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January 1997

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Key Points of Report

State Auditor's Biennial Report on Fiscal Accountability, Audit Effectiveness, and Highlights of Work

January 1997

Key Facts and Findings

- Based on the audit work completed during fiscal years 1995 and 1996, we have concluded that the State has many controls and processes to promote fiscal accountability at the statewide level. While there are opportunities to improve these controls and processes, overall they appear to be functioning effectively.
- Opportunities to improve the condition of four important statewide control systems intended to promote fiscal accountability merit serious consideration by state leaders, especially:
 - Improvements should be made to the development and evaluation of major automation projects.
 - The condition of management controls is inconsistent among state agencies.
 - Control weaknesses persist in the reporting of performance measures.
 - Opportunities exist to improve the State's management of human resources.
- The State may not have deployed audit resources in a way that best uses them to minimize the risks in agencies' operations and maximize the benefits of the audit functions. While the State's two major revenue audit functions were generally effective, our work indicates that the State may not be in a position to achieve expected results from subcontractor monitoring functions, internal audit, and certain subrecipient monitoring functions. Improvements needed in contract monitoring functions are particularly critical.

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This report was completed in accordance with Government Code, Section 321.015.

Executive Summary

With assets of \$116.9 billion, expenditures of \$51.8 billion (including all government, pension, and college and university funds), 283 bond issues outstanding (totaling \$10.2 billion), and 262,000 full-time equivalent employees, it is easy to see that Texas is big business. Thus, it is critical for auditors to help ensure the fiscal accountability of government (meaning the controls needed to manage resources effectively and to protect resources against loss, misuse, or abuse).

State Is Positioned To Ensure Fiscal Accountability

Based on the audit work completed during fiscal years 1995 and 1996, we have concluded that the State has many controls and processes to promote fiscal accountability at the statewide level. While there are opportunities to improve these controls and processes, overall they appear to be functioning effectively. Some of the more important control systems which promote fiscal accountability at the statewide level include:

- Government leaders have accurate information on the State's financial position.
- Controls are generally in place to protect state resources from loss and abuse.
- Major automated systems help manage resources.
- The accuracy of performance measures appears to be improving.
- Investment practices at major entities are generally adequate.

We believe that the opportunities to improve the condition of some of these important statewide control systems merit serious consideration by state leaders, especially:

- Improvements should be made in the development and evaluation of major automation systems.
- The condition of management controls is inconsistent among state agencies.
- Control weaknesses persist in the reporting of performance measures.
- Opportunities exist to improve the State's management of human resources.

Improvements Are Needed In Audit-Type Functions, Especially Contract Monitoring Functions

We believe the State may not have deployed audit resources in a way that best uses them to minimize the risks in agencies' operations and maximize the benefits of the audit functions. While the State's two major revenue audit functions were generally effective, our work indicates that the State may not be in a position to achieve expected results from subcontractor monitoring functions, internal audit, and certain subrecipient monitoring functions.

Improvements in the State's contract monitoring functions are particularly critical. Overall, there is a lack of central guidance and oversight of contract administration, resulting in duplications of effort and a piecemeal approach on a statewide basis. Implementation of an effective statewide contract administration model is necessary to ensure that public funds are used wisely and in

Executive Summary

a manner which provides benefits to the citizens of Texas.

Summary Of Objectives and Scope

The objectives of this biennial report, as specified in Government Code, section 321.015, are to:

- Report on fiscal accountability in the State.

- Evaluate the effectiveness of audits performed by the executive branch.
- Summarize the work of the State Auditor for the two previous years.

We considered all of the reports released by the State Auditor's Office (SAO) during fiscal years 1995 and 1996. In addition, we selected relevant reports released during the first four months of fiscal year 1997.

State Is Positioned to Ensure Fiscal Accountability

With assets of \$116.9 billion, expenditures of \$51.8 billion (including all government, pension, and college and university funds), 283 bond issues outstanding (totaling \$10.2 billion)¹, and 262,000 full-time equivalent employees², it is easy to see that Texas is big business. Thus, it is critical for auditors to help ensure the fiscal accountability of government (meaning the controls needed to manage resources effectively and to protect resources against loss, misuse, or abuse).

Based on the audit work completed during fiscal years 1995 and 1996, the State has many controls and processes to promote fiscal accountability at the statewide level. While there are opportunities to improve these controls and processes, overall they appear to be functioning effectively.

Section 1-A:

Government Leaders Have Financial and Performance Measures Information Needed for Decision-Making

Government leaders have the financial and performance measures information needed for making decisions about state government. Information on the State's financial position is accurate, although different perspectives are provided by the various sources of information. However, the reliability of information agencies report on key performance targets continues to improve but still suffers from persistent control weaknesses. As a result, we were able to certify only 68 percent of performance measures in a July 1996 report. A January 1997 report certified 74 percent of the measures reported by the 13 agencies reviewed and 100 percent of the reports from the 7 universities reviewed.

Financial Information - Government leaders have accurate information on the State's financial position. The information contained in the financial statements of *Texas' 1995 Comprehensive Annual Financial Report (CAFR)*³ is presented fairly and can be relied upon to evaluate the State's financial condition. The CAFR contains audited financial information on the results of operations, bonded indebtedness, and federal financial assistance.

However, a project designed to reconcile the State's financial reports⁴ did note that budget reports (like *Fiscal Size-Up*), internal financial reports (like the *Annual Cash Report*), and the State's CAFR present various perspectives on the financial realities of the State of Texas. To get the full benefit from the range of information and perspectives provided, it is necessary to understand the reports in their own terms and the nature of the differences between them.

Another project⁵ concluded that the State does not have comprehensive accounts receivable information to evaluate how efficient and effective it is in collecting accounts receivable and identifying where improvements are needed. If the State had collected half of the \$3.5 billion it was owed as of August 31, 1994, just one day earlier, \$240,000 in additional interest would have been earned. The State Auditor's

Office and the Comptroller of Public Accounts are forming a task force to analyze and improve the flow of federal funds through the State.

Performance Measures Information - The accuracy of performance measures reports improved during the previous two years, although control weaknesses over the processes of collecting and reporting the information continued to exist in many agencies and institutions.

Of 105 performance measures reviewed at 20 agencies and 1 educational institution for a July 1996 report,⁴⁴ our auditors found that:

- Approximately 68 percent of the measures were determined to be reliable.
- About 20 percent of the measures were inaccurate.
- Factors prevented certification of 12 percent of the measures.

These results represented a 26 percent improvement in reliability over the preceding performance measures audit. The primary reason for improvement was improved controls over the collection and reporting of performance measures data. However, persistent control weaknesses at some agencies resulted in unreliable data. As a result, a significant amount of key performance information could not be relied upon by decision makers.

Section 1-B:

Controls Are Generally in Place to Protect State Resources From Loss and Abuse

Most of the 45 agencies and universities visited as part of the 1995 Financial and Compliance Audit⁶ had controls in place to protect the State's resources. In fact, no audit findings were reported at 28 of these entities. However, we concluded that the condition of internal controls at 4 of the 45 entities was serious enough to constitute a "material weakness." ("Material weakness" refers to a failure within a control system or a lack of controls that is severe enough to allow large errors to go undetected or uncorrected during the normal course of operations.) These entities included:

- **Texas Southern University's Financial Assistance Office^{6,7}** - A material weakness in the control environment continued to exist. Information from subsequent work at the University indicates that a material weakness in the control environment for the Financial Assistance Office continues to exist. As a result, the University is at risk of losing the ability to participate in federal student financial aid programs.

The control environment weakness for the Financial Assistance Office is a symptom of University-wide conditions. Neither proactive leadership nor fundamental oversight systems are in place to prevent a future financial crisis and to ensure accountability for the achievement of fiscal and administrative goals. The University is projected to incur operating deficits totaling over \$8

million during fiscal year 1997 unless radical changes are instituted in financial management practices.

- **Texas Commission on Alcohol and Drug Abuse⁶** - A material weakness in the control environment continued to exist. However, significant changes occurred in senior management and actions were being taken to address the issue.
- **Texas Department of Human Services⁶** - A material weakness existed in certain elements of the internal control structure over the *Food Distribution Program* [*Catalogue of Federal Domestic Assistance (CFDA) No. 10.550*].

Subsequent work at the Department suggests that a material weakness still exists for the *Food Distribution Program*. Material weaknesses have been identified in different elements of the internal control structure for each of the past three years. This indicates a material control environment weakness for the administration of the *Food Distribution Program*.

- **Comptroller of Public Accounts⁶** - A material weakness existed in certain elements of the internal control structure over the general purpose financial statements. Subsequent work at the Comptroller's Office indicates that it is in the process of implementing procedures that should address the material weakness. Though we cannot comment on the effectiveness of the results until the changes are fully implemented, the Comptroller's Office is working diligently to address this matter (with assistance from the State Auditor's Office) and its approach appears to be sound.

Opportunities to Improve State's Management of Human Resources

Major reports prepared by the State Classification Office:

- Identified several discrepancies in the compensation practices between exempt and classified positions⁸
- Recommended changes to the Classification Plan that will make the plan more flexible, equitable, and user-friendly⁹
- Made a recommendation to adjust the Classification Salary Schedule by 3.5 percent for each year of the 1998-1999 biennium¹⁰.

The State Auditor is statutorily required to maintain and make recommended changes to the Classification Plan and to review and report on recommended adjustments to the Classification Salary Schedule.

Section 1-C:

The Condition of Management Controls Is Inconsistent Among State Agencies and Institutions

During fiscal years 1995 and 1996, the SAO evaluated management controls of selected state agencies and universities. The condition of management controls (which are the policies, procedures, information, and resources used to help an entity fulfill its mission) varied greatly:

- Management control systems were generally effective at nine larger entities: **Department of Health,¹¹ Department of Commerce,¹² Texas Rehabilitation Commission,¹³ Department of Parks and Wildlife,¹⁴ Commission for Jail Standards,¹⁵ Texas Department of**

Insurance,¹⁶ Railroad Commission,¹⁷ University of Houston System Administration,¹⁸ and the General Land Office.¹⁹

- Opportunities to improve management control systems existed at five larger entities: **Health and Human Services Commission,²⁰ Texas Department of Transportation,²¹ The University of Texas at El Paso,²² and the Commission for the Blind.²³** Management controls also needed improvement at the **Texas A&M research and service agencies.²⁴**
- Management control systems were not sufficient at seven larger agencies, including:
 - **Department of Mental Health and Mental Retardation²⁵** - While the Department had enhanced service to external customers by focusing on their needs and expectations, Central Office had not provided sufficient support to the Department's state facilities.
 - **Texas A&M University System²⁶** - Management's override of policies and procedures, laws, and channels of communication had eroded the effectiveness of control systems designed to protect resources from misuse and safeguard assets. Follow-up work²⁷ found that Texas A&M University and System Offices had made significant progress in addressing these issues.
 - **East Texas State University²⁸** - The University had not implemented all the management controls needed to ensure that its resources were adequately protected and that the University had adequate support and monitoring mechanisms. (Follow-up work²⁹ indicated that progress had been made toward implementing our recommendations at the "new" Texas A&M University - Commerce.)
 - **Department of Protective and Regulatory Services³⁰** - Although the Department had been in existence for almost two years, it did not have agencywide management systems and controls in place to facilitate achievement of its goals and objectives.
 - **Texas Natural Resource Conservation Commission³¹** - The Commission had accomplished much in terms of consolidation and program implementation, but much remained to be accomplished with regard to overall management systems.
 - **Southwest Texas State University³²** - In several areas, the University's management control systems were deficient in design or implementation. These deficiencies impacted the University's ability to ensure that its mission and objectives would be fully accomplished and that assets would be appropriately safeguarded.

- The progress which the **Texas Workforce Commission**³³ had made during six months following the transfer of the first programs was encouraging. However, when we completed our audit fieldwork on September 30, 1996, we were concerned that management had not established all of the necessary processes to minimize the risks related to the creation of a new agency and the new workforce delivery system.

We also identified material or significant weaknesses in the management control systems at seven small agencies^{34,35}:

- **Commission on the Arts** (weaknesses in controls over grant monitoring)
- **Soil and Water Conservation Commission** (weaknesses in controls over monitoring of the *Agricultural and Silvicultural Nonpoint Source Pollution Abatement Program*)
- **Texas Funeral Service Commission** (overall control environment weaknesses)
- **Texas Board of Polygraph Examiners** (overall control environment weaknesses)
- **Board of Private Investigators and Private Security Agencies** (weaknesses in licensing and investigative functions, involving criminal background checks and investigative case backlogs)
- **Board of Tax Professional Examiners** (weaknesses in the licensing function, involving the automated information system used for registrant tracking)
- **Executive Council of Physical and Occupational Therapy Examiners** (weaknesses in licensing and investigative functions, involving inefficient administrative processes)

Section 1-D:

Major Automated Information Systems Help Manage Resources

We believe that improvements should be made in the development and evaluation of major automation projects. The SAO worked to ensure that state agencies developed information systems in an efficient and effective manner:

- **Assuring quality of major information systems under development** - As part of the Quality Assurance Team (QAT) mandated by the General Appropriations Act and Senate Bill 381, 74th Legislature, we continued to address the need for agencies to improve project management and development processes for major automation projects. The QAT monitors

automation projects which either are estimated to cost more than \$1 million and last a year or longer or which are significant to agency operations. As of November 1996, the QAT was actively monitoring 19 high-risk projects, with total project life cycle costs estimated at \$488 million.

- **Reviewing the benefits of systems after implementation**⁴³ - An audit of post-implementation reviews of information system development projects found that expected benefits related to the information systems examined, totaling \$88 million, had not been consistently achieved. For systems not monitored by the Quality Assurance Team, the audit concluded that the State was not in a position to determine whether the intended benefits had been received for the dollars expended.
- **Contracting for information systems purchases**⁴² - Overall, agency procedures provide reasonable assurance that the best contractor was objectively selected and held accountable for delivering information system goods and services in accordance with the terms of the contract. Although contract management was sufficient to hold the contractor accountable, the contract structure allowed the contracts to be amended, contingent upon certain events. Thus, the scope and cost of contracts frequently escalated over the life of the project.

During fiscal years 1995 and 1996, the State Auditor's Office also audited the major automated information systems used to manage the State's resources. Overall, we found that the systems were able to operate effectively, but noted problems with the accuracy of the information in the systems and the controls which help protect the systems against unauthorized changes to operations, programs, or data.

Audits of statewide automated information systems included:

- **Electronic Benefit Transfer (EBT or "Lone Star Card") System for Food Stamps and Aid To Families with Dependent Children (AFDC)**³⁶ - The system was effectively providing government benefits to recipients of food stamps and AFDC. However, there were opportunities to improve controls to ensure retailers are provided with correct information, access is properly restricted, automated program changes are authorized, disruptions to the system do not occur, and cards and personal identification numbers are replaced in accordance with contract requirements.
- **Human Resource Information System (HRIS)**³⁷ - Users indicated that the system design met their needs. However, we noted that the accuracy of the data provided to HRIS by state agencies, program implementation procedures, and documentation can be improved. HRIS includes personnel information and statistics on over 427,500 active and former state employees.
- **State Property Accounting System (SPA)**³⁸ - SPA contained reasonable policies and procedures for controlling and protecting the State's personal property. SPA, which accounts for about \$5.2 billion in personal property, is

being administered in accordance with statutory provisions by the Comptroller of Public Accounts.

- **Treasury's Automated Systems**³⁹ - Internal controls over automated systems at the Texas State Treasury Department helped protect the State's cash and securities. However, the Treasury had not adequately documented automated applications or sufficiently cross-trained employees to back up key data processing personnel, which would help ensure continued operations if employee turnover occurred. The Treasury held investments worth \$8.2 billion at the end of the 1994 fiscal year.
- **Uniform Statewide Accounting System (USAS)**⁴⁰ - USAS began operation on September 1, 1993, and was fulfilling many of its original requirements for a statewide accounting system. However, we recommended improvements to help USAS provide more reliable, cost-effective information for statewide and agency-level financial decision-making. USAS contains both cash-basis and accrual-basis statewide general ledger accounting data for all state agencies and universities. In addition, it is used as the internal accounting system by 105 agencies.
- **Uniform Statewide Payroll/Personnel System (USPS)**⁴¹ - Agencies using USPS surveyed in April 1995 reported that they were able to perform payroll reconciliation procedures to help ensure that agency payroll amounts were accurate. These results represented an improvement from an earlier survey in October 1994 in which agencies reported difficulties in performing payroll reconciliations due to problems associated with the USPS system. As of April 1995, the system processed approximately 26 percent of total statewide payroll and was used by 95 agencies.

Section 1-E:

Investment Practices at Major Investing Entities Were Generally Adequate

The SAO also reviewed investment practices at six entities with investments of approximately \$100 billion⁴⁵ (value at March 31, 1996). Although controls over investment practices were adequate at most of the major investing entities, there were opportunities for the Legislature, governing boards, or management to enhance accountability for, or performance of, the investments managed by these entities.

Controls over investment practices were generally adequate at four entities with the largest long-term portfolios (**Teacher Retirement System, Texas Education Agency, Employees Retirement System, and The University of Texas System**). At the **State Treasury**, which primarily manages shorter-term investments and has now merged with the **Comptroller of Public Accounts**, improvements were needed in monitoring and documenting policies and procedures. Controls over long-term investments made

by the State Treasury on behalf of the **Texas Lottery Commission** appeared adequate to ensure that future amounts will be sufficient to pay prize installments.

Areas where legislative action could help promote more effective investment practices include:

- Requiring periodic investment reviews of the State's largest investing entities
- Determining whether constitutional restrictions on the use of capital gains and ordinary investment income of the Permanent School Fund and Permanent University Fund impair managements' ability to optimize performance of those funds
- Determining whether the inconsistencies in statutes affecting similar operations of the four largest investing entities are intended
- Ensuring that the establishment of nonprofit corporations to manage state investments does not diminish public accountability

Section 2:

Improvements Are Needed in Audit-Type Functions, Especially Contract Monitoring Functions

The State may not have deployed audit resources in a way that best uses them to minimize the risks in agencies' operations and maximize the benefits of the audit functions. While the State's two major revenue audit functions were generally effective, our work indicates that the State may not be in a position to achieve expected results from subcontractor monitoring functions, internal audit, and certain subrecipient monitoring functions.

Section 2-A:

Revenue Audit Functions at the Comptroller of Public Accounts and the Texas Workforce Commission Are Generally Effective

The State Auditor's Office conducted revenue audits of the **Comptroller of Public Accounts**⁴⁶ and the **Texas Workforce Commission**⁴⁷ during fiscal years 1995 and 1996. The revenue audit functions at both agencies are effective.

We did, however, recommend that the Texas Workforce Commission, with the U.S. Department of Labor's approval, design a plan that will result in more audit resources directed to auditing large employers. Based on averages, an additional \$9.67 of unemployment tax could be collected for each dollar of audit resources transferred from the audits of small employers to large employers.

State Agencies Included in SAO Contract Administration Audits

- Department of Criminal Justice
- Department of Health
- Department of Human Services
- Department of Mental Health and Mental Retardation
- Department of Protective and Regulatory Services
- Department of Transportation
- Texas Commission on Alcohol and Drug Abuse
- Texas Natural Resource Conservation Commission
- Texas Rehabilitation Commission
- Texas Department on Aging
- Interagency Council on Early Childhood Intervention
- Texas Youth Commission
- Texas Commission for the Blind
- Texas Cancer Council
- Department of Housing and Community Affairs
- Juvenile Probation Commission

A number of reports are available on our continuing audits of the contracting practices at these entities.

Section 2-B:

Contract Monitoring Functions Should Be Improved

Implementation of an effective statewide contract administration model is necessary to ensure that public funds are used wisely and in a manner which provides the most benefits to the citizens of Texas.

Overall, there is a lack of central guidance and oversight of contract administration efforts, resulting in duplication of effort and a piecemeal approach on a statewide basis. Pervasive weaknesses in contracting procedures prevent the State from ensuring accountability for public funds and delivery of quality services.

Audits over the last three years have identified widespread mismanagement and weaknesses in contracting procedures which have allowed contractors to exploit the system at the expense of the State.

Section 2-C:

Internal Audit Functions Are Basically Effective, but Could Potentially Be Used in More Productive Ways

The SAO is completing an audit of the effectiveness of internal audit. The scope of the work includes review of internal audit functions at 12 of the State's largest agencies and an analysis of cross-cutting issues. The work completed as of November 15, 1996, suggests that most of the 12 internal audit functions reviewed were basically effective but that current mandates, management and oversight practices, and operating procedures may not promote the greatest return from these resources. A report should be released in February 1997.

Section 2-D:

Opportunities Exist To Improve Subrecipient Monitoring⁴⁸

Compliance with federal requirements for monitoring local service delivery providers (subrecipients) can be improved at three agencies:

- The **Texas Education Agency** did not follow established procedures to monitor subrecipient cash needs and adjust subsequent cash advances. This constituted noncompliance with federal regulations.
- The *HOME Investment Partnership Program* (CFDA 14.239) at the **Texas Department of Housing and Community Affairs** had material noncompliance in the areas of subrecipient monitoring and compliance with the Davis-Beacon Act.
- At the **Texas Department of Human Services**, the subrecipient monitoring tracking system did not accurately determine or record “audit due dates,” and the Department did not limit subrecipient cash advances to immediate cash needs for the *Child and Adult Care Food Program* (CFDA 10.558).

Section 3:

Highlights of Work Performed at Selected Health and Human Service Agencies

During fiscal years 1995 and 1996, the State Auditor’s Office performed significant work at eight health and human service agencies, including management control audits at seven of these eight agencies. (Management control audits evaluate the impact which an entity’s use of policies, procedures, information, and resources have on its ability to fulfill its mission. Improved management controls facilitate the achievement of goals and objectives and also increase coordination and communication. These reports are also listed in Section 1-C.)

Accounting for approximately 70 percent of the State’s total expenditures on health and human services, the seven agencies included:

- **Department of Health**⁴⁹ - Management controls were generally effective, but improvements were needed in contracting for services and performance management. Other control areas needed enhancements. Weaknesses in communication and information were found throughout the management controls.

In another audit of the Medicaid program at the Department of Health,⁵⁰ auditors estimated that the Department could save approximately \$1.9 million annually related to three types of Medicaid overpayments.

- **Health and Human Services Commission**⁵¹ - Although the Commissioner had undertaken a major reorganization to accomplish the work as directed in the mandates of the 74th Legislature and achieved improvements in organizational management, control weaknesses existed in key functional areas of the Commission. During this time of transition, attention should have been given to enhancing controls in operational areas of fiscal management,

grant and contract management, information system coordination, performance measures management, and human resources management.

- **Department of Mental Health and Mental Retardation**⁵² - While the Department had enhanced its service to external customers by focusing on their needs and expectations, Central Office had not provided sufficient support to the Department's state facilities. In order to ensure that management controls were adequate, Central Office should have helped the state facilities implement effective management and administrative processes.
- **Department of Protective and Regulatory Services**⁵³ - Although the Department had been in existence for almost two years, it did not have agencywide management systems and controls in place to facilitate achievement of its goals and objectives. In addition, oversight functions (such as the Board of Directors, the Ombudsman Office, and internal audit) had not been developed sufficiently to provide direction and feedback to Department operations.
- **Texas Rehabilitation Commission**⁵⁴ - The Commission generally had effective management controls, but it did not have a fully developed contract management system to ensure quality provider services at a reasonable cost.
- **Interagency Council on Early Childhood Intervention**⁵⁵ - The Council had generally established a strong system of management controls. However, some controls needed strengthening. With minor exceptions, the Council was in compliance with applicable laws and regulations.
- **Commission for the Blind**⁵⁶ - The Commission's management controls needed improvement to ensure adequate agency oversight, effective management systems, and verification of program income.

The SAO also devoted significant resources to the identification and correction of problems at the **Texas Commission on Alcohol and Drug Abuse**. At the request of the conservator, we lent staff to assist in the Commission's reorganization and in the development of a risk assessment methodology and a compliance manual. We provided three individuals for six months to work in the compliance area and an acting chief financial officer.

Highlights of Work Performed at Public Education Agencies and Institutions of Higher Education

Section 4-A:

Public Education Agencies

During fiscal years 1995 and 1996, the SAO completed three major projects that dealt with state expenditures for public education:

- **Texas Education Agency Monitoring Systems⁵⁷** - The Agency did not use its financial and student performance accountability systems to effectively monitor school districts. This increased the risk that the \$10 billion in state and federal funds (fiscal year 1996) were not fully used to achieve the State's goals for public education. Program funds totaling \$160 million were not spent by districts on direct services as required in 1994. The student dropout rate was more than double the reported rate for 1994.
- **Analysis of school district spending on non-instructional costs⁵⁸** - The 1995 Savings Profile System identified \$470 million in potential cost savings outside of classroom instruction. In addition, non-instructional costs increased at a faster rate than instructional costs during the 1994-1995 school year.
- **Management controls at education service centers⁵⁹** - The six education service centers audited had adequate controls in place to provide reasonable assurance that the goals of the centers were achieved. The results of our audit work were similar to the results of management and service audits conducted by the Texas Education Agency at eight other centers over the last two years.

Section 4-B:

Institutions of Higher Education

The SAO also completed several projects dealing with institutions of higher education. One of these projects concluded that the State's 35 universities are 99.4 percent accurate in reporting semester credit hours. Of the almost \$2 billion appropriated by semester credit hours, \$11.6 million was overfunded.⁶⁰

A material weakness in the control environment continued to exist at **Texas Southern University's Financial Assistance Office**.^{61,62} Information from subsequent work at the University indicates that a material weakness in the control environment for the Financial Assistance Office continues to exist. As a result, the University is at risk of losing the ability to participate in federal student financial aid programs. (These reports are also discussed in Section 1-B.)

The control environment weakness for the Financial Assistance Office is a symptom of University-wide conditions. Neither proactive leadership nor fundamental oversight

systems are in place to prevent a future financial crisis and to ensure accountability for the achievement of fiscal and administrative goals. The University is projected to incur operating deficits totaling over \$8 million during fiscal year 1997 unless radical changes are instituted in financial management practices.

Several components of the **Texas A&M University System** were also audited. (These projects are also listed in Section 1-C.) We found that:

- The Texas A&M University System research and service agencies⁶³ had taken significant steps to effectively accomplish their missions. However, management controls could have been improved at seven of the eight research and service agencies. Recommendations to improve controls were most significant at the **Agricultural Experiment Station, Agricultural Extension Service, Veterinary Medical Diagnostic Laboratory, Forest Service, and Engineering Experiment Station**.
- **East Texas State University**⁶⁴ had not implemented all of the management controls necessary to ensure that its resources were adequately protected and that the University had adequate support and monitoring mechanisms. Many of the weaknesses in management controls identified during this review had previously been brought to the University's attention by the State Auditor's Office or University internal auditors. This condition underscored the need for the University's Board of Regents to enhance its oversight role.

A follow-up project⁶⁵ found that the East Texas State University Board of Regents and the East Texas State University/Texas A&M University - Commerce management had made progress in addressing recommendations from the previous report. However, issues in the areas of property inventory management, human resources, and information systems support functions still needed to be addressed.

- Management's override of policies and procedures, laws, and channels of communication had eroded the effectiveness of control systems designed to protect resources from misuse and to safeguard assets at **Texas A&M University and System Offices**⁶⁶. This breakdown in controls had contributed to poor decision-making, ineffective use of resources, weak oversight of operations, and a general lack of accountability. The results were increased costs of operations, unlawful activities by some members of executive management, increased risks and liabilities associated with System and University operations, and negative publicity. In fiscal year 1994, approximately \$536 million was expended in support of the University's operations.

A follow-up project⁶⁷ found that Texas A&M University and the System Offices had made significant progress in addressing issues from the previous report.

The SAO also completed important projects dealing with Southwest Texas State University, University of Houston System, and public community/junior colleges:

- At **Southwest Texas State University**,⁶⁸ we found that management control systems were deficient in design and/or implementation in several areas. These deficiencies impacted the University's ability to ensure that its mission and objectives were fully accomplished and that assets were appropriately safeguarded.
- At the **University of Houston System**,⁶⁹ management had generally established management controls to fulfill the mission of the System and its components. A financial analysis of the System components provided no indications that management was expending funds inappropriately.
- The SAO also analyzed financial and audited enrollment data from the State's **public community/junior colleges**⁷⁰ to identify areas of potential risk and to determine whether data used to allocate appropriations was accurate. This work resulted in recommendations to reduce state contact hour appropriations by \$2.25 million. However, this amount represented only 0.18 percent of the \$1.2 billion in state contact hour appropriations. Several areas of concern that resulted from our analysis of financial data were communicated to the institutions, including:
 - Expenditures exceeded revenues for 9 colleges, and 11 colleges operated only slightly above break-even.
 - Ten institutions experienced declining reserve levels over the past three years.
 - Auxiliary funds (funds established to account for revenues and expenditures related to student housing, food services, bookstore, etc.) for 17 institutions lost money in 1994. Seven schools' auxiliary funds lost money in each of fiscal years 1992, 1993, and 1994.

Section 5:

Highlights of Work Performed in Other Functional Areas of Texas State Government

The State Auditor's Office completed a variety of important projects in the other functional areas of Texas state government during fiscal years 1995 and 1996.

Section 5-A:

General Government

In addition to significant work on statewide automated systems (the majority of which are administered by the **Comptroller of Public Accounts**), the SAO reported on

important work at the Office of the Attorney General, the General Land Office and Veterans Land Board, and the State Treasury, concluding that:

- The **Office of the Attorney General (OAG)**⁷¹ has made and documented a good-faith first effort to estimate the extent to which child support enforcement offsets welfare costs; however, of the \$498 million cost avoidance reported by the OAG's current methodology, we can attest to \$330.7 million, using reasonable criteria. Estimated cost avoidance could have legitimately risen to \$501.7 million had the OAG considered Food Stamps and non-AFDC cases in its calculations. Further refinements in the methodology used could raise future cost avoidance well beyond the \$498 million presently reported.
- The **General Land Office and Veterans Land Board**⁷² have management control systems which provide reasonable assurance that their goals and objectives are met. A need exists, however, to enhance funds management planning and to improve planning and monitoring for grant and contract administration. The Veterans Land Board needs to formally address long-range planning issues associated with the \$990.6 million land loan program and the \$964 million housing loan program. Review of the \$3 million Coastal Oil-Spill Simulation System and the \$1.3 million Funds Management Information System indicates a need to improve planning and monitoring processes for grant and contract administration.
- Due to corrective action by the Texas Legislature, **TexPool**⁷³ (an investment fund formerly administered by the **State Treasury**) is now required to observe stringent safety requirements. TexPool currently maintains an AAAM rating by Standard & Poor's Managed Funds Group. These additional requirements were necessary because, in the past, TexPool was not operated safely. Questionable management decisions by TexPool administrators contributed to TexPool's liquidity crisis, which ultimately cost the State at least \$97 million.

Section 5-B:

Public Safety and Criminal Justice

We audited the Criminal Justice Information System, prison unit costs, and contracting practices at the Texas Youth Commission. These audits concluded that:

- The **Criminal Justice Information System (CJIS)**⁷⁴, the State's summary information system on criminal offenders, was not fully implemented and had control weaknesses that affected data quality. Also, the process used to identify criminal backgrounds for prehiring purposes was ineffective because criminal histories in other states were not routinely searched. CJIS affects public safety through decision-making by users such as law enforcement agencies, employers, and state leaders.

- Our analysis of prison unit costs at the **Texas Department of Criminal Justice**⁷⁵ identified units and areas which have higher cost variances. These variances may identify opportunities to reduce expenditures or to alleviate the risks associated with potentially inadequate expenditures. High cost variances on the 13 cost categories used for the \$750 million in prison unit costs ranged from 2.5 percent to 37.7 percent, while the low cost variances ranged from -2.3 percent to -46.3 percent. The most significant variances came from miscellaneous fees and services as well as travel.
- Contractors for the **Texas Youth Commission**⁷⁶ were not always selected based on merit and were not adequately monitored to ensure that quality services were provided. In addition, the Commission did not systematically set rates for contracts and did not adequately monitor contractor expenditures. Therefore, the Commission could not ensure that the \$14.2 million spent on contracted services during fiscal year 1994 was appropriately used.

Section 5-C:

Natural Resources

We audited management controls at the Department of Parks and Wildlife, the Railroad Commission, and the Texas Natural Resources Conservation Commission. (These reports are also listed in Section 1-C.) These audits concluded that:

- The **Texas Parks and Wildlife Department's**⁷⁷ management controls promoted efficient and effective service delivery. While the controls were generally effective, improvements would have enhanced the efficiency of several control systems. The Department recognized this need and was working on improving these systems. Efficiency is important since the Department is responsible for managing assets valued at more than \$500 million and plays a key role in the State's outdoor recreation industry.
- While the **Texas Railroad Commission**⁷⁸ had adequate control systems in place, more formal planning, program evaluation, and data analysis were needed to ensure the efficient use of regulatory efforts. Some administrative processes were inefficient and would have benefited from streamlining review procedures and delegating responsibility. Consideration of performance standards in both the awarding of well plugging contracts and in the contracts themselves would have provided the Commission with an evaluation and enforcement tool.
- The **Texas Natural Resource Conservation Commission**⁷⁹ had accomplished much in terms of consolidation and program implementation since its creation in September 1993. In terms of overall management systems, however, much remained to be accomplished. This was not unexpected, given that neither the Texas Air Control Board nor the Texas Water Commission had existing management systems sophisticated enough to support the complex operations of the consolidated entity.

Business and Economic Development and Regulatory Agencies

We also completed important audit work at the Texas Department of Transportation, Texas Department of Insurance, the Texas Workforce Commission, and several small regulatory agencies. (These reports are also listed in Section 1-C.) The results of these projects included the following:

- Although the **Texas Department of Transportation**⁸⁰ had begun many initiatives to increase efficiency of operations and ensure adequate oversight and allocation of resources, management controls over the evaluation of operations should have been strengthened. Review of district operational efficiency in construction, maintenance, and administrative functions indicated an opportunity for potential cost savings of over \$13 million.

The Department underwent a major reorganization due to the retirement of 1,370 employees at the beginning of fiscal year 1994. A new executive director, with his management team, took over Department operation on October 1, 1993.

- The **Texas Department of Insurance**⁸¹ had established key accountability systems related to planning and organization and was taking appropriate steps to establish sound management controls overall. The most notable activity was a major planning and redesign project.

There were opportunities to improve the performance measurement system as the Department adopted a new set of performance measures. Based on fiscal year 1994 reported outcome measures, the Department achieved just over half of its predetermined goals and objectives. However, interpretation of the results is limited by the reliability of the data.

- The progress which the **Texas Workforce Commission**⁸² had made during the six months following the transfer of the first programs was encouraging. However, when we completed our audit fieldwork on September 30, 1996, we were concerned that management had not established all the necessary processes to minimize the risks related to the creation of a new agency and the new workforce development delivery system.
- During the management control audits of small agencies, including 10 regulatory agencies, we consistently identified control weaknesses in the management of information and financial and human resources. In general, the small agencies audited had established control systems over their statutory functions. However, we reported significant control risks which could prevent the following small regulatory agencies from meeting their legislative mandates and/or delivering intended benefits:⁸³
 - **Texas Funeral Service Commission**⁸⁴ (overall control environment weaknesses)

- **Board of Tax Professional Examiners**⁸⁵ (weaknesses in the licensing function, involving the automated information system used for registrant tracking)

- **Executive Council of Physical and Occupational Therapy Examiners**⁸⁶ (weaknesses in licensing and investigative functions, involving inefficient administrative processes)

Objectives and Scope

Objectives

The objectives of this biennial report, as specified in Government Code, Section 321.015, are to:

- Evaluate the effectiveness of audits performed by the executive branch, including:
 - Revenue audits
 - Audits of subcontractors and subgrantees
 - Internal audit
- Report on fiscal accountability in the State, including:
 - Each department's responsibility for establishing and maintaining internal controls
 - Status of accounting systems in the State
- Summarize the audit work of the State Auditor for the previous two years

Scope

We considered each of the reports released by the SAO during fiscal years 1995 and 1996. We also selected relevant reports released during the first four months of fiscal year 1997.

Because audited financial information is not yet available for fiscal year 1996, this report relies primarily on fiscal year 1995 data for most calculations.

For the purposes of this report, we calculated total state spending using information in the State's comprehensive annual financial reports. We included all governmental fund groups, proprietary and trust funds, and college and university funds. Thus, for fiscal year 1995, total state spending amounted to \$51.8 billion.

Other Information

The work on this report was conducted between September and December 1996. The work was performed by the following members of the State Auditor's staff:

- Brad Puett (Project Manager)
- Rebekah Janes
- Tom Valentine (Audit Manager)
- Deborah Kerr, Ph.D. (Director)

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State Is Positioned to Ensure Fiscal Accountability

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| 2. | 97-702 | <i>A Quarterly Report of Full-Time Equivalent State Employees for the Quarter Ending August 31, 1996</i> | 11/6/96 |

Government Leaders Have Financial and Performance Measures Information Needed for Decision-Making

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| 4. | 95-029 | <i>A Briefing Report on Reconciling State Financial Reports</i> | 11/21/94 |
| 5. | 96-027 | <i>An Audit Report on Improving the State's Accounts Receivable and Cash Receipting Process</i> | 12/18/95 |

Controls Are Generally in Place to Protect Resources From Loss and Abuse

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| 6. | 96-063 | <i>A Report on the 1995 Financial and Compliance Audit Results</i> | 5/20/96 |
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The Condition of Management Controls Is Inconsistent Among State Agencies and Institutions

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Improvements Are Needed in Audit-Type Functions, Especially Contract Monitoring Functions

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January 1997

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