	Maternal and Child Health Services Block Grant	Texas Department of Health	53,435,137	0.35%
Subtotal: Major Federal Programs Examined			13,345,415,008	86.28%
Other Major Program Expenditures Covered By SAO Audit Procedures			668,454,328	4.32%
Major Programs Audited By External Auditors			145,643,145	0.94%
Total Major Federal Programs Examined			14,159,512,481	91.54%

Schedule 2:

Schedule Of Findings And Questioned Costs By Federal Agency For The Year Ended August 31, 1994

Under Office of Management and Budget (OMB) Circular A-128, all instances of noncompliance and any questioned costs are required to be reported. This schedule includes a detailed listing of all significant costs questioned as a result of the fiscal year 1994 statewide financial and compliance audit. Questioned costs are amounts charged to a federal program that may be unallowable. These costs result from noncompliance with general, specific or administrative requirements set by the federal grantor. The federal grantor will make the final determination as to the allowability of the costs. Unallowable costs may need to be returned to the federal grantor or program. Instances of insignificant noncompliance and questioned costs were communicated to the federal grantors separately.

The questioned costs are organized by federal granting agency and are also listed with the affected state agency or university. The findings in this schedule, which are identified with a Catalog of Federal Domestic Assistance (CFDA) number, are also included in the "Detailed Findings with Managements' Responses" section.

Schedule Of Findings And Questioned Costs By Federal Agency		
Program	Finding/Noncompliance	Questioned Costs
U.S. DEPARTMENT OF AGRICULTURE		
A. TEXAS DEPARTMENT OF HUMAN SERVICES		
Food Distribution Program (CFDA 10.550)	One of the program's subrecipients did not submit audit reports as required.	\$49,587
School Breakfast Program (CFDA 10.553)	Two of the program's subrecipients did not submit audit reports as required.	65,918
National School Lunch Program (CFDA 10.555)	Two of the program's subrecipients did not submit audit reports as required.	8,002
Child and Adult Care Food Program (CFDA 10.558)	Six of the program's subrecipients did not submit audit reports as required.	932,143
Summer Food Services Program for Children (CFDA 10.559)	One of the program's subrecipients did not submit audit reports as required.	1,926,499
	Inaccurate data resulted in misallocation of indirect costs for FY 1990 through 1993.	(7,440)
State Administrative Expenses for Child Nutrition (CFDA 10.560)	Inaccurate data resulted in misallocation of indirect costs for FY 1990 through FY 1993.	(163,618)

Federal Schedules

Schedule Of Findings And Questioned Costs By Federal Agency		
Program	Finding/Noncompliance	Questioned Costs
State Administrative Matching Grants for Food Stamps Program (10.561)	Inaccurate data resulted in misallocation of indirect costs for FY 1990 through FY 1993.	3,470,280
Temporary Emergency Food Assistance Program (CFDA 10.568)	Seven of the program's subrecipients did not submit audit reports as required.	965,168
Total U.S. Department of Agriculture		\$ 7,246,539
U.S. DEPARTMENT OF JUSTICE		
A. OFFICE OF THE GOVERNOR		
Drug Control and System Improvement - Formula Grant (CFDA 16.579)	Program's subrecipients did not submit audit reports as required.	2,187,405
Total U.S. Department of Justice		\$ 2,187,405
U.S. GENERAL SERVICES ADMINISTRATION		
A. GENERAL SERVICES COMMISSION		
Donation of Federal Surplus Personal Property (CFDA 39.003)	Program's subrecipients did not submit audit reports as required.	8,727,901
	Fifty-eight percent of the donees who received surplus property were ineligible to participate in the program	669,461
	Five subrecipients audit reports were not prepared in accordance with the Office of Management and Budget Circulars A-128 or A-133.	824,933
	Fifty percent of the donated property was not adequately monitored to ensure proper use by donees.	50,273
	Surplus property was donated to donees who had not submitted debarment and suspension certification.	44,895
	Surplus property to be auctioned was lost or stolen.	26,070
Total U.S. General Services Commission		\$ 10,343,533

Schedule Of Findings And Questioned Costs By Federal Agency

Program	Finding/Noncompliance	Questioned Costs
U.S. DEPARTMENT OF EDUCATION		
A. LAMAR UNIVERSITY - BEAUMONT		
Student Support Services (CFDA 84.042)	Relates to disbursements for unallowable expenditures.	799
	Relates to disbursements made for inappropriate expenditures.	926
Jacob K. Javits Gifted & Talented Students Education Grant Program (CFDA 84.206)	Relates to disbursements for unallowable expenditures.	885
	Relates to disbursements made for inappropriate expenditures.	8,905
B. TEXAS COMMISSION FOR THE BLIND AND VISUALLY IMPAIRED		
Rehabilitation Services - Basic Support Program (CFDA 84.126)	Program's subrecipients did not submit audit reports as required.	1,366,332
C. OFFICE OF THE ATTORNEY GENERAL		
Child Support Enforcement Program (CFDA 93.563)	One of the program's subrecipients did not submit audit reports as required.	44,756
Total U.S. Department of Education		\$ 1,422,603
U.S. DEPARTMENT HEALTH AND HUMAN SERVICES		
A. TEXAS DEPARTMENT OF HUMAN SERVICES		
Work Incentive Demonstration Program and Administration (CFDA 93.029)	Inaccurate data resulted in misallocation of indirect costs for FY 1990 through 1993.	(19,032)
Family Support Payments to States Program (AFDC) (CFDA 93.560)	Inaccurate data resulted in misallocation of indirect costs for FY 1990 through 1993.	159,132

Federal Schedules

Schedule Of Findings And Questioned Costs By Federal Agency

Program	Finding/Noncompliance	Questioned Costs
	Federal audit recommendations regarding uncashed checks have not been implemented	824,000
Job Opportunities and Basic Skills Program (CFDA 93.561)	Inaccurate data resulted in misallocation of indirect costs for FY 1990 through 1993.	(508,659)
Refugee and Entrant Assistance - State Administered Program (CFDA 93.566)	Inaccurate data resulted in misallocation of indirect costs for FY 1990 through 1993.	(244,637)
Low Income Home Energy Assistance (CFDA 93.568)	Inaccurate data resulted in misallocation of indirect costs for FY 1990 through 1993.	54,341
Child Care - Families At-Risk of Welfare Dependency (CFDA 93.574)	Inaccurate data resulted in misallocation of indirect costs for FY 1990 through 1993.	(5,335)
Payments to States for Child Care Assistance (CFDA 93.575)	Inaccurate data resulted in misallocation of indirect costs for FY 1990 through 1993.	(58,999)
Child Welfare Services - State Grants (CFDA 93.645)	Inaccurate data resulted in misallocation of indirect costs for FY 1990 through 1993.	(257)
Foster Care - Title IV-E Program (CFDA 93.658)	Inaccurate data resulted in misallocation of indirect costs for FY 1990 through 1993.	(93,215)
Adoption Assistance Program (CFDA 93.659)	Inaccurate data resulted in misallocation of indirect costs for FY 1990 through 1993.	(4,191)
Social Services Block Grant (CFDA 93.667)	Inaccurate data resulted in misallocation of indirect costs for FY 1990 through 1993.	(2,550,412)
State Survey and Certification of Health Care Providers and Suppliers (CFDA 93.777)	Transposition errors occurred in the Quarterly Expenditures Report for the quarter ended June 30, 1994.	(44,291)
Medical Assistance Program (CFDA 93.778)	Inaccurate data resulted in misallocation of indirect costs for FY 1990 through 1993.	(2,804,505)
	Federal Audit Recommendations regarding uncashed checks have not been implemented.	not quantified

Schedule Of Findings And Questioned Costs By Federal Agency

Program	Finding/Noncompliance	Questioned Costs
B. TEXAS DEPARTMENT OF PROTECTIVE & REGULATORY SERVICES		
Child Welfare Services (CFDA 93.645)	Funds were used to pay for services provided to ten clients without sufficient documentation of eligibility for these services.	6,594
Foster Care - Title IV E Program (CFDA 93.658)	Income credits were not properly allocated.	328,848
	The Department did not adjust the federal claim report for questioned costs identified in the fiscal year 1993 Statewide and Financial Compliance audit.	44,000
C. TEXAS COMMISSION ON ALCOHOL AND DRUG ABUSE		
Prevention and Treatment of Substance Abuse Block Grant Program (CFDA 93.959)	Inadequate administrative controls over contract monitoring and rate setting contributed to two contractors having insufficient cost documentation and inaccurate cost information.	3,131,140
Total U.S. Department of Health and Human Services		(1,785,478)
TOTAL QUESTIONED COSTS - ALL AGENCIES		\$ 19,348,270

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 (CFDA 93.045).
- 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.

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.

Overall Conclusion

A material weakness exists in the control environment over the Commission's administration of state and federal grants. This material weakness is indicated by the type and number of problems identified in this report, including the following:

- material weakness in administrative controls for the *Prevention and Treatment of Substance Abuse Block Grant* (CFDA 93.959)
- significant misstatement of assets and failure to disclose liability information in a note to the financial statements
- ineffective controls over the contracting process, including monitoring, obtaining audits, and audit resolution

Although known weaknesses in the administration of \$160 million in state and federal grants were not corrected during fiscal year 1994, the Commission has indicated a commitment to correct the problems.

Related Reports

Related reports on the Commission issued by the State Auditor's Office address the lack of financial monitoring of service providers and the deficiency of controls over developing and setting the rates that are paid to service providers. (See SAO Report Numbers 95-007 and 95-022.) The findings in these reports impact the *Prevention and Treatment of Substance Abuse Block Grant* (CFDA 93.959) and the *Alcohol and Drug and Mental Health Services Block Grant* (CFDA 93.992).

Material Weakness in the Control Environment

The type and number of problems identified in this report indicate a material weakness in the control environment over the Commission's administration of state and federal grants. 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), irregularities (intentional improprieties), and noncompliance 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:

Improve Administrative Controls Over Federal Programs

Material weaknesses were identified in the administrative controls over contract monitoring and rate setting for the *Prevention and Treatment of Substance Abuse Block Grant Program* (CFDA 93.959) and the *Alcohol and Drug Abuse and Mental Health Services Block Grant Program* (CFDA 93.992). The Commission did not require contractors to have independent financial and compliance audits prior to state fiscal year 1994. Also, the Commission has not developed and maintained a documented rate setting methodology nor does the Commission verify the accuracy of contractor cost reports. As a result, material noncompliance with federal regulations could exist.

Two contractors received acceptable program reviews from the Commission's Program Monitoring Division; however, financial field audits by the Commission's Audit Department resulted in questioned costs totaling \$3.1 million. These contractors received approximately four percent of the \$159 million of the federal funds expended in a two-year period audited by the Commission.

Federal regulations require the establishment of appropriate administrative controls to ensure that federal funds are expended for intended purposes.

Recommendation: The Commission should improve administrative controls over contract monitoring and rate setting as follows:

- Require annual financial and compliance audits of contractors by independent auditors.
- Develop a formal documented methodology for use in determining, evaluating, and revising rates paid to contractors.
- Establish procedures to ensure that information contained in the cost reports is reasonable and accurate.

Management's Response: *Management concurs with the State Auditor's recommendations.*

The Commission has already begun rewriting its auditing policies and procedures. In addition, the auditing staff has been increased from FY 1994 levels to oversee grants and contracts. Field surveys and prevention methods have been incorporated into TCADA normal business operations. Also, beginning in FY 1994, all contractors were required to have an audit performed by an independent CPA.

The Commission is also reviewing options to develop procedures and processes for documenting a methodology for rate setting and for ensuring the reasonableness and accuracy of information contained in cost reports. After the conclusion of current discussions with the internal auditors, and other state agencies, the Commission will

establish a new procedure and process for rate methodology and review of cost reports. Procedures will be in place and implemented by September 1, 1995.

Funding and Program Management Division and the Administrative Services Division is responsible for ensuring that corrective actions are taken. Management believes that these corrective actions will limit any possible material noncompliance with federal regulations.

Internal Control Issue 2:

Establish Controls To Identify And Take Action On High-Risk Service Providers

The Commission does not have controls to identify high-risk service providers and continues to employ the services of those with control structure and program deficiencies. Additionally, the Commission lacks an effective means to secure corrective action from service providers due to ineffective communication between departments. The lack of controls and coordination between the departments jeopardizes the performance of the Commission's programs, which are funded by the Federal Government and the State. Service providers were awarded \$150.1 million in federal and state funds during fiscal year 1994.

In 1993, a service provider was funded more than \$200,000 despite repeated and uncorrected deficiencies identified during Commission monitoring visits and single audit reports for 1990 and 1991. Several of the Commission's departments were aware that the service provider had significant problems. These problems included a continual lack of internal controls and corrective actions on reported deficiencies and program eligibility violations.

The same service provider currently owes more than \$9,000 of unallowable costs from fiscal year 1991. These unallowable costs are from a grant that includes funding from both the *Prevention and Treatment of Substance Abuse Block Grant* (CFDA 93.959) and General Revenue Funds.

Statement of Position 92-7, Audits of State and Local Governmental Entities Receiving Federal Financial Assistance requires the Commission to determine whether service providers spend federal financial assistance funds in accordance with applicable laws and regulations. The Commission must also ensure that service providers receiving federal funds meet all eligibility and audit requirements.

Recommendation: The Commission should establish controls to identify and take action on high-risk service providers. The procedures to be developed should determine the overall status of a service provider. This can be accomplished by combining the results and the status of corrective action for Commission monitoring visits and independent auditor reports. In addition, the procedures should provide for effective communication and coordination between departments. Furthermore, the Commission should ensure that unallowed costs are recovered before providing additional funds to a service provider.

Management's Response: *Management concurs with the State Auditor's recommendations.*

Controls are currently being developed that will identify and take actions on high-risk service providers. The Commission agrees that in the past interdepartmental communication has been lacking. To correct this deficiency, a comprehensive report be issued annually for each service provider. This report will include functional reports from the Facility Licensure Department, Investigations Department, and Auditing Department, both field audit reports and desk audit reports, and reports from TCADA functions that are responsible for developing and supporting new programs.

Individual functions reports will be issued as work is performed. Copies of these reports will be placed in the unique service provider file and monitored. The findings on all reports will be followed-up and resolved.

The Program Compliance Division is taking over the program audit function and integrating it with licensure and investigations. The goal is to develop cross-functional work teams to monitor and inspect all licensed or funded programs, eliminating the need to merge information from separate departments. New program audit procedures emphasize outcome instead of process indicators, which will allow the agency to use past performance as a key factor in future funding decisions.

The monitoring of the unique service provider file will include all reports to TCADA being filed timely, identifying any unresolved programmatic and/or financial issues, and a periodic summary of the financial and programmatic operations of the service provider. This process will allow TCADA to identify and take corrective action on high-risk service providers.

All required action will be in place by August 31, 1995.

The Program Compliance Division will have lead responsibility, assisted by the Administrative Services Division, for ensuring that corrective action is taken.

Internal Control Issue 3:

Establish Audit Resolution Procedures

The Commission has not established adequate audit resolution procedures for findings identified in their financial field audits. The following are examples of deficiencies identified:

- Refunds to federal grants have not been identified and appropriately returned. Also, a methodology to allocate questioned costs to the appropriate funding source has not been developed.
- A refund of all known questioned costs for one audit was not requested. Negotiations

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reduced \$2 million in known questioned costs to \$1 million without considering federal liability or state laws.

- The Commission waited 34 days before notifying a contractor of noncompliance with the Agreed Administrative Order and requesting corrective action.
- An audit follow-up of a contractor has not been completed although it has been ten months since the Commission issued its findings.

Without an effective audit resolution process, federal funds are not available for their intended use. Also, the Commission may be required to repay the Federal Government for unresolved questioned costs.

Federal regulations require the Commission to establish audit resolution procedures and return known unallowed costs to the federal grantor. Although a resolution period has not been defined for contractors, federal regulations have established a six-month period as a reasonable period for resolution of subrecipient audit findings.

Recommendation: The Commission should establish effective audit resolution procedures. These procedures should ensure that all unallowed federal costs are identified by funding source and immediately returned to the federal grantor without negotiation of the known questioned costs. The Commission should immediately notify and request corrective action from contractors when they are not in compliance with the Agreed Administrative Orders. Additionally, the Commission should ensure resolution of contractor audit findings within a reasonable time frame, such as six months.

Management's Response: *Management concurs with the State Auditor's recommendations.*

A revised policy is being staffed to redesign the appeals process. The State Office of Administrative Hearings will replace the Audit Review Board in order to ensure resolution of contractor audit findings within a reasonable period. This redesigned process is expected to be completed no later than March 31, 1995, to be presented to the Board by General Counsel on April 10, 1995.

Because of the new management structure, the Assistant Deputy Director for Program Compliance felt it prudent to study the audit related issues and Agreed Order with Austin Rehabilitation Center to ensure appropriateness, which resulted in a necessary delay of implementation. As of this date, Austin Rehabilitation Center is functioning in compliance with the Agreed Order. With the new cease and desist function and added staff in the Program Compliance Office, there will be two points of oversight. Austin Rehabilitation Center will have a follow-up done as part of TCADA's ongoing provider monitoring process.

The Administrative Services Division has lead responsibility, with assistance from the Program Compliance Division, for ensuring corrective action is taken.

Internal Control Issue 4:

Improve Supporting Documentation

Adequate documentation of compliance with specific federal program requirements and other federal regulations was not readily available at the Commission. Documentation supporting percentages used to calculate the amounts expended on categories of services required by the grants, calculations related to cash management, and information on subrecipients of Block Grant funds was either not readily available or had to be recreated. Documentation was not available to accurately determine the portion of the *Prevention and Treatment of Substance Abuse Block Grant* (CFDA 93.959) set aside to provide HIV services.

The lack of current documentation could result in errors and questioned costs that must be returned to the grantor.

Generally, federal guidelines require at least three years of documentation to be maintained. Additionally, adequate documentation provides the Commission with the information necessary to ensure that expenditures are appropriate.

Recommendation: We recommend that the Commission develop procedures that ensure adequate supporting documentation is maintained to comply with federal regulations.

Management's Response: *Management concurs with the State Auditor's recommendations.*

The percentages of clients diagnosed as either drug or alcohol abusers were supplied by the Research Department. Documentation to support data from the Research Department was taken from CODAP (Client Oriented Data Acquisition Process).

The agency concurs that supporting documentation was not readily available. Each record in CODAP can be verified by the source documentation used for data entry. Procedures for retrieving, preparing, maintaining and presenting coherent supporting documentation for support of all calculations are in the process of begin developed. In Fiscal Year 1992 and Fiscal Year 1993, procedures were not developed, and in place, to adequately document methodology for determining Female Service calculations. The agency concurs that supporting documentation was inadequate. A documentation methodology has been developed for Female Services for Fiscal Year 1995 and source documentation is currently being maintained.

Documentation procedures were inadequate to support the HIV set-aside calculations. Limited documentation was available and provided. Previous methods of HIV Early Intervention funding have been addressed and changed for Fiscal year 1995. The new funding changes will more accurately define and identify HIV Services. These new changes are being properly documented and maintained.

The identification of Block Grant subrecipients will be maintained by the Director of Budget and Management Services. All sub-recipients will be entered into the Uniform Statewide Accounting System for better tracking of contractor expenditures.

Documentation concerning cash management is addressed in the cash management finding.

In summary, procedures for retrieving, preparing, maintaining and presenting coherent supporting documentation for support of all calculations will be developed by an independent contractor and supported by in-house staff. These procedures will be in place by August 31, 1995.

The Budget and Management Services Department is responsible for ensuring corrective action is taken.

Federal Compliance Issues

The Commission's most significant federal program is the *Prevention and Treatment of Substance Abuse Block Grant* (CFDA 93.959). The Block Grant was revised for federal fiscal year 1993 and thereafter. The former name was *Alcohol and Drug Abuse and Mental Health Services Block Grant* (CFDA 93.992). Expenditures under both grants were incurred during fiscal year 1994.

We tested 20 of approximately 6,199 payments made during fiscal year 1994. The selected payments accounted for \$571,000 of the \$72.4 million in block grant expenditures.

Recommendations addressed in other sections of this report will impact controls over the Commission's federal programs. The following comments address federal compliance issues developed as a result of audit procedures completed.

Federal Compliance Issue 1:

Fully Comply With Independent Peer Review Requirements

The Commission did not perform independent peer reviews of funded treatment programs as required by the federal fiscal year 1993 *Prevention and Treatment Substance Abuse Block Grant* (CFDA 93.959). Funded programs were not reviewed to assess the efficacy, quality, and appropriateness of treatment services provided to alcohol and substance abusers in Texas.

The Commission is required to have an independent review of at least five percent of the entities that it funds to provide treatment services. The entities reviewed must be representative of all the entities that the Commission utilizes to provide treatment services. Noncompliance may result in the loss of federal funds.

Recommendation: We recommend that the Commission develop and implement a process to perform independent peer reviews of funded entities that provide treatment services during the grant award period. The process that is developed should enable the

Commission to assess the efficacy, quality, and appropriateness of treatment services provided to Texans.

Management's Response: *Management concurs with the State Auditor's recommendations.*

The Commission maintains that the peer review of applications provides valuable information towards identifying the efficacy, quality and appropriateness of treatment services provided to clients. However, the Commission has obtained a copy of the peer review model developed by the Commonwealth of Massachusetts. That process is based on continuous quality improvement and focuses on quality, inclusiveness, customer ownership and is data and outcome driven. The Commission has decided to use the Massachusetts model to be implemented at a more appropriate level which will meet Texas' needs, today. During this fiscal year (FY 1995), the Commission will recruit peer reviewers from Texas' provider base, develop a plan which includes training of peer reviewers, identify which programs will be reviewed and conduct peer review visits. The visits will focus on utilization management. The peer review process will include a review of client assessments, treatment plans, referral systems in place and client interviews to adequately verify client outcomes. Commission staff will play a role in the visits and utilize the data obtained to enhance or change or system.

Texas is in the process of embarking on a managed care plan for substance abuse services (formerly known as C.O.R.E.) and this baseline review will provide the state with valuable information for methods of utilization management to pursue and to continue constructing a more effective treatment system for the future.

The process of recruiting peer reviewers, planning and training began March 1, 1995. The Commission plans to have peer reviewers in the field by June 1, 1995. At least 5% of the programs funded with SAPT Block Grant funds will be visited by August 31, 1995 in accordance with the requirement.

During subsequent years, the Commission will compare and combine utilization management information obtained through the peer review process with utilization management information obtained by TCADA to assess efficacy, quality, and appropriateness of treatment services provided to Texans.

Funding and Program Management Division has lead responsibility, with assistance from Quality and Technical Services Division, for implementing the peer review process.

Federal Compliance Issue 2:

Identify All Subrecipients Who Should Submit Audit Reports

The current system at the Commission may not properly identify all subrecipients who should be submitting audit reports. Discrepancies exist in subrecipient

expenditures recorded within the Commission. As a result, subrecipients may not be properly identified.

Office of Management and Budget (OMB) Circular A-128 requires the Commission to review the audit reports for all subrecipients that receive at least \$25,000 in federal funds in a fiscal year. Noncompliance could cause the loss of federal funds.

Recommendation: The Commission should develop a more accurate process to identify all subrecipients that receive federal grants greater than \$25,000 in a fiscal year. This listing should be utilized to ensure that audit reports are received from all of the applicable subrecipients.

Management's Response: *Management concurs with the State Auditor's recommendation.*

TCADA is in the process of developing an integrated computerized system to meet the needs of the agency. The purpose of the system would be to provide standardized information throughout the various departments on a need-to-know basis. To ensure reliability, the system would be reconciled to the USAS on a monthly basis. The new system would have the ability to provide ad hoc reports and standardized reports on demand. One standardized report will identify all of the subrecipients who should submit an audit report and the date the audit report should be submitted. This system will be in place by September 1, 1995.

The Budget and Management Services Department has lead responsibility, assisted by the Administrative Services Division, for ensuring that corrective action is taken.

Federal Compliance Issue 3:

Ensure Corrective Action Of Subrecipient Audit Findings Within The Required Time Frame

(Prior Audit Issue)

The Commission does not ensure that all subrecipient audit reports are reviewed and that necessary corrective action is taken within six months after receipt. Three of the 18 audit reports tested for the *Prevention and Treatment of Substance Abuse Block Grant* (CFDA 93.959) contained findings. Corrective actions for these audit reports were not obtained as required.

Noncompliance with this requirement could result in questioned costs and the return of funds to the grantor.

Office of Management and Budget (OMB) Circular A-128 requires that the Commission review the audit reports for adequacy and determine whether subrecipients take corrective action within six months of report receipt.

Recommendation: The Commission should review all subrecipient audit reports and ensure that corrective action is taken on all subrecipient audit findings within six months.

Management's Response: *Management concurs with the State Auditor's recommendations.*

An audit follow-up policy and procedures regulation is being drafted and weekly management reports are being implemented to monitor corrective action from audit findings. The policy will be put in place by May 31, 1995.

The Administrative Services Division is responsible for ensuring corrective action is taken.

Federal Compliance Issue 4:

Revise Cash Management Procedures

The Commission does not have adequate cash management procedures in place for the *Prevention and Treatment of Substance Abuse Block Grant Program* (CFDA 93.959). The Commission does not monitor the overall cash needs for the block grant. As a result, insufficient federal funds were requested, which caused negative daily cash balances up to \$1.2 million. Other Commission funds were used to cover expenditures for the block grant.

The Commission had negative cash balances for 15 of 22 state working days tested. The remaining seven days had positive cash balances due to the Commission requesting funds to cover the payroll as required by state law. *Title 31 of the Code of Federal Regulations (CFR), part 205.7(d)* states that the Commission will limit the request for federal funds to the minimum amount required to meet actual, immediate cash needs.

Recommendation: The Commission should revise its cash management procedures. Federal funds requests should be determined using cash balances for the federal program and current cash disbursements. This will help ensure that sufficient funds are requested for immediate cash needs.

Additionally, we recommend the Commission temporarily borrow General Revenue Funds to cover payroll costs (*Texas Government Code, section 403.092 (2)*). The Commission should make arrangements with the Comptroller of Public Accounts to initiate this transaction.

Management's Response: *Management concurs with the State Auditor's recommendations.*

This process has begun. Overall cash needs are monitored on a daily basis by the cash manager. Funds requested for each federal award are determined by immediate cash disbursement needs for the award program, while at the same time taking into account

any refunds returned to the Commission. This ensures that the amount of federal funds requested is minimized to meet actual cash needs. A report is prepared daily to support draws for all vouchers processed through the Grants and Contracts system. In addition, all documents affecting cash (revenues, operating expenditures, refunds, expenditure transfers) flow through the cash manager so that cash balances and available award balances can be accurately maintained and monitored. Documentation on all draws and source documents supporting the draws are maintained in the cash management office and are readily available for inspection (see Audit Comment #5).

The commission concurs with the recommendation to temporarily borrow general revenue funds to cover payroll costs and thus avoid a cash-on-hand issue. Procedures have been implemented for the February 1995 pay period, and federal funds will be drawn prior to the first of each month to repay the general revenue fund on payday.

Corrective action has been taken as of March 9, 1995. The Administrative Services Division was responsible for ensuring that corrective action was taken.

Accounting And Reporting Issue

Accounting and Reporting Issue 1:

Comply With The Financial Reporting Requirements

The Commission's annual financial report is not accurate and complete. A receivable from a service provider totaling \$1,087,895 was not included in the Commission's 1994 Annual Financial Report. Also, the amount of federal questioned costs and amounts due to the State that resulted from this financial field audit were not determined, recorded as a liability on the financial statements, or disclosed in the Notes to the Financial Statements.

The unaudited financial report of the Commission was not issued in accordance with the State Comptroller's annual financial reporting requirements. Errors in reporting may cause users of the financial information to make decisions based on inaccurate data.

The Commission is required to prepare its annual financial report in conformity with the guidelines established by the Comptroller's Office.

Recommendation: The Commission should amend its 1994 Annual Financial Report to comply with the State Comptroller's reporting requirements.

Management's Response: *Management concurs with the State Auditor's recommendations.*

Although the agreed order with Austin Rehabilitation Center (ARC) to repay questioned costs sets up the potential for an accounts receivable, sufficient doubt exists that the receivable will be collected in full. Generally accepted accounting principles call for a conservative approach to accruing receivable because of the potential of misleading

financial statements caused by inflating revenues or, in this case, deflating expenditures. Consequently, any receivable should be offset with an allowance for uncollectible accounts receivable, a contra-asset valuation account showing the portion of accounts receivable not expected to be collected, in an amount sufficient to ensure that only the collectible portion remains as an accrual.

Since the financial condition of ARC and the existing real estate market creates doubt that any of the receivable will be paid, the conservative approach would be to offset the entire amount of the accounts receivable with an allowance for uncollectible accounts receivable, leaving a net accounts receivable balance of zero. Although this presentation is preferable to omission of both the accounts receivable and allowances for uncollectible accounts receivable, either presentation fairly represents the amount the agency is actually expected to realize. Users of the financial information would have been misled if the net receivable had been overstated, and the difference in presentation does not mean the data is inaccurate.

A contingent liability, requiring only a note disclosure, would have been made if there appeared to be a future potential for liability in existence as of the balance sheet date. An actual accrual in the financial statements would have been made if, at the time of presentation, a liability existed as of the balance sheet date.

From the information available and all analysis conducted up to the date the Annual Financial Report was submitted on November 29, 1994, the agency's position was that the money due back to TCADA from ARC was funded by General Revenue and thus no potential liability to the federal government existed, either as a liability or a contingent liability. Based on all information available on the submission date, the presentation was correct in accordance with generally accepted accounting principles and the Comptroller's reporting requirements.

Only after the AFR was submitted did discussions result in a more in-depth analysis of the agreement of ARC and the funds involved, revealing at that point the possibility that some amount would be due back to the federal government. The Commission intends to amend its 1994 AFR if it determines a material understatement of its liabilities has been made as a result of refunds due the federal government from the audit of the Austin Rehabilitation Center. This determination, which will involve both the Auditing Department and the Grants and Contracts Department, should be completed by the end of March. If an amendment is necessary to restate the liabilities, the Commission will also amend the presentation of the asset side of the balance sheet, disclosing an accounts receivable offset with an approximately valued allowances for uncollectible accounts receivable. The amended report, which will be prepared by the Fiscal Services Department, should be completed by April 30, 1995.

The Commission will also set up procedures by March 31, 1995 to ensure that the Fiscal Services Department, the department responsible for the preparation of the AFR, is notified of final audit findings so that accounts receivable and/or payable may be set up on the agency's books of record at the point of determination. That will allow for ongoing tracking of accounts receivable, payout agreements, and remaining balances

so these items can be reported on accurately at any time. separate procedures will be implemented for returning refunds of federal monies to the federal government.

The Administrative Services Division is responsible for ensuring corrective action is taken.

Audit Scope

The primary focus of our audit was the Commission's financial and administrative controls over prevention and treatment programs for alcohol and substance abuse in the State. We gained an understanding of the internal control structure, including the general control environment, as well as controls over the federal programs.

Specific procedures were used to test compliance with the major federal program, *Substance Abuse Prevention Treatment Block Grant* (CFDA 93.959) and *Alcohol and Drug Abuse and Mental Health Services Block Grant* (CFDA 93.992) for federal fiscal years 1993 and 1992, respectively. The Commission incurred expenditures and disbursements for the two block grants totaling \$72.4 million during fiscal year 1994.

Overall Conclusion

The Office of the Attorney General has not fully complied with all federal requirements related to the *Child Support Enforcement Program*. Control weaknesses were noted in the child support collection/distribution functions and cash reconciliation processes. In addition, we noted compliance exceptions not exceeding an 11.6 percent error rate affecting case file processing.

The agency has not properly accounted for all transactions, cleared old reconciling items, and reported the Child Support Enforcement Trust Fund's cash position. Unresolved reconciling items totaled over \$1.9 million as of October 1994. This amount consists mainly of \$1.2 million in unrecovered overpayments to custodial parents over the past 20 years. However, offsets of daily deposits, returned warrants, and suspense items prevent the Trust Fund from being overdrawn. Over \$406.4 million flowed through the child support system during fiscal year 1994.

Continued delays in the implementation of the new Texas Child Support Enforcement System (TXCSES) decrease the agency's ability to effectively address conditions identified in this report. Current plans are for the system to be operational by October 1995. Management is relying on TXCSES to help resolve most of the outstanding issues. Four of the findings in this report have been outstanding since 1991.

Related Report

The federal Office of Child Support Enforcement, Division of Audit, recently reported on the results of its audit of the *Child Support Enforcement Program* for the period January 1, 1992 through December 31, 1992. The findings and recommendations are addressed in a report titled "Program Results/Performance Measurements Audit, State of Texas, Report No. TX-93-PR/PM."

Internal Control Issues

Internal Control Issue 1:

Take Action To Accurately Reflect Cash Position In The Child Support Enforcement Program Trust Fund

The Office of the Attorney General has not taken action to properly account for all transactions, clear old reconciling items, or ensure accurate information about its cash position in the Child Support Enforcement Trust Fund (Trust Fund). This results in a deficit of over \$1.9 million as of October 31, 1994, which is not reflected in the accounting records. Over \$1.2 million of the total fund deficit represents a 20-year accumulation of child support collections overpaid to custodial parents. The Trust Fund's purpose is to receive child support payments and distribute them to the custodial parents.

Although the cash reconciliation identifies the deficit amount, the Trust Fund does not report a negative cash balance on the accounting records. The deficit fund balance is offset by daily

deposits, returned warrants, and suspense items which prevent the Trust Fund from being overdrawn. During fiscal year 1994, over \$406.4 million flowed through the system for the *Child Support Enforcement Program* (CFDA 93.563).

The specific conditions and effects related to the deficit are as follows:

- Unrecovered overpayment to custodial parents that are made from the Trust Fund are not reimbursed by the operating funds for the *Child Support Enforcement Program*. These actions result in using undisbursed funds to cover overpayments and refunds.

Overpayments and refunds usually result from the situations discussed below:

- Some IRS refunds intercepted from the non-custodial parent for payment of delinquent child support obligations resulted in overpayment to the custodial parent. A portion of these refunds should have been returned to the non-custodial parent after the delinquency was satisfied, or to the Federal Government due to amended tax returns.
- Non-custodial parents paid child support with checks, which were later returned by the bank for non-sufficient funds. These payments were deposited into the State Treasury, and warrants for the child support payments had already been sent to the custodial parents when the "bad" checks were identified.
- Calculation errors in arrearage balances, coding errors, mailing errors, and employers' failure to modify wage withholding amounts also results in overpayments and refunds.
- Items identified in the reconciliation process are not disposed of in a timely manner. For example, \$126,663 of warrants voided by the State Treasury in fiscal year 1989 still appear as a reconciling item. The agency has not taken action on this item, which would reduce the deficit amount.
- The data bases that track voided and canceled warrants and undisbursed child support collections are not accurate. Policies and procedures are not consistently followed to maintain the accuracy of the databases. Without accurate information, the actual cash position of the Trust Fund cannot be precisely determined.

The deficit balance was identified by the agency's Internal Audit Department in October 1991 (Report #IA91-45). In February 1994, the retained collections¹ amount in the Trust Fund designated for transfer to the General Fund was decreased by \$44,729 in order to reduce part of the Trust Fund deficit. This amount was netted against the designated transfer, resulting in a reduction of the State's share of operating funds. The \$44,729 was not appropriately recorded on the accounting records.

Recommendation: We recommend that management take action to accurately reflect the cash position and reduce the fund deficit in the Child Support Enforcement Trust Fund by:

- Allocating operating funds to reduce the fund deficit and recognizing this expense through the use of proper accounting entries.
- Resolving old reconciling items and establishing procedures to ensure that all reconciling items are disposed of in a timely manner.
- Reviewing the subsidiary ledger data bases for accuracy and ensuring that established policies and procedures are followed to improve the accuracy of these amounts.

These actions should be taken in conjunction with the implementation of the new child support automated system to help ensure the accuracy of information in the new system. The Internal Audit Department, which brought the issue of the deficit to the attention of management in its October 1991 report, should work with Child Support personnel to resolve this and remaining issues. Management should monitor actions taken to resolve the fund deficit and related conditions.

Management's Response: The Child Support Enforcement Trust Fund is solvent. The fund does not have a cash or fund balance deficit. Over the last ten years, the fund distributed nearly \$2.0 billion to custodial parents. Most of the \$1.9 million in the audit finding stems from IRS offsets of tax refunds to non-custodial parents.

The IRS intercept program created recoupment problems when amended federal tax returns resulted in a reduction of payments from the federal government after funds had been disbursed to the custodial parent. The federal government withholds such amounts from subsequent offset payments to the State without prior notice.

The OAG will ensure that reconciling items are disposed of in a timely manner. The OAG Collections and Distribution Section has verified, by warrant, the information on voided and canceled warrants in the PC database. The Section has policies and procedures in place to reconcile this database daily until TXCSES implementation, at which time the function becomes on-line.

Collections and distribution initiated and worked with New System staff to design an on-line warrant tracking system that will eliminate problems associated with the PC-based tracking system. TXCSES's returned warrants design will record, track, reconcile, balance to the vault, and automatically cancel warrants. It will also report and balance to the general ledger, reissue warrants, and track returned warrants for abandoned property reporting. The design for the returned warrants function has been completed and is now in New System test. Collections and Distribution will keep all warrants reconciled on a manual basis until TXCSES is implemented.

The \$44,729 "write-off" mentioned in the finding was recorded in the agency's general ledger according to the existing agency policies and procedures related to the bad debt. The entry established the accounts receivable and offset the bad debt to the state share. Representatives of the OAG and the SAO have already met and discussed a more definitive method for recording these transactions, and the agency will implement new processes in conjunction with TXCSES implementation. Although the entries will result in more detailed accounting

transactions, the net effect on the state's share of operating funds and the Child Support Trust Fund will be the same.

Internal Control Issue 2:

Reconcile Monthly Collections To Distributions

(Prior Audit Issue)

Monthly reconciliations of child support collections to distributions are not performed. During fiscal year 1994, over \$406.4 million flowed through the system for the *Child Support Enforcement Program* (CFDA 93.563).

Management is aware of the need for monthly reconciliations and believes this issue will be resolved when the new Texas Child Support Enforcement System (TXCSES) is implemented. Some progress has been made by reconciling collections to supporting documentation, a key aspect of the monthly reconciliation process. However, a comprehensive system to reconcile child support collections to distributions has not yet been implemented.

Timely and accurate reconciliations help ensure that financial reports will not contain significant errors or omissions. They also serve as a control measure to detect errors and irregularities involving cash. Differences between monthly collections and distributions could go undetected when reconciliations are not performed.

Recommendation: We recommend that management ensure that procedures are in place and a monthly reconciliation of collections to distributions is performed once the new automated system has been implemented.

Management's Response: *We concur. The program has made significant progress in achieving reconciliation objectives over the last year. The OAG has also created a Financial section within the Child Support Division to coordinate and monitor all child support financial issues.*

Also, the OAG has devoted staff to reconcile cash on the child support case level to the general ledger in the current system. This reconciliation was completed in February 1995.

In addition, the OAG has included in the Texas Child Support Enforcement System (TXCSES) design, the capability of reconciling cash, as well as collections to disbursements on a daily basis. Detailed financial reports have been designed and specific procedures for performing reconciliations have been written. These items are being tested in the TXCSES and specific staff assignments for performing TXCSES reconciliations have been made.

Internal Control Issue 3:

Establish Procedures To Properly Account For Discrepancies In Deposits Made By Counties

Procedures are not in place to properly account for discrepancies in deposits made by counties through the Office of the Attorney General's Collection Automation Project (CAP). The lack of shared responsibility at the local level does not provide assurance that child support payments reported through CAP are properly accounted for and transferred to the Child Support Enforcement Trust Fund (Trust Fund). CAP was designed to reduce the agency's processing volume by providing a means to collect child support payments from counties, large employers, and the agency's field offices through electronic fund transfers.

The agency identified existing problems, but the following weaknesses persist which create the risk that errors or irregularities could occur and not be detected in a timely manner:

- Responsibility for deposit shortages is not shared with county offices participating in CAP. As a result, the Child Support Enforcement Trust Fund (Trust Fund) is absorbing unresolved shortages, further contributing to the Trust Fund deficit.
- The agency's accounting records do not reflect the differences between deposit amounts reported by the county and amounts actually deposited into the State Treasury's concentration account. Shortages are netted against any existing overage or balances in the State Treasury's concentration accounts, creating a net amount that is transferred to the Trust Fund.
- Deposit differences exist in the concentration accounts, dating back to January 1993, which have not been investigated or resolved by the agency.

In instances where shortages exist, non-custodial parents get credit for child support payments that were not received by the agency. Conversely, non-custodial parents may not receive credit for making child support payments when deposit overages exist.

Almost \$156 million (38 percent) of the total child support collections (\$406.4 million) processed during fiscal year 1994 were received through electronic fund transfers from CAP participants. Child support payments are deposited into State Treasury concentration accounts by CAP participants for transfer to the Trust Fund.

Recommendation: We recommend that management establish procedures to properly account for discrepancies in deposits made by counties through the Office of the Attorney General's Collection Automation Project (CAP) as follows:

- Guidelines should be developed to resolve discrepancies in deposits initiated at the county level. These guidelines should also include specific responsibilities of CAP participants and the Office of the Attorney General. Repeated errors in deposits submitted by counties could indicate weaknesses in controls at the local level and should be reported to the County Auditor.

- The agency's accounting records should properly reflect the differences in deposit amounts. Overage amounts should be transferred to the Suspense Account for subsequent identification of the child support payment. The operating funds for the *Child Support Enforcement Program* (CFDA 93.563) should be used to replenish shortages until the funds can be recovered from the appropriate party.
- Discrepancies in concentration accounts should be investigated and resolved in a timely manner.

Management's Response: Deposit discrepancies in electronic fund transfers (EFT) net to less than one percent of the \$156 million EFT payments processed in fiscal year 1994. Even so, we concur that improved practices and procedures should be developed in coordination with the State Treasury and counties to handle the collections involving State Treasury accounts using EFT.

Through EFT, the Office of the Attorney General expedites almost two million payments per year to families by a factor of seven to fourteen days, and saves the state significant operating costs through automated processing of these collections. On the other hand, the process is largely dependent on Treasury banking procedures, as well as the voluntary cooperation of participating counties, at no great benefit to them and minimal cost to the State.

However, we recognize that reporting and deposit procedures within the existing system could be improved. Actions taken and planned include the following:

- *Daily logs to ensure balancing of deposit vouchers with payment details will be converted to a mainframe reconciliation process in the New System.*
- *Collections & Distribution have requested more frequent than monthly statements from the State Treasury. (However, since these accounts are not established by the OAG or the county, we are limited to modifications in procedures that the State Treasury will be able to accommodate.)*
- *Representatives of the Collections & Distributions and Recoupment sections of Client Services, Accounting, and New System staff will continue to meet with the Treasury to look into more effective alternatives for handling county e.f.t. funds and to establish procedures that can be incorporated into the overall recoupment process. Collections and Distributions has already held a working-level meeting with the State Treasury staff to identify potential areas for more timely information exchange.*
- *OAG staff are developing policies and procedures for notifying counties of deposit discrepancies and will provide copies to the county auditor when warranted. The notification procedures should be in place by April 1995.*

Federal Compliance Issues

Recommendations addressed in other sections of this report could impact controls over federal funds for the *Child Support Enforcement Program* (CFDA 93.563).

The Office of the Attorney General's most significant federal program, the *Child Support Enforcement Program*, is administered by the U.S. Department of Health and Human Services through the U.S. Office of Administration for Children and Families. The agency collected and distributed approximately \$406 million in child support payments during fiscal year 1994 and received \$97.2 million to administer the program.

Federal Compliance Issue 1:

Take Timely And Appropriate Action To Process Child Support Cases

(Prior Audit Issue)

The Office of the Attorney General has not used all information at its disposal to take timely and appropriate action to process child support cases in the *Child Support Enforcement Program* (CFDA 93.563). Federal regulations require the agency to diligently pursue certain actions to establish and enforce child support collections. The following exceptions for case file processing were found during fiscal year 1994:

Federal Requirements	No. of Cases Tested	Exceptions Noted	Error Rate
Paternity	43	5	11.6%
Locate	221	23	10.4%
Support	36	3	8.3%
Enforcement	38	3	7.9%
Eligibility	297	1	0.3%

At the direction of the Division of Audit of the federal Office of Child Support Enforcement, different audit criteria and methodology were used during the fiscal year 1994 audit as compared to past audits. Application of this criteria resulted in significantly lower error rates than those reported in prior years.

Federal guidelines contained in *Code of Federal Regulations (CFR), Title 45, Section 305*, use a 25 percent error rate to determine substantial compliance with program requirements. However, the effectiveness of child support services is reduced unless all opportunities are taken to fully process the cases.

Recommendations: We recommend the agency take timely and appropriate action to process child support cases using all sources of available information. All attempts to process child support cases should be documented in the case files. The Internal Audit Division, together with

the program monitoring function, should identify the causes for the types of errors noted and continue to provide feedback to management on the effectiveness of child support services.

Management's Response: Achieving compliance with federal requirements for processing child support cases has been and remains a top priority for the Office of the Attorney General. In addition, results of the latest audit by the U.S. Department of Health and Human Services indicated that the OAG is in compliance with audit criteria established by the federal Office of the Child Support Enforcement (OCSE). Efficiency rates for selected functions as noted in the report, were as follows:

<i>Establishing Paternity</i>	<i>84%</i>
<i>Support Obligations</i>	<i>87%</i>
<i>Enforcement of Support Obligation</i>	<i>97%</i>

Auditor Clarification: The audit results noted in the response above are for the period January 1 through December 1992. Also, program auditors used efficiency (compliance) rates in their report instead of error rates. Error rates for the selected functions noted in the response above are as follows:

Establishing Paternity	16%
Support Obligations	13%
Enforcement of Support Obligations	3%

Federal Compliance Issue 2:

Ensure Accuracy Of Child Support Arrearage Balances

(Prior Audit Issue)

The Office of the Attorney General does not maintain accurate records of child support arrearage balances. Of the 26 arrearage balances tested, 8 contained errors, resulting in a 31 percent error rate. This error rate increased from the 20 percent noted in the prior year audit.

The following conditions contribute to the inaccuracy of these balances:

- Incorrect payment amounts are recorded.
- Inaccurate payment start and end dates are reflected.

The accuracy and documentation of recorded child support arrearage balances is necessary to ensure the proper payment and distribution of child support collections. Over \$406.4 million flowed through the system for the *Child Support Enforcement Program* (93.563) in fiscal year 1994.

Recommendations: We recommend the agency ensure the accuracy of the arrearage balances. Arrearage amounts entered on the data base should be verified against the manual calculations. Procedures should be developed to review case file data when it is entered, modified, or deleted in order to minimize errors. The Internal Audit Division and the Program Monitoring Section

should continue to review arrearage calculations to identify problems and recommend corrective action.

Management's Response: *We concur with the auditor's recommendations. The Child Support Division of the Office of the Attorney General has undertaken efforts to ensure the accuracy of data entry relating to child support arrearages. We will continue to pursue efforts to ensure the accuracy of this information. Such efforts include:*

- *To reduce errors and promote uniformity, specific training on calculating arrearage balances was developed. Staff who successfully complete the training are designated as "Certified Arrears Calculators." These staff are delegated the responsibility of ensuring the accuracy of arrears information.*
- *We will review possible recertification of these arrears calculation experts to ensure that their reviews of the child support cases regarding arrears calculations are being conducted properly. We will ensure that these calculation reviews are limited to staff that have been recertified so as to better control the quality of the reviews conducted by these staff.*
- *The ability to change arrears information on the database has been restricted so that only authorized staff have the capacity to update arrearage information. Authorized staff are issued unique identification codes which are required to access update screens for arrearage balances in the database. The only staff having this authorization are those who have been certified as arrears calculators and have been identified to the database as such.*
- *Increase the number of field reviews and audits of child support cases from a quarterly basis to a monthly basis. These reviews are to be conducted at the area level by the area staff "Case Readers" who are specifically trained to perform the task.*
- *Continue efforts of the child support staff and in particular our Program Monitoring Section to perform quarterly control reviews of our case purification and conversion efforts. These reviews will have a more narrowly-defined purpose (arrears information).*
- *Develop a critical elements list which identifies those elements which are required to be reviewed to ensure the accuracy in calculating arrears and for conversion purposes as well.*
- *Develop a procedure for updating arrears balances in order to establish some uniformity for particular types of cases which need to be updated.*
- *Form a focus group to review all negative arrears cases and develop procedures for correcting cases with true negative arrearages.*

These efforts, which are either on-going or expected to be completed by Fall 1995, should reduce the arrearage error rates. The OAG will continue all efforts to ensure the accuracy of data elements for the caseload of more than 650,000.

In addition, Internal Audit has begun to develop a new approach for future arrearage audits. Rather than simply testing and reporting on arrearage balances, Internal Audit will attempt to pinpoint the main cause(s) of inaccurate balances and controls over input, and make constructive control recommendations to alleviate those cause(s).

Federal Compliance Issue 3:

Revise "Bad" Check Collection Procedures To Comply With Federal Regulations And Minimize Losses

One of the mechanisms used by the agency to recover child support payments made with "bad" checks does not comply with federal regulations. These child support payments were already disbursed to the custodial parents before the "bad" check status was discovered. Over the last two fiscal years, over \$540,000 of the total \$1 million in "bad" checks from non-custodial parents has been recovered by withholding subsequent child support payments to the custodial parents without their voluntary consent.

Child support payments must be distributed in accordance with federal regulations of the *Child Support Enforcement Program* (CFDA 93.563). The federal Office of Child Support Enforcement informed the agency that deviations from the distribution requirements can occur if voluntary consent is obtained from the custodial parent. The amount recovered for "bad" checks could decrease since the agency must change its procedures to comply with federal regulations.

Recommendation: Since notification regarding the federal regulations, the agency has been reviewing procedures for recovering "bad checks." We recommend that management comply with federal regulations by revising its procedures for recovering child support payments made with "bad" checks. In addition, the following procedures should be implemented:

- Request custodial parents to sign an authorization allowing subsequent child support payments to be used to recover money for "bad" checks.
- Accounts should be flagged when non-custodial parents make two child support payments with "bad" checks. The requirement for these non-custodial parents to submit cash, money orders, or cashier checks to meet the child support obligation should be enforced. Alternatively, personal checks from these non-custodial parents should be held by the agency for ten days before the child support payment is distributed to the custodial parent.
- The agency should more aggressively pursue recovery of "bad" checks. Non-custodial parents should be reported to local law enforcement officials when repeated violations occur, and enforcement action to garnish their wages should be considered.

Management's Response: We agree with these findings and recommendations. In summary,

- *TXCSES is designed to be in line with federal regulations regarding recoupment of collections.*
 - *TXCSES is designed to assist in identifying and dealing with cases where we have received multiple insufficient checks. The Remittance Processing Device (RPD) will also be programmed to provide the same support for checks processed with a coupon.*
 - *The agency is pursuing recovery of "bad checks" through a special project to locate and make contact with non-custodial parents on "old" non-sufficient funds (NSF) checks where current case information is insufficient to pursue collection. The Recoupment Section anticipates collecting over \$10,000 with its first efforts at locating non-custodial parents on these old NSF checks. In addition, TXCSES design is being finalized to include automated letters, and the Recoupment Section will increase personal collections of debts when system efforts are unsuccessful at collection.*
 - *The Recoupment Section is looking statewide at which counties will pursue recovery of "bad checks," and coordinating with the Special Enforcement Officers to develop recoupment procedures with local law enforcement officials when this option is available in the counties. We plan to finalize these procedures by June 1995.*
 - *The Child Support Division has established specific procedures for checks of more than \$800. In such cases, the Collections Processing supervisor contacts the bank and verifies that there are sufficient funds in the account. Exceptions to this procedure include employer checks for multiple employees, cashiers' checks, money orders, and District Clerks' checks.*
- If the bank verifies that funds are available to cover the check, the payment is posted to the record. If funds are not available, the check is deposited into the Suspense Fund, and the bank is called again (within three days) to determine whether the check is cleared.*
- *The OAG is pursuing changes to federal regulations to allow the use of cost effective methods for recoupment purposes.*

Federal Compliance Issue 4:

Comply With All Subrecipient Monitoring Requirements

(Prior Audit Issue)

The Office of the Attorney General did not comply with all federal regulations for subrecipient monitoring. One subrecipient for the *Child Support Enforcement Program* (CFDA 93.563) did not submit an audit report, which results in \$44,756 in questioned costs.

Office of Management and Budget (OMB) Circular A-128 requires subrecipients to submit audit reports within 13 months of their fiscal year end. These audit reports ensure proper spending of federal funds.

Recommendation: We recommend that the Office of the Attorney General continue efforts to obtain the late report in order to fully comply with all subrecipient monitoring requirements.

Management's Response: *OAG management acknowledges the continued improvement it has made in it's subrecipient monitoring system. OAG management concurs with the auditor's recommendation that the Office of the Attorney General comply with all subrecipient monitoring requirements.*

The finding identifies one subrecipient for not submitting their required annual audit. The subrecipient in question is in fact a county political subdivision. The OAG was aware of the issue in advance of this finding, and had attempted to acquire the report. Unfortunately, factors contributing to publication of this county's report were outside the OAG's control.

Receipt of the report is anticipated in the near future and it is also believed that the report will not contain any material or immaterial findings of misuse, fraud, or abuse of Title IV-D funds which passed through the Office of the Attorney General to this subrecipient.

Audit Scope

Our audit primarily focused on the federal requirements of the *Child Support Enforcement Program* (CFDA 93.563) and related internal accounting and administrative controls. We gained an understanding of the internal control structure, including the general control environment, as well as controls over receipt and disbursement of child support payments, cash management, federal financial reports, administrative requirements, allowability of costs, and subrecipient monitoring. Specific procedures were used to test compliance with the major federal program. In fiscal year 1994, over \$406.4 million in child support payments were processed through the Child Support Enforcement Trust Fund. Federal expenditures to administer the program totaled \$97.2 million during the same period.

Overall Conclusion

The Commission has not monitored subrecipients of the *Rehabilitation Services - Basic Support* program since 1990, and for the third consecutive year, has not obtained an approved indirect cost allocation plan. However, the Commission met other federal requirements for administering its \$30.7 million of federal assistance.

Federal Compliance Issues

Federal Compliance Issue 1:

Implement A Subrecipient Monitoring System

The Texas Commission for the Blind has not monitored subrecipients of the *Rehabilitation Services - Basic Support* program (CFDA 84.126) since 1990, as required by federal regulations. The regulations require the Commission to review subrecipient audit reports and ensure that all findings are resolved.

The review of subrecipient audit reports ensures proper spending of federal funds. No adequate audit reports have been received or reviewed for fiscal years 1990 through 1994. This results in over \$1.3 million in questioned costs for funds provided to subrecipients during the five years.

Office of Management and Budget (OMB) Circulars A-128 and A-133 require subrecipients to submit audit reports no later than 13 months after their fiscal year end. The regulations also require the Commission to review the reports for adequacy and obtain corrective action for all audit findings within six months of report receipt.

Recommendation: We recommend that the Commission implement a subrecipient monitoring system in accordance with federal regulations.

Management's Response: *The Texas Commission for the Blind maintains extensive controls over its grant process. All grants over \$100,000 issued since 1990 have required subrecipients to submit audited financial reports. Payments under the grants are not made until subrecipients furnish invoices, evidence of payment, and pay their match amount. Grant purchases requiring competitive bidding must also include written evidence of the solicitation of bids. This documentation is reviewed by the grant administrator and the Deputy Director for Administration and Finance before payments are made.*

However, the TCB acknowledges that for the period 1990-1994 it was not in compliance with all the grant monitoring provisions of OMB Circulars A-128, and A-133. The Commission has not performed reviews of subrecipient audit reports in accordance with the provisions of Circular A-133. Additionally, the Commission has not appropriately required subrecipients receiving grant awards between \$25,000 and \$100,000 to have either program or institutional audits.

Blind And Visually Impaired, Texas Commission For The

SAO 5-080

To bring the grant monitoring process into compliance with the federal regulations, TCB will take the following actions:

- *Require subrecipients receiving over \$25,000 to submit appropriate audit reports.*
- *Perform appropriate reviews of audit reports and follow up on any exceptions.*
- *Request all subrecipients that received grants over \$25,000 during the period 1990-1994 submit available audit reports.*
- *Conduct reviews on those reports to determine if grant funds were expended in accordance with grant provisions.*
- *Conduct field reviews of subrecipients not having obtained appropriate audits.*

We appreciate the cooperation of the SAO in working with the TCB on this finding. All future grants will be in compliance with the full provisions of the federal regulations.

Federal Compliance Issue 2:

Obtain An Approved Indirect Cost Allocation Plan

(Prior Audit Issue)

For the third consecutive year, the Commission did not have an approved plan to allocate its indirect costs among federal programs. Indirect costs are costs incurred for a common purpose and which cannot be directly attributable to one particular program, such as expenditures incurred by accounting, purchasing, or human resources.

As required by the *Office of Management and Budget (OMB) Circular A-87*, the Commission must develop a plan to allocate indirect costs, due to its participation in federally funded programs. All indirect costs are currently being charged to the *Rehabilitation Services - Basic Support* program (CFDA 84.126). The amount of indirect costs that should have been charged to this and other federally funded programs is undeterminable.

During fiscal year 1994, the Commission submitted two different plans for approval. The first plan was complex and difficult to comprehend, and the second plan did not include sufficient supporting documentation. Neither plan was approved.

Recommendation: We recommend that the Commission work to submit an approved plan by the February 25, 1995, deadline. The plan should include all necessary aspects, as outlined in *OMB Circular A-87* in a clear and concise manner to ensure approval.

Management's Response: *The TCB has worked diligently to develop an approved indirect cost plan. To accomplish this the Commission employed a nationally recognized firm with extensive experience in developing plans for Texas agencies.*

The first indirect cost plan developed by the contractor was submitted to our cognizant agency, the Department of Education, on March 30, 1994. This plan was rejected as being too complex and not in a format they were accustomed to. A second plan was submitted on September 23, 1994. On November 15, 1994 we received a letter from the Department of Education requesting additional information.

Our contractor is currently negotiating with the Department of Education to determine the format of the additional information. We have recently met with the contractor to determine the additional documentation that the agency needs to provide. TCB will continue to work toward obtaining an acceptable indirect cost plan.

Audit Scope

The primary focus of our audit was the Commission's administrative controls over its major federal program, the *Rehabilitation Services - Basic Support* program which received \$27.7 million. This program represents 90 percent of the Commission's \$30.7 million of total federal assistance. We gained an understanding of the internal control structure, including the general control environment and federal program. We tested the internal control structure related to the major federal program. Specific procedures were used to test compliance with the major federal program.

Overall Conclusion

The Department has established systems to ensure compliance with requirements for the *Job Training Partnership Act* (\$212 million) and bonds outstanding (\$99 million), and the systems are generally working.

Related Audit Report

We issued a report in October 1993, titled *A Review of Management Controls at the Texas Department of Commerce* (SAO Report No. 94-013). The report contains recommendations which could impact the *Job Training Partnership Act*, administered by the U.S. Department of Labor.

Federal Compliance Issue

The Department's most significant federal program, the *Job Training Partnership Act* (CFDA 17.246 and 17.250), is administered by the U.S. Department of Labor. Recommendations addressed in other sections of this report could impact controls over this program.

Federal Compliance Issue 1:

Comply With Federal Cash Management Funding Technique Requirements

The Department did not comply with a federal cash management funding technique requirement for the *Job Training Partnership Act* program (CFDA 17.250). The Department had excess federal funds on hand for 7 of 20 state working days tested. The State incurs an interest liability for each day the Department holds federal funds.

Five of the seven days of noncompliance were due to the Department not having adequate procedures in place to minimize cash requests and prevent excess federal funds on hand. During the five days of noncompliance, the funds were on hand for four to five days rather than the three days required by federal regulation. The remaining two days of noncompliance were due to interagency transfers.

Title 31 Code of Federal Regulations (CFR), part 205.7 (c)(4) states that federal funds shall not be requested more than three business days prior to disbursement.

During fiscal year 1994, the Department reviewed and revised its cash management procedures to comply with the new regulation. However, the procedures need further revision in order for the Department to comply with the requirements.

Recommendation: We recommend the Department comply with federal cash management funding technique requirements by revising current procedures. In addition, the Department should continue its efforts to resolve cash management issues relating to interagency transfers.

Management's Response: At the beginning of FY 1994, Commerce reviewed and revised its cash management procedures to comply with the new regulations. In spite of these revisions, situations occurred which we did not anticipate. Commerce will continue to improve its cash management procedures to ensure that we are in full compliance with the requirement that cash be disbursed within three days of request of funds. Commerce currently waits for notification from the State Treasury that the Department of Labor's wire transfer of funds has been received before releasing transactions for data entry and submission to the Comptroller. In order to expedite the process, Commerce will release the transactions before notification from the State Treasury. If problems with the wire transfer occur, this change in procedure will cause transactions to go into error status due to insufficient funds in the State Treasury.

Commerce processed all interagency transfers of pass through funds according to the Comptroller's Accounting Policy Statement 14. Accounting Policy Statement 14 requires that federal pass through transactions between agencies be entered in the statewide accounting system by the Comptroller as central entry documents. Due to the requirement for central entry, Commerce has experienced delays of up to several weeks in processing these transactions. Without some type of modification by the Comptroller to the procedure for central entry, Commerce cannot disburse these funds within the required three days. Concerns about the delay in processing central entry documents have been communicated to the Comptroller. The Department will continue to work with the Comptroller to resolve processing delays relating to interagency transfers.

Internal Control Issue

Internal Control Issue 1:

Develop Disaster Recovery Plan For Automated Data

(Prior Audit Issue)

The Department does not have a disaster recovery plan for its current processing environment, which increases the risk of delays in recovering information should a disaster occur. Risks to information processing and the steps necessary to resume processing after a disaster have not been identified. Automated systems have not been prioritized, and no provisions exist for processing at another location.

In our fiscal year 1992 report, we recommended that the Department establish a centralized data processing division and develop formal policies and procedures addressing critical automated functions such as planning, security, and disaster recovery. In our fiscal year 1993 report, we commented that management planned to address this issue by implementing a local area network.

The Department has made progress in addressing the recommendations. It now has several networks. The network administrators are meeting frequently, and the Department plans to develop procedures to address common issues. A manual addressing security and risk management has also been developed; however, it does not contain a disaster recovery plan.

Recommendation: We recommend that the Department develop a written disaster recovery plan which covers the current processing environment and includes types of risks, priority for recovering data, and provisions for processing at another location.

Management's Response: *Within the past several months the Department of Commerce has changed its automation environment and physical location. The agency replaced the Data General minicomputer with a DEC Alpha 2100, installed a fourth local area network, and changed the Internet provider. This transition took place as the agency was in the process of relocating its operation to two separate locations. The new automated environment completes the long-range plan of having the agency on a common platform to share information and to eliminate redundant processes. We concur that in light of the many changes, both in terms of physical location and automated equipment, all former documentation needs to be reviewed and updated to reflect the new environment. This includes the disaster recovery plan, the development of policy and procedures for the local area networks, and an update of the system backup and archive procedures. Also the risk management manual needs to be updated.*

These issues will be addressed as soon as Data Services relocates to permanent facilities. A local area network policy and procedure manual will be published, a disaster recovery plan will be developed, a data services request form will be finalized, the procedures for system backups and archives will be updated, and the risk management manual will be reviewed to comply with the Department of Information Resources mandates.

Audit Scope

The Department's *Job Training Partnership Act* program, with expenditures of \$212 million, was the primary focus of this audit. This federal program is the State's principal job training and employment program. In addition, we tested bond-related disclosures in the annual financial report and verified compliance with significant bond covenants. The Department had one bond issue outstanding at August 31, 1994, totaling \$99 million.

We gained an understanding of the overall control environment and the administrative controls relevant to the federal program and significant bond covenants. We performed procedures to determine whether the Department complied with established requirements for its federal program. We also followed up on prior audit issues.

Overall Conclusion

The Comptroller's Office collected and accurately reported \$17 billion in net tax revenues and transfers of \$10.6 billion during fiscal year 1994. As the State's financial reporting officer, the Comptroller is responsible for compiling and publishing the State's Comprehensive Annual Financial Report (CAFR). The Comptroller's Office can make improvements to the State's financial reporting process. In addition, the Comptroller's Office had continuing difficulties reconciling cash between the Uniform Statewide Accounting System and the Treasury's cash accounting system during fiscal year 1994.

Internal Control Issues

As the State's financial reporting officer, the Comptroller is responsible for compiling and publishing the State's Comprehensive Annual Financial Report. Internal Control Issue 1 and both Accounting and Reporting Issues identify improvements that can be made to the State's financial reporting process.

Internal Control Issue 1:

Improve Effectiveness Of Quality Control Function

The Comptroller's Office needs to improve its quality control function to provide timely detection and correction of financial reporting errors before the comprehensive annual financial report (CAFR) is completed. As a result of weaknesses in the quality control function, errors occurred in the unaudited comprehensive annual financial report which required correction before the CAFR was released.

As the State's financial reporting officer, the Comptroller's Office is responsible for the accuracy and completeness of the State's annual financial reports. The Comptroller's Financial Reporting Section compiles the State's annual financial report by an extensive consolidation of approximately 300 agency financial reports. The State Auditor's Office has worked closely with the Financial Reporting Section to compile the State's annual financial reports since the first report was produced for the 1987 fiscal year. The State Auditor's Office has aided in this process through extensive review of draft reports to ensure the accuracy of the final report.

Recommendation: We recommend that the Comptroller improve the effectiveness of the quality control function to ensure that errors are detected and corrected prior to review by the State Auditor's Office.

Management's Response: *We have benefitted from the Auditor's involvement in the production of the annual financial reports, but recognize the need to more clearly establish a division of functions between the agencies. We also agree to improve our quality control function to reduce normal reporting errors in drafts of the financial reports prior to their being presented to the Auditor for review. We have already established an independent quality assurance function that will be responsible for providing more timely detection and correction of financial reporting errors.*

Internal Control Issue 2:

Improve Cash Reconciliation Process

The Comptroller's Office and the State Treasury need to improve the cash reconciliation process between the Uniform Statewide Accounting System (USAS) and the Treasury's cash accounting system. With the implementation of USAS in 1994, the old reconciliation method proved ineffective since the new system requires a higher level of sophistication in the reconciliation process. This improved process had not been perfected when USAS became the State's primary accounting system. As a result, the Comptroller and Treasury had continuing difficulties with the reconciliation process during fiscal year 1994.

An effective reconciliation system provides monitoring and control to ensure the accuracy of the State's cash records, including individual agency accounting records. The lack of an effective reconciliation process increases the risk that errors and irregularities will not be detected in a timely manner by management.

Recommendation: We recommend the Comptroller continue coordination efforts with the State Treasury to complete improvement of the cash reconciliation system by May 1995. These actions can be accomplished by:

- clearing all outstanding reconciling items within one monthly accounting cycle
- continuing to identify conditions that create reconciling items and installing processes to eliminate reconciling items caused by those conditions

Management's Response: *We agree that a more effective cash reconciliation process was needed in 1994. The implementation of USAS in 1994 impacted our cash reconciliation process in ways that we had not anticipated. USAS captures data at a higher level of detail, increasing the need for greater automation to ensure timely reconciliation. We have coordinated our efforts more closely with the State Treasury in developing an effective reconciliation process that is accomplishing the criteria outlined above by the State Auditors. Although we had difficulties with the reconciliation process because of the newness of the system, we were able to confirm that all accounts were properly and accurately superintended. The improvements in the reconciliation process will ensure the continued integrity of the financial accounts in a timely manner.*

Accounting And Reporting Issues

Accounting And Reporting Issue 1:

Effectively Use The Statewide Accounting System

The Uniform Statewide Accounting System (USAS) is not used to generate the comprehensive annual financial report (CAFR). Currently, the State compiles its financial position once a year by an extensive, mostly manual, consolidation of the relevant financial

data. This data is obtained from approximately 300 state agencies and universities and from analysis of information on USAS.

The Legislature has appropriated approximately \$100 million since 1988 for the development and implementation of the statewide accounting system (USAS). These funds were made available to improve the amount, timeliness, and quality of financial information, including strengthening management capabilities.

Government Code, §403.013 (d) states that the Comptroller shall prepare a CAFR "from information requested from the Comptroller under Subchapter B, Chapter 2101, until it can be prepared from information contained in a fully operational uniform automated statewide accounting and reporting system." Although the Comptroller's Office has not met this USAS objective, they have organized a work group to address how to improve processes for the collection of financial data. The work group plans to develop the procedures necessary to capture all financial data needed to produce the CAFR.

Recommendation: We recommend that the Comptroller develop and implement a detailed action plan to convert from the mostly manual process of compiling financial information to an automated process using information maintained on USAS. The plan should identify specific tasks, resources, and time frames.

Management's Response: *We agree that a more detailed action plan should be developed for producing the CAFR from USAS. We are currently developing such a plan. We consciously did not choose to produce the CAFR during the first year of implementation due to outstanding issues that needed to be identified and resolved, so as not to jeopardize the State's fiscal integrity.*

Accounting And Reporting Issue 2:

Ensure Accuracy Of The Financial Reporting Entity

The Financial Reporting Section (FRS) did not establish adequate procedures to provide reasonable assurance that the State's financial reporting entity was properly defined and reported.

FRS did not provide sufficient guidance to state agencies and universities. Consequently, the information gathered by FRS from state agencies and universities was not sufficient to determine if all possible organizations and relationships were considered and if conclusions were reasonable.

An accurate assessment of the State's financial condition is not possible unless the financial reporting entity is properly defined and reported.

Governmental Accounting Standards Board (GASB) Statement No. 14, *The Financial Reporting Entity*, establishes standards for defining and reporting on the financial reporting entity. It also establishes standards for reporting participation in joint ventures. FRS has three years to implement GASB 14 from the date of its release. Late consideration of GASB 14 contributed to the problems identified in applying the statement.

Recommendation: We recommend that the FRS develop procedures to review and evaluate the reporting entity and changes in the reporting entity on an ongoing basis to ensure that the State's financial reporting entity is properly defined and reported. We recommend that the supporting documentation of all organizations considered be centrally accumulated and reviewed for reasonableness by the FRS. We also recommend that the FRS annually review changes in generally accepted accounting principles and adjust their instructions as appropriate. In addition, if certain standards require more lead time for agencies to implement, FRS should consider interim notification to agencies to provide sufficient lead time for implementation of new standards.

Management's Response: *We agree to implement the recommendations outlined above by the State Auditors. Because of the importance and difficulty in implementing this accounting statement, we will work closely with the State Auditors to ensure all instructions and processes, for identifying these reporting entities, are adequate for that purpose.*

Audit Scope

The primary focus of audit work at the Comptroller was the statewide consolidation process and the Comptroller's financial accounts material to the State's Comprehensive Annual Financial Report (CAFR). In fiscal year 1994, the Comptroller collected \$17 billion in net tax revenues and transferred \$10.6 billion from the General Revenue Fund to other funds. At the end of the fiscal year, the State had cash balances of \$8.2 billion and the Comptroller held \$500 million for others in its trust and agency funds.

Consolidation work was conducted to determine if the CAFR was accurate and presented in accordance with Generally Accepted Accounting Principles. We gained an understanding of the internal control structure for the consolidation process. We also tested the accuracy of the compilation of the annual financial reports for over 280 state agencies, universities, and component units.

For material accounts, we gained an understanding of the internal control structure for the Comptroller's annual financial report including the general control environment and controls over cash receipts, cash balances, and journal vouchers. Certain financial accounts were also tested, including General Fund tax revenues and operating transfers out, trust and agency fund payables, and cash balances for all funds.

Overall Conclusion

The Texas Education Agency is not adequately protecting its automated information. The Internal Audit Department did not base its audit plan on a current risk assessment and has never received a peer review.

The Agency is in compliance with most federal regulations related to the \$1.5 billion of federal funds disbursed in fiscal year 1994.

The accounts in the Agency's 1994 Annual Financial Report that were tested as part of the statewide financial audit are materially accurate and properly reported. These accounts included Investments, \$8.5 billion; Purchases of Investments, \$1 billion; Sales of Investments, \$613 million; Education Expenditures, \$7.6 billion; Transfers In, \$6.8 billion; and Revenues from Licenses, Permits and Fees, \$336 million.

Other Related Reports

The State Auditor's Office has verified that \$140,364.00 in adjustments have been made as required by the U.S. Department of Health and Human Services' letter of resolution. These adjustments resulted from the November 1993 report on the *State Legalization Impact Assistance Grant* (CFDA 93.565) issued by the Department's Office of Inspector General. The report related to the Texas Education Agency and other state agencies. See *Appendix 2: Verification Of Letter Of Resolution Adjustments*.

Internal Control Issues

Internal Control Issue 1:

Develop And Administer Information Security Policies And Procedures

Policies and procedures over access security for the Texas Education Agency's automated information resources are incomplete. In addition, adequate resources have not been dedicated to monitor controls that safeguard information resources. Without the development and enforcement of security policies and procedures, automated information becomes more susceptible to improper modifications or deletions by unauthorized personnel. Weaknesses in security over federal program information resources which result from the lack of policy and procedure enforcement include:

- Programmers have access to the Financial Management System programs.
- Some programmers have access to data for the Federal Funding Program and Compensatory/Bilingual/Migratory systems.
- Computer operators are using the same user identification.
- Procedures to change user access in response to employee termination or change in job duties are not consistently performed.

These automated systems processed \$1.5 billion of federal funds in fiscal year 1994.

Department of Information Resources' (DIR) standards, adopted by the *Texas Administrative Code* [1 TAC §201.13(b)], require that by September 1, 1993, agencies are to have written internal policies and procedures for the protection of information resources.

Recommendation: The Agency should assign responsibility to develop and implement security policies and procedures over access to automated resources to help ensure the adequate protection of its State-owned information. DIR's standards and guidelines can assist the Agency in the development of policies and procedures which would also address the weaknesses cited above.

Management's Response: *The agency agrees with this finding. The Agency's Department of Information Systems will take corrective action according to the following 1995 timetable:*

<i>March</i>	<i>Assign responsibility to develop and implement security policies and procedures over access to automated resources.</i>
<i>March-May</i>	<i>Develop security policies and procedures consistent with DIR standards and guidelines.</i>
<i>June</i>	<i>Acquire Agency approval for the newly developed security policies and procedures.</i>
<i>June-September</i>	<i>Implement the approved security policies and procedures.</i>
<i>September</i>	<i>Request follow up audit of agency security policies and procedures.</i>

Internal Control Issue 2:

Plan Annual Audits Based On A Current Risk Assessment

The Texas Education Agency's Internal Audit Division (Division) did not perform a current risk assessment to identify issues for its fiscal year 1994 or 1995 audit plans and has never received an internal audit peer review. An annual assessment should be performed to identify significant issues currently affecting the Agency. The 1995 audit plan contains limited financial and electronic data processing (EDP) audits even though these areas could significantly impact the Agency.

The internal audit function provides a mechanism for quality control that helps ensure that the entity is accomplishing its goals efficiently and that appropriate internal controls are operating. A peer review provides management with feedback on the Division's compliance with Internal Auditing Standards and identifies areas for improvement within the internal audit function.

Recommendation: We recommend that the Division perform and use an annual risk assessment of significant issues as a basis for the annual audit plan. Financial and EDP control issues should be considered in both the risk assessment and the formation of the audit plan. The Division should also participate in an internal audit peer review.

Management's Response: The Agency concurs with this finding. The 1994-95 internal audit plan was developed based on a risk assessment instrument; however, that instrument has not been formally revised on an annual basis. The risk assessment instrument was developed several years ago in order to create a five-year audit plan as recommended by the State Auditor's Office at that time. Areas that were initially identified as high risk, plus those areas specifically brought forward to the Internal Audit Division as needing immediate attention, are taken into consideration in developing the internal audit plan each year. Internal Audit adjusts for any changes that have taken place in the Agency's organization and believes that the results of the initial risk assessment remain valid. Those areas rated as the highest risk are being included in the internal audit plan. Although the 1995 audit plan appears to contain limited financial and EDP audits, this may not be entirely accurate. Internal audit is heavily involved in the development of new systems, including a new financial management system, and modifications of existing systems at the Agency. In addition, EDP systems existing within an audited division are examined as part of the audit.

The Internal Audit Division is currently working on revising its risk assessment instrument. The internal audit plan for fiscal year 1995-96 will be based on this revision. The Division will re-evaluate the risk assessment annually. The Internal Audit Division will undergo a peer review by August 31, 1995.

Federal Compliance Issues

Recommendations addressed in other sections of this report could impact controls over federal funds, especially for the Agency's most significant federal programs administered by the U.S. Department of Education.

Federal Compliance Issue 1:

Ensure Accuracy Of Time Reports

(Prior Audit Issue)

Time reports used for allocating administrative expenditures between state and federal programs were not accurate. Three of five divisions tested did not submit accurate June 1994 time reports due to mathematical errors and an incorrect time charge.¹ In addition, supervisory review and approval, which is required by the operating procedures, was not performed by three of the five divisions.

As a result, allocations of expenditure variances between programs were not accurate. State funds are unnecessarily used when federal programs are undercharged. If the federal funds are overcharged, then the State must repay the Federal Government.

The allocation system identifies variances between budgeted and actual expenditures. The system processes approximately \$2.2 million of administrative expenditures annually. The time report errors were caused by a lack of proper review and verification of the reports before submission and a lack of adherence to Agency operating procedures.

Recommendation: We recommend that Agency employees adhere to operating procedures on time reports and that these reports be reviewed by management before submission. In addition, the Agency's Internal Auditor should perform an audit of one month of time reports for each division to verify their accuracy and ensure adherence to operating procedures.

Management's Response: TEA implemented its new automated time and effort reporting system. During August 1994, all employees who were subject to time and effort reporting procedures received instructions on how to use the new system along with a brief exam testing their knowledge about those procedures. The system is currently in use for recording of all work subject to time and effort. Use of this system will eliminate routine math errors. The agency's Technology Support Division will add to its curriculum a course on the new automated system for future instruction.

Operating procedures were put into place to explain all responsibilities of management and each employee. The problems in lack of proper review and verification have been addressed in the new system that spells out an approval sequence for each division to follow, including required electronic approval by a division manager. Failure to complete the approval process in the proper order within established time deadlines will trigger non-compliance reports alerting management of delinquent divisions.

Management will review the possibility of periodic training updates to agency personnel to eliminate incorrect time charges. The Internal Audit Division will study the feasibility of performing annual audits of one month of time reports for each division. Changes to the Internal Audit Plan are subject to management and Board priority. It should also be noted that because fiscal year 1995 is already in progress, the time needed to complete audits of each division may not be available.

Federal Compliance Issue 2:

Conduct Timely Reviews For All Subrecipient Audit Reports

(Prior Audit Issue)

Although the Texas Education Agency has made substantial improvements in the report resolution process, it does not conduct timely reviews of all subrecipient audit reports. As a result, the Agency cannot ensure that all subrecipient audit findings are resolved within the required time. Delayed reviews could result in the Agency being unaware of noncompliance by subrecipients.

Seven of 45 audit reports tested were not reviewed in a timely manner. The reports were reviewed six months past the report receipt date. *The Office of Management and Budget Circular A-128* requires the Agency to review audit reports for adequacy and determine whether subrecipients have taken corrective action on audit findings within six months after report receipt.

The subrecipients receive federal funding from the following federal programs: *School Breakfast (CFDA 10.553)*, *National School Lunch (CFDA 10.555)*, *Chapter 1 - Local Education Agencies*, *Migrant Education - Basic State Formula (CFDA 84.011)*, *Special*

Education State Grants (CFDA 84.027), Vocational Education - Basic Grants to States (CFDA 84.048), Improving Schools (CFDA 84.151), and Drug-Free Schools and Communities (CFDA 84.186).

Recommendation: We recommend that the Agency continue its efforts to conduct timely reviews for all subrecipient audit reports.

Management's Response: *The School Financial Audits Division has continued to make modifications to the procedures implemented last year to the audit review process. These modifications call for the review of all audit reports within three months of receipt, thereby leaving three months for follow-up of instances of subrecipient non-compliance. We anticipate this year, barring unforeseen circumstances, being in full compliance with The Office of Management and Budget Circular A-128 requirements.*

Federal Compliance Issue 3:

Improve Procedures For Reporting Federal Pass-Through Funds

The Agency materially understated the amount of federal funds passed through to school districts on the Schedule of Federal Financial Assistance in the 1994 Annual Financial Report by \$52.9 million. This misstatement occurred because the Agency did not record all federal expenditures by the school districts as of August 31, 1994.

The Comptroller's Reporting Guidelines require all federal program funds expended by subrecipients during the state fiscal year to be reported as pass-throughs by the granting state agency. This includes the costs incurred by subrecipients which are not yet recorded by the state agency as of the end of the fiscal year.

Recommendation: We recommend that the Agency's Accounting Division improve its procedures for determining school district federal expenditures as of August 31. This will help ensure that federal pass-throughs are accurately reported. Because of the difficulty in receiving expenditure reports from school districts within the time frames necessary to prepare the annual financial report, the Agency should consider using estimates based on budgeted amounts.

Management's Response: *The Agency Accounting Division must rely on the program divisions for school districts' expenditure reports which are received and reviewed by TEA program divisions before being recorded in the accounting system.*

The problem is that all final expenditure reports are due to TEA on August 15 or later, and all divisions involved do not have enough time during August and September to process all final expenditure reports, settle payments, calculate the carryover amounts for all new projects, and also begin flowing funds to school districts in September.

We will follow the State Auditor's recommendation that future reports be prepared using estimates based on budgeted amounts.

Audit Scope

The primary focus of our audit was the Agency's financial and administrative controls over the nine major federal programs which disbursed \$1.5 billion in fiscal year 1994. We gained an understanding of the internal control structure, including the general control environment and tested controls related to the federal programs. Specific procedures were used to test compliance with the major federal program requirements.

Financial accounts significant to the statewide financial statements were also tested. These accounts include Investments, \$8.5 billion; Purchases of Investments, \$1 billion; Sales of Investments, \$613 million; Education Expenditures, \$7.6 billion; Transfers In, \$6.8 billion; and Revenues from Licenses, Permits and Fees, \$336 million.

Overall Conclusion

The Commission complied with federal requirements related to the *Employment Services Program* and *Unemployment Insurance Program* with one exception. The Commission is not complying with federal cash management requirements for the *Unemployment Insurance Program*. *Unemployment Insurance Program* expenditures totaled \$1.4 billion during fiscal year 1994.

Additionally, the Commission's significant statewide accounts totaling \$5.3 billion are accurately reported.

Federal Compliance Issue

Federal Compliance Issue 1:

Ensure Compliance With Federal Cash Management Requirements

The Commission is not complying with the federal cash management requirements for the *Unemployment Insurance* program (CFDA 17.225). This program has two components which use different methods of requesting federal funds.

Administrative Funds. The Commission requested and received federal administrative funds earlier than allowed for the two months tested. This is a result of the Commission requesting and receiving funds 10 days before pay day to comply with state law for processing of payroll. The Commission's average day of clearance is the first state working day of the month, since over 85 percent of the Commission's employees are on direct deposit. The U.S. Treasury-State Agreement states that the "State shall time its request for funds such that a prorated amount of its administrative award shall be deposited in the State account on the average day of clearance for payroll during each pay period."

Noncompliance with the funds request requirements may result in a state interest liability. The regulations state that if this funding technique is properly applied, no interest liability will be incurred by the state or the Federal Government.

Payments to Beneficiaries. The payments to beneficiaries account, which is required to have an ending zero balance, had an excess or deficit cash balance for all 65 days tested. The U.S. Treasury-State Agreement states that for payments to beneficiaries, the Commission "shall request federal funds based on the actual amount of funds that cleared the Commission's account in the State Treasury that day."

Recommendation: We recommend the Commission comply with federal cash management requirements. The administrative funds (payroll) requests should be made on the first state working day of the month. General revenue funds may be temporarily used to cover federal payroll costs as provided by Government Code, Section 403.092 (c).

Additionally, if the Commission cannot comply with the funds request requirements for the payments to beneficiaries, an alternate request method should be selected and agreed upon with the U.S. Treasury.

Management's Response: *The Texas Employment Commission will contact Financial Management Services (FMS) for additional guidance on the cash management procedures currently in place. Based upon the guidance provided by FMS, we will adjust procedures as needed to be in compliance with the Cash Management Improvement Act.*

Audit Scope

The primary focus of our audit was the Commission's financial and administrative controls over the two major federal programs, *Employment Services* and *Unemployment Insurance*. *Employment Services* expenditures totaled \$57 million, while spending for *Unemployment Insurance* was \$1.4 billion. Additionally, we tested the accuracy of significant statewide accounts totaling \$5.3 billion which were reported in the Commission's Fiscal Year 1994 Annual Financial Report.

We gained an understanding of significant aspects of the internal control structure, including the general control environment, as well as controls over cash disbursements, payroll / personnel, and federal programs. Specific procedures were used to test compliance with the major federal programs and to test significant accounts, including cash and operating transfers in the Expendable Trust Funds.

Overall Conclusion

The number and complexity of the problems identified, ineffective communication of policies and procedures within the program, and a net loss in operations indicates that a material weakness exists in the control environment over the *Donation of Federal Surplus Personal Property* program. The program received approximately \$34 million of federal property valued at original acquisition cost. The problems identified resulted in total questioned costs of \$10,343,533 (OAC). The operating loss may indicate that the program may not be able to continue operations.

While the Commission has resolved 7 of the 14 outstanding prior year issues, inadequate inventory controls, ineligible donees obtaining property, and nonadherence to policies for monitoring the use of property donated to donees still remain unresolved. As a result, material weaknesses and material noncompliance with federal regulations continue to exist in the program.

A "material weakness" is a lack of procedures which could allow large errors or fraud to occur and not be detected during the normal course of operations. "Material noncompliance" is a failure to follow federal program requirements in a significant number of instances.

Material Weakness In Control Environment

The number and complexity of problems identified, the ineffective communication of policies and procedures, and the net loss in program operations, indicate a material weakness over the control environment of the *Donation of Federal Surplus Personal Property* program (CFDA 39.003). The control environment reflects the attitudes, awareness, and actions of management concerning the importance of controls and the emphasis on properly administering the program. A weakness in the control environment can have an impact on the implementation of management's operating policies and procedures. This increases the risk that unintentional mistakes and intentional improprieties could occur and go undetected.

Seven of the 14 prior year issues related to the *Donation of Federal Surplus Personal Property* program remain unresolved. Two of these issues are significant enough to be categorized as material noncompliance with federal regulations and one as a material weakness in internal controls. Also, three additional issues were noted this year that were not noted in previous years.

Internal Control Issues

Internal Control Issue 1:

Evaluate The Operating Loss In The *Donation of Federal Surplus Personal Property* Program

Expenditures in the *Donation of Federal Surplus Personal Property* program (CFDA 39.003) exceeded revenue, resulting in a net operating loss of \$759,483 for fiscal year 1994. Excess costs incurred in the program were funded from the program's cash reserves in the State Treasury. At August 31, 1994, the cash in the State Treasury was \$1,006,235.

The program is designed to be self-supporting. While the program had sufficient reserves to cover excess expenditures, a continuation of the current trend could jeopardize the State's ability to continue offering this program.

Recommendation: The Commission should evaluate the net operating loss in the *Donation of Federal Surplus Personal Property* program. A detailed analysis of program operations should be done to determine where expenditures can be reduced and revenues raised. Once cost savings and revenue enhancements are identified, adjustments should be made to ensure the long-term viability of this program.

Management's Response: *We agree with the recommendation and have already taken action to reduce operating costs. The program's cash reserves were accumulated in past years by the Texas Surplus Property Agency when revenues exceeded costs. These funds are available to fund program operations in lieu of raising donee charges. However, we agree that the program should be self-supporting and will continue to seek ways to increase revenues and further reduce costs. Most significantly, we are working with the General Services Administration to reduce or eliminate many of the program's burdensome and costly federal requirements.*

Internal Control Issue 2:

Correct Material Weakness To Ensure Property Is Adequately Accounted For And Stored

(Prior Audit Issue)

The Commission did not have adequate controls in place to ensure federal surplus property was properly accounted for and stored. As a result, a material weakness exists in the control system over inventory. Adequate controls ensure that property is safeguarded against loss and unauthorized use.

Controls should be in place when property is received and distributed. A lack of controls caused the following:

- Overages of \$362,000 (OAC) and shortages of \$166,000 (OAC) occurred in the largest district, which represents 10 percent of total inventory of the district.
- Auction property of \$73,000 (OAC) was inadequately recorded in inventory records, and property of \$26,070 (OAC) was lost or stolen. This resulted in questioned costs of the same amount.
- Twenty-four percent (11 of 46) of donees tested obtained property from district warehouses before it was recorded in the inventory system.
- Two of the four districts' fencing contained holes, gaps, or sections without any barbed wire. One district fence was surrounded by trees and shrubs which facilitates burglaries. In addition, property of \$128,000 (OAC) stored in the yard was left susceptible to the elements and theft.

- Districts were not using available resources to evaluate inventory turnover which could cause excessive inventory accumulation.

In addition, a monthly physical inventory was not adequately performed due to automation problems with the inventory system. A monthly inventory is one of the most significant controls for accountability and storage. The largest district had not performed a monthly inventory for six months. Without adequate inventory controls, the potential risk of loss, misuse, or theft of property is significantly increased.

Federal Property Management Regulations, Sections 101-44.204 and 101-44.205, require the state agency to have procedures and facilities to ensure that surplus property is properly accounted for and adequately warehoused.

Recommendation: The Commission should develop controls to ensure federal surplus property is properly accounted for and stored. Specifically:

- Receiving personnel should ensure that all property is accounted for by physically counting all property received and all property disbursed.
- Alternative procedures should be developed when the automated controls cannot be adequately performed.
- Property should not be donated to donees until it is entered into the inventory system.
- Property should be protected from the elements and theft by repairing fences surrounding district property and storing susceptible property in the warehouse.
- Available resources should be used to routinely evaluate inventory turnover.

Management's Response: We concur with this recommendation. Procedural policies have been developed to guide and assist the districts to consistently maintain a physical inventory, emphasize inventory control, and ensure verification of each operation. These policies will be enforced. The Federal Surplus Property ("FSP") compliance auditor will monitor the inventory process and verify and document compliance with policies. The perimeter security fences have been repaired and will be maintained at all districts to protect inventory. The inventory turnover will be monitored, evaluated and reported to program management on a regular basis to determine excessive inventory accumulation.

Internal Control Issue 3:

Effectively Communicate Policies And Procedures To Employees

Policies and procedures in the *Donation of Federal Surplus Personal Property* program (CFDA 39.003) were not effectively communicated to employees. Employees did not receive timely and reliable communication of policies and procedures, including reporting relationships and responsibilities. Program management was not aware of the following conditions until they were brought to their attention during the audit:

- Policies and procedures put in place by management to ensure compliance with federal regulations were not communicated routinely and consistently. As a result, material noncompliance with federal regulations occurred.
- Changes to existing policies and procedures were not formally documented and communicated to employees, resulting in confusion and misunderstanding.
- Program management implemented a new policy that relied on automation for implementation. Program personnel did not inform management that the automated control was not working. As a result, management relied upon a control that was not functioning as prescribed.
- Management was not aware that accounting records were not monitored for delinquent accounts receivable. A Commission policy makes delinquent donees ineligible to receive property, but does not designate who is responsible for execution. Consequently, accounts receivable status was not monitored as expected by district and administrative personnel increasing the risk that ineligible donees were participating in the program.

Management is responsible for establishing and maintaining a system of administrative and accounting controls. A key mechanism in ensuring effective controls is communication of policies and procedures. Communication in an organization should flow up, down, and across the organization.

Recommendation: Management in the *Donation of Federal Surplus Personal Property* program should develop a method to effectively communicate policies and procedures to employees. The method should ensure that all employees are made aware of and kept current on policies and procedures. The policy should document all reporting relationships and job responsibilities. In addition, the job responsibilities should be clarified and discussed with employees.

Management's Response: *We concur with this recommendation. The operational handbook is currently being updated to include functional policies and procedures. Input from all FSP employees will be solicited during development. The handbook with all future updates, will be made available to all FSP employees. Training and testing will be provided to maximize individual job knowledge and performance. Policies will be tested after implementation to ensure controls are functional. Procedures for monitoring and collecting delinquent accounts receivable are being developed and will be included in the handbook.*

Internal Control Issue 4:

Improve Computer System Maintenance Process

The Commission did not ensure that necessary computer maintenance of the *Donation of Federal Surplus Personal Property* (CFDA 39.003) program's automated system was performed in a timely and effective manner. Specifically:

- Prioritization of maintenance requests was not performed and communicated to automation personnel.
- The status of programming maintenance was not adequately documented.
- Monthly meetings to improve communications concerning automation problems were not initiated until December 1994 between the district users, program management, and automation personnel. In addition, the January meeting proceeded with neither input nor involvement from the district users.

Ongoing communication of computer problems helps to ensure that computer systems continue to meet the needs of the users. Communication problems among various groups impacted by the computer system can result in necessary program maintenance not being performed in a timely manner.

Recommendation: The Commission should improve its computer system maintenance process for the *Donation of Federal Surplus Personal Property* program's automated system. Specifically, program management should assume responsibility for establishing priorities for computer maintenance and should track the status of program modifications. In addition, program management should ensure that a mechanism for communication among district users, program management, and automation support is implemented so that problems and needs can be communicated to all involved parties.

Management's Response: *We agree with the recommendations. FSP management will implement a revised procedure which addresses all elements and recommendations in this finding no later than April 1, 1995. This process will include regularly scheduled meetings with FSP administration, district staff, and GSC Automation Resources staff.*

These meetings will help establish necessary communications with district personnel and will make the monthly meetings between FSP and GSC Automation Resources personnel primarily for the solution of unusual problems/issues and the establishment of long range automation plans.

Internal Control Issue 5:

Resolve Prior Automation Issues

The Commission has addressed four of six prior year automation issues. However, the following prior year automation issues remain unresolved:

- Periodic changing of *Donation of Federal Surplus Personal Property* live data is not documented. Documentation of data modification is necessary to ensure that only authorized changes are made to the data.
- Automation Resources is not notified in a timely manner of employee transfers and terminations. Notification of employee transfers and terminations is necessary to ensure that only authorized users have access to computer resources.

- Adequate controls have not been developed to compensate for programmer access to *Donation of Federal Surplus Personal Property* programs and data. Compensating controls increase the likelihood that unauthorized data modification is detected.

Recommendation: The Commission should resolve the remaining prior year automation issues. Changes to *Donation of Federal Surplus Personal Property* data should be documented, and the Commission should ensure that Automation Resources is notified within one day of employee terminations and transfers. Additionally, compensating controls over programmer access should be implemented. One such control would be periodic testing of program data.

Management's Response: *We concur with this recommendation. Live data has been changed only twice in the past year, by FSP personnel under carefully controlled circumstances. GSC Automation Resources personnel have never changed live data. However, a new procedure has been initiated to implement the recommendations in this finding. This new procedure involves automated logging of this change activity. Both Automation Resources and FSP management will review and retain copies of the logs. On March 1, 1995, GSC will implement new procedures to notify Automation Resources of employee transfers and terminations in a timely manner.*

GSC Automation Resources management has developed and implemented adequate compensating controls regarding programmer access. The initial implementation occurred in December 1994. Final enhancements were completed in February 1995.

Federal Compliance Issues

The examination included determining federal compliance with how surplus property was used, if surplus property was donated to eligible donees, and if adequate controls were in place to account for and store inventory. The examination was conducted at all four district warehouses. Forty-five transactions were tested for each specific compliance requirement.

Recommendations addressed in other sections of this report impact controls over federal funds, especially for the Commission's most significant federal program, *Donation of Federal Surplus Personal Property*.

Federal Compliance Issue 1:

Correct Material Noncompliance To Ensure Only Eligible Donees Participate In The *Donation of Federal Surplus Personal Property* Program

(Prior Audit Issue)

The Commission did not ensure only eligible donees participated in the *Donation of Federal Surplus Personal Property* program (CFDA 39.003). Fifty-eight percent (52 of 90) of the donees tested that received surplus property were ineligible to participate in the program, resulting in questioned costs of \$669,461 (OAC). This represents material noncompliance with federal regulations over eligibility.

The Commission has established policies and procedures for updating the eligibility status of donees. However, management did not ensure that the process for updating eligibility files was adequate. For example:

- Reliance was placed on prior administration "technical knowledge" for updating eligibility files despite significant problems noted in this area in previous audits.
- When the Commission began administering the program in September 1993, management elected not to review and update the eligibility of non-profit donees.
- When changes in policies and procedures occurred, eligibility files were not reviewed and updated accordingly.
- Management did not inform key personnel about changes to policies and procedures related to eligibility.

Federal Property Management Regulations 41, Chapter 101-44.207 require the Commission to review and update eligibility files, as frequently as necessary, to ensure current and accurate documentation to support the continuing eligibility of donees.

Recommendation: The Commission should ensure that only eligible donees participate in the *Donation of Federal Surplus Personal Property* program. This can be accomplished by identifying all eligibility files that need to be updated and following all federal policies and procedures for ensuring eligibility status. Additionally, key personnel should be aware of all established policies and procedures for updating eligibility files.

Management's Response: *We concur with this recommendation. Management has taken steps to ensure the accuracy of eligibility files. During the transition of the program from the Texas Surplus Property Agency ("TSPA") to the General Services Commission ("GSC"), management relied upon the knowledge and documentation of the prior administration as the only viable alternative to closing the doors of this program to donees. Closing the program would have resulted in operating for a period of several months with no income while staff was trained and approximately 5,000 donee eligibility files were revised.*

Management began the process of updating eligibility files with the public agency files. Public agency files constituted approximately 85% of the total donee files. Eligibility determination for public agencies is less complex and, therefore, less time-consuming than for nonprofit corporations. Nonprofit corporations were reviewed on or before their expiration date.

Prior to December 1994, the program did not have adequate staffing to update eligibility files without computer automation. Detailed information had to be obtained by manually searching donee records. Information is now readily available due to automated data processing system enhancements made during December 1994. Eligibility files requiring updating are now identified through monthly computer reports. Additionally, this report can be generated upon request at any time.

Eligibility forms were revised during 1994 to comply with federal policies and procedures for ensuring eligibility status. All donees are now required to execute new eligibility forms at least every three years or more frequently if necessary to ensure continued current and accurate documentation.

Management is now using several methods of informing personnel throughout the program of established policies and procedures for updating donee eligibility files. Additionally, effective March 1995, the FSP compliance auditor will perform a random comparison of eligibility files against the computer donee data.

Federal Compliance Issue 2:

Correct Material Noncompliance By Complying With Monitoring Procedures At The Fort Worth District

(Prior Audit Issue)

The Fort Worth district is not complying with monitoring procedures for federal surplus property donated to donees. The Fort Worth district processed 24 percent of total surplus property donated in fiscal year 1994. Fifty percent (12 of 24) of the donated property tested was not adequately monitored to ensure proper use. As a result, questioned costs of \$50,273 (OAC) and material noncompliance with federal requirements occurred.

Code of Federal Regulations (CFR), Title 41, part 101-44.208, requires the Commission, through the use of utilization surveys and reviews, to ensure that donated property is placed in use within one year of its donation and that the donated property, during the period of restriction, is used for the purpose for which it was acquired. The Commission must also comply with the State Plan of Operation which requires the Commission to send utilization questionnaires to donees within six months of donating compliance items and to obtain a response within one year.

The Commission has established procedures for monitoring the use of federal surplus property donated to donees; however, these procedures are not being followed by personnel. Therefore, the following conditions resulted:

- Compliance items were not placed in use within one year.
- Donees did not respond to utilization questionnaires within one year.
- Personnel did not conduct timely follow up on utilization questionnaires when donees did not respond.
- Pertinent information from utilization questionnaires or on-site visits was not recorded.
- Personnel did not report noncompliance to the United States General Services Administration as required by federal regulations and the State Plan of Operation.

Recommendation: The Commission should ensure the Fort Worth district complies with monitoring procedures for federal surplus property donated to donees. Personnel should follow

established procedures for monitoring the use of property donated. We also recommend that the Commission report all instances of noncompliance to the United States General Services Administration, as required.

Management's Response: *We concur with this recommendation. This was a prior audit issue at all four districts. Deficiencies were corrected at the other three districts.*

Fort Worth district personnel have been directed, both verbally and in writing, to follow the existing procedures for monitoring the use of donated property. The district director has indicated that he understands the procedure and is responsible for its implementation. The FSP compliance auditor will review performance of this procedure with the district director during the rest of this year and report any procedural deviations to the program administrator.

All compliance donations in fiscal year 1994, and those in fiscal year 1995 to date, will be reviewed by the district staff to ensure that any instance of noncompliance has been reported to the United States General Services Administration. Verification results will be tested by the FSP compliance auditor and reported in writing to the program administrator and the GSC Office of Internal Audit.

Federal Compliance Issue 3:

Enforce Subrecipient Audit Report Requirements

The Commission did not enforce federal regulations requiring subrecipients to submit audit reports. The Commission did not obtain all of the required audit reports from subrecipients participating in the *Donation of Federal Surplus Personal Property* program (CFDA 39.003), resulting in questioned costs of \$8,727,901 (OAC). Additionally, of 12 subrecipients audit reports tested, 5 were not prepared in accordance with *Office of Management and Budget (OMB) Circulars A-128 and A-133*. This results in an additional \$824,933 (OAC) of questioned costs.

The subrecipients are required to submit audit reports in accordance with *Office of Management and Budget (OMB) Circulars A-128 and A-133*, no later than 13 months after their fiscal year end. The audit reports provide assurance that the federal assistance is properly utilized.

Recommendation: We recommend that the Commission enforce subrecipient audit report requirements by obtaining all audit reports as required.

Management's Response: *The audit reports that were not obtained are for donees who participated in the program under TSPA during its final fiscal year which ended August 31, 1993. FSP management has monitored compliance for donees who became subject to single audit reporting requirements after the program was transferred to GSC on September 1, 1993. However, TSPA management had not informed donees of the single audit requirements until May 1993. GSC management chose not to retroactively impose single audit criteria on donees whose audit reports were required as a result of federal surplus property received prior to September 1, 1993.*

Recent and proposed federal changes will greatly reduce the impact of single audit requirements on the FSP program. Effective October 11, 1994, the General Services Administration issued a policy to value surplus property at 23.3% of its original acquisition cost. Surplus property was previously valued at 100% of original acquisition cost for purposes of the Single Audit Act. This change will reduce the number of donees subject to single audit requirements from over 200 for fiscal year 1994 to an estimated 50 donees in subsequent years. In addition, pending federal legislation would change the dollar threshold on federal financial assistance for single audit purposes from \$25,000 to \$100,000. Approximately five (5) donees would be subject to single audit requirements when the \$100,000 threshold is combined with the market value change.

Federal Compliance Issue 4:

Ensure Resolution Of Subrecipient Audit Findings Within The Required Timeframe

The Commission did not resolve all subrecipient audit findings within the required timeframe for the *Donation of Federal Surplus Personal Property (CFDA 39.003)* program. The Commission failed to obtain corrective action from 20 percent (1 of 5) of the subrecipient files tested for unresolved findings. In addition, the Commission did not document review dates for subrecipient audit reports.

Office of Management and Budget (OMB) Circulars A-128 and A-133, require the Commission to review the audit reports for audit findings and to obtain corrective action within six months of report receipt.

Recommendation: We recommend that the Commission ensure resolution of subrecipient audit findings within six months by reviewing reports in accordance with federal regulations.

Management's Response: *We agree with this recommendation. As explained in the response to "Enforce Subrecipient Audit Report Requirements", these donees' single audit reports are for the year ended August 31, 1993. For federal financial assistance received since the program was transferred to GSC on September 1, 1993, FSP management will continue to ensure resolution of subrecipient audit findings in accordance with federal regulations.*

Federal Compliance Issue 5:

Comply With Federal Debarment/Suspension Requirements

(Prior Audit Issue)

The Commission did not comply with federal debarment and suspension requirements. Federal surplus property was donated to donees who had not submitted debarment and suspension certifications, resulting in questioned costs of \$44,895 (OAC).

Since the Commission began administering the program in September 1993, letters were distributed to donees requesting debarment and suspension certifications. However, the

Commission did not prevent donees who subsequently failed to submit the required certifications from participating in the program.

Title 41 of the Code of Federal Regulations (CFR), Part 105-68.5, requires the Commission to obtain certifications from donees that they are not debarred or suspended from participating in federal assistance programs.

Recommendation: The Commission should comply with debarment and suspension requirements by preventing donees who do not submit debarment and suspension certifications from participating in the program.

Management's Response: *We concur with this recommendation. The automated data processing system was modified so that employees are automatically warned when donees do not have debarment and suspension certifications on file. Additional procedures are being developed to ensure compliance.*

Federal Compliance Issue 6:

Ensure That Price Adjustments Are Justified At The Houston District

(Prior Audit Issue)

The Houston District is not justifying price adjustments made to handling fees. Although the Commission has procedures for justifying price adjustments, 33 percent (5 of 15) of price adjustments tested at the Houston District were not justified. The price adjustments ranged from discounts of \$74 to \$770.

Federal Property Management Regulation 41, part 101-44.202 (5), requires the service and handling fees the Commission charges to be fair and equitable to all donees. Adequate justification of price adjustments is necessary to ensure donees are charged fair and equitable handling fees.

Recommendation: The Commission should ensure that the Houston District justify all adjustments to handling fees.

Management's Response: *We agree that all districts should justify adjustments to handling fees. Procedures for justifying price adjustments were communicated by memo to all districts in October 1993. However, Houston District management did not implement the procedure until March, 1994. We have directed the current manager of the Houston office to ensure that this is done. The FSP compliance auditor will monitor.*

Federal Compliance Issue 7:

Develop Formal Policies And Procedures To Ensure That Petroleum Violation Escrow Funds Have Not Been Substituted

The Commission does not have formal policies and procedures in place to ensure that state or other federal funds have not been substituted with Petroleum Violation Escrow funds. For fiscal year 1994, the Petroleum Violation Escrow funds were valued at \$57 million. In the

absence of policies and procedures, the Commission cannot be assured that state, local, or other federal funds have not been replaced with Petroleum Violation Escrow funds.

Title 10 of the Code of Federal Regulations (CFR), part 420.4(5), requires each state receiving federal financial assistance to establish policies and procedures designed to ensure that the funds will be used to supplement, not supplant (substitute), state, local, and other federal funds ordinarily available to the program.

Recommendation: The Commission should develop formal policies and procedures to ensure that state, local, or other federal funds are not substituted with Petroleum Violation Escrow funds.

Management's Response: *We will develop recommended policies and procedures. However, the "supplement, not supplant" rule only applies when other state or federal funds have been provided to fund the program in question. Only two of the programs directly administered by the State Energy Conservation Office/General Services Commission have historically received state or federal funds apart from Petroleum Violation Escrow (PVE) on oil overcharge funds. These are the Institutional Conservation Program and the State Energy Conservation Plan. By statute, Chapter 2305 of the Government Code, the Department of Housing and Community Affairs and the Texas Department of Transportation separately and directly administer several programs which receive oil overcharge monies in addition to other state and federal funds.*

The "supplement, not supplant" rule is also not violated when PVE funds are used to continue a program for which independent state or federal funds have been exhausted or depleted. In each case, the Department of Energy must approve the expenditure of PVE funds. In short, most of these programs would not exist in the absence of oil overcharge monies.

Audit Scope

The primary focus of our audit was the Commission's administrative controls over the *Donation of Federal Surplus Personal Property* program valued at \$34 million of original federal acquisition cost and the *Petroleum Violation Escrow (PVE)* funds valued at \$57 million. The Commission performed the administrative function for the PVE program on behalf of the Office of the Governor. We gained an understanding of the internal control structures related to these federal programs and tested compliance with significant federal requirements. We also followed up on all unresolved prior audit issues identified in Appendix 2.

General Services Commission Appendix:

Background

The objective of the *Donation of Federal Surplus Personal Property* program is to distribute federal surplus property to state and local public agencies and certain nonprofit, tax exempt activities (donees). Personal property which is surplus to the needs of the Federal Government is approved for transfer to the states on a fair and equitable basis by the United States General Services Administration.

The Commission serves as the link between the federal agencies that generate the property and eligible organizations in Texas which use donated property for a wide variety of programs. The program is designed to be self-supporting, assessing a service and handling fee to sustain its operations.

The *Donation of Federal Surplus Personal Property* program is the Commission's largest federal program. The program received approximately \$34 million of federal property valued at original acquisition cost and generated \$2 million in program income from service and handling fees in fiscal year 1994.

Material weaknesses in internal controls and material noncompliance with federal regulations have existed in this program since fiscal year 1991. The status of prior year issues is highlighted below:

Status Of Prior Year Issues:

Status of Prior Year Issues		
<i>Donation of Federal Surplus Personal Property Program</i>	Unresolved	Resolved
Develop a System to Monitor Subrecipients		X
Comply with Federal Financial Report Requirements		X
Comply with Property Accountability and Storage Requirements	X	
Comply with Federal Property Distribution Requirements	X	
Comply with Property Utilization Requirements	X	
Comply with Eligibility Requirements	X	
Enhance Access Controls over Inventory	X	

Status of Prior Year Issues		
<i>Donation of Federal Surplus Personal Property Program</i>	Unresolved	Resolved
Ensure Separation of Duties in the Automated Environment		X
Strengthen Backup and Recovery Procedures		X
Implement Systems Development Methodology		X
Enhance Inventory System's Input Controls		X
Enhance Controls over General Services Administration Form 123		X
Comply with Federal Debarment/Suspension Requirements	X	
Sustained Program Weaknesses	X	
Other		
Restrict Access to Computer System	X	

The issues identified above were unresolved findings from fiscal years 1991, 1992, and 1993. SAO report numbers 2-109, 3-048, and 4-076, highlight the specific conditions noted in each of the three past fiscal years. This report highlights the specific conditions noted in fiscal year 1994.

Overall Conclusion

In general, the Office's Criminal Justice Division has established a system to ensure compliance with federal regulations for its largest federal program, the *Drug Control and System Improvement-Formula Grant*. This program provides financial assistance to state and local units of government for the purpose of reducing the violation of state and local laws relating to controlled substances and spent \$30 million during the 1994 state fiscal year. Also, we have verified the resolution of the findings in the letter from the U.S. Department of Health and Human Services.

Related Report

The State Auditor's Office has verified that \$1 million in adjustments have been made as required by the U.S. Department of Health and Human Services' letter of resolution. These adjustments resulted from the November 1993 report on the *State Legalization Impact Assistance Grant* (CFDA 93.565) issued by the Department's Office of Inspector General. The report related to the Governor's Office of Immigration and Refugee Affairs and four other state agencies. The verification of the adjustments will be discussed in the management letters of the affected state agencies and in *Appendix 2: Verification Of Letter Of Resolution Adjustments..*

Federal Compliance Issue

The Governor's Office's most significant federal program is the *Drug Control and System Improvement - Formula Grant* (CFDA 16.579), which is administered by the U.S. Department of Justice. This program, which is administered by the Office's Criminal Justice Division, provides financial assistance to state and local units of government for the purpose of reducing the violation of state and local laws relating to controlled substances. Fiscal year 1994 expenditures were \$30 million, which represented 79 percent of the funds received from the Justice Department (\$38 million) and 42 percent of all federal funds received by the Office (\$71 million).

The majority of the program's funds, \$29 million or 97 percent, are passed on to subrecipients which are state and local governmental entities. The issue discussed below concerns the receipt of required audit reports from these subrecipients.

Federal Compliance Issue 1:

Continue Efforts To Obtain Delinquent Subrecipient Audit Reports

The Governor's Office has not received two out of 70 (three percent) required subrecipient audit reports as of December 31, 1994. The reports were due October 31, 1994. The delinquent reports result in questioned costs of \$393,554 for the *Drug Control and System Improvement - Formula Grant* program (CFDA 16.579).

The receipt and review of these audit reports ensure proper spending of federal funds by subrecipients. The Governor's Office has a policy to notify, and eventually sanction, subrecipients who have not submitted audit reports within the required time frame.

Office of Management and Budget Circular A-128 requires subrecipients to submit audit reports no later than 13 months after their fiscal year end. Federal regulations also require the reports to be reviewed for adequacy and corrective action obtained within six months of receipt of the reports.

Recommendation: We recommend that the Governor's Office continue its efforts to obtain the required audit reports from subrecipients.

Management's Response: *For the ensuing year, procedures for notifying grantees regarding delinquent reports will be accelerated to ensure receipt of all audit reports by the required dates.*

Audit Scope

The primary focus of our audit was the Office's compliance with the federal requirements for their largest program, the *Drug Control and System Improvement - Formula Grant*. This program spent \$30 million during the 1994 state fiscal year, which represents 42 percent of the office's total federal financial assistance of \$71 million.

We gained an understanding of the general control environment. We also verified the adjustments made in connection with the U.S. Department of Health and Human Services' letter of resolution.

Overall Conclusion

The Department is in compliance with most federal regulations related to the \$4.2 billion in federal funds expended in fiscal year 1994. We also tested accounts that were significant to the State's financial statements and determined that the accounts are materially accurate and properly reported. These accounts included \$4.1 billion of federal revenues, human services expenditures of \$6 billion, and accounts payable of \$475 million.

Related Report

The State Auditor's Office has verified that \$1,005,089 in adjustments have been made as required by the U.S. Department of Health and Human Services' letter of resolution. These adjustments resulted from the November 1993 report on the *State Legalization Impact Assistance Grant* (CFDA 93.565) issued by the U.S. Department of Health and Human Services Office of the Inspector General. The report related to the Texas Department of Health and other state agencies. See *Appendix 2: Verification Of Letter Of Resolution Adjustments*.

Internal Control Issue

Internal Control Issue:

Address Automation Issues Cited In Prior Years

(Prior Audit Issue)

The Department has not fully addressed the computer access and disaster recovery issues cited in fiscal years 1991 and 1993. Programmers still have unrestricted access to some data files which could result in unauthorized modification or loss of data. This access is not monitored on a regular basis. In addition, although progress has been made towards developing a disaster recovery risk analysis, it has not been completed in accordance with the implementation schedule developed by the Department of Information Resources. These conditions expose the Department of Health to a risk of delays in processing critical information in the event of a disaster. Data accuracy and disaster recovery are essential since the Department processed \$4.2 billion in federal funds during fiscal year 1994.

Recommendation: We recommend the Department of Health restrict programmer access to data files, complete the risk analysis, and update the disaster recovery plan based on the results of the risk analysis.

Management's Response: *The Texas Department of Health is willing to accept the risk for data access by programmers. The Department has received the final risk assessment from the contractor and has initiated procurement of disaster recovery plans. The Department has already contracted for disaster recovery plans for the Bureau of Vital Statistics. Payroll and other applications will follow.*

Federal Compliance Issues

Recommendations addressed in the internal controls section of this report could impact controls over federal funds, especially for the Department's most significant federal programs administered by the U.S. Department of Health and Human Services.

Federal Compliance

Federal Compliance Issue 1:

Comply With Administrative Requirements

The Department does not comply with *Maternal and Child Health Services Block Grant (CFDA 93.994)* administrative requirements. The Department lacks sufficient accounting procedures and fiscal controls to determine if they are meeting required spending thresholds.

Over \$58 million in federal *Maternal and Child Health Services Block Grant* funds were expended in fiscal year 1994. The block grant requires that a minimum of 30 percent of grant funds be used to provide services to children and a minimum of 30 percent of the funds be used to provide services to children with special health needs. Current accounting procedures do not allow the Department to determine if they are meeting these requirements.

Federal regulations set forth in *Code of Federal Regulations (CFR), Title 45, Section 96.30* require the Department to establish accounting procedures and fiscal controls in order to ensure compliance with block grant requirements.

Recommendation: We recommend that the Department comply with block grant administrative requirements. The Department should develop accounting procedures and fiscal controls to monitor spending activity and ensure block grant spending thresholds are met.

Management's Response: *We agree that the Department's accounting systems to document and monitor spending thresholds can be improved. The necessary improvements are in process and will be operational no later than September 1, 1995.*

Federal Compliance Issue 2:

Consider Impact Of Unresolved Subrecipient Questioned Costs

The Department does not have documented procedures to consider unresolved subrecipient questioned costs for materiality and possible footnote disclosure in the financial statements. The Department's subrecipients had approximately \$127,000 in unresolved questioned costs at the end of fiscal year 1994. The lack of procedures could hinder the preparation of accurate financial statements.

Office of Management and Budget (OMB) Circular A-128 requires the agency to consider whether subrecipient audits necessitate adjustment of the agency's own records. Furthermore,

the *State Comptroller's Reporting Requirements for Annual Financial Reports of State Agencies* guidelines for fiscal year 1994 require the Department to compile subrecipient questioned costs and determine their impact on the financial statements. Subrecipient questioned costs determined to be material to a federal program or fund should be disclosed as a contingent liability in the Notes to the Financial Statements. Material refunds owed to the Federal Government which originate from questioned costs require an adjustment to the financial statements.

Recommendation: We recommend that the Department develop a process whereby they can evaluate the impact of unresolved subrecipient questioned costs. If material, the questioned costs should be properly presented in the financial statements.

Management's Response: *The Department will document its procedure for considering unresolved subrecipient questioned costs for materiality and possible footnote disclosure in the financial statements.*

Audit Scope

The primary focus of our audit was the Department's compliance with federal requirements. We tested the Department's three largest federal programs which are the *Medical Assistance Program, Special Supplemental Food Program for Women, Infants and Children*, and the *Maternal and Child Health Services Block Grant*. These programs represent \$4.1 billion, or 97 percent, of the Department's fiscal year 1994 federal expenditures of \$4.2 billion. We gained an understanding of the general control environment and tested controls related to federal programs and cash disbursements. Specific procedures were used to test compliance with program requirements.

We also tested accounts that were significant to the State's financial statements and determined that the accounts are materially accurate and properly reported. These accounts included \$4.1 billion of federal revenues, human services expenditures of \$6 billion, and accounts payable of \$475 million.

Overall Conclusion

The Board has established a system to ensure compliance with federal regulations for its two largest federal programs, the \$56.3 million *Federal Family Education Loan Program* (CFDA 84.032) and the \$40.8 million *Vocational Education Program* (CFDA 84.048). This system is working, however, the Board is not adequately tracking all subrecipient audit reports for the *Vocational Education Program*. The \$486 million Loans and Contracts Receivable account, which is significant to the statewide financial report, is fairly stated. In addition, the Board has established a system to ensure compliance with bond covenants for the \$499 million in outstanding bonds as of August 31, 1994. This system is working and ensures that bondholder's interests are protected. The Board issues bonds for educational loans to eligible Texas college students.

Federal Compliance Issue

Federal Compliance Issue 1:

Improve The Subrecipient Audit Tracking System

The Board does not adequately track all subrecipient audit reports for the *Vocational Education Program-Basic Grants to States* (CFDA 84.048). Without an adequate tracking system, the Board cannot ensure compliance with federal requirements.

Office of Management and Budget Circular (OMB) A-128 requires the Board to determine whether subrecipients have met Single Audit Act requirements, which provide assurance that funds were spent in accordance with applicable laws and regulations.

Recommendation: We recommend that the Board improve the subrecipient audit tracking system. The system should include data to ensure that:

- All audit reports are both received and reviewed.
- Corrective action is obtained for all audit findings.
- Outstanding reports, findings, and questioned costs are addressed.

Management's Response: *We have initiated a process we feel confident will eliminate recurrence of the problem and ensure compliance with federal requirements that funds will be spent in accordance with applicable laws and regulations.*

We have established a log in fiscal year 1995 to record receipt, review, and appropriate resolution of audit findings. Reports are reviewed for existence of findings and questioned costs when we receive the audit report. Resolution of findings will be initiated then. Follow-up on all 1993 comments will be carried out with the reviews of the 1994 reports. The resolution may be as simple as acceptance of the institution's corrective action plan or further communication to negotiate an appropriate corrective action. Final resolution of audit findings will be approved by the Assistant Commissioner for Community and Technical Colleges upon staff recommendation. The target date for final resolution of this comment is six months after receipt of the final 1994 audit report.

Audit Scope

The primary focus of our audit was the Board's \$486 million in student loans outstanding. The loan programs are funded by 21 bond issues representing the majority of the Board's outstanding debt as of August 31, 1994. We gained an understanding of the Board's general control environment, as well as the administrative controls over major federal programs, including the \$56.3 million *Federal Family Education Loan Program* (CFDA 84.032) and the \$40.8 million *Vocational Education Program* (CFDA 84.048). We also gained an understanding of management's controls over bonds payable and related financial activities. The Loans and Contracts Receivable account, which is significant to the statewide financial statements, was also tested. Specific procedures were also performed to test compliance with bond covenants and compliance with requirements for major federal programs.

Overall Conclusion

The Department is in compliance with most federal regulations related to the \$5.2 billion of federal funds expended in fiscal year 1994. However, we noted a material control weakness and one instance of material noncompliance.

In addition, federal revenue, expenditures, and other accounts significant to the statewide financial statements are materially accurate and properly reported.

Other Related Reports

The State Auditor's Office has verified that \$377.06 in adjustments have been made as required by the U.S. Department of Health and Human Services' letter of resolution. These adjustments resulted from the November 1993 report on the *State Legalization Impact Assistance Grant* (CFDA 93.565) issued by the Department's Office of Inspector General. The report related to the Department of Human Services and other state agencies. See *Appendix 2: Verification Of Letter Of Resolution Adjustments*.

Internal Control Issues

Internal Control Issue 1:

Improve Oversight Of Commercial Distributors

The Department does not provide sufficient oversight of commercial distributors in the *Food Distribution* program (CFDA 10.550). The lack of oversight has resulted in inaccurate and untimely reports and inaccurate inventory records for the *Food Distribution* program. Because of this material weakness, the operating environment will not readily prevent or detect errors, irregularities, and material noncompliance with federal laws and regulations.

The Department is responsible for receiving, allocating, and distributing commodities valued at approximately \$65 million to eligible recipient agencies. In fiscal year 1994, the Department began contracting with commercial distributors to carry out these duties. This new system has complicated the reporting process. While the commercial distributors maintain the inventory records, the Department prepares the federal reports (FNS-155s).

Examples of inadequate oversight include:

- Not requiring commercial distributors to provide written documentation to support totals on monthly activity reports or to submit timely receiving documentation necessary for updating the automated system. This lack of documentation forces program management to override the automated system and manually produce the reports. This increases the likelihood of mathematical and data entry errors.

- Not enforcing the deadlines by which commercial distributors must submit required monthly activity reports that are used to prepare the federal reports. This has caused the Department to miss federal deadlines.
- Not utilizing annual physical inventory reports prepared by Department field audit staff to adjust the inventory data base. Actual inventory counts should be used to support the accuracy of the reports. Because adjustments are not being made for actual inventory counts, the inventory data base does not contain reliable information.
- Allocating only two contract managers to monitor seven commercial distributors. Field audit staff could assist in contract monitoring.

Federal regulations (7 CFR, Sections 250.16 and 250.17) require the Department to:

- Maintain accurate and complete records with respect to the receipt, distribution/use, and inventory of donated foods.
- Complete and submit monthly reports covering the receipt and distribution of donated foods no later than 30 calendar days following the reporting period.

Recommendation: We recommend that the Department improve oversight over commercial distributors by:

- 1) Continuing efforts to strengthen contract requirements with commercial distributors and adding administrative sanctions for those in violation.
- 2) Utilizing physical inventory counts to adjust the Department's inventory records and continuing to pursue coordination with field audit staff on monitoring and auditing of the commercial distributors.
- 3) Requiring commercial distributors to provide complete and accurate reports within applicable deadlines.

Management's Response:

- 1) *We are currently working on the next Request for Proposals (RFP) to secure new contracts for commercial distributors. Options are being developed for administrative and financial sanctions to provide meaningful penalties for the failure to meet contract requirements. The RFP is scheduled to be published in July 1995.*
- 2) *We are immediately implementing the practice of adjusting inventory records utilizing physical inventory counts from our auditors. We are finalizing arrangements for our field auditors to obtain copies of monthly monitoring reports prior to conducting an annual audit of the distributors. The distributor audit will include an examination of their allocation and reporting systems. These plans will be completed by June 1995.*

- 3) *We sent a letter to each distributor reinforcing the requirement for timely and accurate reports. Beginning in February 1995 our monitoring staff will follow up on this requirement using a revised monitoring document that greatly expands the level of detail examined during monthly reviews.*

Internal Control Issue 2:

Reconcile Federal Reports To The Accounting Records

Until September 1994, the Department did not regularly reconcile quarterly federal reports to the accounting records for 22 federal programs with total fiscal year 1994 expenditures of \$4.8 billion. In addition, the Department did not have procedures to ensure all adjustments were posted to the accounting records in a timely manner.

Regular reconciliations and timely posting of adjustments are necessary to ensure that information in federal reports and the financial statements is accurate and complete. Without such procedures, there is an increased risk that information in federal reports or financial statements could be inaccurate and/or incomplete.

Recommendation: We recommend that the Department reconcile federal reports to the accounting records for the five previous years and continue to prepare current year reconciliations on a regular basis. We also recommend that the Department develop procedures to ensure all adjustments are posted in a timely manner.

Management's Response:

Current Operation:

- 1) *We are currently working on reconciling the most recent Quarterly reports and keeping them current as they are completed.*
- 2) *We will next begin working on the previous five years. There are approximately 580 individual program reconciliations for that time period, of which approximately 521 are partially complete. We need to determine what is left and compile each quarter to make it complete.*

Actions to be Taken:

- 1) *When the quarters are complete, we will need to track through them to see what adjustments still need to be made.*
- 2) *As we complete the reconciliations for the current quarter, we will be developing procedures to correct any new reconciling items within the next quarter.*

Internal Control Issue 3:

Document Procedures For The Survey And Certification Quarterly Expenditures Report

The *State Survey and Certification of Health Care Providers and Suppliers* program (CFDA 93.777) at the Texas Department of Human Services does not have formal procedures for preparing and reviewing the Federal Quarterly Expenditures Report. The absence of procedures increases the risk of errors. Transposition errors in the June 30, 1994, Quarterly Expenditures Report resulted in federal expenditures being underreported by \$44,291.

Recommendation: We recommend that the Department document the procedures for preparing and reviewing the Quarterly Expenditures Report. The report review process should include tracing all reported amounts to the supporting documentation. The review also should verify that the federal and state matching rates were correctly applied to each cost center. The \$44,291 error on the June 30, 1994, Quarterly Expenditures Report should be corrected on a future report.

Management's Response: *Formal procedures for the preparation and review of the Quarterly Expenditures Report will be prepared in February, 1995 as recommended. The \$44,921 transposition error on the June 30, 1994 report was corrected on the December 31, 1994 report.*

Federal Compliance Issues

Recommendations addressed in other sections of this report could impact controls over federal funds, especially for the Department's most significant federal programs administered by the U. S. Department of Health and Human Services and the U. S. Department of Agriculture.

We reviewed programs totaling 98 percent of the Department's \$5.2 billion in federal pass-throughs and expenditures. The Department is in compliance with most federal regulations for the programs reviewed. The following comments address occurrences of noncompliance in the federal programs we reviewed.

Federal Compliance Issues

Federal Compliance Issue 1:

Document Information Given To AFDC Clients

(Prior Audit Issue)

For the third consecutive year, the Department did not document that it informed all *Aid to Families with Dependent Children* (AFDC) program (CFDA 93.560) clients of their rights to services and their responsibility to participate in the *Job Opportunities and Basic Skills Training* (JOBS) program (CFDA 93.561). Thirty-three percent of the AFDC case files tested (15 of 45) did not contain a copy of required Form 2580 documenting that the Department informed the client of the JOBS program services and their rights and responsibilities regarding the JOBS program. This represents material noncompliance with federal regulations.

Federal regulations require clients to participate in the JOBS program in order to receive payments from the AFDC program unless they are determined to be exempt from participation. The objective of the JOBS program is to offer employment and training opportunities to enable clients to become self-sufficient. If clients are not informed of these opportunities, this objective may not be met.

Title 45 of the Code of Federal Regulations (CFR), Section 250.40, requires the Department to inform all AFDC clients in writing at the time of application or redetermination about the JOBS program.

Although procedures are in place which address the written notification requirement in the *Income Assistance Handbook* used by eligibility staff, they do not expressly state that a written notification of rights and responsibilities is required for all AFDC applicants.

In addition, the *Self-Support Services Handbook*, used by employment services staff, states: "During the certification process for AFDC, eligibility staff inform clients of their rights and responsibilities. Staff review Form 2580 with the client, obtain the client's signature and date on the form, and file a copy of the form in the case file." This handbook is not used by eligibility staff, but might imply to the Department's employment worker that eligibility staff has provided the written notification to all AFDC clients.

Recommendation: We recommend that the Department document in case files that all AFDC clients have been informed of their rights to and responsibilities for JOBS services. Additionally, we recommend that the Department clarify the procedures in the *Income Assistance Handbook* so it is clear that all AFDC applicants should be informed of their rights and responsibilities concerning the JOBS program. This clarification should be consistent with the procedures used by the employment staff located in the *Self-Support Services Handbook*.

Management's Response: *CSS agrees that the Department should document in case files that all eligible AFDC clients have been informed of their rights to and responsibilities for JOBS services.*

A workgroup of State Office staff from Client Self-Support Services (CSS) sections for Eligibility Services, Employment Services, Educational Services and Program Automation began meetings in January 1995 to clarify policy and procedures. Initiatives will include clarification in handbook material and BJST training, and a Quick Quality Tip broadcast to Eligibility staff.

Federal Compliance Issue 2:

Comply With All Subrecipient Monitoring Requirements

(Prior Audit Issue Included)

Continue Efforts To Obtain Delinquent Subrecipient Audit Reports

(Prior Audit Issue)

The Department did not receive 11 out of 356 required subrecipient audit reports. The delinquent reports result in questioned costs of \$3,947,317 for the following federal programs:

Program	CFDA Number	Questioned Cost	1993 Total Program Pass-throughs and	Percentage of Program
Food Distribution	10.550	\$49,587	\$74,830,062	less than 1
School Breakfast	10.553	65,918	2,603,037	3
National School Lunch	10.555	8,002	5,034,181	less than 1
Child & Adult Care Food	10.558	932,143	93,651,621	1
Summer Food Service Program for Children	10.559	1,926,499	12,638,993	15
Temporary Emergency Food Assistance - Administrative Costs	10.568	965,168	3,421,439	28
TOTAL		\$3,947,317	\$192,179,333	2

The receipt and review of these audit reports ensures proper spending of federal funds by subrecipients. The Department has a policy to notify and eventually sanction subrecipients who have not submitted audit reports within the required timeframe.

Office of Management and Budget (OMB) Circular A-128 requires subrecipients to submit audit reports no later than 13 months after their fiscal year end. Federal regulations require the reports to be reviewed for adequacy and obtain corrective action within six months of receipt of the reports.

The Department has made notable improvements in reducing delinquent subrecipient audit reports. In fiscal year 1993, there were 166 delinquent audit reports which resulted in questioned costs of \$28,059,001.

Recommendation: We recommend that the Department continue its efforts to obtain the required audit reports from subrecipients.

Management's Response: *The Department has made significant progress in the last two years in its efforts to obtain the required audit reports from subrecipients. These efforts will be continued in the next reporting period in an effort to bring all subrecipients into compliance with single audit reporting requirements. In the case of the eleven contractors cited as "overdue", all contractors are being handled in accordance with the*

sanction process for the collection of "overdue" single audits. These contracts will be terminated if the required audits are not submitted.

Develop Procedures To Adjust Financial Statements For Subrecipient Questioned Costs

The Department is not complying with all subrecipient monitoring requirements. There are no procedures in place to determine whether subrecipient questioned costs require an adjustment to the Department's financial statements. The Department's subrecipients had approximately \$503,730 in unresolved questioned costs at the end of fiscal year 1994. The lack of procedures could hinder the preparation of accurate financial statements.

Office of Management and Budget (OMB) Circular A-128 requires the recipient to assess the materiality of questioned costs resulting from subrecipient audit reports. Questioned costs assessed as material will result in an adjustment to the recipient's financial statements.

Recommendation: We recommend the Department comply with all subrecipient monitoring requirements. An assessment of subrecipient questioned costs should be performed to determine whether an adjustment to the financial statements is needed.

Management's Response: *The Department will develop and implement procedures to ensure that all questioned costs are assessed to determine whether an adjustment to the financial statements is needed.*

Ensure Accurate Subrecipient Tracking Information

The Department's subrecipient monitoring tracking system contains inaccurate data in the field "Audit Due Date." The system automatically designates the frequency of the audit (annual or bi-annual) based upon the dollar amount of the federal assistance. This is not in compliance with federal requirements.

State and local governments are required to submit an annual audit when they receive \$25,000 or more of federal assistance. Not-for-profit entities receiving \$25,000 or more can submit a bi-annual A-133 audit if their financial audit is done every two years. However, if the laws or regulations require an annual audit, then an annual audit must be performed.

Not having accurate data in the tracking system could result in audit reports not being received. Delinquent audit reports prevent the Department from monitoring their subrecipients and result in questioned costs.

Recommendation: We recommend the Department correct their subrecipient tracking system to ensure all data fields contain accurate information to ensure timely receipt and review of audits.

Management's Response: The data field "Audit Due Date" in the Single Audit Management System will be reprogrammed by February 1, 1995 to designate all State and Local government contractors as having annual due dates when they receive \$25,000 or more of federal assistance. Not-for-profit contractors receiving between \$25,000 and \$100,000 will be programmed to have annual due dates unless they demonstrate that they qualify to submit a bi-annual A-133 audit.

Federal Compliance Issue 3:

Implement Federal Audit Recommendations Regarding AFDC And Medicaid Uncashed Checks

The Department has not implemented Federal audit recommendations regarding uncashed checks for the *Aid to Families with Dependent Children* (AFDC) (CFDA 93.560) and *Medicaid* (CFDA 93.778) programs which are more than 180-days old. This has resulted in questioned costs for the AFDC program of more than \$824,000, noncompliance with federal regulations, and interest assessments against the State. Information was not available to quantify questioned cost for the *Medicaid* program.

In January 1992, the Department of Health and Human Services (HHS) Office of Inspector General reported that the Department was not identifying and reporting uncashed checks for AFDC administrative costs or *Medicaid* program and administrative costs. The Department was, however, reporting uncashed checks for AFDC program costs.

The Department agreed with HHS to implement procedures to estimate the uncashed checks each quarter until a detailed check tracking system under development became fully operational. The reported estimates would be adjusted annually to actual amounts. The Department also agreed to calculate and repay interest earned on unreported and uncashed checks which were issued in 1989 and subsequent fiscal years. Interest assessments will continue until corrective action is taken.

The Department has not reported any estimates of uncashed checks for AFDC administrative costs and *Medicaid* program and administrative costs. Also, in fiscal year 1994, the Department discontinued reporting uncashed checks for AFDC program costs because of unreliable information provided by the check tracking system.

Federal regulations addressing both AFDC (45 CFR 201.67) and *Medicaid* (42 CFR 433.40) state that, if a check remains uncashed beyond a period of 180 days from the date it was issued, the check will no longer be regarded as an amount expended, and the funds must be returned to the Federal Government. At the end of each calendar quarter, the state agency must identify those checks which remain uncashed beyond the 180-day period and report the federal portion on quarterly federal expenditure reports as a credit.

Recommendation: We recommend the Department implement federal audit recommendations regarding uncashed checks which are more than 180-days old. Uncashed check estimates should be reported quarterly for both AFDC and *Medicaid* program and administrative costs until the check tracking system provides reliable information to report the actual amount of uncashed

checks. The Department should determine actual amounts and adjust the reported estimates as soon as possible to stop interest assessments against the State.

Management's Response: At the time of the Department of Health and Human Services (HHS) audit, this agency was in the process of developing a warrant tracking system to allow timely reporting of uncashed warrants. In compliance with recommendations in the HHS audit report, a refund of estimated interest accrued through Federal Fiscal Year 1993 was calculated and adjusted in Federal cost reports for the quarter ended March 31, 1994. Beginning in Fiscal Year 1994, file information used in the Warrant Tracking System became corrupted, rendering reports generated by the system unusable. At the time, it was anticipated that the file problems would be corrected within a short time allowing adjustment based on actual figures. Correction of these problems has taken longer than expected, but at present it appears that reliable information is available to allow adjustment to the March, 1995 quarterly reports. In addition to adjusting for December, and March, 1995 uncashed warrants, we will also include an adjustment for the amount of questioned costs noted in the audit finding.

In regard to the \$824,000 in questioned costs, we wish to point out that this amount represents the Federal share of uncashed 180 day old warrants that must be refunded to the Federal Government as required by Federal regulations. Should such warrants be cashed at a later time, the amount again becomes chargeable to the Federal Government. The interest assessments spoken to in the audit finding represent a refund of interest earned by the State on these funds.

Federal Compliance Issue 4:

Ensure The Accuracy Of Cost Allocation Data

(Prior Audit Issue)

Incorrect and incomplete data resulted in misallocations of indirect costs to federal programs. Indirect costs are costs common to all federal programs which cannot be directly associated with a particular federal program. Examples of indirect costs are expenditures incurred by accounting, personnel, or information systems departments. The federal share of indirect costs charged to federal programs was approximately \$400 million for fiscal year 1994. We noted misallocations of indirect costs related to information systems and the Audit Division.

Inaccurate Data For Allocating Information Systems Costs

Errors occurred in allocating various information systems costs due to weaknesses in controls over data processing which were identified by the Internal Audit department. The Department detected the errors and determined the amount of costs overclaimed and underclaimed for fiscal years 1990 through 1993 which resulted in the following net questioned costs:

Program	CFDA#	Net Questions Costs Under (Over) Claim
Summer Food Service Program for Children	10.559	(7,440)
State Administrative Expenses for Child Nutrition	10.560	(163,618)
State Administrative Matching Grants for Food Stamp Program	10.561	3,471,280
Work Incentive Demonstration Program and Administration	93.029	(19,032)
Family Support Payments to States - Assistance Payments	93.560	159,132
Job Opportunities and Basic Skills Training	93.561	(508,659)
Refugee and Entrant Assistance - State Administered Programs	93.566	(244,637)
Low-Income Home Energy Assistance	93.568 ¹	54,341
Child Care for Families At-Risk of Welfare Dependency	93.574	(5,335)
Payments to State for Child Care Assistance	93.575	(58,999)
Child Welfare Services - State Grants	93.645 ²	257
Foster Care - Title IV - E	93.658 ²	(93,215)
Adoption Assistance	93.659 ²	(4,191)
Social Services Block Grant	93.667	(2,550,412) ³
Medical Assistance Program	93.778	(2,804,505)

- 1 Program transferred to Texas Department of Housing and Community Affairs effective 9/1/92.
- 2 Program transferred to Texas Department of Protective and Regulatory Services effective 9/1/93.
- 3 The net effect of the overclaim is zero because this is a block grant, and other eligible costs can be submitted to fully recoup the funds.

Recommendation: We recommend that the Department ensure the accuracy of cost allocation data used to allocate information system costs by implementing Internal Audit's recommendations as presented in their report #0094-001. The recommendations include improvements in the areas of computer program changes, data processing, documentation, and communication. In addition, adjustments should be made to federal reports to reflect the effect of the above questioned costs.

Management's Response: The Internal Audit recommendations as outlined in Report #0094-001 have been implemented. Adjustments to the affected federal programs were made on appropriate quarterly expenditure reports for the quarter ended March 30, 1994.

Lack Of Supporting Documentation

(Prior Audit Issue)

In fiscal year 1993, the Audit Division did not have documentation to explain the difference between detailed time reports and a quarterly summary report of audit hours resulting in a misallocation of approximately \$8,147 to federal programs. It was not possible to determine the effect on individual federal programs since there is no documentation to explain the difference. The misallocation represented one percent of related expenditures for the quarter tested. The Audit Division is planning to automate its monthly time reporting process.

Recommendation: We recommend that the Audit Division complete implementation of the new time reporting process and ensure that data provided to the Cost Allocation Section is supported by adequate documentation.

Management's Response: *The Audit Department has implemented internal control procedures to ensure that data entry into the time reporting system is accurate. We anticipate completion of the time reporting automation system by the end of March 1995.*

Audit Scope

The primary focus of our audit was the Department's financial and administrative controls over \$5.2 billion of federal funds expended during fiscal year 1994. We gained an understanding of the internal control structure, including the general control environment, and tested controls related to federal programs, cash disbursements, and Food Stamp inventories. Specific procedures were used to test compliance with the major federal program requirements.

Financial accounts significant to the statewide financial statements were also tested. These accounts included Other Assets, \$583 million; Accounts Payable, \$552 million; Funds Held for Others, \$587 million; Federal Revenue, \$2.5 billion; and Expenditures-General Fund, \$3.8 billion.

Overall Conclusion

Lamar System is generally complying with the significant bond covenants of its 13 outstanding bond issues (\$26.4 million). However, the System should continue its efforts to increase housing revenues to ensure payment of debt service requirements. In addition, the three Lamar University components are generally complying with federal regulations regarding the *Federal Family Education Loan* (\$3.7 million) and the *Federal Pell Grant* (\$3.3 million) student financial assistance programs. However, areas for improvement were identified at all three components. Lamar-Beaumont (LUB) should address its eight issues identified in this report, including improving controls over cash management and the preparation of its Annual Financial Report.

Also, the components' prior year issues involving fixed assets, salaries paid proportional to funding source, and personnel documentation have been resolved. Based on work performed by Lamar System Internal Audit (Report No. AU1094), the prior year issue related to timely appropriation reconciliations is still outstanding.

Lamar University System

Lamar University - Beaumont

Bond Issue

Bond Issue 1:

Continue Efforts To Increase Housing System Revenues And Control Costs

(Prior Audit Issue)

Lamar University-Beaumont's Housing System revenues were not sufficient to pay both the Housing System operating expenses and the debt service requirements of the Housing bonds. This resulted in a \$4,000 operating deficit at the end of fiscal year 1994. Although the University's ability to meet future principal and interest payments could be threatened if expenditures continue to exceed revenues, it appears that management has implemented a plan to eliminate the deficit.

During fiscal year 1994, Housing System operations improved significantly. Despite a six percent decline in enrollment at Lamar-Beaumont, housing revenues increased by six percent and operating expenditures decreased by five percent. In addition, monthly budget to actual reports were used to monitor performance and marketing efforts were expanded to increase enrollment and on-campus housing occupancy.

Recommendation: Management should continue its efforts to increase revenues and control costs. This will ensure that both the Housing System operating expenses and future principal and interest payments on the bonds will be met.

Management's Response: Management concurs with the auditor's recommendation that continuing efforts need to be made to address the housing deficit by both increasing revenues

and constraining costs. Lamar University-Beaumont has implemented and will be diligent in pursuing programs to improve revenues by raising the occupancy rate, including: recruiting students from outside of the Golden Triangle area; increasing the use of housing scholarships; and increasing the attractiveness of student residence activities. In addition, management is working to decrease expenses by proposing the elimination of the Assistant Vice President for Auxiliary Services position and one cashiering position. A new Vice President of Student Affairs position is proposed, which would assume responsibility for student housing. By doing this, management intends to create closer ties between housing and student life, thereby increasing the attractiveness of student life in a residence facility. The new consolidated student bill soon to be available from the Student Information System will eliminate the need for a separate cashiering function to service housing bills.

Federal Compliance Issues

Federal Compliance Issue 1:

Improve Cash Management Procedures

The University does not have adequate cash management procedures to ensure that requests for reimbursement are only made for current expenditures and to prevent excess cash from being requested. The University held an excess cash balance totaling \$88,292 for 53 days. At that time, the University returned \$38,301, but inappropriately retained \$49,991. The remaining \$49,991 is composed of \$1,682.95 of unallowable expenditures which are questioned costs and \$48,307.97 of unresolved reconciling items that had been previously disallowed by the Department of Education. Inadequate cash management procedures may result in the University having to pay interest on federal funds and in the loss of future federal funding.

Requests for reimbursement of federal funds should only be made for the amount of current expenditures, which are supported by the accounting records. In addition, the *Office of Management and Budget (OMB) Circular A-110* requires procedures to minimize the time between the transfer of funds from the U.S. Treasury and the disbursement by the University. Any excess cash on hand should be returned to the Department of Education within three working days.

Recommendation: The University should improve its cash management procedures to ensure that requests for reimbursement are only made for current expenditures and to prevent excess cash balances. Any excess cash must be returned within three working days. In addition, the University should return the questioned costs of \$1,682.95 to the Department of Education and determine if any interest is due since June 20, 1994, when the funds were received. These questioned costs are composed of \$884.94 for the *Jacob K. Javits Gifted and Talented Students Education Grant Program (CFDA 84.206)* and \$798.01 for the *Student Support Services program (CFDA 84.042)*. The University should also immediately contact the Department of Education in an attempt to resolve the reconciling items totaling \$48,307.97 and, if applicable, return any associated questioned costs.

Management's Response: Management concurs with this recommendation. Management recognizes the need to properly manage cash balances in grant accounts. Management believes that procedures in place are appropriate and sufficient to prevent excess cash balances. The situation described in the audit was a result of errors rather than procedural or policy flaws. An excess cash balance of \$88,292 accumulated during the audit period of which \$38,301 was returned to the Department of Education and \$49,991 was retained due to unresolved reconciling items. The Supervisor of Research & Grants will immediately contact the DOE to resolve the reconciling items and return any questioned costs. This issue will be resolved by March 31, 1995.

Management's research into the questioned costs of \$1,682.95 indicates that they were never collected from the agency. Of the \$1682.95, all but \$637.60 has been addressed by the DOE and adjustments have been made to the grant accounts. The \$637.60 has been credited by management to the Grant through journal entry on Feb. 16, 1995.

Federal Compliance Issue 2:

Ensure Grant Expenditures Are Appropriate And Allowable

The University is not ensuring that its federal grant expenditures are appropriate and allowable. A total of \$4,230.44 federal grant expenditures made during the last month of the grant appear inappropriate. In addition, a total of \$5,601.35 federal grant expenditures are unallowable because they were incurred after the grant's ending date. Since the University received federal reimbursement for these expenditures, these inappropriate and unallowable expenditures represent questioned costs of \$8,905.47 for the *Jacob K. Javits Gifted and Talented Students Education Grant Program* (CFDA 84.206) and \$926.32 for the *Student Support Services Program* (CFDA 84.042)

Inadequate controls may result in the University having to pay interest on federal funds that were inappropriately requested and in the loss of future federal funding. For fiscal year 1994, the University had a total of \$11.3 million in federal program expenditures.

The Office of Management and Budget (OMB) Circular A-21 defines allowable costs as those that are reasonable and allocable to the grant. In addition, *Title 34 of the Code of Federal Regulations (CFR), section 80.23*, states that a grantee may charge to the award only costs resulting from obligations of the funding period unless carryover of unobligated balances is permitted. The grantee must liquidate all obligations incurred under the award not later than 90 days after the end of the funding period.

Recommendation: We recommend that the University implement procedures to ensure that federal expenditures are appropriate and allowable. The procedures should ensure that expenditures are not made for inappropriate items at the end of grants and are not charged after the end date of grants, in accordance with the federal guidelines. The University should return the questioned costs totaling \$9,831.79 to the Department of Education and determine if any interest is due.

Management's Response: Management concurs with the recommendation that procedures to protect against inappropriate expenditure of federal grant funds must be maintained. The Supervisor of Research and Grants, is charged with the responsibility to see that procedures are followed. Since the audit period, management has implemented a new accounting system with enhanced controls and reporting capabilities. Among these controls is the ability to put an immediate freeze on accounts as the project period lapses, preventing the entry of inappropriate requisitions and purchase orders. The Supervisor of Research and Grants is responsible to monitor accounts and impose a freeze when budgets are at minimal levels or when the project period expires. Additionally, the new system provides on line access to account information which can be used to assess account status far more expeditiously than under the system operative during the audit period. These procedures and capabilities have been in effect since September 1, 1995. Research and Grant accountants review each requisition for propriety and must approve requisitions before P.O.'s are issued. Management is confident that the new controls, combined with the procedures which have been in force and which have in the vast majority of cases provided appropriate protection, will ensure compliance with regulations.

Management agrees, upon completion of review with the DOE, to return the unallowable expenditures totaling \$9,831.79 and any interest due. The Supervisor of Research & Grants is responsible for this task. This exercise is in process and should be completed by March 31, 1995.

Federal Compliance Issue 3:

Ensure Accuracy And Timeliness Of Annual Financial Report

The University did not submit an accurate annual financial report to the State Comptroller. The University submitted its prior year Schedule of Federal Financial Assistance in its current year Annual Financial Report. Additionally, portions of the annual financial report contained errors due to the University's failure to adhere to the *Comptroller's Reporting Requirements for Colleges and Universities*.

Specifically, we noted the following errors as they pertained to the 1994 Schedule of Federal Financial Assistance:

- Various program names, numbers, and expenditure amounts were incorrectly stated within the schedule.
- Note 2 incorrectly reported total pass-through amounts of \$1,257,210 as Federal Revenues - per Exhibit C, instead of including the amount as a reconciling item to the note. As a result, Federal Revenues and Additions to Fund Balance have been overstated.
- Although the 1994 Federal Schedule D-5 was completed, it was not scheduled to be submitted until January 19, 1995.

The annual financial report, including the Schedule of Federal Financial Assistance, represents management's assertions regarding financial position and results of operations for the fiscal year. Comptroller's reporting requirements and guidelines prescribe standard accounting procedures and terminology to ensure consistent and accurate reporting among agencies. The accuracy of the report is a reflection of management's ability to provide reliable and useful financial information.

Recommendation: We recommend that the University submit a complete and accurate annual financial report to the State Comptroller within the required time frames. Reviews of the annual financial reports should be performed at both the University and System level to ensure that report content and format is free from errors and is in compliance with Comptroller's reporting requirements.

Management's Response: *Lamar University-Beaumont management and System Office management concur with the finding. While copies of the Fiscal Year 1994 annual financial report were reviewed, an incorrect Schedule D-5 was inadvertently included in the copy sent to the printers. The Controller of Lamar University-Beaumont will increase controls over the master copy in future years to prevent a recurrence of this problem. The Controller of Lamar University-Beaumont has transmitted by facsimile on January 19, 1995 the correct schedule to the State Comptroller. In the future, the Controller of Lamar University-Beaumont will insure that pass-through amounts are correctly reflected in Exhibit C.*

Federal Compliance Issue 4:

Financial Aid Office Should Not Receive Loan Proceeds From Lenders

The University's Student Financial Aid Office should not receive loan proceeds from the lenders of the *Federal Family Education Loan Program (FFELP)* (CFDA 84.032). The office both processes the loan applications and receives the loan proceeds from the lenders. This increases the risk that office personnel could process unauthorized loans and retain the loan proceeds when they are received.

Title 34 of the Code of Federal Regulations (CFR), section 668.14(d)(1)-(2), requires an institution to ensure that its procedures for administering the student financial aid programs include an adequate system of internal checks and balances.

Recommendation: We recommend that the Student Financial Aid Office not receive loan checks. All loan checks should be delivered directly from the lenders to the Bursar's Office, which should continue disbursing loan checks to borrowers.

Management's Response: *The University concurs with this recommendation and beginning with the 1995-96 year will transfer all responsibilities associated with loan check receipt to the Bursar's Office. Bursar is responsible for implementing procedures by May, 1995.*

Federal Compliance Issue 5:

Delay Disbursements To First-Time Borrowers

The University did not delay the initial disbursement of *Federal Family Education Loans Program (FFELP)* (CFDA 84.032) loans to all first-time borrowers. Disbursements were not delayed for the required 30 days in 20 percent (4 of 25) of the student files tested.

Title 34 of the Code of Federal Regulations (CFR), section 682.604, requires that the first installment of *FFELP* proceeds to a student who is enrolled in the first year of an undergraduate program of study and who has not previously received a Stafford or SLS loan, not be released until 30 days after the first class day. Failure to properly delay disbursements to first-time borrowers could result in the distribution of loan funds to ineligible borrowers.

Recommendation: We recommend that the University delay disbursements to all first-time borrowers as required.

Management's Response: *The University concurs with this recommendation. Current procedures to delay the release of loan proceeds to first-time, first-year borrowers will be enhanced to ensure federal compliance. Financial Aid Officer/Loan Coordinator is responsible for implementing procedures by March, 1995.*

Federal Compliance Issue 6:

Award Proceeds May Not Be Withheld

The University may not withhold award proceeds from *Federal Pell Grant Program* (CFDA 84.063) and *Federal Family Education Loan Program (FFELP)* (CFDA 84.032) recipients who have outstanding university obligations. Current University check disbursement procedures require payment of any outstanding university obligations before a student may receive his or her loan proceeds.

Institutions may not withhold award proceeds from *Federal Pell Grant* and *FFELP* recipients who meet the eligibility requirements as set forth in *Title 34 of the Code of Federal Regulations (CFR), sections 682 and 690*. Payment of outstanding university obligations is not a requirement for the distribution of award proceeds.

Recommendation: We recommend that the University not withhold federal award proceeds from students who have outstanding university obligations. There are alternatives that the University may utilize for the collection of student's outstanding obligations, such as restricting registration, withholding grades, or notifying a collection agency.

Management's Response: *The University concurs with this recommendation. The University will alter its policy regarding the release of student aid checks to comply with federal regulations. Federal awards in excess of direct institutional educational expenses will be promptly released to students regardless of other institutional monetary obligations. Bursar is responsible for implementing procedures by February, 1995.*

Federal Compliance Issue 7:

Provide Timely Exit Counseling Information

The University is not providing timely exit counseling (loan repayment) information to all recipients of the *Federal Family Education Loan Program (FFELP)* (CFDA 84.032). Inadequate exit counseling procedures could result in an increased loan default rate. Twenty-four percent (6 of 25) of the students files tested indicated that the student did not receive timely exit counseling. One of the six files did not contain documentation of exit counseling.

Title 34 of the Code of Federal Regulations (CFR), section 682.604, requires that the institution conduct timely exit counseling with each borrower who ceases to be enrolled at least half-time. If a student does not attend a counseling session, exit counseling information must be mailed within 30 days to the student. Documentation of this counseling must be maintained in the student's file.

Recommendation: We recommend that the University provide timely exit counseling information to all students who cease to be enrolled at least half-time and that documentation be maintained in the student files. Procedures to identify students who withdraw from the University and who cease to be enrolled at least half-time should be enhanced to ensure compliance.

Management's Response: *The University concurs with the recommendation that exit counseling must be provided on a timely basis. During the SIS implementation, procedures to identify and notify these students will be enhanced. Financial Aid Officer/Loan Coordinator is responsible for implementing procedures by May, 1995.*

Federal Compliance Issue 8:

Report Enrollment Changes In A Timely Manner

The University is not reporting all enrollment changes for the *Federal Family Education Loan Program (FFELP)* (CFDA 84.032) within the required time frames. Enrollment changes occur when a student graduates, withdraws, drops a class, or is expelled. Noncompliance with this requirement may result in delayed loan repayment to lenders.

The 60-day notification requirement was not met for 52 percent (13 of 25) of the student files tested; 4 of the 13 had not been reported at all. Current procedures are not sufficient to report students who withdraw or cease to be enrolled at least half-time in a timely manner.

Title 34 of the Code of Federal Regulations (CFR), section 682.610, requires the institution to report enrollment changes to the guaranty agency within 60 days. If an institution does not expect to report enrollment changes on the student status confirmation report within the next 60 days, that institution must notify the guaranty agency or lender by letter within 30 days.

Recommendation: We recommend the University report enrollment changes to lenders within the required time frames. Procedures should be established to ensure that enrollment change notification other than student status confirmation reports is submitted within 30 days.

Management's Response: *The University concurs that borrower enrollment changes must be reported to lenders/guarantors on a timely basis. Procedures/supervision of the loan programs will be enhanced to ensure compliance. Financial Aid Officer/Loan Coordinator is responsible for implementing procedures by May, 1995.*

Lamar University System
Lamar University - Orange

Federal Compliance Issues

Federal Compliance Issue 1:

Provide Timely Exit Counseling Information

The University is not providing timely exit counseling (loan repayment) information to all recipients of the *Federal Family Education Loan Program (FFELP) (CFDA 84.032)*. Inadequate exit counseling procedures could result in an increased loan default rate.

Eighty-five percent (17 of 20) of the files tested for students who graduated, ceased to be enrolled at least half-time, or withdrew did not contain documentation of exit counseling.

Title 34 of the Code of Federal Regulations (CFR), section 682.604, requires that the institution conduct exit counseling with each borrower who graduates, ceases to be enrolled at least half-time, or withdraws from school. Documentation of this counseling must be maintained in the student's file.

Recommendation: We recommend the University provide exit counseling information to all students who graduate, cease to be enrolled at least half-time, or withdraw. Documentation of this counseling should be maintained in the student files.

Management's Response: *We concur with the auditors' finding. However, in a majority of the files that were sampled, students that had ceased enrollment or dropped below half-time on the Orange campus were still enrolled in the System for at least six (6) hours and therefore, not scheduled for exit interviews. The auditors explained that the only enrollment that can be considered is that on the Orange campus because we are separate financial aid entities.*

To ensure that Lamar University-Orange is in compliance with Federal regulations, the Financial Aid Office will request a monthly report of all drops and withdrawals, on the Orange campus only, from the Admissions and Records Office. This report will be examined by personnel in the Financial Aid Office and compared to the list of borrowers. If a borrower

has dropped below the minimum required hours, she will be scheduled for an exit interview and mailed a notice of said interview along with information packet from the appropriate guaranteeing agency by the tenth (10th) of each month. Copies of all information mailed or discussed with student in person will be maintained in the student files. This procedure will commence beginning January 1, 1995.

Federal Compliance Issue 2:

Report Enrollment Changes To Lenders

The University is not reporting all enrollment changes for the *Federal Family Education Loan Program (FFELP)* (CFDA 84.032) within the 60-day federal requirement. Enrollment changes occur when a student graduates, withdraws, drops a class, or is expelled. Noncompliance with this requirement may result in delayed loan repayment to lenders.

The 60-day notification requirement was not met for 65 percent (13 of 20) of the files tested because procedures are not sufficient to report students who graduated, cease to be enrolled at least half-time, or withdrew.

Title 34 of the Code of Federal Regulations (CFR), section 682.610, requires that the institution notify the guaranty agency within 60 days when the school discovers that a loan recipient has ceased to be enrolled at least half-time. If an institution does not expect to report enrollment changes on the student status confirmation report within the next 60 days, that institution must notify the guaranty agency or lender by letter within 30 days.

Recommendation: We recommend the University report enrollment changes to guarantors within the 60-day requirement. The University should revise its procedures to ensure all students who graduate, cease to be enrolled at least half-time, or withdraw are reported within the required time frame.

Management's Response: *We concur with the auditors' finding. However, in a majority of the files that were sampled, students that had ceased enrollment or dropped below half-time on the Orange campus were still enrolled in the System for at least six (6) hours and therefore, not reported to the lenders or appropriate guaranteeing agencies within the sixty (60) day federal requirement. The auditors explained that the only enrollment that can be considered is that on the Orange campus because we are separate financial aid entities.*

To ensure that Lamar University-Orange is in compliance with Federal regulations, the Financial Aid Office will request a monthly report of all drops and withdrawals, on the Orange campus only, from the Admissions and Records Office. This report will be examined by personnel in the Financial Aid Office and compared to the list of borrowers. If a borrower has dropped below the minimum required hours, she will be reported to the lender or the appropriate guaranteeing agency by the tenth (10th) of each month. Copies of enrollment change notifications will be maintained in the student files. This procedure will commence beginning January 1, 1995.

Federal Compliance

Federal Compliance Issue 1:

Provide Timely Exit Counseling Information

The University is not providing timely exit counseling (loan repayment) information to all recipients of the *Federal Family Education Loan Program (FFELP)* (CFDA 84.032). Inadequate exit counseling procedures could result in an increased loan default rate. Twelve percent (3 of 25) of the student files tested did not receive timely exit counseling.

Title 34 of the Code of Federal Regulations (CFR), section 682.604, requires that the institution conduct exit counseling with each borrower who ceases to be enrolled at least half-time. If a student does not attend a counseling session, this information must be mailed to the student within 30 days. Documentation of this counseling must be maintained in the student's file.

Recommendation: We recommend that the University provide timely exit counseling information to all students who cease to be enrolled at least half-time and that documentation be maintained in the student files. Procedures should be developed to identify students who withdraw from the University and who cease to be enrolled at least half-time.

Management's Response: *Management concurs with the audit recommendation. Under the supervision of the Director of Financial Aid, Lamar University-Port Arthur will order the computer report SFA008 to identify students who withdraw from the university or cease to be enrolled at least half-time. The SFA008 lists all students who dropped hours or withdrew within a specified time frame. This report will be cross-checked with a listing of Stafford Loan recipients bi-monthly. The Student Information System computer (on-line for Spring 1995) will have the FOCUS program, Registration Audit Report, to perform the similar function as the SFA008. Students who have withdrawn or dropped below half-time will have exit counseling or exit counseling material mailed to them within thirty days. Documentation of the exit counseling will be maintained in the student's folder. Implementation will begin after the submission of the Fall 1994 Student Status Confirmation Report is submitted to the Texas Guaranteed Student Loan Corporation.*

Federal Compliance Issue 2:

Report Enrollment Changes In A Timely Manner

The University is not reporting all enrollment changes for the *Federal Family Education Loan Program (FFELP)* (CFDA 84.032) within the required time frames. Enrollment changes occur when a student graduates, withdraws, drops a class, or is expelled. Noncompliance with this requirement may result in delayed loan repayment to lenders. The 60-day notification requirement was not met for 28 percent (7 of 25) of the student files tested; 1 of the 7 had not been reported at all. Procedures are not sufficient to report students who withdraw or spring graduates within a timely manner.

Title 34 of the Code of Federal Regulations (CFR), section 682.610, requires the institution to report enrollment changes to the guaranty agency within 60 days. If an institution does not expect to report enrollment changes on the student status confirmation report within the next 60 days, that institution must notify the guaranty agency or lender by letter within 30 days.

Recommendation: We recommend the University report enrollment changes to lenders within the required time frames. Timely reporting of students who graduate in the spring semester can be achieved by submitting a list of confirmed graduates to the guarantor. Procedures should also be developed to identify students who withdraw from the University or who ceased to be enrolled at least half-time.

Management's Response: *Management concurs with the audit recommendation. Under the supervision of the Director of Financial Aid, Lamar University-Port Arthur will use the SFA008 computer report on a bi-monthly basis to identify students who withdraw or drop below half-time within the specified time frame by cross checking this report with a list of Stafford loan recipients. After submission of the Fall 1994 Student Status Confirmation report the institution will notify Texas Guaranteed Student Loan Corporation and other guarantors by letter within 30 days if submission of a Student Status Confirmation report is not expected within the next 60 days. A list of students who graduate on December 16, 1994 for the Fall 1994 semester will be submitted within 30 days after graduation (January 15, 1995) to the Texas Guaranteed Student Loan Corporation.*

Audit Scope

Lamar System

The primary focus of our audit was on Lamar System's 13 outstanding bond issues, totaling \$26.4 million. For each bond issue, we tested the bond-related disclosures in the Fiscal Year 1994 Annual Financial Report and verified compliance with significant bond covenants.

Lamar University Components

The primary focus of our audit was on the three Universities' two largest student financial assistance programs: the *Federal Family Education Loan Program (FFELP)* and the *Federal Pell Grant Program*. We tested the administrative controls relating to the major federal programs. Specific procedures were used to test compliance with federal requirements. We also performed follow-up procedures on prior year management letter comments related to fixed assets, salaries paid proportional to funding sources, personnel documentation, and timely appropriation reconciliations. For fiscal year 1994, the total dollar value of the programs at each university is as follows:

	<u>PELL</u>	<u>FFELP</u>
Lamar-Beaumont	\$ 2,583,848	\$ 3,705,149
Lamar-Orange	\$ 620,081	\$ 0
Lamar-Port Arthur	\$ 132,362	\$ 16,473

Mental Health & Mental Retardation, Texas Department Of

SAO 5-097

Overall Conclusion

The Department's accounts that are significant to the statewide financial report, which include all *Human Services Expenditures*, are accurately reported. The Department expended approximately \$1.3 billion to provide mental health and mental retardation services to Texans in fiscal year 1994. This audit also identified areas where the Department can improve controls which help protect its automated information.

Prior Audit Issues

The State Auditor's Office has verified that \$18,358 in adjustments have been made as required by the U.S. Department of Health and Human Services' letter of resolution. These adjustments resulted from the November 1993 report on the State Legalization Impact Assistance Grant (CFDA 93.565) issued by the Department's Office of Inspector General. The report related to the Texas Department of Mental Health and Mental Retardation and other state agencies. See *Appendix 2: Verification Of Letter Of Resolution Adjustments*.

Internal Control Issues

Internal Control Issue 1:

Evaluate The Appropriateness Of USAS Access

(Prior Audit Issue)

Policies for granting access to the Uniform Statewide Accounting System (USAS) are not enforced. At August 31, 1994, a total of 338 Department employees were defined as USAS users. Ninety-three (28 percent) of these individuals had the ability to approve payment transactions (batch release). Eighty-two of the 93 individuals also had data entry capabilities. Allowing the same employee the ability to perform these tasks increases the risk of unauthorized transactions and misuse of funds.

The Department had not monitored access requests submitted to verify that duties were appropriately segregated at each facility. The Department had not evaluated whether the number of employees able to record, correct, and approve transactions within USAS was appropriate given each facility's size and number of accounting employees. Facilities have been informed of the need for strong internal controls. The Department's Internal Audit staff has recently completed a review and has also expressed concerns over these issue areas.

Recommendation: The Department should continue improving the processes which evaluate the appropriateness of the access granted at each location, segregate tasks where possible, and monitor the USAS access requests to ensure compliance with Department policies.

Management's Response: Management agrees. Central Office has removed the accounting entry capability for all non-accounting personnel. A complete review of USAS access is being

initiated. Facilities will be asked to justify in writing the necessity for any individual having both entry and release capability, including the internal controls in place to prevent unauthorized transactions and misuse of funds. We expect a significant reduction in the number of individuals that will have both entry and release capability. This process should be completed by May 1, 1995.

Internal Control Issue 2:

Complete The Disaster Recovery Plan

(Prior Audit Issue)

The current disaster recovery plan is not adequate to provide an efficient and timely strategy for restoring computing resources in the event of disaster. Without a current and comprehensive plan, the Department risks delays in processing critical information, including payroll, accounting, client data, and billing information.

The Department has signed a contract, and preliminary work has begun for developing a disaster recovery plan. The risk assessment process began in December 1994 and is scheduled to be completed during 1995. While these procedures are being performed, the agency does not have an adequate plan in case of disaster.

Recommendation: The Department should complete development, implementation, and testing of an adequate disaster recovery plan.

Management's Response: *We concur. The old disaster recovery plan is and has been for several years, inadequate. We have joined several other agencies in a statewide contract with Sungard, Inc. to begin the process of rebuilding a disaster recovery plan that will be of value to the organization. The risk assessment contract is well underway and we are approximately 50% of the way through the initial business recovery plan interviews. We intend to request management support and funding for the next steps in the process as part of the FY 96-97 funding process.*

Audit Scope

The primary purpose of our audit was to determine the material accuracy of *Human Services Expenditures* incurred by the Department. The Department expended approximately \$1.3 billion to provide mental health and mental retardation services to Texans.

We gained an understanding of the internal control structure, including the general control environment, as well as controls over cash disbursements, payroll/personnel, and journal vouchers. We also performed follow-up procedures on prior year audit comments.

Natural Resources Conservation Commission, Texas

SAO 5-045

Overall Conclusion

In general, the Commission has established a system to ensure compliance with federal regulations for the Superfund program. However, our audit did find that the Commission is not adequately ensuring compliance with two federal regulations for the program. We also identified that computer access procedures are not always being followed.

Federal Compliance Issues

The Commission's most significant federal program, the *Hazardous Substance Response Trust Fund* (CFDA 66.802) and which is commonly referred to as Superfund, is administered by the Environmental Protection Agency.

Federal Compliance Issue 1:

Ensure Compliance With The Davis-Bacon Act

The Texas Natural Resource Conservation Commission is not adequately ensuring compliance with the Davis-Bacon Act for its *Hazardous Substance Response Trust Fund* grants (CFDA 66.802). The Commission has not been performing regular reviews of contractor payrolls or on-site compliance inspections.

The Act requires that laborers and mechanics on federally financed construction projects be paid wages not less than those established for the locality by the Secretary of Labor.

Title 29 of the *Code of Federal Regulations (CFR), Part 5*, says the federal grantor agency is responsible for ensuring compliance with the Act. Investigations are required of all contracts with such frequency as necessary to ensure compliance. The investigations should include interviews with employees to ensure proper job classifications and examination of payroll data.

The federal grantor, the Environmental Protection Agency, has provided direction in its *EPA Superfund Guidance - Davis-Bacon Act/Service Contract Act and Related Bonding*. It says that early and complete labor compliance inspections are essential to a sound compliance program on all projects. These inspections should include reviews of contractor and subcontractor payrolls and on-site inspections and employee interviews as necessary. If a contractor is not in compliance, corrective action could be necessary which might include suspending payments, terminating contracts and calculating liquidated damages, and beginning debarment proceedings.

Without adequate monitoring, the Commission lacks assurance that contractors are complying with the Act. Noncompliance with the Act could result in questioned program costs.

Recommendation: The Commission should ensure that its contractors are in compliance with the Davis-Bacon Act. Monitoring should include review of contractor payrolls and on-site inspections and employee interviews, as necessary, to ensure compliance.

Management's Response: *The TNRCC hired a contractor to (1) review change orders and overhead rates for compliance with federal regulations (2) assist with cost negotiations and (3) to conduct Davis-Bacon reviews. Given a staff shortage and budget limitations, the Pollution Cleanup Division has determined that the contractor's number one priority is assisting project managers with contract and change order negotiations. A prime consultant has confirmed that by using this contractor, the TNRCC was able to better negotiate contract terms for the "fixed cost of money." The contractor's advice has generated cost savings of over \$59,000 each month. Subsequent to your audit, the consultant completed three Davis-Bacon reviews.*

When submitting monthly payroll reports, Superfund contractors must certify compliance with the Davis-Bacon Act. Because Davis-Bacon reviews are procedural in nature and generate no savings, the Division has prioritized its limited resources in order to maximize Superfund funding. We are currently determining whether oversight engineers, as part of their contracted project management/review function, should ascertain compliance with the Act.

Federal Compliance Issue 2:

Ensure Minority And Women's Business Utilization Reports Are Properly Submitted

Minority and Women's Business Utilization Reports for the *Hazardous Substance Response Trust Fund* program (CFDA 66.802) are not always being submitted timely and accurately. We tested reports for the third quarter of the federal fiscal year 1994 for six grants. For two of the grants no report was submitted and the other four were submitted after the federal deadline. Of the four grant reports submitted, three had incorrect contract ID numbers and the other had an incorrect federal financial agreement ID number.

Title 40 of the *Code of Federal Regulations (CFR), Part 35.6665*, requires that Minority and Women's Business Enterprise (M/WBE) Reports be submitted within 30 days after the end of each federal fiscal quarter, regardless of whether the recipient awards a contract to an MBE or WBE during that quarter.

If reports are not submitted accurately and in a timely manner, it could hinder the determination of M/WBE participation goals. Noncompliance with federal reporting requirements could also result in questioned program costs.

Recommendation: We recommend that the Commission ensure that Minority and Women's Business Utilization Reports are submitted in accordance with federal requirements.

Management's Response: M/WBE reports have not been consistently reported to EPA primarily because the Division has not received the reports back from the consultants and/or contractors in a timely manner. To ensure timely reporting, for each monthly invoice the Division will require contractors to complete a form which will provide mandatory M/WBE information. By doing this, the Division's contractors will no longer be required to prepare quarterly reports, as the information will be collected as part of the monthly billing process. The Division will then prepare the necessary reports using the information provided.

Internal Control Issue

Internal Control Issue 1:

Ensure Computer Access Procedures Are Followed

(Prior Audit Issue)

The Texas Natural Resource Conservation Commission should ensure that computer access procedures are followed. In response to a prior year finding, the Commission has developed formal agency-wide procedures for requesting and approving access to the computer system. However, we tested August 1994 employee terminations and found that some employees did not have their computer access privileges promptly removed. We also found that one employee out of ten tested did not have the required access authorization form on file with the access administrator.

Unauthorized computer access increases the risk of errors and irregularities that may affect the automated systems that are crucial to the Commission's operations.

Recommendation: We recommend more timely reviews of employee job status changes to ensure that procedures have been followed. Access privileges to the computer system should be promptly removed when an employee terminates. The Commission should also ensure that all employees have proper access authorization on file.

Management's Response: We agree with the finding and recommendation. Our current process does include formal procedures for granting, modifying, or removing access. However, we are working on a process to further address computer access procedures and authorization. This process will reflect our increasing reliance on distributed processing. Additionally, we have purchased network management tools that will allow us to audit agency-wide for compliance with computer access procedures. We plan to have this new process in place by March 1, 1995.

Audit Scope

The primary focus of our audit was the *Hazardous Substance Response Trust Fund* (Superfund) program. The program comprised 56 percent (\$38 million) of the agency's total federal funds. We gained an understanding of the internal controls that would prevent or detect noncompliance with federal requirements. We tested compliance with the general and specific program requirements.

Protective And Regulatory Services, Texas Department Of

SAO 5-099

Overall Conclusion

Our audits continue to indicate that the Department is not complying with all federal requirements for two of its largest federal programs. Expenditures for these programs total \$100 million and represent 45 percent of total federal funds expended by the Department in fiscal year 1994. Payments have not been limited to appropriately documented clients and costs for the *Child Welfare Services* program. This resulted in material noncompliance with federal requirements. Discrepancies continue to exist in *Foster Care* eligibility data between automated systems. In addition, the Department has overcharged federal funds due to its method of allocating *Foster Care* income credits. Also, noncompliance with cash management requirements was noted for the *Foster Care* program.

Other Related Reports

The U.S. Department of Health and Human Services' Office of Inspector General issued a report (Report # A-06-92-00086) with findings related to the *Foster Care* program, which is administered by the Texas Department of Protective and Regulatory Services. Additionally, the State Auditor's Office issued a report in September 1994, on the review of management controls at the Department (SAO Report No. 95-003). The effect of the exceptions and issues identified in these reports was considered in our fiscal year 1994 audit plan for the Department.

Internal Control Issue

Internal Control Issue 1:

Revise Federal Cash Management Monitoring Procedures

The Department does not have sufficient cash management monitoring procedures in place to minimize federal cash requests and prevent holding excess funds for the *Foster Care* program (CFDA 93.658). The Department requested and had excess federal funds on hand for 16 of the 39 state working days tested. The State incurs an interest liability for each day federal funds are held by the Department.

Title 31 of the *Code of Federal Regulations (CFR)*, part 205.7(c)(4), states that federal funds shall not be requested more than three business days prior to disbursement. An interest liability begins the day the federal funds are credited to a state account and continues until the State pays out the funds for program purposes.

Recommendation: We recommend the Department revise cash management monitoring procedures to ensure federal funds are requested only for immediate cash needs.

Management's Response: We acknowledge that there were procedures in fiscal year 1994 that were insufficient to minimize the interest liability with regards to the holding of federal funds for the *Foster Care* Program.

We agree with your recommendation and have developed a specific action plan in which the implementation phase is scheduled to begin in February, 1995 and continues through the reporting period for fiscal year 1995.

Internal Control Issue 2:

Monitor Reconciliation Of Federal Reports To The Accounting Records

The Department has not ensured that quarterly federal reports are reconciled to the accounting records on a regular basis for its 18 federal programs. Additionally, procedures are not in place to ensure that all adjustments are posted to the accounting records in a timely manner. Because these controls are not in place, errors could exist in the accounting records or federal reports which do not get corrected.

Although the Department contracts with the Department of Human Services for these services, the Department has the responsibility to monitor the work and verify that all appropriate procedures are performed. Regular reconciliations and timely posting of adjustments are necessary to ensure that information in federal reports and the financial statements is accurate and complete.

Recommendation: We recommend that the Department more closely monitor its contracted accounting services. Specifically, the Department should ensure that all outstanding reconciliations are performed and that current year reconciliations are performed on a regular basis. Additionally, the Department should ensure that the Department of Human Services develops adequate procedures to verify that all adjustments are posted in a timely manner to the accounting records.

Management's Response: *There are approximately 105 reconciliations for the Department of Protective and Regulatory Services since it started in September of 1992. Of those 105 reconciliations, we have completed 59. We are currently working on the most recent quarter, and will then begin working backwards to complete the reconciliations that have not been finished.*

Corrections to reconciling items in the prior quarters cannot be made until all the reconciliations have been completed, and we can track through the quarters to see if any corrections have been done. As we complete the reconciliations for the current quarters, we will be developing procedures to correct any new reconciling items within the quarter.

Protective And Regulatory Services, Texas Department Of

SAO 5-099

Federal Compliance Issues

Recommendations addressed in other sections of this report could impact controls over federal funds, especially for the Department's most significant federal programs administered by the U. S. Department of Health and Human Services.

Federal Compliance Issue 1:

Limit Payments To Appropriately Documented Clients And Costs

(Prior Audit Issue)

Out of 45 *Child Welfare Services* (CFDA 93.645) clients tested, the Department paid \$6,594 for purchased services provided to ten clients without sufficient documentation showing that the clients were eligible for these services. As a result, the Department is in material noncompliance with the federal eligibility and allowable cost requirements for this program.

The ten errors totaled \$3,267 of purchased services, which represents 35.4 percent of the \$9,241 tested. An error rate of five percent or more is considered material noncompliance. The \$6,594 in questioned costs represents total unauthorized payments made on behalf of these clients for the fiscal year ended August 31, 1994.

The Department uses *Child Welfare Services* funds to prevent child abuse and ensure the safety of abused children. The \$21.9 million spent on this program in fiscal year 1994 included payments for psychological evaluation and testing, therapy, counseling, and parent skills training for clients.

Before clients are considered eligible for these services, a caseworker must document the need for the services and authorize the payment for the services. Ten of the 45 clients tested received services for which eligibility was not documented under the *Child Welfare Services* program.

Five of these ten clients received services before the need was documented in a service plan. The service plan, which is prepared by the caseworker, defines the services needed by the client.

For one of the ten clients, the need for the services was documented, but the authorization for the services was not documented.

For four of the ten clients, the need for services was not documented in a service plan and there was no form authorizing the services.

Recommendation: We recommend that the Department ensure that services are provided to eligible clients and that payments are made only for allowable costs as mandated by federal regulations. The Department should strengthen procedures and provide training to ensure that services are properly authorized and that the need for services is properly documented. Additionally, the Department should reimburse the \$6,594 of questioned costs to the program.

Management's Response: State office program specialists will publish a statewide memorandum by March 1, 1995 reminding contract managers to follow existing agency policy concerning corrective and adverse actions to include the recoupment of payments to contractors made prior to written authorizations for service. New agency policy will be addressing corrective and adverse actions as a result of monitoring of contracts. This policy will not be effective until sometime after May 1, 1995.

In addition, a Protective Services Action (PSA) memorandum and training will be provided to staff to ensure that staff document needed services to children before the services are authorized and received. During the last quarter of 1994, staff were trained on Section 6000 of the Child Protective Services Handbook (CPSH). This training addressed services provided to children in substitute care. A section of this training was specific to identifying and documenting needed services before services are provided. A second training will be provided to staff in the spring/summer of 1995. This training will also focus on documenting client needs in the plan of service before services are authorized.

Management will also send a PSA to staff instructing them that client needs must be identified and documented in the service plan before services can be authorized. This memorandum will be sent no later than March 1, 1995.

The \$6,595 adjustment will be made when sustained by the Administration for Children and Families, U.S. Department of Health and Human Services.

Federal Compliance Issue 2:

Agree Eligibility Information Between Automated Systems

(Prior Audit Issue)

As noted in the prior year, the client information system and the payment system did not contain the same eligibility information for all clients. Additionally, the Department's method of identifying discrepancies in the eligibility information could render incomplete results because their methodology does not include all clients. The Department determined that 60 of the 10,000 children in the Foster Care Program (CFDA 93.658) had conflicting eligibility information between the two systems. This determination does not include closed case files.

This conflict in eligibility information can cause incorrect payments, resulting in noncompliance with federal requirements. The Department is in the process of determining the dollar impact of the 60 eligibility errors which affect fiscal years 1993 and 1994. At this time, the dollar impact of any eligibility errors in closed case files cannot be determined.

The errors occurred because the Department is not following the procedures established to ensure that the eligibility information in both systems is the same. Also, the Department does not have procedures to ensure that all eligibility discrepancies are identified. However, the Department is currently improving the automated systems to match eligibility status between the client information system and the payment system.

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Recommendation: We encourage the Department to continue improving its automated systems to ensure that eligibility information matches. Until the improvements are made, the Department should establish procedures to ensure that all eligibility errors are identified for both active and closed client cases. Additionally, the Department should complete the correction of errors already detected.

Management's Response: *The Department concurs that the manual interface between the automated Foster Care, Adoption And Conservatorship Tracking System (FACTS) and the automated Level of Care (LOC) file is inadequate. There is an active work order in the Department of Human Services MIS to create an electronic interface between the two files which will prevent discrepancies from occurring in the future. We expect this project to be complete by late Spring 1995.*

The report used to identify the 60 eligibility errors mentioned above will be run on a monthly basis to identify any additional mismatches which may occur between now and the time the electronic interface is implemented. The department will, of course, complete the correction of errors already detected and any other errors detected.

Federal Compliance Issue 3:

Allocate Foster Care Income Credits In Accordance With Federal Requirements

The Department did not allocate Foster Care income credits in accordance with federal requirements for the *Title IV-E Foster Care Program (CFDA 93.658)*. When allocating income credits between the state and federally funded portions of cost, the income credits were applied disproportionately higher against the State's share of cost. Consequently, federal funding sources were overcharged. The Department's calculation for questioned costs totaled \$328,847.75.

Income received by *Title IV-E* eligible children is considered a credit or reduction against the child's monthly cost of care. *Office of Management and Budget (OMB) Circular A-87* requires that income be credited against state and federal funding sources based on the proportion that each source contributes to the cost of the program.

Recommendation: We recommend that the Department allocate *Title IV-E* income credits in accordance with federal requirements.

Management's Response: *Foster Care billing system programming changes instituted in December 1991 directed that a Title IV-E eligible foster care child's income was to be applied first to the maintenance costs above the level allowable to be matched by Title IV-E federal funds. Any remaining child's income was allocated at the same state/federal ratio as the Title IV-E allowable maintenance costs.*

Effective November, 1994 foster care billing system programming has been revised to deduct income from the total maintenance costs per child prior to applying state/federal cost allocation methodology.

The agency concurs with the finding and will make a voluntary decreasing adjustment of \$328,847.75 if this finding is sustained by the Administration for Children and Families, U.S. Department of Health and Human Services.

Federal Compliance Issue 4:

Make Timely Adjustments For Identified Questioned Costs

The Department did not make an adjustment to the federal claims report for approximately \$44,000 in *Foster Care* program (CFDA 93.658) questioned costs identified in the fiscal year 1993 *Statewide and Financial Compliance Audit Results* report.

The additional \$44,000 in questioned costs were identified in fiscal year 1993 during the follow-up of a prior-year finding. These costs resulted from an error in the Department's initial calculation of questioned costs. Although the additional questioned costs were communicated to the Department during the fiscal year 1993 audit, no corresponding adjustments were made to the federal claims report.

Recommendation: We recommend that the Department make timely adjustments to the federal claims reports when questioned costs are identified. The \$44,000 in questioned costs identified in the fiscal year 1993 audit should be returned to the Federal Government through an adjustment to the federal claims report.

Management's Response: *Included in the FY 1992 Statewide and Financial Compliance audit (SAO-3-078-92 or CIN A-06-94-25-320) was a finding entitled, "Initiate Prompt Updates In Response To Rate Changes." In accordance with that finding, a decreasing adjustment of \$695,075 was made to the Title IV-E federal claim.*

Follow-up work on this finding during the FY 1993 Statewide and Financial Compliance audit identified that an incorrect foster care daily rate was used to calculate the original finding. Daily rates effective January 1, 1992 were used rather than the rates effective September 1, 1991. The daily rate for the Level of Care V was revised in January, 1992 which resulted in a different percentage of Title IV-E allowable costs. The recalculation of the finding resulted in an additional federal overpayment of \$44,317. Although identified as questioned costs to the agency staff, this finding was not included in the final FY 1993 audit report.

States are required by the federal government to identify all adjustments to federal claims resulting from audits to be tracked and identified by the federal common identifying number (CIN). These CIN's are assigned when audits are reviewed by the cognizant federal agency. During the federal review process, it has been this agency's experience, that some findings

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are deemed immaterial and are not sustained by the federal agency. It is this agency's practice to make decreasing/increasing federal claims when sustained by the cognizant federal agency.

The agency agrees that the agency staff made an error in the original calculation of the FY 1992 finding and that an additional decreasing adjustment of \$44,317 is appropriate. This adjustment will be made when sustained by the Administration for Children and Families, U.S. Department of Health and Human Services.

Federal Compliance Issue 5:

Establish Policies And Time Frames For Processing Foster Care Eligibility Corrections

The Department does not have standardized policies or time frames for processing *Foster Care* (CFDA 93.658) eligibility corrections. Consequently, regional offices have established their own informal policies, and corrections are not always processed in a timely or consistent manner. We noted that one regional office waits up to one year before correcting errors identified in a client's eligibility status. This delay can result in incorrect payments and noncompliance with federal requirements.

Federal regulations require that payments be made only to clients eligible for federal funding. Also, good management practices suggest that known errors be corrected in a timely manner to ensure accuracy of payments.

Recommendation: We recommend that the Department establish policies and procedures for the processing of *Foster Care* eligibility corrections. These policies should designate a reasonable time frame for completion of the eligibility correction.

Management's Response: *The Department concurs that there needs to be written, agency-wide policies for correcting foster care eligibility errors. State office program staff expect that an eligibility error be corrected as soon as it is detected by the eligibility worker, or if the result of monitoring, as soon as it is reported to the eligibility worker. Timely correction will prevent future incorrect billings to the wrong foster care assistance program.*

In addition, the Department will set reasonable time frames for corrections of past inaccurate billings. These corrections will automatically adjust the agency's Title IV-E claim as appropriate.

These expectations will be stated in a planned revision of the foster care assistance application and review policies contained in the agency's Child Protective Services Handbook.

Audit Scope

The primary focus of our audit was the Department's financial and administrative controls over its three major federal programs relating to the State's child and adult protective services. These three programs had federal expenditures of approximately \$170 million for fiscal year 1994. We gained an understanding of the internal control structure, including the general control environment, as well as controls over federal cash management and federal programs. Specific procedures were used to test compliance with the major federal programs.

Overall Conclusion

The Commission has established a system to ensure compliance with federal regulations for its two largest federal programs, *Rehabilitation Services - Vocational Rehabilitation of State Grants* and *Disability Insurance*. These programs represent 96 percent of the Commission's \$193 million of total federal assistance. However, the Commission is not complying with two federal requirements.

Federal Compliance Issues

Federal Compliance Issue 1:

Comply With Federal Cash Management Funding Technique Requirements

The Commission is not complying with the federal cash management funding technique requirements for the *Rehabilitation Services - Vocational Rehabilitation of State Grants* program (CFDA 84.126). The Commission requests federal funds ten days before payday to cover payroll expenses. This resulted in excess federal funds on hand for 9 of twenty-one state working days tested. The State incurs an interest liability for each day excess funds are held by the Commission.

Title 31 Code of Federal Regulations (CFR), part 205.7(c)(4) states that federal funds shall not be requested more than three business days prior to disbursement. However, state law requires that sufficient funds be in the State Treasury the tenth day before pay day or the payroll will not be processed. To facilitate compliance with federal regulations, general revenue funds may be temporarily used to cover federal payroll costs [Texas Government Code, section 403.092 (c)]. The Comptroller of Public Accounts must be notified to initiate this transaction.

Recommendation: The Commission should comply with federal cash management requirements. Federal funds should be requested for immediate cash needs no more than three business days prior to disbursement. The Commission should make arrangements with the Comptroller to temporarily transfer general revenue funds to cover federal payroll costs. General revenue funds should be reimbursed as soon as federal funds are received and no later than pay day.

Management's Response: *We agree with the SAO recommendation to comply with federal cash management requirements. Since funding for payroll can be from general revenue on a temporary basis, we will work with the Comptroller as necessary.*

Federal Compliance Issue 2:

Ensure That Indirect Cost Rate Proposals Are Adequately Supported

In a recent review of the 1995 Indirect Cost Rate Proposal draft, the U.S. Department of Health and Human Services' Office of Inspector General reported that the policies and procedures related to the preparation of indirect cost rate proposals are not sufficient to ensure that the proposals are adequately supported. The indirect costs of various pools were incorrectly allocated, and vouchered costs may be overstated on the 1995 Proposal draft.

The same methodology that was used to prepare this proposal was used to prepare previous years' proposals, resulting in potential under- or overrecoveries of prior years' indirect costs.

Office of Management and Budget (OMB) Circular A-87 defines indirect costs as those incurred for a common or joint purpose benefitting more than one objective and which are not readily assignable to the cost objective. Direct costs are those costs that can be identified specifically with a particular cost objective. It is essential that each item of cost be treated consistently either as direct or indirect. Indirect cost pools should be distributed to benefitting cost objectives on an equitable basis with the benefits derived. In addition, OMB A-87 states that all costs in the plan will be supported by formal accounting records.

Recommendation: The Commission should continue to work with the U.S. Department of Health and Human Services' Office of Inspector General to resolve the issues identified with the 1995 Indirect Cost Proposal draft. The Commission should also revise its policies and procedures to ensure that indirect cost rate proposals are adequately supported, the costs are correctly allocated, the allocation bases are appropriate and equitable, and the cost pools are properly classified and treated consistently. Any under- or overrecoveries of prior years' indirect costs should be reflected in future indirect cost proposals.

Management's Response: *While we do not agree with all of the issues raised by the DHHS IG, we do agree with the recommendation of the State Auditor's Office. We will continue to work with the DHHS IG to resolve the issues and we will take all corrective actions required.*

Audit-Scope

The primary focus of our audit was the Commission's administrative controls over its major federal programs. The *Rehabilitation Services - Vocational Rehabilitation of State Grants* program received \$114 million and the *Disability Insurance* program received \$71 million. These programs represent 96 percent of the Commission's \$193 million of total federal assistance. We gained an understanding of the internal control structure, including the general control environment and federal programs. We tested the internal control structure related to the major federal programs. Specific procedures were used to test compliance with the major federal programs.

Overall Conclusion

Texas A&M University's account which is material to the statewide comprehensive annual financial report is reported accurately. Accurate financial statements are a tool for decision-making and analysis of operations. The System Administrative and General Offices have established a system to ensure compliance with bond covenants, and this system is working. The system ensures that bondholders' interests are protected. Bonds payable at August 31, 1994, were approximately \$650 million.

In addition, Texas A&M University at Galveston is generally complying with the federal regulations regarding its student financial assistance programs.

Texas A&M University System

Texas A&M University At Galveston

Federal Compliance Issues

Federal Compliance Issue 1:

Improve Controls For Cash Management

The University does not have adequate controls over cash management. Cash management monitoring and accounting controls are not adequate to ensure timely federal reimbursement. This issue was originally communicated to management by Texas A&M System Internal Audit in August 1992 (Report No. 921002). Inadequate controls may result in the loss of interest on the University's local funds and the loss of federal funds if not requested within program deadlines.

Although Department of Education expenditures for 1993-1994 totaled \$610,180, only two drawdowns totaling \$159,205 were made for reimbursement. This suggests that the University is using local funds to finance its federal programs. In addition, these two transactions were not recorded in the accounting records, but were found on the bank statements and federal reports. No documentation could be found supporting the amounts of the drawdowns.

The *General Appropriations Act (Art. V, sec. 22(1)(c))* requires that state entities utilize federal funds to the maximum extent possible. In addition, cash receipts should be properly recorded in the accounting records to accurately reflect the University's cash position.

Recommendation: We recommend that the University's new fiscal officer (hired in August 1994) continue to improve controls over cash management:

Procedures for drawing funds should be developed in accordance with federal regulations and communicated to the appropriate personnel. These procedures should include a process for supervisory review and the recording of transactions in the accounting records.

- Drawdowns should be made regularly to minimize the loss of interest on local funds and loss of federal reimbursement.

Drawdowns should be supported by actual expenditures related to the federal programs. Departments which utilize federal funds, including Student Financial Aid, are responsible for monitoring and communicating their cash needs to the appropriate fiscal personnel.

Management's Response: We acknowledge that the University should improve controls over Cash Management in its process for requesting federal funds. A new Fiscal Officer and Assistant Fiscal Officer were employed August 15 and 22 respectively to address these and other needed improvements in the TAMUG Fiscal Office.

Accounts in the general ledger have been set up for PELL, SEOG, and College Work Study for federal fiscal year 1 July 1994 through 30 June 1995. The budgets based on the Notice of Funding have been posted to the accounts. New accounts will be set up annually.

A federal drawdown was made on August 31, 1994 based on the expenditures in the subsidiary ledger accounts less the drawdowns already made for the year. Another drawdown was made on October 4, 1994. The drawdowns have been received and accounting transactions for both drawdowns have been recorded.

In the future, the Financial Aid Office will initiate and provide the necessary information needed to draw down federal funds on an as needed basis. The drawdown will be made within 5 working days from receipt of this information, after the information is reconciled to the accounting records.

Written procedures for the Fiscal Office will be prepared.

Federal Compliance Issue 2:

Improve Controls Over Federal Financial Reports

The University does not have adequate controls for the preparation of its federal financial reports. Reimbursements for federal expenditures may be delayed because of incomplete or inaccurate reports. This issue was previously communicated to management by Texas A&M System Internal Audit in September 1994.

The amount of disbursements for the *Federal Pell Grant Program* (CFDA 84.063) reported on a Department of Education Federal Cash Transaction Report could not be traced to the accounting records. In addition, no reconciliations between the accounting records and the reports were prepared.

Office of Management and Budget Circular A-110, Attachment G, requires the periodic submission of complete and accurate reports relating to federal programs to the federal sponsoring agency.

Recommendation: The University should improve the controls over its federal financial reports. Procedures for the preparation, review, and reconciliation of federal financial reports should be prepared in accordance with federal regulations and communicated to employees.

Management's Response: *We acknowledge that improvements are needed in controls over the federal financial reports. Our new Fiscal Officer has prepared the Federal Cash Transaction Report (PMS272) for the period 1 April 1994 through 30 June 1994 based on accounting records and submitted the report by September 6, 1994.*

Written procedures for the preparation, review, and reconciliation of federal financial reports will be prepared.

Federal Compliance Issue 3:

Financial Aid Office Should Not Receive Loan Proceeds From Lenders

The University's Student Financial Aid Office should not receive loan proceeds from the lenders of the *Federal Family Education Loan Program (CFDA 84.032)*. The office both processes the loan applications and receives the loan proceeds from the lenders. This increases the risk that personnel could process unauthorized loans and retain the loan proceeds when they are received.

Title 34 of the Code of Federal Regulations (CFR), Section 668.14(d)(1)-(2), requires an institution to ensure that its procedures for administering the student financial aid programs include an adequate system of internal checks and balances.

Recommendation: We recommend that the Student Financial Aid Office not receive loan checks. All loan checks should be delivered directly from the lenders to the Fiscal Office, which should continue disbursing these checks to borrowers.

Management's Response: *Arrangements are already in process to notify our vendors that all loan checks are to be sent to our Fiscal Office. The Fiscal Office will provide a list of names to the Financial Aid Office for additional processing. The Financial Aid Office will generate a check release form that will be provided to the Fiscal Office before the check can be released to the student.*

Federal Compliance Issue 4:

Disburse Pell Grant Payments At Prescribed Times

The University did not disburse all *Federal Pell Grant (CFDA 84.063)* payments according to federally prescribed time frames. Eighty percent (16 of 20) of payments tested were credited to the student accounts more than three weeks before the first day of classes. These payments occurred from five to seven days early.

Title 34 of the Code of Federal Regulations (CFR), *Section 690.78*, requires that student accounts be credited no earlier than three weeks before the first day of classes of a payment period.

Recommendation: The University should disburse *Federal Pell Grant* payments to students at prescribed times. Procedures should be implemented to ensure that the Student Financial Aid Office communicates the disbursement dates to the Fiscal Office.

Management's Response: *We acknowledge that Pell Grant payments can be applied to student accounts no earlier than 20 days before the first day of classes of a payment period.*

Pell Grant payments will not be applied to student accounts earlier than 20 days before the first day of classes in compliance with federal requirements.

Audit Scope

Our work, performed at Texas A&M University, included a review of the significant account which was material to the statewide annual financial report. We gained an understanding of the general control environment, cash disbursements, and payroll/personnel. In addition, current fund expenditures (\$438 million) were tested.

We also tested the System's bond-related disclosures in the annual financial report and verified compliance with significant bond covenants. Bonds payable at August 31, 1994, were approximately \$650 million.

We performed tests of the administrative controls and compliance requirements for the two major student financial aid programs at Texas A&M University at Galveston. In fiscal year 1994, the University disbursed \$1.6 million for its *Federal Family Education Loan* program and \$370,000 for its *Federal Pell Grant* program.

Overall Conclusion

The University has made progress in implementing corrective measures to resolve the material weakness identified in the 1993 student financial aid audit, such as reorganizing the Student Financial Aid Office and acquiring the services of a consultant. However, the University has not developed and distributed current written policies and procedures for its student financial aid operations. As a result, the University cannot ensure that it is resolving the material weakness identified in the fiscal year 1993 audit and that its daily operations are consistent and in compliance with federal regulations. In addition, the University did not fully comply with the state laws when entering into a \$300,000 contract related to student financial aid. We performed limited follow-up procedures and will conduct a complete review of the federal student financial aid programs in fiscal year 1995 to determine if the material weakness has been resolved. The University received approximately \$35 million in federal student financial aid funds for fiscal year 1994.

The University's bond schedules and bond-related *Notes to the Financial Statements* in the 1994 Annual Financial Report are materially correct and in conformity with the Comptroller's reporting requirements. At August 31, 1994, the University reported three outstanding bond issues, totaling \$23.9 million.

Internal Control Issue

Internal Control Issue:

Develop Student Financial Aid Policies And Procedures

The University has not developed and distributed current written policies and procedures to improve the control environment within the Student Financial Aid Office. As a result, the University cannot ensure that it is resolving the material weakness identified in the fiscal year 1993 audit and that its daily operations are consistent and in compliance with federal regulations.

Current written policies and procedures are an essential element of the control environment, which ensures consistency and control over daily operations. They also serve as a management control mechanism by standardizing recurring tasks.

Recommendation: We recommend that the University develop and distribute current written policies and procedures for its student financial aid operations. The University should also implement procedures to ensure that these policies and procedures are revised on a timely basis in the future.

Management's Response: *In an effort to ensure that the University's daily financial aid operations are consistent and in compliance with federal regulations, the University is reviewing and revising, as applicable, its written policies and procedures in the area of financial aid.*

The Financial Aid Office will distribute written, updated, and current policies and procedures to the University community and others, as appropriate, no later than March 31, 1995. Moreover, the Financial Aid Office will routinely review, for modification, these policies and procedures on a quarterly basis or more frequently if policy changes dictate.

The Financial Aid Office is developing a growing dissemination list of persons, agencies, and groups who should receive the written policies and procedures. This listing will be amended as appropriate.

State Compliance Issue

State Compliance Issue:

Fully Comply With State Law Regarding Contracts

The University did not fully comply with state law when entering into a contract relating to student financial aid. The University did not obtain prior approval from the State's General Services Commission for a \$300,000 personal services contract.

Texas Annotated Code (TAC), Section 113.11,(4), states that for purchases of services estimated to cost more than \$100,000 per year, the General Services Commission must review any proposed specifications or statements of work and determine whether the award should be made. This review ensures that the services are needed and reasonable.

Recommendation: We recommend that the University fully comply with all applicable state laws and regulations when entering into contracts.

Management's Response: *The University processed the Request for Proposal to conduct services for the TSU Financial Aid Delivery System Project as a Consulting Services Contract. The resulting contract was processed as a Consulting Services Contract and invoices against that contract were presented to the Comptroller as a consulting service. In November 1994, the Comptroller of Public Accounts informed TSU that they had determined this was not a consulting services contract but rather a personal services contract. Since the contract was already executed and operational, TSU could not obtain prior approval from the General Services Commission for the personal services contract.*

The University has installed controls in the procurement process to assure that future contracts are properly classified and that the appropriate prior approval is obtained before the contract is executed.

Audit Scope

The primary focus of our audit was on the University's three bond issues (\$23.9 million). For each bond issue, we tested the bond-related disclosures in the Fiscal Year 1994 Annual Financial Report and verified compliance with significant bond covenants. Follow-up work was performed to determine the status of actions taken by the University to resolve the fiscal year 1993 material weakness identified in the control environment of the Student Financial Aid Office. We performed limited follow-up procedures because the University has not had sufficient time to correct all of the problems previously identified. The University received approximately \$35 million in federal student financial aid funds for fiscal year 1994. A complete review of the federal student financial aid programs will be conducted in fiscal year 1995 to determine if the material weakness has been resolved.

Overall Conclusion

The Department is not adequately protecting its automated resources by restricting access to the computer system and computer facilities. In fiscal year 1994, the automated system was used to process \$1.6 billion in contractor payments. However, the Department has a system in place to ensure compliance with regulations for its largest federal program, *Federal Highway Research, Planning and Construction* (\$1.3 billion). In addition, the Department's accounts that are significant to the statewide financial statements are accurate and properly reported. The accounts tested included federal revenues (\$1.1 billion), expenditures (\$2.9 billion), and interagency transfers (\$1.9 billion).

Internal Control Issues

Internal Control Issue 1:

Restrict Access To Automated Resources

Access to the Department's automated resources is not adequately restricted. Security policies and procedures for maintaining the use of the computer resources are incomplete, and three systems are not adequately protected by the existing security policies and procedures.

Although the Information Systems Division has published some security policies for the mainframe, the following conditions were found:

- Formal policies and procedures for access security of personal computers, local area networks, and client server systems do not exist.
- Data in the output spool and system software manuals are not protected from unauthorized use.
- A risk assessment has not been done to determine the criticality and sensitivity of engineering systems.

Three systems, the Contract Information System, Human Resources Information System, and Automated Purchasing System, need improved security procedures to protect access to the information contained within them.

Restricting access to all computer systems will decrease the risk of unauthorized or accidental access, modification, or damage to computer resources. The Department relies on the computer for day-to-day operations, including the processing of \$1.6 billion in contractor payments for fiscal year 1994.

Recommendation: Develop additional security policies and procedures to restrict access to the computer system:

- Develop security policies and procedures over local area networks, personal computers, and client server systems.

- Protect data in the output spool and systems software manuals from unauthorized use.
- Perform a risk assessment and implement security controls over engineering systems.
- Improve security procedures for the Contract Information System, Human Resources Information System, and Automated Purchasing System.

Management's Response: We concur that additional policies and procedures will decrease risk to computer resources in some instances. The Risk Analysis Project, scheduled to complete in September 1995, will provide information necessary to develop additional security procedures to restrict access to the computer system. An action plan will be implemented based on the Risk Analysis findings.

- *Policies and procedures for access security of Texas Department of Transportation's local area networks, personal computers, and client servers will be implemented by December 31, 1995.*
- *The output spool issue has been addressed. On January 3, 1995, Texas Department of Transportation Manual Notice 95-1 was issued to implement a computer job naming standard. Additionally, the software was implemented and controls defined to CA-Top Secret to provide for the protection of sensitive job output on the JES spool. We concur that the systems software manuals should be protected and badge reader locks will be installed by September 1, 1995.*
- *We concur with the issue on risk assessment and this issue will be addressed in the Risk Analysis project scheduled for completion in September, 1995.*
- *The Information Systems Division and the Office of Primary Responsibility (OPR) for Contract Information System (CIS) have discussed the potential security risk for that system. The OPR (the Construction and Maintenance Division) has chosen to accept the risk for this system. This decision will be reviewed after the Risk Analysis project is complete.*

We concur that security procedures should be improved for the Human Resources Information System (HRIS). A project is currently underway to restrict on-line access to the HRIS subsystems. This project is scheduled to be completed by May 1995.

The Automated Purchasing System (APS) consist of two major components: The Small Purchases (formally known as SPOT Purchases) and the American Software Inc (ASI) systems. Online access for both components is controlled by the Top Secret Security (TSS) System. The ASI systems also has it's own security system (AMSOFT security) which controls the functions that the users are allowed to perform. This is also controlled by TSS through the application control file.

The SMALL Purchases portion is in production and the programs are moved to production status by the Quality Assurance section. The Common Systems of ASI are in production, and the production libraries are not under the control of Quality Assurance at this time but an

action plan will be developed to turn these and all future ASI production programs over to Quality Assurance.

Internal Control Issue 2:

Enforce Procedures Over Computer Log-On Assignments

Policies for computer log-on procedures are not always followed or enforced. Log-on identification codes of terminated and transferred employees are not always deleted or suspended. Group identifications are used for batch jobs, and the use of the CA-Top Secret Master Security Account is not monitored.

Lack of controls over computer log-on procedures may allow unauthorized and undetected transactions and may compromise the integrity of the computer systems.

Recommendation: Enforce policies and procedures for monitoring, deleting, and changing computer log-on assignments.

Management's Response: *We concur with this issue and will implement steps for monitoring compliance with security procedures and the use of the Master Security Account by July 1, 1995.*

Internal Control Issue 3:

Control Access To Computer Facilities

Access to the main computer facility at the Camp Hubbard location is not adequately controlled. The Department controls access by a card key system, door locks, and video camera surveillance. However, instances of unlocked doors and incomplete surveillance of doors were observed. In one instance, unimpeded access was made through two doorways directly into the computer room. In addition, two card key system readers were not working properly, and codes for terminated employees were not deleted.

Restricted access to the computer room reduces the risk of intentional or inadvertent damage to computer equipment. Unauthorized access could result in damage to equipment or data records.

Recommendation: Control access to computer facilities by ensuring that doors are locked, the card key reader system is working properly, and camera surveillance covers all appropriate entrances. Card keys for terminated employees should be deactivated.

Management's Response: *The access problems stated in this issue have been corrected and a review of card key access will be conducted by Information Systems Division personnel on a yearly basis. The additional surveillance cameras will be installed by July 1, 1995. Procedures have been implemented to correct the problem of deactivating card keys for terminated employees.*

Internal Control Issue 4:

Assign Responsibility For Physical Security

Responsibility for physical security at Camp Hubbard computer facilities is not sufficiently assigned. The job descriptions for two managers with responsibility for computer room operations do not clearly delineate security duties. In addition, responsibility for fire prevention systems and procedures and computer room access is not assigned.

Physical security responsibilities should be specifically assigned to ensure that necessary security procedures are performed. Clear responsibility would encourage managers to implement, follow, and enforce security procedures. Without appropriate assignment of responsibility, the risk increases that the physical security of the computer system will not be properly maintained.

Recommendation: Specifically assign the responsibility for computer room physical security. In addition, responsibility for physical security of the building and fire prevention systems should also be assigned.

Management's Response: *We concur. The Manager of Computer Operation's job description will be updated to include responsibility for oversight of the physical security of all the operations area and the fire protection systems. This will be completed by March 31, 1995. The job description for the Manager for the Procurement and General Administrative Support Branch will be amended to reflect responsibility for Building Six security, excluding the Computer Operations area. This will be completed by March 31, 1995.*

Federal Compliance Issues

The Department's most significant program, the *Federal Highway Research, Planning and Construction* program (CFDA 20.205), is funded by the U.S. Department of Transportation through the Federal Highway Administration. During fiscal year 1994, this program expended \$1.3 billion for federally funded projects.

Recommendations addressed in other sections of this report could impact controls over federal funds, especially for the Department's most significant federal program.

Federal Compliance Issue 1:

Ensure Accuracy Of Accounting Records To Support Contractor Payments

The Houston and Fort Worth Districts are not ensuring accurate accounting records to support contractor payments. Inaccurate payments to contractors resulted from mathematical and posting errors and were not detected by project bookkeepers. No errors were noted in the Pharr District.

Our review covered 45 of the approximately 9,194 construction payments made during fiscal year 1994. The selected construction payments represent over \$402 million of the \$1.3 billion in construction expenditures for federally funded projects. We noted errors on three construction projects. These errors have been corrected by the Department.

DISTRICT	PROJECT #	AMOUNT	TYPE OF ERROR
Fort Worth	NH 92 (83) M	\$24,685	Overpayment
Houston	F 514 (102)	\$12,505	Overpayment
Houston	IR 45-1 (267) 060	\$44,460	Underpayment

Federal requirements state that program recipients are to maintain accurate accounting records. Recordkeeping procedures are designed to prevent, detect, and correct errors in a timely manner. They also provide for accurate contractor payments.

Recommendation: Ensure accurate accounting records to support contractor payments.

Management's Response: *We concur with your recommendation. A recent process review of the Department's procedures for determination and documentation of pay quantities, conducted by the Federal Highway Administration, resulted in the following conclusions:*

- *The Department has a very good system available for use by the districts for determination and documentation of pay quantities on active Federal-aid highway projects.*
- *The implementation of the processes/procedures by district project personnel is uniform and consistent.*
- *The system is satisfactory and no recommendations are made for improvement at this time.*

The above conclusions are based on an overall opinion on the implementation of the process. However, the Construction and Maintenance Division is developing a Construction Records Management training workshop to be conducted at the districts in an attempt to target the area offices and/or Districts that need help in this area. Furthermore, the Field Engineers in the Construction and Maintenance Division will continue to monitor these procedures as part of their project review process.

Federal Compliance Issue 2:

Submit Final Vouchers On A Timely Basis

The Department is not submitting final vouchers on a timely basis. Eight of the 45 final vouchers tested were submitted more than 12 months after the final acceptance date of the project. The Department completed 320 final vouchers in fiscal year 1994.

Title 23 of Code of Federal Regulations (CFR), section 140.107 states that final vouchers are to be promptly submitted. Region VI of the Federal Highway Administration (FHWA) has interpreted "prompt submission" to be within one year of the FHWA's final acceptance date of a project to the date the final voucher is paid.

Recommendation: The Department should submit final vouchers within the 12-month time frame required for "prompt submission."

Management's Response: *There are three primary reasons that final vouchers are submitted later than one year after project completion:*

- a. The final clearance from the Federal Highway Administration has not been received.*
- b. There is insufficient federal apportionment to apply to the project, ie., we are waiting to free up some apportionment so we can collect all of the federal share of the project funding.*
- c. There is insufficient federal obligation authority to apply to the project, ie., we are waiting for obligation authority to become available so we can collect all of the federal share of the project funding.*

The reasons noted in b. and c. should be mitigated in a few years due to the increased amount of funding now set aside for construction engineering and contingencies. In the future we will submit final vouchers within the one year time frame required for "prompt submission" when possible.

Audit Scope

The primary focus of our audit was the Department's financial and administrative controls over the *Federal Highway Research, Planning and Construction* program (\$1.3 billion) relating to the State's transportation system. We gained an understanding of the internal control structure, including general control environment, controls over federal billing, cash disbursements, payroll indirect costs, and the federal program. Specific procedures were used to test compliance with the major federal program. We gained an understanding and tested general controls over automated operations. Certain financial accounts were also tested, including federal revenues (\$1.1 billion), expenditures (\$2.9 billion), and interagency transfers (\$1.9 billion).

Overall Conclusion

The University of Houston System's bond schedules and bond-related *Notes to the Financial Statements* in the 1994 Annual Financial Report are materially correct and in conformity with the Comptroller's reporting requirements. At August 31, 1994, the System reported five outstanding bond issues, totaling \$100 million.

The University of Houston is in compliance with the federal regulations regarding its Mathematical and Physical Sciences Program (\$11.3 million for fiscal year 1993), and the University of Houston - Downtown is generally complying with the federal regulations relating to the *Federal Family Education Loan* (\$2.8 million) and the *Federal Pell Grant* (\$2.9 million) programs. However, the University of Houston - Downtown and the University of Houston should ensure compliance with federal regulations for their student financial assistance programs.

Federal Compliance Issues

Federal Compliance Issue 1:

Provide Timely Exit Counseling Information

(Prior Audit Issue)

The University is not providing timely exit counseling (loan repayment) information to all recipients of the *Federal Family Education Loan Program* (CFDA 84.032). Inadequate exit counseling procedures could result in an increased loan default rate.

Although progress has been made in conducting exit counseling, timely exit counseling information was not provided for 45 percent (5 of 11) of the student files tested. Procedures are not sufficient to ensure exit counseling information is mailed within the 30-day requirement.

Title 34 of the Code of Federal Regulations (CFR), section 682.604, requires that the institution conduct exit counseling with each borrower who ceases to be enrolled at least half time. If a student does not attend a counseling session, this information must be mailed to the student within 30 days. Documentation of this counseling must be maintained in the student's file.

Recommendation: We recommend that the University revise its current procedures to provide timely exit counseling information to all students who cease to be enrolled at least half-time. Documentation of this counseling should be maintained in the student files.

Management's Response: Management agrees with this finding. The University is adding 4 FTE's to its student loan component, including an Assistant Director. This will allow more frequent scheduling of exit conferences as well as timely generation of exit counseling materials.

Federal Compliance Issue 2:

Report Enrollment Changes To Lenders

(Prior Audit Issue)

The University is not reporting all enrollment changes to the lenders of the *Federal Family Education Loan Program* (CFDA 84.032) within the 60-day federal requirement. Enrollment changes occur when a student graduates, withdraws, drops a class, or is expelled. Noncompliance with this requirement results in delayed loan repayment to lenders.

The 60-day notification requirement was not met for 63 percent (7 of 11) of the files tested because procedures are not sufficient to report spring and summer graduates.

Title 34 of the Code of Federal Regulations (CFR), section 682.610, requires that the institution notify the guaranty agency within 60 days. If an institution does not expect to report enrollment changes on the student status confirmation report within the next 60 days, that institution must notify the guaranty agency or lender by letter within 30 days.

Recommendation: We recommend the University report enrollment changes to lenders within the 60-day requirement. Timely reporting of students who graduate in the spring and summer semesters can be achieved by submitting a list of confirmed graduates to the guarantor.

Management's Response: *Management agrees with this finding. The University is adding 4 FTE's to its student loan component including an Assistant Director. This will allow for timely reporting. In addition, by utilizing TGSLC's Tex Net software we will be able to electronically export Spring and Summer graduates in a timely fashion.*

University Of Houston System

University Of Houston - Downtown

Federal Compliance Issues

Federal Compliance Issue 1:

Financial Aid Office Should Not Receive Loan Proceeds From Lenders

The University's Student Financial Aid Office should not receive loan proceeds from the lenders of the *Federal Family Education Loan Program* (CFDA 84.032). The office both processes the loan applications and receives the loan proceeds from the lenders. This increases the risk that personnel could process unauthorized loans and retain the loan proceeds when they are received.

Title 34 of the Code of Federal Regulations (CFR), section 668.14(d)(1)-(2), requires an institution to ensure that its procedures for administering the student financial aid programs include an adequate system of internal checks and balances.

Recommendation: We recommend that the Student Financial Aid Office not receive loan checks. All loan checks should be delivered directly from the lenders to the Fiscal Office, which should continue disbursing these checks to borrowers.

Management's Response: *Effective March 1995 we will attach a form to each student loan application requesting that loan checks be mailed to the Accounting Office with their room location rather than this office. The Accounting Office will work with this office to develop and implement procedures for checks going directly to that area.*

Federal Compliance Issue 2:

Payment Authorizations For University Obligations Must Be Optional

The University may not require *Federal Pell Grant Program*(CFDA 84.063) and *Federal Family Education Loan Program - FFELP* (CFDA 84.032) recipients to authorize payment of outstanding university obligations. The statement on the Financial Aid Application, which authorizes outstanding university obligations to be deducted from the students' award proceeds, does not state that this authorization is optional. Students must sign the statement in order to receive their award proceeds. As a result, student financial aid funds are being used for items other than educational expenses.

Title 34 of the Code of Federal Regulations (CFR), sections 690.78 (a)(1)-(2) and 682.604 (d), states that institutions may use Federal Pell Grant Program and FFELP awards to pay charges other than tuition and fees and room and board (if provided by the school) only if the student authorizes such payment in writing. However, the institution may not require the student to authorize such payments. Payments may only be made for educational expenses.

Recommendation: We recommend that the University not require students with financial aid to authorize payment of outstanding university obligations. The University should make students aware that authorization for payment of institutional debt is not a requirement for *FFELP* or *Federal Pell Grant Program* disbursement.

Management's Response: *Management agrees with this finding. The current statement on the Financial Aid Application, which authorizes outstanding university obligations to be deducted from the student award proceeds, will be deleted.*

In the future, the Business Affairs office will deduct amounts from the students' award proceeds to pay outstanding university obligations, only after the student authorizes such payment in writing. The Business Affairs office will prepare a special form for this purpose.

Federal Compliance Issue 3:

Provide Exit Counseling Information

The University is not providing exit counseling (loan repayment) information to all recipients of the *Federal Family Education Loan Program* (CFDA 84.032). Inadequate exit counseling procedures could result in an increased loan default rate.

Eighty percent (16 of 20) of the files tested for students who graduated, ceased to be enrolled at least half time, or withdrew did not contain documentation of exit counseling. *Title 34 of the Code of Federal Regulations* (CFR), section 682.604, requires that the institution conduct timely exit counseling with each borrower who graduates, ceases to be enrolled at least half time, or withdraws from school. Documentation of this counseling must be maintained in the student's file.

Recommendation: We recommend the University provide exit counseling information to all students who graduate, cease to be enrolled at least half-time, or withdraw. Documentation of this counseling should be maintained in the student files.

Management's Response: *Management concurs with the finding. In the future, documentation will be placed in the student files reflecting attendance at exit interviews or dates when packets are mailed.*

Federal Compliance Issue 4:

Report Enrollment Changes To Lenders

The University is not reporting all enrollment changes to the lenders of the *Federal Family Education Loan Program* (CFDA 84.032) within the 60-day federal requirement. Enrollment changes occur when a student graduates, withdraws, drops a class, or is expelled. Noncompliance with this requirement results in delayed loan repayment to lenders.

The 60-day notification requirement was not met for 70 percent (14 of 20) of the files tested because procedures are not sufficient to report students who graduated, ceased to be enrolled at least half time, or withdrew.

Title 34 of the Code of Federal Regulations (CFR), section 682.610, requires that the institution notify the lender within 60 days when the school discovers that a loan recipient has ceased to be enrolled at least half time.

Recommendation: We recommend the University report enrollment changes to lenders within the 60-day requirement. The University should revise its procedures to ensure all students who graduate, cease to be enrolled at least half-time, or withdraw are reported within the required time frame.

Management's Response: *Management concurs with the finding. We will use an additional part-time staff member to notify guarantors of enrollment changes within the 60 day limit.*

Audit ScopeUniversity of Houston System

The primary focus of our audit was on the System's five significant bond covenants (\$100 million). For each bond issue, we tested the bond-related disclosures in the fiscal year 1994 Annual Financial Report and verified compliance with significant bond covenants.

University of Houston

The primary focus of our audit was on the University's Mathematical and Physical Sciences Program (\$11.3 million for fiscal year 1993). We audited the program for fiscal year 1993; however, it was not considered to be a major federal program for the 1994 fiscal year. We reviewed the administrative controls relating to the major federal program and performed specific procedures to test compliance with federal requirements. Additionally, follow-up work was performed related to the *Federal Family Education Loan Program* (\$32 million) to determine the status of two prior year student financial assistance issues related to exit counseling and enrollment change requirements.

University of Houston - Downtown

The primary focus of our audit was on the University's two largest student financial assistance programs: the *Federal Family Education Loan Program* (\$2.8 million) and the *Federal Pell Grant Program* (\$2.9 million). We tested the administrative controls relating to the major federal programs. Specific procedures were used to test compliance with federal requirements.

Overall Conclusion

The University of Texas System's accounts which are material to the statewide comprehensive annual financial report are reported accurately. The significant accounts at The University of Texas at Austin consisted of current unrestricted funds revenues (\$570 million) and expenditures (\$581 million). The significant accounts at The University of Texas System Administration consisted of investments (\$6 billion) and investment income and realized gain on investments for endowment and similar funds (\$166 million).

In addition, System Administration has established a system to ensure compliance with bond covenants, and this system is working. Bonds payable at August 31, 1994, were approximately \$1 billion.

The University of Texas at Austin and The University of Texas at San Antonio have established control systems to ensure compliance with most federal regulations for their major federal programs, and these systems are working. The University of Texas at Austin received approximately \$140 million through its major federal programs during fiscal year 1994. Non-major programs tested at The University of Texas at Austin amounted to \$7.2 million. In fiscal year 1994, The University of Texas at San Antonio disbursed \$22.7 million in student financial aid.

The University Of Texas System

University Of Texas At Austin, The

Internal Control Issue

Internal Control Issue 1:

Strengthen Controls Over Data Processing

Compensating controls over data processing should be strengthened in the Office of Student Financial Services (OSFS). Within the decentralized data processing environment at the University of Texas at Austin, OSFS programmers are responsible for placing programs into production and also running these programs against production data. Programmer performance of these functions results in a control weakness and, at a minimum, requires adequate compensating controls. However, compensating controls were found to be weak as exemplified by the following:

- Program modifications are not consistently documented.
- An audit trail of program promotions is not retained.
- Management does not review job submissions.

When data processing activities are decentralized, OSFS management is responsible for ensuring the existence of adequate compensating controls for their data processing resources. The lack of such controls increases the likelihood that data from the financial aid system could be deleteriously altered.

Recommendation: We recommend that OSFS management strengthen compensating controls over data processing. Specifically, documentation and monitoring activities should be increased for the program modification, program promotion, and job submission functions.

Management's Response: *We agree that program modifications are not consistently documented. In the future, we will compile electronic documents indicating the program revisions or new programming agreed upon during senior administrative staff meetings. Current year documents will be available electronically. Previous years' documents will be printed to hard copy, filed, and deleted from electronic storage.*

We agree that program promotions are not permanently retained and monitored ("program promotions" are when computer programs are taken from the testing mode on test data to the actual programming mode on real data). When this takes place, an electronic record is created. This information is retained on-line for approximately six weeks. We will print a report of this information on a monthly basis to maintain a complete history of program promotions. The OSFS Associate Director will be responsible for monitoring this information. The Associate Director of OSFS will review listings of computer program job submissions at least monthly.

We plan to initiate all new procedures as soon as possible. All procedures described will be fully implemented by Fall 1995.

Federal Compliance Issues

Recommendations addressed in other sections of this report impact controls over federal funds, especially for the University's most significant federal programs funded by the U.S. Department of Education.

Federal Compliance Issue 1:

Office Of Student Financial Services Should Not Receive Loan Proceeds From Lenders

The University's Office of Student Financial Services should not receive loan proceeds from the lenders of the *Federal Family Education Loan Program* (CFDA 84.032). The office both processes the loan applications and receives the loan proceeds from the lenders. This increases the risk that office personnel could process unauthorized loans and retain the loan proceeds when they are received.

Title 34 of the Code of Federal Regulations (CFR), section 668.14(d)(1)-(2), requires an institution to ensure that its procedures for administering the student financial aid programs include an adequate system of internal checks and balances.

Recommendation: We recommend that the Office of Student Financial Services not receive loan checks. All loan checks should be delivered directly from the lenders to the Bursar's Office, which should continue disbursing these checks to borrowers.

Management's Response: *We agree that the functions of awarding financial aid and handling proceeds from loans should be performed by separate departments. Although we have these functions separated within the Office of Student Financial Services, we will start a new procedure requiring the lenders to send the checks directly to the Office of Accounting. This new procedure will be on a trial run for the Summer 1995 semester and fully implemented by the Fall 1995 semester.*

Federal Compliance Issue 2:

Payment Authorizations For University Obligations Must Be Optional

The University may not require *Federal Pell Grant Program* (CFDA 84.063) and *Federal Family Education Loan Program - FFELP* (CFDA 84.032) recipients to authorize payment of outstanding university obligations. The statement on the Financial Aid Notification (FAN) letter, which authorizes outstanding university obligations to be deducted from the students' award proceeds, does not state that this authorization is optional. Students must sign the statement in order to receive their award proceeds. As a result, student financial aid funds are being used for items other than educational expenses.

Title 34 of the Code of Federal Regulations (CFR), sections 690.78 (a)(1)-(2) and 682.604 (d), states that institutions may use Federal Pell Grant Program and FFELP awards to pay charges other than tuition and fees and room and board (if provided by the school) only if the student authorizes such payment in writing. However, the institution may not require the student to authorize such payments. Payments may only be made for educational expenses.

Recommendation: We recommend that the University not require students with financial aid to authorize payment of outstanding university obligations. The University should make students aware that authorization for payment of institutional debt is not a requirement for *FFELP* or *Federal Pell Grant Program* disbursement. This can be done by rewording or omitting the related certification statement, contained on the FAN.

Management's Response: *We agree to revise the Financial Aid Notification form so that the student will clearly recognize that having institutional debts deducted from his/her financial aid is an option. This will be fully implemented for the 1995-1996 school year.*

Federal Compliance Issue 3:

Provide Timely Exit Counseling Information

The University is not providing timely exit counseling (loan repayment) information to all recipients of the *Federal Family Education Loan Program* (CFDA 84.032). Inadequate exit counseling procedures could result in an increased loan default rate. Timely exit counseling information was not provided for 85 percent (17 of 20) of the student files tested. Seven files did not contain any exit counseling documentation, while ten files showed exit counseling was not provided in a timely manner.

Title 34 of the Code of Federal Regulations (CFR), section 682.604, requires that the institution conduct timely exit counseling with each borrower who ceases to be enrolled at least half time. Documentation of this counseling must be maintained in the student's file.

Recommendation: We recommend the University provide timely exit counseling information to all students who cease to be enrolled at least half-time and that documentation be maintained in the student files.

Management's Response: *We agree that the borrowers who were unable to attend an exit counseling session were not mailed the required materials in the time specified. The materials were mailed to them as soon as this was discovered. We now have in place a program to identify those students who have dropped to less than half time. We will ensure that they will have the appropriate exit counseling session or materials on a timely basis.*

Federal Compliance Issue 4:

Report Enrollment Changes

The University is not reporting all enrollment changes for the *Federal Family Education Loan Program* (CFDA 84.032) within the 60-day federal requirement. Enrollment changes occur when a student graduates, withdraws, drops a class, or is expelled. Noncompliance with this requirement may result in delayed loan repayment to lenders.

The 60-day notification requirement was not met for 70 percent (14 of 20) of the student files tested. Procedures are not sufficient to report spring graduates within the 60-day requirement.

Title 34 of the Code of Federal Regulations (CFR), section 682.610, requires the institution to report enrollment changes to the guaranty agency within 60 days. If an institution does not expect to report enrollment changes on the student status confirmation report within the next 60 days, that institution must notify the guaranty agency or lender by letter within 30 days.

Recommendation: We recommend the University report enrollment changes to lenders within the 60-day requirement. Timely reporting of students who graduate in the spring semester can be achieved by submitting a list of confirmed graduates to the guarantor.

Management's Response: We agree that some enrollment changes were not reported within the 60-day requirement. The circumstance affected only Spring '94 graduates. We have adjusted our procedures so that a list of spring graduates will be reported to the guarantor or lender within 60 days after the student record is updated for spring graduation.

The University Of Texas System

University Of Texas At San Antonio, The

Internal Control Issues

Internal Control Issue 1:

Strengthen The Control Environment Of The Student Financial Aid Office

A control environment weakness exists in the Student Financial Aid Office at the University. Vacancies in the Director and Assistant Director positions, high turnover rates, and outdated policies and procedures are all contributing factors to the control environment weakness. During the audit, 16 issues were identified, 9 of which were significant enough to be included in this report. The control environment reflects the overall attitudes, awareness, and actions of management concerning the importance of and its emphasis on controls. A weakness in the control environment increases the risk that unintentional mistakes and intentional improprieties could occur and go undetected within the department.

Title 34 of the Code of Federal Regulations (CFR), section 668.14, states that for an institution to continue to participate in any federal financial aid programs, the institution must demonstrate that it is capable of administering the federal programs. A strong control environment within the department is essential to ensure that the financial aid programs are properly administered. Management is responsible for establishing and maintaining control systems which provide reasonable assurance regarding compliance with state and federal regulations.

Recommendation: We recommend that the University strengthen the control environment of the Student Financial Aid Office by hiring a financial aid director and by updating policies and procedures to ensure compliance with federal regulations.

Management's Response: The Assistant Director was away from the office for six weeks due to a family medical emergency. The Assistant Director has returned to full time work since the audit was completed. An Associate Director with many years of financial aid experience was hired and reported for work the week of the audit. The search for a Financial Aid Director was opened three times in the last two years. An offer was made but was rejected. A search for a Director of Financial Aid for UTSA will be opened in February with an aim to hire in late Spring. These actions will give the stability and oversight required to operate a strong and efficient Financial Aid Office.

This past year we worked with GTE to install an Imaging System, but they were unable to fulfill their contract. We will once again this year begin working with an outside contractor to install an Imaging System that will function throughout the whole financial aid process from application to awarding. We have made significant progress in the procedures and operational policies of the Financial Aid Office and will continue to monitor and improve on the procedures and policies of the operation of the office to provide assurance that we are in compliance with State and Federal regulations.

The University's internal auditor will monitor all areas in which findings were noted and will work closely with Financial Aid administrators to improve and monitor all functions within the office.

Internal Control Issue 2:

Restrict Access To Student Records System

(Prior Audit Issue)

Although progress has been made since the 1990 fiscal year statewide audit, access to the University's student records system is still not adequately restricted. Passwords for access to the student records system are not required to be changed regularly, and the notification procedures in place do not consistently ensure that access capabilities of a departing employee are immediately removed. Since access is not adequately restricted, if a user were to secure another's password, it would be possible to gain access to the update capabilities of that second user.

Progress has been made in resolving the prior finding by the installation of RACF, an access security software package, and by the restriction of programmer update access to the student records system. RACF requires passwords for the initial access to the computer system to be changed in a timely manner.

Because the system stores confidential student information, strong access restrictions are essential to prevent corruption of information. In addition, access capabilities should be removed immediately after an employee leaves the University.

Recommendation: We recommend the further restriction of access to the student records system by instituting required password change intervals. In addition, the University's employee exit procedures should include prompt notification to the computer security administrators.

Management's Response: *The programming necessary to enforce periodic changes of ISIS passwords has been completed. It will be implemented in the production system at the end of this calendar year and the parameters will be set to require a change of password every 45 days. The change will be on the same schedule as the required change of the RAC-F password.*

The Office of Information Technology is informed when an employee leaves the University or is assigned to a different department, but there is frequently a delay of a week before this information is made available to the computer security administrators. We will work with

the Human Resources department to make it possible to get this information at the time of the exit procedure. We will also request that the personnel in the employee's home department inform us by electronic mail as soon as it becomes clear that the employee will be leaving so that we have the first possible notice and can adjust the security in a more timely manner.

Federal Compliance Issues

Recommendations addressed in other sections of this report impact controls over federal funds, especially for the University's most significant federal programs which are funded by the U.S. Department of Education.

Federal Compliance Issue 1:

Revise Satisfactory Academic Progress Policy

The University's student financial aid satisfactory academic progress policy should be revised. The policy's incremental progress standard does not ensure that a student's progress is sufficient to obtain a degree within the maximum time frame.

Title 34 of the Code of Federal Regulations (CFR), section 668.16, states that the policy must include a schedule that designates the minimum amount of work that a student must successfully complete at the end of each increment to complete an educational program within the maximum time frame.

Recommendation: We recommend the University revise its student financial aid satisfactory academic progress policy to comply with federal regulations. The policy's incremental progress policy should designate the amount of work that a student must complete for each increment in order to successfully finish the program within the maximum time frame.

Management's Response: *The University's policy stated a requirement of 10 hours per long semester to comply with Federal Regulations for the purpose of monitoring grade point average and successful completion of graduation requirements. While the policy did not specifically state so, it was assumed that additional hours would be accumulated through summer enrollment. In response to the finding, the University will revise its stated policy to fully comply with Federal regulations, and will implement procedures that ensure that students receiving financial aid complete their degree program within the stated maximum time frame.*

The revised policy will specify that a full-time student must complete 24 semester credit hours per academic year (adjusted accordingly for other categories of enrollments).

Federal Compliance Issue 2:

Student Financial Aid Office Should Not Receive Loan Proceeds From Lenders

The University's Student Financial Aid Office should not receive loan proceeds from the lenders of the *Federal Family Education Loan Program* (CFDA 84.032). The office both processes the loan applications and receives the loan proceeds from the lenders. This increases the risk that office personnel could process unauthorized loans and retain the loan proceeds when they are received.

Title 34 of the Code of Federal Regulations (CFR), section 668.14(d)(1)-(2), requires an institution to ensure that its procedures for administering the student financial aid programs include an adequate system of internal checks and balances.

Recommendation: We recommend that the Student Financial Aid Office not receive loan checks. All loan checks should be delivered directly from the lenders to the Bursar's Office, which should continue disbursing these checks to borrowers.

Management's Response: *The University concurs with State Auditor's recommendation that Federal Family Education Loan Program (FFEL) checks should be received by the Bursar's office and not the Financial Aid Office. Implementation of this new procedure will begin immediately by notifying the many lenders that submit FFEL checks to the University. It is not known at this time how quickly these various institutions can change the mailing/delivery address for UTSA, and until that time, checks will continue to be received in the Financial Aid Office. There is a concern that changing our present procedure may have a negative impact on customer (student) service, and this new procedure must be evaluated over the next six months.*

Federal Compliance Issue 3:

Award Proceeds May Not Be Withheld

The University may not withhold award proceeds from *Federal Pell Grant Program* (CFDA 84.063) and *Federal Family Education Loan Program - FFELP* (CFDA 84.032) recipients for payment of noneducational university obligations. Current University check disbursement procedures inappropriately require payment of any outstanding university obligations before a student may receive his or her loan proceeds.

Institutions may not withhold award proceeds from *Federal Pell Grant Program* and *FFELP* recipients who meet the eligibility requirements as set forth in *Title 34 of the Code of Federal Regulations (CFR), sections 682 and 690*. Payment of outstanding university obligations is not one of the eligibility requirements for distribution of award proceeds.

Recommendation: We recommend that the University not withhold federal award proceeds from students who have outstanding university obligations. There are alternatives that the

University may utilize for the collection of student's outstanding obligations. These alternatives include restricting registration, withholding grades, or notifying a collection agency.

***Management's Response:** The University concurs with the State Auditor's recommendation that only educational costs can be collected from Federal Financial Aid programs. University obligations such as parking fines and library fines shall be collected separately from the Disbursement of Federal financial aid program funds. The holds presently entered on a student's account will not be liquidated using proceeds from federal programs unless the student voluntarily offers to pay at that time. This may cause students unnecessary delays in the advance registration process if these obligations are not cleared at the time of disbursement, but then that should encourage the voluntary payments.*

Federal Compliance Issue 4:

Maintain Student Files

The University is not adequately maintaining student files to support the disbursement of federal financial aid. Several documents could not be located during the audit, other documents had not been properly filed, and the disbursement date of financial aid to the students is not recorded. Inadequate filing practices make it difficult to determine compliance with federal program requirements and could result in disbursements of funds which are not properly supported.

Twelve percent (3 of 25) of the entrance counseling forms requested could not be found, and 30 percent (6 of 20) of the exit counseling forms could not be found. There were also six instances in which no date was recorded on the check authorization form, and one instance in which a check release form was not located. Many documents related to the *Federal Family Education Loan Program* (CFDA 84.032) for the 1993-1994 award year, which ended in May 1994, had not been properly filed as of November 1994. In addition, the University does not record the date that financial aid is disbursed to the students.

Title 34 of the Code of Federal Regulations (CFR), section 668.23 (f)(1)-(3), requires institutions administering federal financial aid programs to establish and maintain, on a current basis, adequate student records. *Section 682.610 (b)* requires the University to maintain the date of transmittal of *Federal Family Education Loan* proceeds by the school to the student. In addition, *section 690.81* requires financial records to reflect all *Federal Pell Grant Program* transactions, which includes the date of each payment to the student.

Recommendation: We recommend the University maintain student files on a current basis to support the disbursement of federal financial aid. All unfiled documents relating to financial aid recipients should be filed, and all filing should be kept current. In addition, the University should implement procedures to record the date that students actually receive their financial aid.

***Management's Response:** It is the policy of the Financial Aid Office to file all documents pertaining to a student in the student's folder with the exception of the disbursement release forms. The frequency in which these forms are accessed made it necessary to keep them*

separated from the files temporarily. Although this is not a violation of the Department of Education regulations, in order to more efficiently serve students and the University we have filed the release forms in the students' files and will continue this practice. As discussed in [Federal Compliance Issue 5], the disbursement release forms will be initialed and dated by the Bursar's Office as of the date the check is delivered to the student.

The Exit Counseling Forms could not be located in some cases due to weak procedures sighted in [Federal Compliance Issue 6]. We have instructed the front line to ensure that all students who withdraw from the University complete the exit process, then front line personnel will appropriately document the file. We have already strengthened the exit interview process for students graduating from the University and will document the students' files accordingly. Each semester Exit Interview Packages will be mailed and documented to all students who cease to be enrolled at least half-time. We believe the new procedures developed in response to [Federal Compliance Issue 6] will adequately document the students' files.

Regarding reference to Entrance Counseling Forms, eighteen months ago we changed the way we receipted documentation at the front counter. For most documents received, we enter the document received date on our document tracking system and print a copy of the screen and give this to the student as a receipt. This procedure was apparently being used for documenting the completion of entrance counseling. This has been corrected and the front desk staff has been reinstructed on proper procedure which should eliminate further occurrence of not completing the Entrance Counseling Form.

Federal Compliance Issue 5:

Distribute Loan Proceeds At Prescribed Times

The University is distributing *Federal Family Education Loan Program* (CFDA 84.032) proceeds to students earlier than ten days before the first class day. Twenty-four percent (6 of 25) of the student files tested did not indicate that loan proceeds were not released to the student prior to ten days before the first class day. In five of the six files, the date recorded on the check release form was earlier than ten days before the first class day. For one of the six files, the release date was not recorded on the check release form. Early distribution of loan proceeds increases the risk of payment to ineligible students.

Title 34 of the Code of Federal Regulations (CFR), section 682.604 prohibits an institution from delivering loan proceeds to a registered student earlier than ten days before the first day of classes.

Recommendation: We recommend the University distribute loan proceeds at prescribed times. The University should not distribute loan proceeds earlier than ten days before the first class day. In addition, procedures should ensure that release dates are recorded on check release forms.

Management's Response: *Loan proceeds will not be released sooner than 10 days before the first day of class effective immediately. The loan release form will be initialed and dated as of the day the student picked up the check.*

Federal Compliance Issue 6:

Provide Exit Counseling Information

The University is not providing exit counseling (loan repayment) information to all recipients of the *Federal Family Education Loan Program (CFDA 84.032)*. Forty-five percent (9 of 20) of the student files tested did not contain documentation of exit counseling. In addition, procedures are not sufficient to identify students who do not re-enroll the following semester, and as a result require exit counseling. Inadequate exit counseling procedures could result in an increased loan default rate. *Title 34 of the Code of Federal Regulations (CFR), section 682.604*, requires that the institution conduct exit counseling with each borrower who ceases to be enrolled at least half time. This includes students who withdraw, drop classes, graduate, or simply do not re-enroll at the University. If a student does not attend a counseling session, this information must be mailed within 30 days. Documentation of this counseling must be maintained in the student's file.

Recommendation: We recommend the University provide exit counseling information to all students who cease to be enrolled at least half-time and that documentation be maintained in the students' files. Procedures should be developed to identify students who require exit counseling because they do not re-enroll.

Management's Responses: *For those students who withdraw during the semester we have had a procedure established where they must come to the financial aid office, and we then require they complete the exit interview process which is documented and placed in their student file. For those students who graduate we have instituted a formal exit interview session (as of Spring 1994) where bankers are present to answer questions and provide guidance. Their participation has been documented and placed in their student file. For those students who do not re-enroll we will institute a procedure where they are identified at the time the SEVR tapes are run and an exit interview packet will be mailed and documented. UTSA has a very low default rate of 6.4% which has stayed steady over the last four years.*

Federal Compliance Issue 7:

Report Enrollment Changes In A Timely Manner

The University is not reporting all enrollment changes for the *Federal Family Education Loan Program (CFDA 84.032)* in a timely manner. Enrollment changes occur when a student graduates, withdraws, drops a class, or is expelled. Forty-five percent (9 of 20) of the students tested were not reported within the required time frames. Noncompliance with this requirement may result in delayed loan repayment to lenders.

Title 34 of the Code of Federal Regulations (CFR), section 682.610, requires the institution to report enrollment changes to the guaranty agency within 60 days. If an institution does not

expect to report enrollment changes on the student status confirmation report within the next 60 days, that institution must notify the guaranty agency or lender by letter within 30 days.

Recommendation: We recommend the University report enrollment changes to the guarantors or lenders in a timely manner. Timely reporting of students who graduate can be achieved by submitting a list of confirmed graduates to the guarantors.

Management's Response: *We have already taken steps to strengthen this procedure. The student enrollment verification report (SEVR) tapes were run on a timely basis in Fall of 1994 and will continue to be run on a timely schedule to meet our reporting requirements to the lenders and guarantors. We sent the exit interview forms for Spring 1994 graduates to the lenders and guarantors on a timely basis, and will continue to do so in the future. We will improve documentation by including the date exit interview forms are mailed. We believe the changes we have implemented over the last year will satisfy the reporting requirements for enrollment changes.*

Audit Scope

Our work, performed at The University of Texas at Austin and The University of Texas System Administration, included a review of the material accounts which are significant to the statewide annual financial report. The significant accounts at The University of Texas at Austin consisted of current unrestricted funds revenues (\$570.3 million) and expenditures (\$580.7 million). The significant accounts at The University of Texas System Administration consisted of investments (\$6.4 billion) and investment income and realized gain on investments for endowment and similar funds (\$165.5 million). We gained an understanding of the general control environment, cash receipts, cash disbursements, payroll/personnel, journal vouchers, and investments. The following financial statement accounts were tested: investments, investment income, and current unrestricted funds revenues and expenditures.

In addition, we tested the System's bond-related disclosures in the annual financial report and verified compliance with significant bond covenants. Bonds payable at August 31, 1994, were approximately \$1 billion.

We performed tests of the controls and compliance requirements of the largest federal programs at The University of Texas at San Antonio and The University of Texas at Austin. The University of Texas at Austin received approximately \$140 million through its major federal programs during fiscal year 1994. Non-major programs tested at The University of Texas at Austin amounted to \$7.2 million. In fiscal year 1994, The University of Texas at San Antonio disbursed \$22.7 million in student financial aid. We also gained an understanding of the controls over selected non-major federal programs at The University of Texas at Austin and The University of Texas M.D. Anderson Cancer Center.

Appendix 1:

Audit Scopes For Agencies With No Findings

As noted in "Our Compliments", 30 of the 57 entities we visited do not have any findings in the areas that we audited. The scope of our audit work at these entities is described below. It is important for the reader to understand that we may have only audited a very specific portion of the agency's operations. Our audit work would not necessarily disclose all matters that might be reportable conditions or material weaknesses as defined in the "Auditor's Report on the Internal Control Structures".

Agricultural Finance Authority, Texas

The primary focus of our audit was to determine the Authority's compliance with significant covenants contained in the Certificate of Resolution and the Authority's governing statute. The Authority is required to have an audit of its activities each fiscal year. We performed a compliance audit to satisfy this requirement. As of August 31, 1994, the Authority reported \$17.9 million in notes payable. We gained an understanding of the administrative and accounting controls and tested the Authority's compliance with required balances in the interest and sinking fund, the reserve fund, and Guaranty Subaccount and certain reporting requirements.

Armory Board, Texas National Guard

The primary focus of our audit was the Board's compliance with significant bond covenants and the presentation of bond related disclosures in the 1994 Annual Financial Report. At August 31, 1994, the Texas National Guard Armory Board reported eight bond issues outstanding, totaling \$33 million. We gained an understanding of the administrative and accounting controls and tested bond related revenue and expenditure accounts to determine compliance with significant bond covenants. In addition we examined the bond related notes to the financial statements to determine compliance with reporting guidelines.

Criminal Justice, Texas Department of

The primary focus of our audit was the Department's compliance with significant bond covenants and the presentation of bond related disclosures in the 1994 Annual Financial Report. At August 31, 1994, the Texas Department of Criminal Justice reported 12 bond issues outstanding, totaling \$226.9 million. We gained an understanding of the administrative and accounting controls and tested bond related revenue and expenditure accounts to determine compliance with significant bond covenants. In addition we examined the bond related notes to the financial statements to determine compliance with reporting guidelines.

East Texas State University

The primary focus of our audit was the University's compliance with significant bond covenants and the presentation of bond related disclosures in the 1994 Annual Financial Report. At August 31, 1994, the East Texas State University reported three bond issues outstanding, totaling \$888,000. We gained an understanding of the administrative and accounting controls and tested bond related revenue and expenditure accounts to determine

compliance with significant bond covenants. In addition we examined the bond related notes to the financial statements to determine compliance with reporting guidelines.

General Land Office & Veteran's Land Board

The primary focus of our audit was the Veterans Land Board's loans and contracts receivables for the veterans programs. We gained an understanding of the internal control structure, including control environment, and controls over cash receipts and cash disbursements. We tested certain accounts, including, Veterans Loans and Contracts Receivable, Bonds Payable, and Amount to be Provided for Retirement of General Long-Term Debt. We also tested the accuracy of bond information presented in the 1994 Annual Financial Report. Specific procedures were used to test for compliance with the bond covenants.

Hospital Equipment Financing Council, Texas

The primary focus of our audit was the Council's compliance with significant bond covenants and the presentation of bond related disclosures in the 1994 Annual Financial Report. At August 31, 1994, the Texas Equipment Financing Council reported one bond issue outstanding, totaling \$11.9 million. We gained an understanding of the administrative and accounting controls and tested bond related revenue and expenditure accounts to determine compliance with significant bond covenants. In addition we examined the bond related notes to the financial statements to determine compliance with reporting guidelines.

Insurance, Texas Department of

The primary focus of our audit was the Department's Trust and Agency Fund account "Funds Held in Custody for Others". We gained an understanding of the internal control structure, including the general control environment, as well as controls over cash and investments. We also performed substantive tests of the asset accounts, cash and investments, which relate to the account "Funds Held in Custody for Others".

Midwestern State University

The primary focus of our audit was the University's compliance with significant bond covenants and the presentation of bond related disclosures in the 1994 Annual Financial Report. At August 31, 1994, the Midwestern State University reported seven bond issues outstanding, totaling \$4 million. We gained an understanding of the administrative and accounting controls and tested bond related revenue and expenditure accounts to determine compliance with significant bond covenants. In addition we examined the bond related notes to the financial statements to determine compliance with reporting guidelines.

National Research Laboratory Commission, Texas

The primary focus of our audit was the Commission's compliance with significant bond covenants and the presentation of bond related disclosures in the 1994 Annual Financial Report. At August 31, 1994, the Texas National Research Laboratory Commission reported one bond issue outstanding, totaling \$250 million. In addition the Texas Public Finance Authority reported \$238 million of general obligation bonds outstanding on behalf

of the Commission. We gained an understanding of the administrative and accounting controls and tested bond related revenue and expenditure accounts to determine compliance with significant bond covenants. In addition we examined the bond related notes to the financial statements to determine compliance with reporting guidelines.

Parks & Wildlife Department, Texas

The primary focus of our audit was the Department's bond issues and its three largest non-major federal programs, totaling \$25 million. We gained an understanding of the controls related to the non-major federal programs. For the bond issues, we gained an understanding of the internal control structure at the Texas Public Finance Authority as it relates to the bonds issued on behalf of the Department. In addition, we tested compliance with significant bond covenants. At August 31, 1994, the Authority reported \$29.4 million of general obligation bonds outstanding on behalf of the Department.

Public Finance Authority, Texas

The primary focus of this audit was the Authority's compliance with bond covenants and related transactions for its general obligation and revenue bonds. The total indebtedness relating to these bonds includes \$2.0 billion in general obligation bonds and \$639 million in revenue bonds. These bonds were issued primarily to finance the acquisition, construction, repair, renovation, and other improvements to buildings for the use of state agencies. We gained an understanding of the general control environment. Certain financial accounts were also tested, including bonds payable, bond and note proceeds, payments for refunding, due to other funds, and operating transfers.

Stephen F. Austin State University

The primary focus of our audit was the University's compliance with significant bond covenants and the presentation of bond related disclosures in the 1994 Annual Financial Report. At August 31, 1994, Stephen F. Austin State University reported two bond issues outstanding, totaling \$20 million. We gained an understanding of the administrative and accounting controls and tested bond related revenue and expenditure accounts to determine compliance with significant bond covenants. In addition we examined the bond related notes to the financial statements to determine compliance with reporting guidelines.

Texas A&M System

Texas A&M System Administrative & General Offices

We tested the System's bond-related disclosures in the annual financial report and verified compliance with significant bond covenants. Bonds payable at August 31, 1994 were approximately \$650 million.

Texas A&M University

Our work included a review of the significant account which was material to the statewide annual financial report. We gained an understanding of the general control

environment, cash disbursements, and payroll/personnel. In addition, current fund expenditures (\$438 million) were tested.

Texas State Technical College

The primary focus of our audit was the College's compliance with significant bond covenants and the presentation of bond related disclosures in the 1994 Annual Financial Report. At August 31, 1994, the Texas Public Finance Authority reported \$12.8 million of revenue bonds outstanding on behalf of the College. We gained an understanding of the administrative and accounting controls at the Texas Public Finance Authority and tested bond related revenue and expenditure accounts to determine compliance with significant bond covenants. In addition we examined the bond related notes to the financial statements to determine compliance with reporting guidelines.

Texas State University System

System Office

The primary focus of our audit was the System's compliance with significant bond covenants and the presentation of bond related disclosures in the 1994 Annual Financial Report. At August 31, 1994, the Texas State University System reported one bond issue outstanding, totaling \$27 million. We gained an understanding of the administrative and accounting controls and tested bond related revenue and expenditure accounts to determine compliance with significant bond covenants. In addition we examined the bond related notes to the financial statements to determine compliance with reporting guidelines.

Angelo State University

The primary focus of our audit was the University's compliance with significant bond covenants and the presentation of bond related disclosures in the 1994 Annual Financial Report. At August 31, 1994, Angelo State University reported four bond issues outstanding, totaling \$8.5 million. We gained an understanding of the administrative and accounting controls and tested bond related revenue and expenditure accounts to determine compliance with significant bond covenants. In addition we examined the bond related notes to the financial statements to determine compliance with reporting guidelines.

Sam Houston State University

The primary focus of our audit was the University's compliance with significant bond covenants and the presentation of bond related disclosures in the 1994 Annual Financial Report. At August 31, 1994, Sam Houston State University reported seven bond issues outstanding, totaling \$17 million. We gained an understanding of the administrative and accounting controls and tested bond related revenue and expenditure accounts to determine compliance with significant bond covenants. In addition we examined the bond related notes to the financial statements to determine compliance with reporting guidelines.

Southwest Texas State University

The primary focus of our audit was the University's compliance with significant bond covenants and the presentation of bond related disclosures in the 1994 Annual Financial Report. At August 31, 1994, Southwest Texas State University reported 12 bond issues outstanding, totaling \$63.9 million. We gained an understanding of the administrative and accounting controls and tested bond related revenue and expenditure accounts to determine compliance with significant bond covenants. In addition we examined the bond related notes to the financial statements to determine compliance with reporting guidelines.

Sul Ross State University

The primary focus of our audit was the University's compliance with significant bond covenants and the presentation of bond related disclosures in the 1994 Annual Financial Report. At August 31, 1994, Sul Ross State University reported one bond issue outstanding, totaling \$10,000. We gained an understanding of the administrative and accounting controls and tested bond related revenue and expenditure accounts to determine compliance with significant bond covenants. In addition we examined the bond related notes to the financial statements to determine compliance with reporting guidelines.

Texas Tech University

The primary focus of our audit was the University's compliance with significant bond covenants and the presentation of bond related disclosures in the 1994 Annual Financial Report. At August 31, 1994, Texas Tech University reported eight bond issues outstanding, totaling \$60 million. We gained an understanding of the administrative and accounting controls and tested bond related revenue and expenditure accounts to determine compliance with significant bond covenants. In addition we examined the bond related notes to the financial statements to determine compliance with reporting guidelines.

Texas Tech University Health Sciences Center

The primary focus of our audit was the University's compliance with significant bond covenants and the presentation of bond related disclosures in the 1994 Annual Financial Report. At August 31, 1994, Texas Tech University Health Sciences Center reported three bond issues outstanding, totaling \$18 million. We gained an understanding of the administrative and accounting controls and tested bond related revenue and expenditure accounts to determine compliance with significant bond covenants. In addition we examined the bond related notes to the financial statements to determine compliance with reporting guidelines.

Treasury Department, Texas State

The primary focus of our audit was the Department's financial and administrative controls over programs relating to the State's cash management and investment functions. We gained an understanding of the internal control structure, including the general control environment, as well as controls over investments and collateral for state deposits. We

tested certain financial accounts, including investments and obligations under reverse repurchase agreements. We also verified the KPMG Peat Marwick audit of the Texas Local Government Investment Pool, TexPool.

University of Houston System Administration

The primary focus of our audit was the System's five outstanding bond issues (\$100 million). For each bond issue, we tested the bond-related disclosures in the fiscal year 1994 Annual Financial Report and verified compliance with significant bond covenants.

University of North Texas

The primary focus of our audit was the University's compliance with significant bond covenants and the presentation of bond related disclosures in the 1994 Annual Financial Report. At August 31, 1994, the North Texas State University reported five bond issues outstanding, totaling \$30.5 million. We gained an understanding of the administrative and accounting controls and tested bond related revenue and expenditure accounts to determine compliance with significant bond covenants. In addition we examined the bond related notes to the financial statements to determine compliance with reporting guidelines.

University of North Texas Health Science Center

The primary focus of our audit was the University's compliance with significant bond covenants and the presentation of bond related disclosures in the 1994 Annual Financial Report. At August 31, 1994, North Texas State University Health Science Center reported one bond issue outstanding, totaling \$640,000. We gained an understanding of the administrative and accounting controls and tested bond related revenue and expenditure accounts to determine compliance with significant bond covenants. In addition we examined the bond related notes to the financial statements to determine compliance with reporting guidelines.

University of Texas System, The

University of Texas System Administration, The

Our work, performed at The University of Texas System Administration, included a review of the material accounts which are significant to the statewide annual financial report. The significant accounts at The University of Texas System Administration consisted of investments (\$6.4 billion) and investment income and realized gain on investments for endowment and similar funds (\$165.5 million). We gained an understanding of the general control environment, cash receipts, cash disbursements, payroll/personnel, journal vouchers, and investments. The following financial statement accounts were tested: investments, investment income, and current unrestricted funds revenues and expenditures. In addition, we tested the System's bond-related disclosures in the annual financial report and verified compliance with significant bond covenants. Bonds payable at August 31, 1994, were approximately \$1 billion.

Water Development Board, Texas

The primary focus of our audit was the *Capitalization Grants for State Revolving Funds Program*. The program comprised 97 percent of the Agency's total federal funds. We also audited 26 outstanding bond issues totaling \$659 million. We gained an understanding of the internal controls that would prevent or detect noncompliance with federal requirements and bond covenants. In addition, we tested compliance with the general and specific program requirements as well as compliance with bond covenants.

Water Resources Finance Authority, Texas

The primary focus of our audit was the Authority's compliance with significant bond covenants and the presentation of bond related disclosures in the 1994 Annual Financial Report. At August 31, 1994, the Texas Water Resources Finance Authority reported one bond issue outstanding, totaling \$436 million. We gained an understanding of the administrative and accounting controls at the Texas Water Development Board and tested bond related revenue and expenditure accounts to determine compliance with significant bond covenants. In addition we examined the bond related notes to the financial statements to determine compliance with reporting guidelines.

Woman's University, Texas

The primary focus of our audit was the University's compliance with significant bond covenants and the presentation of bond related disclosures in the 1994 Annual Financial Report. At August 31, 1994, Texas Woman's University reported six bond issues outstanding, totaling \$12.9 million. We gained an understanding of the administrative and accounting controls and tested bond related revenue and expenditure accounts to determine compliance with significant bond covenants. In addition we examined the bond related notes to the financial statements to determine compliance with reporting guidelines.

Appendix 2:

Verification Of Letter Of Resolution Adjustments

The State Auditor's Office has verified the adjustments made by the Texas Department of Health and the Texas Department of Mental Health and Mental Retardation. The adjustments at the Department of Health were \$234,017 for the use of outdated population ratios and \$771,072 for unallowable interest payments. The adjustment at the Department of Mental Health and Mental Retardation was \$18,358 for the use of outdated population ratios. These adjustments should represent the final resolution of the report on the *State Legalization Impact Assistance Grant*.

This report was issued in November 1993 by the U.S. Department of Health and Human Services' Office of Inspector General. The focus of the report was grant management activity at the Governor's Office of Immigration and Refugee Affairs and four other state agencies. The report identified \$760,860 in unallowable costs and \$49,929,295 in costs where the administering agencies did not have assurances that the costs were limited to actual and allowable costs.

The Governor's Office and the administering agencies did not concur with many of the findings. The Office and agencies prepared responses to the findings and worked with the federal administrative agency to resolve the issues. In September 1994, The U.S. Department of Health and Human Services issued a letter of resolution accepting most of the State's responses and only requiring the State Auditor's Office to verify the adjustments related to the use of outdated population ratios and unallowable interest payments.

Appendix 3:

What Is The Statewide Audit?

The State Auditor's Office performs an annual single audit for the State of Texas which complies with the Single Audit Act of 1984 and Office of Management and Budget (OMB) Circular A-128. The single audit covers the State's financial statements, Schedule of Federal Financial Assistance, controls, and compliance. Audit reports on the financial statements and Schedule of Federal Financial Assistance are included in the *Comprehensive Annual Financial Report*. Audit reports on controls and compliance are included in this report, the *1994 Financial And Compliance Audit Results*. Insignificant instances of noncompliance and questioned costs are communicated separately to the federal granting agencies impacted.

Together, the single audit and these reports meet the requirements of the Single Audit Act and OMB Circular A-128 for each state agency and university. No additional single audit or report is required of each state agency or university, even if the agency's or university's federal assistance programs were not specifically reviewed in the audit this year.

Subrecipient state agencies and universities which receive federal assistance through non-state entities are responsible for providing copies of the *Comprehensive Annual Financial Report* and the *1994 Financial And Compliance Audit Results* to those entities. Extra copies of the *Comprehensive Annual Financial Report* may be obtained from the Comptroller's Office. Extra copies of this report may be obtained from the State Auditor's Office.

The State Auditor's Office forwards copies of the *Comprehensive Annual Financial Report* and *1994 Financial And Compliance Audit Results* to each federal granting agency on behalf of all state agencies and universities.

Questions concerning the audit or the reports may be directed to the Federal Coordinator at (512) 479-4976.

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